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Richard Lehman regularly works with law firms, accountants, businesses and individuals struggling to find their way through the complexities of the US tax law. *In short, Lehman is a valuable resource to each of these audiences.*

With over 46 years as a tax lawyer in Florida, Lehman has built a national reputation for being able to handle the toughest tax cases, structure the most sophisticated income tax and estate tax plans, and defend clients before the IRS.

- Mr. Lehman's international practice spans the globe. This has resulted in Lehman's representation of foreign investors giving tax and practical advice in acquiring and selling a wide range of commercial businesses and other U.S. investment assets. This includes not only the acquisition and sale of active businesses in the U.S. but also investments in all fields of real estate including raw land, shopping centers, commercial office buildings, condominiums, residential apartments, residential homes and the like.

Pre-Immigration Income & Estate Tax Planning

By Richard S. Lehman Esq. • TAX ATTORNEY

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ON-DEMAND VIDEO

PRESENTED BY
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LEHMAN TAX LAW
RICHARD S. LEHMAN, ATTORNEY AT LAW

PART OF THE LEHMAN TAX LAW KNOWLEDGE BASE SERIES

Pre-Immigration Income & Estate Tax Planning

Tax Treaty - Tie Breaker Rules

Citizenship
The Ultimate Tie Breaker

EXCEPTIONAL CIRCUMSTANCES
AND SPECIAL BENEFITS

Students

What is Pre-Immigration Income Estate Tax Planning?

We are talking about an individual who is presently an alien individual who is going to become a U.S. tax resident for federal income tax purposes.

Once that happens, they are subject to tax on their worldwide income. They may also become U.S. residents for estate tax purposes. This means if they were to die in the U.S. they will be taxed on their wealth, like all Americans. If they become U.S. residents for estate tax purposes they transfer their wealth at death to beneficiaries. *We will discuss all of this.*

Pre-Immigration Income Tax Planning

The earnings that they have made outside of the United States before they became U.S. citizens may be accrued earnings. They may have gains from the assets they own or income that they will not collect that is not going to show up until after these people move to the United States.

- This is gains and wealth that has accrued before they come to the U.S. but they have not “realized and recognized” (a tax term) their gain.

Pre-Immigration Income Tax Planning

This seminar will discuss the tax planning techniques to preserve such wealth, earnings and fortunes, that the U.S. taxpayer who is immigrating to the U.S. has earned prior to their “tax residency”.
We will examine how to avoid these traps.

Definition for Tax Purposes

Non Resident Alien vs Resident Alien

The Resident Alien

- Taxation on Worldwide Income Similar to Taxation on U.S. Citizens
- Tax Planning

TAXATION PATTERN

U.S. Resident Alien ("Tax Resident") - Subject to Taxation

1. Income Taxation - Worldwide Income
2. Estate Taxation - Worldwide Assets
3. Gift Taxation - Worldwide Assets

U.S. Tax Residents

First, I will list the ways one becomes a U.S. taxpayer and then we will discuss them in detail.

1. **Marriage.**

One can become a tax resident by becoming a U.S. citizen by way of marriage or naturalization.

2. **Election.**

An immigrant may elect to be taxed as a U.S. resident by electing such status on their U.S. tax return.

3. **Permanent Residency.**

The U.S. may grant the right to permanent residency. This is the issuance of a Green Card in the United States. The green cardholder will be a U.S. taxpayer.

U.S. Tax Residents

4. U.S. Tax Residency:

Time of Physical Presence in the United States.

- Individuals who physically spend a certain amount of time in the U.S. can be subject to a U.S. income Tax as tax residents who are taxable on their worldwide income.
- This can occur if one physically spends too much time in the U.S. This is known as the “Substantial Presence Test”.

However, this Substantial Presence Test does not apply to certain individuals that will fit into two exceptions to the “Substantial Presence” test. These exceptions will permit an alien individual to stay in the U.S. for a longer period of time than the time required by the “Substantial Presence”. *We will review these exceptions.*

U.S. Tax Residents

5. The Closer Connection Exception.

The first exception is the Closer Connection Exception. An alien who has a “closer connection” to a foreign country may stay for a longer period of time in the U.S. without becoming a U.S. taxpayer.

6. Tax Treaties.

Individuals who are governed by a tax treaty between their home country and the United States may stay in the U.S. even longer during the calendar year without becoming U.S. tax residents. This will be explained later.

STATUS FOR TAX PURPOSES

Non-Resident Alien - Not a “Resident Alien”

Resident for Income Tax Purposes

1. Green Card
2. Substantial Presence Test
3. Voluntary Election

Exceptions:

4. The Closer Connection
5. Treaties: Tie Breaker

Income Tax Residents

We're going to look first just at the income tax situation. I will repeat what I said about U.S. tax rates.

