PRE-IMMIGRATION TAX PLANNING

CPE Presentation (Tax)
to the
Chinese American CPA Association
of the San Gabriel Valley

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Presented by:

Andrew Bernknopf, Esq.
De Castro, West, Chodorow, Mendler, Glickfeld & Nass, Inc.
I. OVERVIEW
GENERAL PRINCIPLES

Subject to coordination with foreign tax effects:

• Trigger income/gain before U.S. residency start date (“RSD”).
• Defer deductible expense/loss until after RSD.
• Step-up basis in assets (without sale for foreign purposes) before RSD.
• Pre-residency gifts.
• De-control CFCs before RSD.
• Post-immigration U.S. reporting compliance.
II. BACKGROUND RULES
Green Card vs. Other Visas

- Day-count does not matter under Code if green card obtained.
- Closer connections do not help under Code.
- Treaty tiebreaker may not help.
- Strong factor for E&G domicile.
- Potential exit tax.
Day Counting (Substantial Presence Test)

• Rolling 3-year test.
• Non-residency rule of thumb: Keep under 120 days.
• Closer connections and < 183 days.
• Treaty tiebreaker.
• Risk of U.S. tax residency status before green card.
Residency Starting Date (RSD)

• Pre-Immigration Transactions Must Precede RSD.

• RSD Rules: First Day of U.S. Presence in Tax Year.

• Year-Before Election.
Estate & Gift Tax Residency

• E&G residency is “domicile”.

• U.S. estate, gift and GST tax on worldwide assets.

• Full exemption amount.
Anti-Deferral Regimes

Backstops to U.S. taxation of U.S. tax resident’s worldwide income:

• CFC (controlled foreign corporation).
• PFIC (passive foreign investment company).
• Foreign Grantor Trust.
• Foreign Non-Grantor Trust.
Reporting of Foreign Items

*Stiff penalties for non-compliance with these foreign reporting requirements. (Not every foreign form listed below.)

**Note:** Much duplication and overlap among these forms.

- Foreign Accounts – TD F 90-22.1 (so-called “FBAR”). Due June 30, no extensions.
- Foreign Financial Assets – Form 8938
- CFC – Form 5471
- PFIC – Form 8621
- Foreign Non-Grantor Trust Distributions, Transactions / Foreign Gifts, Bequests – Form 3520
- Foreign Grantor Trust – Form 3520-A
- CFP (Controlled Foreign Partnership) – Form 8865
- Transfer to Foreign Corporation – Form 926
- 25%-Foreign-Owned U.S. Corporation – Form 5472
Comparison of Form 8938 & & FBAR Requirements

“The new Form 8938 filing requirement does not replace or otherwise affect a taxpayer's obligation to file Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts). Individuals must file each form for which they meet the relevant reporting threshold.”

## Comparison of Form 8938 & FBAR Requirements

<table>
<thead>
<tr>
<th>Who Must File?</th>
<th>Specified individuals, which include U.S citizens, resident aliens, and certain non-resident aliens that have an interest in specified foreign financial assets and meet the reporting threshold</th>
<th>U.S. persons, which include U.S. citizens, resident aliens, trusts, estates, and domestic entities that have an interest in foreign financial accounts and meet the reporting threshold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does the United States Include U.S territories?</td>
<td>No</td>
<td>Yes, resident aliens of U.S territories and U.S. territory entities are subject to FBAR reporting</td>
</tr>
<tr>
<td>Reporting Threshold (Total Value of Assets)</td>
<td>$50,000 on the last day of the tax year or $75,000 at any time during the tax year (higher threshold amounts apply to married individuals filing jointly and individuals living abroad)</td>
<td>$10,000 at any time during the calendar year</td>
</tr>
</tbody>
</table>

Comparison of Form 8938 & & FBAR Requirements (cont’d 2)

