Essential Planning Issues for International Investors and Their Advisors

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Unlike many countries around the world, the United States has a stable economy, a reliable, peaceful democracy, and strong laws that protect U.S. property rights. Wealthy individuals and business owners from all over the world continue to invest in U.S. companies, real estate, and other property because of the stability of the U.S. markets. The U.S. also provides more privacy than any other country in the world. As a result, foreign investors have invested billions of dollars in the United States to safeguard their wealth from financial or political upheaval in their home countries, and to provide safety and privacy for their families.

Several developments in international law, combined with political and economic factors around the globe have combined to drive foreign investment in the United States. This article will explore some of those developments, outline the basic rules for application of U.S. tax law to foreign investors, and highlight the importance of helping non-U.S. persons plan proactively to minimize their tax exposure and dramatically increase their privacy and protection, helping secure their wealth for themselves and for future generations.

In many countries personal privacy can literally be a matter of life and death. In fact, many international investors value privacy and personal security far more than tax savings. Fortunately, many of the strategies available to reduce U.S. tax liability serve the dual purpose of providing a great deal of privacy for the investor. For investors with significant wealth, well-designed strategies can protect and enhance their wealth for many years into the future, ensuring the American dream for future generations.

The U.S. becomes the new privacy haven

In 2014 the United States implemented the Foreign Account Tax Compliance Act (FATCA) as part an effort to identify U.S. taxpayers who were holding assets outside the United States to try and avoid tax liability. FATCA essentially required all foreign financial institutions and other entities to disclose financial information of U.S. taxpayers to the U.S. government. Importantly,

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FATCA imposed a *unilateral* reporting requirement from other countries to the United States; it did not require reporting from the U.S. to any other jurisdiction.

Also in 2014 the Organisation of Economic Co-operation and Development (OECD)[i] adopted the Common Reporting Standard (CRS), an automatic *bilateral* exchange of information requiring countries that have adopted the CRS to share financial data on individuals from other countries who have invested in the CRS countries. In other words, countries that adopt the Common Reporting Standard agree to automatically gather financial information on foreign investors and send that information to the investor's home country. Countries that have previously been privacy havens like Bermuda, the British Virgin Islands, the Cayman Islands, and Switzerland have all adopted the CRS.[ii] In all, at least 90 jurisdictions have either implemented or have committed to implement the CRS by 2018. The United States has no incentive to adopt CRS, arguably making the U.S. the last remaining privacy haven for foreign investors.[iii]

Wealthy international investors and their advisors understand that CRS has generally eliminated financial privacy around the world. The economic and political stability, financial privacy, and strong emphasis on an individual's property rights in the United States make the U.S. the most attractive market for foreign investment anywhere on the globe. As a result, foreign investors are buying U.S. businesses, real estate, and personal property at a dramatic rate. But unless investors engage in careful planning <u>*before*</u> investing in or moving to the U.S., the tax consequences can be severe! Careful planning can save many thousands – and potentially millions – of dollars in tax liability. Proactive planning can also increase privacy for the investor and protect his or her wealth for generations to come. Individuals must not engage in tax evasion through foreign investment strategies, but there are many valid reasons for individuals to engage in proactive planning to maximize privacy and legally reduce their tax liability. The first step toward planning is to understand how the U.S. imposes taxes on non-U.S. persons.

Non-U.S. Citizens and U.S. Tax Law

United States citizens pay income tax on their worldwide income, regardless where the income is earned. If a U.S. citizen makes a taxable gift, the value of the gift is subject to U.S. tax rules wherever the property is located when the gift is made. Similarly, when a U.S. citizen dies, the value of their estate for tax purposes is based on the citizen's worldwide property holdings. But many non-U.S. citizens are surprised to learn that many of these rules also apply to them if they fail to plan carefully.

The United States has complicated and confusing rules for non-U.S. persons who invest or buy property in the United States. It's possible to become a U.S. person for income tax purposes but not for gift or estate tax purposes, or vice versa, even without realizing it. Because making a mistake on tax residency can potentially trigger millions of dollars in tax liability, it's essential to understand how tax residency is determined.

Income tax residency: It's a matter of counting days.

Individuals who are not U.S. persons for income tax purposes must report and pay taxes only on that portion of their income that is U.S. "source" income – that is, income derived from the individual's activities or investments in the United States. But if the person becomes a U.S. person for income tax purposes, he or she must pay tax on their worldwide income. It's possible to be treated as a U.S. resident for income tax purposes simply by the amount of time a person spends in the U.S., and people often get it wrong.

