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Overview of U.S. Tax System

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- Federal Taxes
 - ▣ Income Tax (includes tax on capital gains)
 - ▣ Transfer Taxes
 - Estate Tax
 - Gift Tax
 - Generation Skipping Taxes
- State and Local Taxes
 - ▣ Income Taxes
 - ▣ Inheritance Taxes
 - ▣ Realty Transfer Taxes

Citizens and Residents of the U.S.

- Must pay U.S. income taxes on their worldwide income.
 - Includes, *inter alia*, all interest income and capital gains derived from anywhere in the world. (Please note that, for this purpose, gain is determined by reference to historic cost basis even if the asset was acquired many years before becoming a U.S. resident.)
 - Shares owned in a foreign corporation may be subject to current U.S. tax on the pro-rata share of the corporation's undistributed earnings if the company is a controlled foreign corporation (CFC) or a passive foreign investment company (PFIC).
- Citizens – There are said to be 6 million American citizens who live outside the U.S.
- Residents for Income Tax Purposes.
 - Green Card Holders
 - Substantial Presence Test
- Treaty Tie-Breakers: An individual who is a resident of the U.S. and a country with which the U.S. has an income tax treaty that contains the necessary relief provisions, may apply these rules to determine which country can claim the individual as a resident for tax purposes.
 - Does not apply to citizens
 - Problems for Green Card Holders

Who Is A U.S. Citizen?

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- Persons born in the U.S.
- Naturalized persons.
- Persons born outside the U.S. with a U.S. parent in certain circumstances.
Depends on:
 - Year of child's birth
 - U.S. physical presence of U.S. parent
 - Examples
 - Children born to two U.S. citizen parents are U.S. citizens
 - Children born after 12/23/52 and before 11/14/86
 - One parent is a U.S. citizen; and
 - Was physically present in the U.S. for at least 10 years prior to the child's birth (at least 5 of which were after the age of 14).
 - Children born on or after 11/14/86
 - One parent is a U.S. citizen; and
 - Was physically present in the U.S. for at least 5 years prior to child's birth (at least 2 of which were after age 14).

Immigration Status – Permanent Residence

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- A foreign national who is a “lawful permanent resident” of the U.S. during a calendar year is a resident of the U.S. in that year.
- A lawful permanent resident is generally referred to as a “green card holder”.
- A lawful permanent resident is one who has been granted the privilege of residing permanently in the U.S. as an immigrant. Application for a green card is not sufficient to establish residence for income tax purposes. (Compare with transfer tax.)
- Taxation applies irrespective of whether the individual has any real intention of residing in the U.S. on a permanent basis.
- Resident status is deemed to continue unless it is rescinded or administratively or judicially determined to have been abandoned.
 - Please note that one cannot merely put the card aside even if it has expired.
 - The time at which the loss of lawful permanent resident status is effective for tax purposes depends on whether the loss occurs at the initiative of the taxpayer or of the government. If initiated by the individual, the loss is effective when the application is filed with the Immigration and Naturalization Service or with a consular office. If initiated by the government, residence ends upon issuance of a final administrative or judicial order.

Substantial Presence Test

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- An individual is considered a resident alien under the substantial presence test if he or she was in the U.S. 183 days or more during any calendar year.
- Resident alien status can also be established under a three-year test which counts 183 days to include:
 - ▣ each day in the current year; plus
 - ▣ during the first preceding year, 1/3 days in the U.S.; plus
 - ▣ during the second preceding year, 1/6 days in the U.S.
- **General rule:** to avoid resident alien status, average annual days lived in the U.S. should not exceed approximately 120 days.
- Test is based on a strict counting of the days.

Substantial Presence Test - Exemptions

- Certain individuals such as students who enter the U.S. on an F-1 visa, or other student visa are exempt from the substantial presence test for a period of time, usually five years.
- Closer connection test: One who is physically present in the U.S. for fewer than 183 days in one calendar year who has a “tax home” outside the U.S. for the entire year can avoid U.S. residence by establishing a closer connection with another country.
 - No individual who has taken steps toward applying for a green card can maintain a “closer connection” with a foreign country.
 - Both the closer connection to the foreign country and the foreign tax home must be maintained during the entire year.
 - The Regulations permit a foreign individual to have a closer connection to 2 foreign countries (but not more) if a tax home is maintained in one of the 2 countries at all times during the year, and if the individual changes the tax home only once during the year, has at all times a closer connection to the country of each tax home than to the U.S., and is subject to tax as a resident in each of the 2 foreign countries at least during the time the tax home is maintained there.
- Use of treaties.