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>When do you have an interest in an account or asset?</strong></td>
<td><strong>Financial interest:</strong> you are the owner of record or holder of legal title; the owner of record or holder of legal title is your agent or representative; you have a sufficient interest in the entity that is the owner of record or holder of legal title.</td>
</tr>
<tr>
<td>If any income, gains, losses, deductions, credits, gross proceeds, or distributions from holding or disposing of the account or asset are or would be required to be reported, included, or otherwise reflected on your income tax return</td>
<td><strong>Signature authority:</strong> you have authority to control the disposition of the assets in the account by direct communication with the financial institution maintaining the account.</td>
</tr>
<tr>
<td></td>
<td><strong>See instructions for further details.</strong></td>
</tr>
</tbody>
</table>

### Comparison of Form 8938 & FBAR Requirements (cont’d 3)

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>What is Reported?</strong></td>
<td>Maximum value of specified foreign financial assets, which include financial accounts with foreign financial institutions and certain other foreign non-account investment assets</td>
<td>Maximum value of financial accounts maintained by a financial institution physically located in a foreign country</td>
</tr>
<tr>
<td><strong>How are maximum account or asset values determined and reported?</strong></td>
<td>Fair market value in U.S. dollars in accord with the Form 8938 instructions for each account and asset reported</td>
<td>Use periodic account statements to determine the maximum value in the currency of the account.</td>
</tr>
<tr>
<td></td>
<td>Convert to U.S. dollars using the end of the taxable year exchange rate and report in U.S. dollars.</td>
<td>Convert to U.S. dollars using the end of the calendar year exchange rate and report in U.S. dollars.</td>
</tr>
<tr>
<td><strong>When Due?</strong></td>
<td>By due date, including extension, if any, for income tax return</td>
<td>Received by June 30 (no extensions of time granted)</td>
</tr>
</tbody>
</table>

<table>
<thead>
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</thead>
<tbody>
<tr>
<td><strong>Where to File?</strong></td>
<td>File with income tax return pursuant to instructions for filing the return</td>
<td>Mail to: Department of the Treasury Post Office Box 32821 Detroit, Mt 48232-0621 For express mail to: IRS Enterprise Computing Center ATTN: CTR Operations Mailroom, 4th Floor 985 Michigan Avenue Detroit, MI 48226 Certain individuals may file electronically at BSA E-Filing System</td>
</tr>
</tbody>
</table>

Comparison of Form 8938 & FBAR Requirements (cont’d 5)

<table>
<thead>
<tr>
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<tbody>
<tr>
<td><strong>Penalties</strong></td>
<td>Up to $10,000 for failure to disclose and an additional $10,000 for each 30 days of non-filing after IRS notice of a failure to disclose, for a potential maximum penalty of $60,000; criminal penalties may also apply</td>
<td>If non-willful, up to $10,000; if willful, up to the greater of $100,000 or 50 percent of account balances; criminal penalties may also apply</td>
</tr>
<tr>
<td><strong>Types of Foreign Assets and Whether They are Reportable</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial (deposit and custodial) accounts held at foreign financial institutions</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

## Comparison of Form 8938 & FBAR Requirements *(cont’d 6)*

<table>
<thead>
<tr>
<th>Types of Foreign Assets and Whether They Are Reportable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial account held a U.S. financial institution</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
<td>Financial account held at a U.S. branch of a foreign financial institution</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
<td>Foreign financial account for which you have signature authority</td>
</tr>
<tr>
<td>No, unless you otherwise have an interest in the account as described above</td>
</tr>
<tr>
<td>Foreign stock or securities held in a financial account at a foreign financial institution</td>
</tr>
<tr>
<td>The account itself is subject to reporting, but the contents of the account do not have to be separately reported</td>
</tr>
</tbody>
</table>

Comparison of Form 8938 & FBAR Requirements (cont’d 7)

<table>
<thead>
<tr>
<th>Types of Foreign Assets and Whether They are Reportable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign stock or securities not held in a financial account</td>
</tr>
<tr>
<td>Foreign partnership interests</td>
</tr>
<tr>
<td>Indirect interests in foreign financial assets through an entity</td>
</tr>
<tr>
<td>Foreign mutual funds</td>
</tr>
<tr>
<td>Domestic mutual fund investing in foreign stocks and securities</td>
</tr>
</tbody>
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### Comparison of Form 8938 & FBAR Requirements (cont’d 8)

