Private Bank

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Planning for a move to the US

Contents

Introduction

"Land of the Free" is a bit of a misnomer when describing the US – moving there is anything but free, especially for the unwary who don't plan in advance.

Thoughtful planning is critical before arriving in the US.

There are basic planning considerations applicable to foreign persons coming to the US so they understand the tax landscape, identify goals in advance of a move and make informed decisions before arriving. It is a process that takes time.

OVERVIEW OF US TAX RATES

Federal income tax		
	Top marginal income tax rate	37%
	Long-term capital gains/qualified dividends	20%
	Net investment income tax (interest/ dividends/gains)	3.8%
	Medicare tax on wages	1.45% + 0.9% supplemental
Gift and estate taxes		
	Top marginal transfer tax rate	40%
	US domiciliaries exemption	$13,610,000
	Non-US domiciliaries exemption	$60,000

Information throughout reflects current rules under the Internal Revenue Code, Treasury Regulations, and other guidance promulgated by the United States Department of the Treasury. Information is current as of November 2023 and is subject to change.

US taxation of individuals

US INDIVIDUALS

US income tax

US citizens and residents are taxed on their worldwide income, regardless of where the individual resides. For example, a US citizen living permanently in the UK with businesses in China, Australia and India would be liable for US income taxes, subject to certain tax treaties, on income generated by all ventures no matter where the income is earned. Currently, the highest marginal federal US income tax rate is 37%.[2] State income taxes may also apply depending on if an individual is a resident of a US state that imposes an income tax.

US transfer tax

For US citizens, most green card holders and all individuals who are considered domiciled in the US, the US will tax transfers of property regardless of where in the world they occur and irrespective of the assets that are transferred. "Domicile" status is acquired when a person lives in the US, even for a brief period, with no definite present intention of moving out of the US. US domiciliaries are subject to gift, estate and generation-skipping transfer (GST) taxes on their worldwide assets based on gradual rates up to 40%, with an exemption of $13,610,000.

NON-US INDIVIDUALS

US income tax

Generally, non-resident aliens[3] (NRA) are subject to US income tax only on their US-source income, which includes interest,[4] dividends from US securities and rents from US real estate (generally subject to withholding at a 30% rate on a gross basis, unless a reduced rate or an exemption applies under a treaty), and income that is effectively connected with a US trade or business (taxed on a net basis at graduated rates).

Generally, capital gains are not subject to US tax for an NRA, except for on the sale of interests in US real property (including stock of US real property holding companies)[5] and sales of interests in certain partnerships conducting business in the US.[6]

US transfer tax

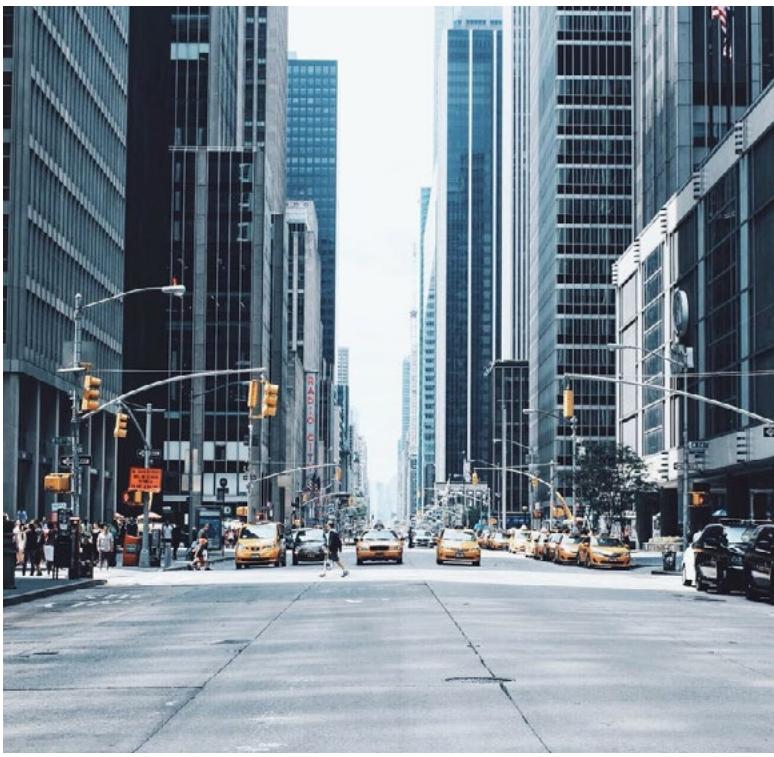
Non-US-domiciled individuals are subject to US federal gift, estate and GST taxes only on transfers of "US situs assets." The federal gift and estate tax rates applicable to a transfer made by an NRA are as high as 40%, but with only a $60,000 exemption (GST tax may also apply).

