On average, 1 million people attain legal immigrant status each year in the U.S. In 2017, 44.5 million people in the U.S. were immigrants.¹

People choose to immigrate to the U.S. for a variety of reasons: in search of safety and security that cannot be found at home, in pursuit of a quality education or in the hope of achieving the “American dream.” Whatever the reason, those who come to the U.S. — and, in particular, those with great wealth — have a lot to learn about the American tax system.

The U.S. is one of only two countries in the world that imposes taxes based on citizenship, rather than on whether or not an individual resides in the country,² and is the only country with inheritance, estate and gift taxes. As such, foreign nationals may not fully appreciate the importance of planning prior to becoming a citizen.

Future immigrants would be wise to take the time to assess their financial situation and plan accordingly before they become U.S. taxpayers in order to best conserve their wealth for themselves and future generations.

**The Three Types of U.S. Taxpayers**

There are three types of U.S. taxpayers: non-resident aliens, resident aliens and U.S. citizens.

**Non-Resident Aliens**

Non-resident aliens only pay taxes on U.S. source income and U.S. situs assets, such as U.S. real estate or tangible property in the U.S. There are, however, some differences between the definition of U.S. situs for U.S. estate tax purposes and gift tax purposes. Most notably, stock of U.S. corporations is considered to have a U.S. situs for purposes of the U.S. estate tax, but not for the gift tax. This provides pre-immigration gifting opportunities for non-resident aliens and can ultimately help reduce their U.S. taxable estates down to a potentially non-taxable level.

**Resident Aliens**

Whether a non-citizen is deemed a “resident alien” for income tax purposes depends primarily on how much time they spend in the U.S. Those who are considered long term or “permanent” residents (e.g., green card holders) must pay tax on their worldwide income. Whether they must pay transfer tax on worldwide assets is determined through a subjective test that is intended to determine the individual’s intent to remain in the U.S. indefinitely.

**U.S. Citizens**

U.S. citizens are subject to income and transfer taxes on worldwide assets, regardless of where they reside. However, the exemption amount available to U.S. resident aliens and citizens is currently $11.4 million (and $22.8 million for a couple where both spouses are U.S. citizens or residents) so a substantial amount of assets can be sheltered from the U.S. estate tax, depending on the net worth of the individual.

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² The other country is Eritrea.
FIVE IMPORTANT PRE-IMMIGRATION CONSIDERATIONS

Sufficient time should be allowed for planning to shelter worldwide assets from the U.S. tax net, especially if the person has significant assets or stands to inherit significant assets from family in the home country. It is recommended the following steps be taken before permanently moving to the U.S.:

Review Holdings in Foreign Corporations and Offshore Mutual Funds

Before immigrating to the U.S., it is important to seriously consider divesting holdings in offshore mutual funds and foreign private investment companies (PIC). Non-resident aliens commonly use such entities to hold U.S. situs assets, thus shielding these assets from U.S. estate tax at their death. Unfortunately, such structures are not often suitable for U.S. persons, as they will attract the potential application of the U.S. Controlled Foreign Corporation (CFC) and Passive Foreign Investment Company (PFIC) rules. These rules require additional IRS reporting, as well as the taxation of undistributed income and gains within the entity or fund at ordinary income tax rates. The potential for taxation on income of this type has only increased after the passage of the Tax Cuts and Jobs Act in December 2017.

Consider the Implications of Foreign Trusts

Before moving to the U.S., both settlors and beneficiaries of foreign grantor trusts should take time to review the fiduciary structures they have in place and ensure they are properly prepared for the nuances of U.S. tax law. The tax consequences and considerations are different for settlors and beneficiaries, and understanding them is critical to protecting assets both in the present and for future generations.

Generally speaking, settlors do not want their trusts to be considered foreign under U.S. law once they have immigrated to the U.S. The additional reporting requirements, as well as the increased likelihood of future audits by the IRS, make this an unappealing situation.

On the other hand, beneficiaries would prefer that their trust is considered a foreign grantor trust. When distributions are made to U.S. beneficiaries from a foreign grantor trust, all income and capital gains are attributed to the foreign settlor, who may live in low- or no-tax jurisdictions. However, the beneficiary will also need to ensure he or she is compliant with U.S. reporting requirements and potentially contend with tax consequences related to PICs, CFCs and undistributed net income.

These topics are explored in more detail in our paper, “Pre-Immigration Tax Planning: Foreign Trusts.”

Establish a Gifting Program

Once an individual becomes a U.S. resident alien or citizen, he or she will be subject to a 40% gift tax if the total value of gifts of property owned worldwide exceeds the $11.4 million gift and estate tax exemption afforded to U.S. citizens and permanent residents. So before entering the U.S. tax net, it’s important to understand the value of one’s worldwide assets. If assets are expected to exceed the exemption, outright gifts can be made pre-immigration in order to reduce the overall taxable estate. However, keep in mind that gifts to U.S. persons will increase that person’s taxable estate. If such gifts are substantial enough to increase the net worth of the recipient so that it exceeds the exemption amount, a trust might be a more tax-efficient vehicle for gifting.