- Once you become a U.S. tax resident you are subject to income tax on your worldwide income like every other American.
- You are subject to tax on the graduated rates.
- The rates start at 10% on the first \$36,000 and go as high as 37% for income over \$250,000 (single) \$500,000 (married). There is an additional tax on investment income of 3.8% or more than \$200,000.
- This is the U.S. tax only and does not consider state and city income taxes. Florida has no personal income tax.
- A resident of New York City might have additional city income taxes and New York state income taxes that total more than 10% in additional tax.

Residency Starting Date

Substantial Presence Test

Residency starting date for individuals meeting substantial presence test. In the case of an individual who meets the substantial presence test with respect to any calendar year, the residency starting date shall be the first day during such calendar year on which the individual is present in the United States.

Substantial Presence Test

NON RESIDENT ALIEN			RESIDENT ALIEN		
Residency "Days"	Days in US	Year	Formula	Days in US	Residency "Days"
120	120	2021	100%	120	120
40	120	2020	33.33%	150	50
20	120	2019	16.67%	120	20
180	Total			Total	190

Residency Starting Date

Green Card

Residency starting date for individuals lawfully admitted for permanent residence. In the case of an individual who is a lawfully permanent resident of the United States at any time during the calendar year, but does not meet the substantial presence test, the residency starting date shall be the first day in such calendar year on which he or she was present in the United States while a lawful permanent resident of the United States.

Residency Starting Date

Assumption No. 1:

The alien individual (Non Resident Alien) has no physical presence in the U.S. for the years 2019 and 2020

ALTERNATIVE Assumption No. 2:

The Non Resident Alien had the following U.S. physical presence in the year 2021.

- January 1, 2021 - February 15, 2021 = **46 days**
 - August 31, 2021 - December 31, 2021 = **123 days**
- Total Days in U.S. = 169 days**

- Green Card Issued: August 31, 2021
- With Presence in U.S. August 31, 2021
- Tax Status: U.S. Tax Resident starting August 31, 2021

Residency Starting Date

Assumption No. 1:

The alien individual (Non Resident Alien) has no physical presence in the U.S. for the years 2019 and 2020

Assumption No. 2:

The Non Resident Alien had the following U.S. physical presence in the year 2021.

- January 1, 2021 - February 15, 2021 = **46 days**
- August 1, 2021 - December 31, 2021 = **153 days**

Total Days in U.S. = 199 days

- Green Card Issued: August 1, 2021
- With Presence in U.S. August 1, 2021
- Tax Status: U.S. Tax Resident starting January 1, 2021

The Closer Connection Exception

**Exception
where individual
is present in the
United States
during less than
one-half of
current year and
closer connection
to foreign country
is established.**

An individual shall not be treated as meeting the substantial presence test of this paragraph with respect to any current year if . . .

- (i) such individual is present in the United States on fewer than 183 days during the current year, and
- (ii) it is established that for the current year such individual has a tax home (as defined in section 911(d)(3) without regard to the second sentence thereof) in a foreign country and has a closer connection to such foreign country than to the United States.

EXCEPTIONAL CIRCUMSTANCES AND SPECIAL BENEFITS

Students

A foreign student who has obtained the proper immigration status will be **exempt** from being treated as a U.S. resident for U.S. tax purposes even if he or she is here for a substantial time period that would originally result in the student being taxed as a U.S. resident.

This student visa not only permits the student to study in the United States, but to pay taxes only on income from U.S. sources not worldwide income.

The visa also permits the student's direct relatives to accompany the student to the United States and receive the same tax benefits.

Tax Treaty - Tie Breaker Rules

Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

- (a) He shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);
- (b) If the State in which he has his center of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
- (c) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a citizen;
- (d) If each State considers him as its citizen or if he is a citizen of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

Citizenship

The Ultimate Tie Breaker

An individual who has a habitual abode in both countries (or neither) is treated as a resident only of the country of his nationality. If all of the other tiebreaker rules are even, the final determination of tax residency will depend on the citizenship.

“He shall be deemed to be a resident of the Contracting State of which he is a citizen”

Finally, if the taxpayer is a citizen of both countries, then it is left to the tax authorities in both countries as to which country can claim the taxpayer as the resident for tax purposes.