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</thead>
<tbody>
<tr>
<td><strong>Types of Foreign Assets and Whether They are Reportable</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign accounts and foreign non-account investment assets held by foreign or domestic grantor trust for which you are the grantor</td>
<td>Yes, as to both foreign accounts and foreign non-account investment assets</td>
<td>Yes, as to foreign accounts</td>
</tr>
<tr>
<td>Foreign-issued life insurance or annuity contract with a cash-value</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Foreign hedge funds and foreign private equity funds</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Foreign real estate held directly</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

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</thead>
<tbody>
<tr>
<td>Foreign real estate held through a foreign entity</td>
<td>No, but the foreign entity itself is a specified foreign financial asset and its maximum value includes the value of the real estate</td>
<td>No</td>
</tr>
<tr>
<td>Foreign currency held directly</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Precious Metals held directly</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Personal property, held directly, such as art, antiques, jewelry, cars and other collectibles</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>‘Social Security’- type program benefits provided by a foreign government</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>
III. PLANNING
Pre-Immigration Rules of Thumb

*Must coordinate foreign treatment before doing any U.S. pre-immigration transactions.

• Sell or step-up basis in gain assets before RSD.
• Trigger income before RSD.
• Hold loss assets until after RSD. / Wait for deductible payments until after RSD.
• Gifts to non-U.S. recipients before U.S. domicile.
• Decontrol CFCs before RSD.
Pre-Immigration Transactions

• Basis step-up by “check-the-box” election for foreign entity before RSD or “busted 351”.

• Foreign trusts
  - Rarely works for U.S. immigrant settlor because of 5-year grantor trust rule.
  - But excellent vehicle for non-U.S. parents/grandparents for benefit of U.S. immigrant descendants.
  - Outright gifts of income property to non-U.S. donee.
    - Must be no strings attached.
    - Risk that asset never comes back. (For example, will dispute or forced share to other relatives by law.)
  - **Do not** transfer property to “nominee” owner. Must transfer all benefits and burdens of ownership.
IV. POST-IMMIGRATION PLANNING /CLEAN-UP
Entity Planning /Clean-Up

- Consider applicable elections for entities.
  - QEF (pass-thru) election for PFICs.
  - Post-RSD check-the-box elections for entities.

- Existing foreign trusts.
  - Check underlying CFCs for possible dissolution within 30 days of death.

- Look at tax-efficient ways to distribute assets to U.S. or domesticate trust.

- Portfolio interest borrowing.
- 10% shareholder/partner rule (including attributed shares).
- No equity kickers.
Compliance Clean-Up

• Backdrop
  - “FATCA” (Foreign Account Tax Compliance Act) due diligence and reporting by non-U.S. financial institutions.
  - IRS leveraging of foreign bank investigations and data mining from participants in voluntary disclosure program.
  - IRS announced emphasis on foreign reporting obligations and “first time” filers.

• Corrective Compliance
  - Voluntary Disclosure Program
  - “Quiet” Amended Returns
  - “Going Forward” Filing
Circular 230 Notice

- This presentation does not provide legal tax advice. The materials are not intended to be used for (i) the purpose of avoiding federal tax penalties that may be imposed, or (ii) promoting, marketing or recommending any entity, investment, plan or arrangement to any person.
Andrew Bernknopf, Esq.
Attorney / Member
De Castro, West, Chodorow, Mendler, Glickfeld & Nass, Inc.
10960 Wilshire Boulevard • Suite 1400 • Los Angeles, CA 90024
Direct Dial: (310) 445-7657
Email: aberknkopf@dwclaw.com

PRACTICE EMPHASIS:
Andrew Bernknopf integrates the practice of tax law and business law. He handles the full gamut of federal, state and international tax matters. He also negotiates business transactions and drafts the governing legal documents.

TAX EXPERTISE:
• Tax structuring for U.S. inbound and outbound businesses and investments
• U.S. income, estate and gift tax planning for international families
• Tax structuring of real estate investments and business transactions
• Taxation of financial instruments and investments
• Entertainment industry tax matters

EDUCATION:
B.A., Yale University
J.D., Harvard Law School
LL.M., Taxation, New York University School of Law