Substantial Presence Test - Definitions

- “United States” means the 50 states and the District of Columbia but not the territories, possessions and commonwealths
 - ▣ Includes the territorial waters of the U.S. and the seabed in the territorial waters
- “Day” includes any part of a day with 3 modifications:
 - ▣ Regular commuters for employment from a place of residence in Mexico or Canada to the U.S.
 - ▣ An individual who is in transit between 2 points outside the U.S. and who is physically present in the U.S. for less than 24 hours is not treated as present in the U.S.
 - ▣ Crews of foreign vessels

Dual-Status Years

- Refers to years in which an individual is both a resident and a nonresident.
- First Year of Residency:
 - An individual who is a resident for the current year, but was not a resident at any time in the prior year, is a resident only for the portion of the current year which begins on the residency starting date:
 - Under the substantial presence test, the residency starting date is the first day in the current year on which the individual was present in the U.S. (One can exclude visits of up to ten days if there was a closer connection to a foreign country in which the individual has a tax home than to the U.S.)
 - Under the green card test, the residency starting date is when the individual is present in the U.S. while a lawful permanent resident.
- Last Year of Residency:
 - The last day on which the individual is present in the U.S. or the last day on which the individual still holds a green card, whichever is later, but, to avoid U.S. residency during the last portion of the year, the individual must prove a closer connection to a foreign country than to the U.S.
 - Can also exclude temporary visits of less than 10 days under the same circumstances as for one coming to the U.S.
- There is no lapse in the case of an individual who is resident in any part of each of two consecutive years.

Liability for U.S. Estate and Gift Tax

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- U.S. Citizens and those deemed “resident” in the U.S. for Estate and Gift Tax Purposes are subject to a complex tax regime on worldwide assets.
- U.S. “Non-residents” are subject to Estate and Gift Tax on U.S. situs assets.
 - ▣ Real Estate.
 - ▣ Tangible personal property (e.g. art) located in the U.S.
 - ▣ Securities of U.S. companies (estate tax only).

Liability for Estate and Gift Taxes

- Residency for Estate and Gift Tax purposes is based upon domicile.
 - ▣ Distinct from “substantial presence” and Green Card analysis for Income Tax purposes. Domicile: where one lives with the intent to remain.
 - ▣ Green Card holders are generally presumed to be residents, but can, under limited circumstances, rebut presumption based upon “intention.”
 - ▣ Similarly, although one with a temporary visa is generally not considered a U.S. domiciliary, under certain circumstances, courts have held that temporary visa holders demonstrating intent to remain might be domiciliaries for Estate and Gift Tax purposes.

State and Local Tax

- In addition to Federal Income, Estate and Gift taxes, U.S. citizens and most non-U.S. persons residing in the U.S. are also subject to complex regime of significant state and local taxation.
 - Inheritance Taxes
 - Income Taxes
 - Transfer Taxes
 - Particularly important in real estate context

Expatriations

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- According to U.S. Treasury reports, 5,411 individuals, a record number, expatriated in 2016. This compares to 4,279 in 2015 which was also a record.
- According to a July 14, 2014 survey released by the deVere Group, the increased desire to expatriate has been as a result of FATCA making it difficult to bank overseas and a belief that they are under suspicion by the IRS.
- ABA Tax Section has asked the IRS to confirm that some expatriates will not be treated as U.S. citizens. (Bloomberg Daily Tax Report 3/3/2015.)
 - Applies to individuals who ceased being U.S. citizens prior to the enactment of the American Jobs Creation Act which was effective June 3, 2004 or those who complied with the provision of the law as it existed between 2004 and the enactment of the Heroes Earnings Assistance and Relief Act in 2008.

Expatriation

- Applies a mark-to-market rule (i.e., exit tax) under which covered expatriates are treated as having sold all property for fair market value.
- Trustees of nongrantor trusts must withhold 30% on any distribution made to a covered expatriate.
- Estate or gift tax is imposed on the receipt of bequests and gifts from a covered expatriate. Also applies to transfers in trust.

Expatriation

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- Current expatriation tax regime effective as of June 17, 2008.
- A person who renounces U.S. citizenship or who gives up a U.S. green card after holding the green card in at least 8 of the past 15 calendar years.
- Applies to “covered expatriates” who meet any of three standards:
 - The taxpayer’s five-year average income tax exceed \$162,000, adjusted for inflation;
 - The taxpayer’s net worth as of the date of expatriation exceeds \$2 million (not adjusted); and
 - The taxpayer fails to certify that compliance for the 5 years preceding expatriation. Certification is made on IRS Form 8854.
- Exceptions:
 - Certain dual citizens from birth who have not resided in the U.S. for more than 10 of the past 15 years; and
 - Certain persons who expatriate before age 18½.

Expatriation

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- Mark-to-market tax on expatriation - §877A
- Deemed to have sold all assets for FMV as of date of expatriation
- \$699,000 exemption (Inflation adjusted amount)
- Assets of grantor trust deemed owned by expatriate
- Non-grantor trust not deemed owned by expatriate, but
- Trustee must subsequently withhold 30% of all distributions from non-grantor trust
- Non-grantor trust is any trust that expatriate is not a grantor

Expatriation

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- Gifts/bequest from covered expatriate - §2801
- U.S. person who receives gift/bequest from covered expatriate subject inheritance tax = 40%
- Test for covered expatriate on date of expatriation
- Transfers to domestic trust trigger tax
- No tax on transfer to foreign trust, but tax on subsequent distribution to U.S. person



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