Four Tax Planning Principles

The Income Tax Objectives

- A. Acceleration of Gains - Non U.S. Property
- B. Acceleration of Income from Foreign Sources
- C. Deferral of Loss Recognition
- D. Deferral of Payment of Deductible Expenses

Four Tax Planning Principles

1. A Nonresident Alien, prior to becoming a U.S. tax resident will want to make sure that he or she does not have to pay a U.S. tax on gains that have accrued as a practical matter before their residency period. The first strategy is to accelerate (realize and recognize) any and all gains earned by the Taxpayer prior to becoming a Resident Alien.
2. The second key strategy is to accelerate income that is expected to be paid after residency. Income payments should be collected prior to residency to avoid being taxed by the U.S.

Four Tax Planning Principles

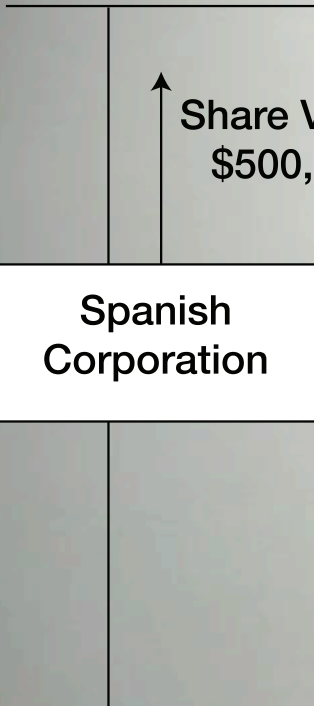
3. The third strategy is to defer recognizing a loss until after obtaining tax residency as a Resident Alien so that the loss can be used against post residency gains. Assets with a fair market value below cost can be sold after residency. Those losses may be taken against gains in assets earned after U.S. residency. These losses can reduce or wipe out gains from the sale of assets that accrue after U.S. residency.
4. The fourth strategy is to defer paying deductible expenses until after the Residency Starting date. Several types of payments (both business and personal) in the U.S. are deductible from a U.S. Taxpayer's income to determine the actual taxable amount of income.

Accelerate Gains Prior to Residency Starting Date

Assume a nonresident alien owned \$1.0 Million Dollars worth of shares of General Motors that was purchased for \$50,000. If the shares are sold after U.S. tax residency is assumed when the immigrant is a Resident Alien, there will be a tax on \$950,000 in gains. A sale of these same shares by a Nonresident Alien before becoming a Resident Alien would result in no taxable gain.

PHASE I

Spanish Business
Person



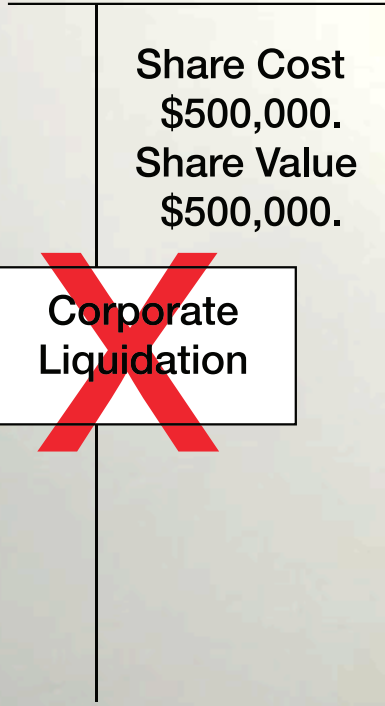
Share Value
\$500,000.

Spanish
Corporation

Original Capital
\$500,000.

PHASE II

Spanish Business
Person



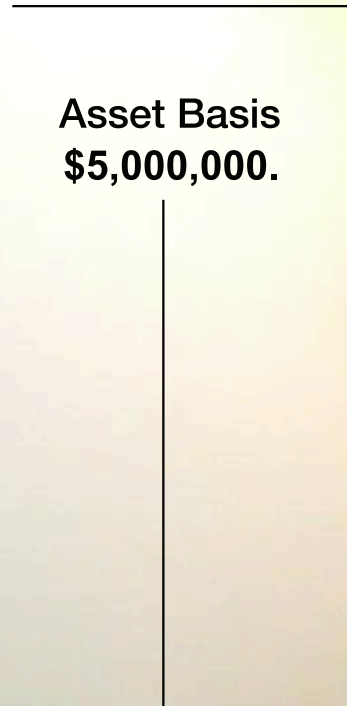
Share Cost
\$500,000.
Share Value
\$500,000.

~~Corporate
Liquidation~~

Asset Value
\$5,000,000.

PHASE III

Spanish Business
Person



Asset Basis
\$5,000,000.

Asset Value
\$5,000,000.

Accelerate Income Prior to Residency Starting Date

For example, assume a non resident alien owns a foreign corporation that conducted a business in his home country that now has \$2 Million in receivables that will not be collected until after the owner has become a Resident Alien for U.S. tax purposes.