Drop-Off Trusts

Emigrants can shelter excess assets from the U.S. estate tax for future generations through the use of trusts, referred to as “drop-off” trusts. In many U.S. states, a dynasty trust can be created that would grow free of state income tax and transfer tax for future descendants. The five-year rule related to income tax should be kept in mind here. Drop-off trusts should generally not be funded with all of a settlor’s assets, and the trustee should avoid making large or numerous distributions to the settlor to minimize the likelihood that the IRS will claim the settlor had retained control over trust or trustee.³

Non-Citizen Spouses

Sometimes, an immigrant’s spouse does not become a U.S. citizen. Unless spouses have kept their assets separate and the immigrant spouse has no need or desire to provide for the non-U.S. spouse either during lifetime and/or at death, pre-immigration planning may be needed to mitigate taxes once the emigrant becomes a U.S. resident. Although there is no gift or estate tax on asset transfers between U.S. spouses, this marital deduction is not available if the receiving spouse is not a U.S. citizen. Gifts or bequests to non-citizen spouses exceeding the current estate tax exemption incur the same 40% transfer tax as gifts or bequests to non-spouses. This catches many long-term permanent residents by surprise, since most other U.S. tax regulations apply to permanent residents as well as citizens.

Before immigrating, emigrant spouses can make unlimited transfers to anyone free of U.S. tax, so spousal gifting prior to immigrating has the potential tax savings of 40%. Alternatively, immigrant spouses could use their estate and gift tax exemption to leave funds for their non-citizen spouses; however, this would preclude their leaving assets to other heirs without incurring the same 40% estate tax. Typically, to avoid immediate estate tax on gifts to non-citizen spouses that exceed the exemption, U.S. immigrant spouses would establish a qualified domestic trust (QDOT) benefiting the surviving spouse. QDOTs of more than $2 million must have a corporate trustee or post a bond. Further, distributions of principal from a QDOT are

³ U.S. Internal Revenue Code Section 2036
subject to estate tax at the highest marginal tax rate of
the decedent spouse, making this an unwieldy and, for the
surviving spouse, unpleasant structure.

Accelerate Gains and Defer Losses
It may be beneficial to try to accelerate the recognition of
income before immigration (or hold off on realizing losses
until the emigrant becomes a U.S. taxpayer). This will depend
on whether the tax rates in the home country are lower than
those in the U.S. Any built-in gains that may exist in a stock
portfolio, for example, can be recognized before immigrating.
U.S. stocks can simply be sold and then repurchased to
step up the basis of those stocks. Non-U.S. taxpayers are
not subject to U.S. capital gains tax on the sale of securities
but U.S. taxpayers will have to pay a 15 to 20% capital gains
tax (plus the 3.8% Net Investment Income Tax for those in
higher tax brackets) so it’s best to realize those gains to the
greatest extent possible before immigrating to the U.S.

Furthermore, the basis can be stepped up on other
 corporate assets by artificially recognizing income on those
assets through a check-the-box election on IRS Form 8832.
This election would be considered a deemed liquidation of
the company for U.S. tax purposes only. It will not trigger
a tax event in the home country. Note however that not
all corporations are eligible for a check-the-box election.
For example, this election is not available for “per se
corporations” such as the Sociedad Anonima or SA, which is
used widely in Latin America.

Explore the Use of Insurance
Pre-immigration planning solutions may involve the use of
life insurance. Whether it is a traditional whole life policy or
a private placement life insurance policy (PPLI), insurance
can enjoy the benefits of tax-free growth and distributions if
properly titled and funded. Drop-off trusts can also be used
in combination with PPLI.

Remember that in the event the drop-off trust was
established within five years of immigration and there are
U.S. beneficiaries, the immigrant would still be subject to
income tax on the assets in the trust (even if he or she had
no access to them and did not receive distributions). A PPLI
policy could provide substantial income tax savings in this
scenario as the assets in the policy would not be subject to
income tax. This type of policy can be less expensive than
a traditional life insurance policy (as the death benefit is
typically smaller) but can provide access to more investment
options and the ability to access funds in a tax-efficient
manner. Any planning using this type of policy should be
done with an experienced cross-border insurance tax
planner to ensure that all compliance requirements are
being met in the U.S. and the home country in order to reap
the tax benefits.

In order to ensure that the death benefit of the policy is not
included in the estate of the insured, it should be purchased
and owned by an irrevocable life insurance trust (ILIT) that is
managed by an independent trustee. These types of trusts
are commonly used by U.S. citizens and residents.

CONCLUSION
With thoughtful planning, it’s possible to avoid running
afoul of unfamiliar or unexpected aspects of U.S. tax law
that could have a significant impact on family wealth. When
considering a move to the U.S. those with substantial wealth
should engage with competent, experienced advisors who
are familiar with the ins and outs of U.S. tax law and can
provide advice that makes the transition as easy as possible.
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As a senior director and global family wealth strategist, Joan works closely with families and their advisors to provide comprehensive wealth planning. She specializes in multinational planning, business succession, family governance and philanthropy.

With more than 25 years of experience working with large, multi-generational families, she is frequently invited to speak to clients and professional groups such as the American Bar Association, the Hong Kong American Chamber of Commerce and numerous estate planning councils throughout the United States, Canada, the Middle East and Asia. She has recently been featured in various publications and broadcast media including The Wall Street Journal, Trusts & Estates magazine, the American Journal of Family Law and CNBC-Asia. Joan received her MBA (Finance) from Rollins College, her Bachelor of Education from Queens University, and her Bachelor of Music from McGill University.

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