Many foreign investors are familiar with the "183 day rule." They (wrongly) assume that if they spend fewer than 183 days in the U.S. during the year they can avoid being classified as an income tax resident and only report their U.S.-source income. But it isn't that simple.

If a person holds a green card or is otherwise a lawful permanent resident of the United States and he or she spends at least one day in the U.S., that person is a U.S. resident for income tax purposes. They will remain an income tax resident of the U.S. unless resident status is formally rescinded or abandoned.[iv] Even without a green card, if a non-U.S. resident spends 183 days or more in any one year, that person becomes a U.S. tax resident for income tax purposes and must report their worldwide income.

For individuals who spend significant time in the U.S. year after year, the number changes. If a non-U.S. resident spends at least 31 days in the U.S. in one year and an *average of more than 121 days over that year and the prior two-years,* that person will be treated as a U.S. resident for income tax purposes.[v] This catches many non-U.S. citizens off guard, exposing them to tax penalties and interest for failing to report and pay U.S. tax on their worldwide income.

Transfer (gift and estate) tax residency: A subjective determination

The law is different for U.S. gift, estate, and generation-skipping transfer tax system (collectively referred to as the "transfer tax"). If a non-U.S. citizen lives in the U.S. and has no intention to move away from the U.S., that person is a "U.S. person" under U.S. transfer tax laws. When he or she dies, the United States taxes the entire value of that person's worldwide assets. Unlike the determination for income tax residency, which is based on the number of days an individual is in the U.S., transfer tax residency is a matter of determining a person's intent based on a series of factors, including:

- How long the person stays in the U.S. compared to other countries, and how often the person travels between countries;
- Relative size, cost, and nature of homes (vacation home, owned, rented, etc.);
- Location of the individual's immediate family, business, and social contacts;
- Membership in religious and other organizations;
- Location of expensive/cherished personal possessions;

- Place of driver's license and vehicle registration;
- Location of bank and investment accounts;
- Reasons for residency in the U.S. (temporary employment, etc.); and
- Declarations of residency or intent made in visa applications, estate planning documents, letters, and oral statements.[vi]

If a person is not a U.S. transfer tax resident, he or she will only be subject to transfer tax on the value of their property located in the U.S. If he or she is determined to be a U.S. person for transfer tax purposes, the value of his or her worldwide property will be subject to the U.S. transfer tax system.[vii]

International treaties, specific exemptions, and other special circumstances may apply, but international investors and their advisors must understand that the U.S. taxes income and property differently and the tax can be very expensive. Most importantly, much of that tax is completely unnecessary for investors who plan proactively before buying property in the U.S.

Early planning is essential!

The tax rules are complicated, and they're very different for non-citizens than they are for U.S. citizens. The attorneys at Evergreen Legacy Planning, LLP can guide international investors through the process of planning before investing in the U.S. or before establishing a tax connection to the United States. Evergreen Legacy Planning, LLP has helped clients from all over the world safely navigate the confusing U.S. tax laws to create strategies that provide significant tax savings, help protect their U.S. investments from lawsuits, and provide much-needed privacy in their home countries.

Planning BEFORE moving or investing can save international investors thousands – and potentially MILLIONS – of dollars in unnecessary taxes.

In addition, we can help investors keep their financial matters as private as possible, providing additional security for wealthy individuals, their families, and their wealth.

Contact us to learn more:

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Notes

[i] The OECD is an international economic coalition of countries that promotes global economic policies to "…improve the economic and social well-being of people around the world." (Source: OECD website, http://www.oecd.org/about/) The United States is a member of the OECD but has not signed on to the Common Reporting Standard (CRS).
[ii] For an updated list of the status of countries that have committed to the Common Reporting Standard please visit http://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/crs-by-jurisdiction/
[iii] The United States may still exchange financial and other information with other countries through a tax treaty or other agreement with that country, but not under the Common Reporting Standard, and the level of information the U.S. shares with other countries is very limited.
[iv] This is the general rule. There are first-year and final-year exceptions, certain visa exceptions, certain tax treaty exceptions, and some exceptions where the individual can demonstrate a closer connection to another country. The income tax rule for establishing income tax residency and the exceptions to the rule are outlined in Internal Revenue Code §7701 and Treasury Regulations §301.7701(b)-1(b).
[v] IRC §7701(b)(3)(A)
[vi] See IRS Publication 570 for a discussion of the similar "closer connection" factors.
[vii] To make matters even more confusing, the rules are different for purposes of the U.S. gift tax and U.S. estate tax. This is one of many reasons it's imperative to plan proactively before an individual who *may be* a U.S. person for tax purposes makes any gifts of property that *may have* a legal connection to the United States.