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GUEST ARTICLE: Pre-Immigration US Tax Planning - Act Now, Save Heartburn Later

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Getting one's tax affairs in order before moving to the US will save a great deal of cost and time later on, as the author of this article, an expert in the international aspect of US taxes, explains.

For all kinds of reasons, many individuals wish to make the US their home, but many of them are unprepared for the singular joys of the country's worldwide system of tax and level of reporting responsibility that citizenship brings with it. As tax filing deadlines approach, it is an opportune time to consider some of the issues. The author of this item is Seth J Entin, shareholder in the international law firm of Greenberg Traurig. His practice focuses on federal income tax, with an international perspective.

The editors of this news service are pleased to share these views and invite readers to respond. They can email tom.burroughes@wealthbriefing.com

The US has been and continues to be a desirable place for high net worth foreign individuals to move to. Timely pre-immigration US tax planning is critical for a high net worth foreigner who is considering moving to the US, and the failure to plan until it is too late may have extremely costly US tax consequences.

Take, for example, the case of a successful individual who is not a US citizen or resident and who lives in a foreign country. This individual has significant wealth of her own. She owns foreign companies that she founded years ago and that are now extremely valuable, and she has also invested in a portfolio of stocks that has appreciated significantly. In addition, this individual stands to inherit significant wealth from her parents, who are also not US citizens or residents.

This individual is considering moving to the US with her spouse and children, while her parents will remain abroad. This move will bring with it a host of potential US tax liabilities. With proper planning, however, this individual can take legitimate steps in advance to significantly minimize US taxes once she becomes a US citizen or tax resident.

It is critical that all of this planning be implemented before this individual becomes a US citizen or a tax resident. "After the fact" planning will not achieve these benefits, and may in fact be detrimental. The rules for when US residency starts for income and estate tax purposes are fairly technical. In fact, individuals who are not familiar with the US tax system are sometimes unpleasantly surprised to find out that they have already become US tax residents for U.S. income and/or estate tax purposes without even knowing it.

The following are a few examples of key US tax planning that our individual must accomplish before she becomes a US citizen or tax resident:

-- If our individual becomes a US citizen or tax resident and then sells her assets (such as her foreign operating companies or her portfolio of investment assets), she will be subject to US income tax on all of her gain, even the gain that has built-up over the years that she was a nonresident. This is a harsh feature of the US tax system. Fortunately,

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however, with proper planning, however, such as making certain tax elections for the foreign companies or selling the assets in her portfolio and purchasing new investment assets, the individual may be able to realize her built-in gains free of US income tax before she becomes a US resident.

-- If our individual becomes a US citizen or tax resident, she may be subject to "double tax" on the earnings of her foreign companies. That is, the companies will be subject to foreign corporate tax on their earnings. Then, on top of that, the individual will be subject to US income tax on the dividends she receives from the companies. Assuming for example, a 30 per cent foreign corporate tax rate, the earnings of these foreign companies can be subject to double tax at a combined foreign and US tax rate of well over 50 per cent. Fortunately, with proper planning involving converting the foreign companies to entities that are treated as "pass-through entities" for US tax purposes, the individual may be able to credit some or all of the foreign income taxes against her IRS tax liability. This can reduce or eliminate double taxation.

-- The US tax law has several detrimental regimes that apply to US citizens or residents who own "passive" foreign investments. One example is the dreaded "passive foreign investment company," or "PFIC" regime, which can significantly increase the rate of US income tax payable on income and gains from certain "passive" foreign assets, such as foreign mutual and hedge funds. The individual should review her portfolio of investments with a US tax advisor in advance to make sure to divest herself of these tax-inefficient investments or to make certain elections that can minimize the adverse effects of these regimes.

-- Estate planning is critical for high net worth foreigners coming to live in the US. Under current law, if our individual dies while a US. citizen or tax resident, her estate will be subject to U.S. estate tax on her worldwide assets, at rates of up to 40 per cent of the fair market value of those assets. Fortunately, however, with pre-planning involving a properly structured family trust, she may legitimately avoid those assets being subject to US estate tax on her death and the deaths of her descendants.

-- Similarly, if, after moving to the US, our individual and her children inherit assets from her parents, those inherited assets will become part of their US taxable estates and will be subject to estate tax on their deaths, also at rates of up to 40 per cent of the fair market value of those assets. Fortunately, however, with a properly structured family trust created by the individual's parents, these assets may legitimately be kept out of their US descendants' US taxable estates.

Pre-immigration tax planning is extremely technical. Any pre-immigration plan will have to be designed and implemented with great care from a US tax standpoint, and the planning will have to be coordinated with the individual's home country tax advisor. Moreover, the US imposes a host of filing requirements for US individuals who own foreign companies or financial assets, receive gifts from foreign persons or distributions from foreign trusts, and who have signature authority over foreign accounts. An individual moving to the US must be prepared to scrupulously comply with these reporting rules.

While pre-immigration tax planning often requires significant work, the resulting tax savings may be significant.

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