These receivables might be accelerated, for example, by the liquidation of the taxpayer's company and the transfer of the receivables to the taxpayer at their present fair market value, prior to the **Residency Starting Date**.

The taxpayer may also sell his interest in the company or to the company for a Promissory Note. The ongoing foreign company may collect the receivables which are then paid to the seller and Non Resident Alien, in payment of the Promissory Note he received to sell his shares to the company.

Income Assets to Accelerate

- Pension Plans
- Stock Options
- Prepaid Rent
- Repaid Royalties
- Prepaid Dividends
- Prepaid Interest
- Annuity Products

Defer Recognizing Loss

- In today's times there may be wealthy immigrants coming to the U.S. who have significant losses in their investment portfolios. If it is economic, these portfolios should not be liquidated and losses should not be realized and recognized prior to immigration to the U.S.; as they can be extremely valuable to use against capital gains in the U.S.; and even against ordinary income in the U.S. under certain circumstances.
 - Assume the taxpayer bought General Motors and purchased the stock at \$1,000 and now it was only worth \$500.
 - In the event the investor were to sell his stock at a loss prior to becoming a Resident Alien, the loss is useless against other income. Had the General Motors stock been sold in the year of Residency there would be a tax loss since as a Resident Alien, the taxpayer would pay a tax on all of his worldwide net losses and gains.

Example of Sale at Loss

- Assume a non resident alien taxpayer from Panama has purchased a Panama apartment at the high end of the market for \$4.0 Million, and it is worth \$3.0 Million before he immigrates to the United States.
- Assume the Panamanian taxpayer will be immigrating to the U.S. effective January 1, 2022.
- Assume that same taxpayer invests \$100,000 in a U.S. corporation after obtaining tax residency and sells the U.S. corporation after obtaining Resident Alien status for \$1 Million in excess of its cost to the Panamanian investor.

Example of Sale at Loss

- In the event the investor were to sell his Panama apartment at a loss prior to becoming a Resident Alien and then sell his profitable U.S. corporation at a gain in the following year when he is a Resident Alien, there will be a capital gains tax on the \$1.0 Million gain at a cost of \$150,000- \$200,000.
 - Had the Panama apartment been sold in the year of Residency there would be no tax cost at all since as a Resident Alien, the taxpayer would pay a tax on all of his worldwide net losses and gains, thereby reducing his U.S. gains by his Panama losses.

The Estate and Gift Tax

Not only does the United States charge an income tax on income earned in the United States, it also charges on “Estate and Gift Tax” on people who become U.S. tax residents and also on nonresident aliens, but only on a few limited types of assets.

The Estate and Gift Tax

The U.S. estate and gift tax is a tax on the “transfer of wealth”. As we will discuss, U.S. tax residents who transfer wealth are subject to one standard that is applied to their total wealth transferred if they die owning significant assets or if they transfer significant assets during life.

We will see that there is a different standard applied in determining whether a non U.S. citizen is subject to the estate and gift tax than the standard that applies for determining the amount of an immigrant’s income or capital gains tax.

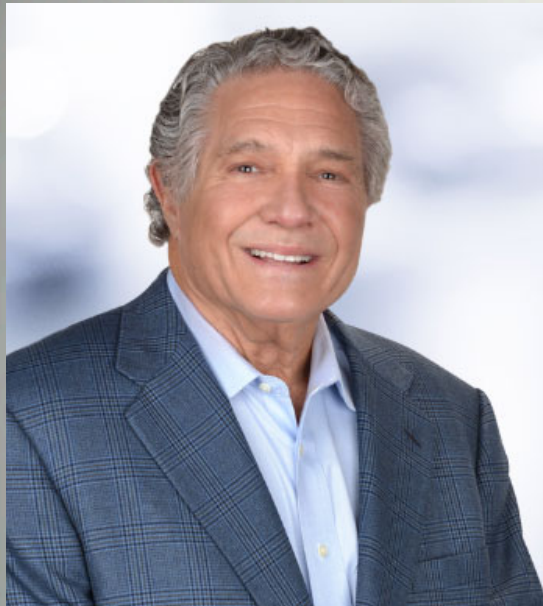
The U.S. applies a transfer tax on the transfer of one’s wealth by virtue of death or lifetime gift. It is similar to an inheritance tax, that many countries charge, however, it is a tax on the transferor and not the beneficiary.

Estate Tax

Definition of Residency

A “resident” decedent is a decedent who, at the time of his death, had his domicile in the United States. The term “United States”, as used in the estate tax regulations, includes only the States and the District of Columbia. The term also includes the Territories of Alaska and Hawaii prior to their admission as States. See section 7701(a)(9). A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefore Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.

Pre-Immigration Income & Estate Tax Planning



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