[2] A preferential tax rate of 20% (plus a 3.8% net investment income tax where applicable) applies to certain qualified dividends and long-term capital gains. Certain deductions are allowed.
[3] A non-resident alien is any individual who is not a US citizen or US national and who has not passed the green card test or the substantial presence test.
[4] Some exceptions apply for interest income such as interest on certain deposits with banks, financial institutions and insurance companies, and "portfolio interest" (which includes interest on most publicly offered debt instruments).
[5] Under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), buyers of US real property interests have to withhold 15% of the sale price to the non-US seller, subject to certain exceptions.
[6] Pursuant to IRC Sec. 1446(f), buyers of interests in certain partnerships conducting business in the United States must withhold 10% of the sale price paid to the non-US seller, subject to certain exceptions and limitations.

ASSETS GENERALLY CONSIDERED US SITUS FOR ESTATE AND GIFT TAX PURPOSES

ASSET	ESTATE TAX	GIFT TAX
Cash	Yes, if deposits with US brokers, money market accounts and cash in safe deposit boxes	Likely yes, if gift takes place in the US
Real estate	Yes, if located in the US	Yes, if located in the US
Tangible property (e.g., jewelry, antiques, art)	Yes, if located in the US at the time of death, unless in transition	Yes, if gift takes place in the US
Shares of US corporations	Yes, irrespective of location of certificates	No
Life insurance proceeds	No, if insured is an NRA, unless NRA owns a US policy on life of another (cash value subject to estate tax)	No
US mutual funds	Yes, irrespective of where held or whether or not publicly traded	No
US debt obligations	No, if "portfolio debt"	No
US partnership interests	Likely yes, unsettled under US tax law, but partnerships organized under US law, holding US property or conducting business in the US could trigger estate tax	Likely no, absent any specific structuring or series of transactions, which could be perceived as a pre-arranged plan to circumvent the situs rules, but unsettled under US law

RESIDENCY FOR US INCOME TAX



The concept of US income tax residency for US federal income tax purposes is different from that for US federal gift and estate taxes. Residence for income tax purposes is determined by an objective test, as explained below. Residence of a non-US citizen for purposes of gift and estate taxes is based on domicile, which is a subjective "facts and circumstances" test. An individual can be a US income tax resident but not domiciled for US gift and estate taxes, and vice versa.

Individuals are US income tax residents if they are US citizens or meet either the "green card test" or the "substantial presence test."

Green card test

Individuals holding a permanent resident card (a "green card") will be considered US residents for income tax purposes and will be subject to US income tax on their worldwide income. Holding or possessing a green card is the key fact under the green card test, regardless of where the individual resides or the amount of time the individual spends in the US in any given year.

A green card holder will remain subject to US income tax on their worldwide income until (i) they surrender the green card; (ii) the immigration authorities revoke it; or (iii) there is a judicial determination of abandonment, under current immigration laws.

Substantial presence test

A non-US individual may be subject to US income tax on their worldwide income if they are deemed to have a substantial presence in the US. For these purposes, a substantial presence is calculated by looking at the number of days spent there, taking into consideration the current year and the two preceding years using the following calculation:

All the days present in the US in the current calendar year
+ 1/3 of the days present in the US in the prior year
+ 1/6 of the days in the US in the second prior year

If an individual is present in the US for at least 183 days using this rolling day count calculation (and at least 31 days during the current year), they will be deemed substantially present and subsequently considered a US income tax resident with exposure to US income tax on their worldwide income.

As a result of the multi-year formula, an individual who is present in the US for fewer than 121 days year after year will remain below the 183-day threshold.[7]

Once an individual reaches the 183-day count,[8] they may be liable for US income tax on their worldwide income retroactive to the beginning of the calendar year.

When calculating the number of days present in the US, it is important to note that any time spent in the US on a given day is generally counted as a full day. For example, if an individual leaves the US at 12:05 am, that five-minute period is still counted as one day in most instances.

Certain individuals such as students, professional athletes, individuals holding diplomatic visas, employees of international organizations, teachers and trainees are not considered US residents under the substantial presence test, regardless of the number of days spent in the US.

Closer connection exception and treaty tiebreaker test

Even if an NRA meets the substantial presence test but is present in the US for fewer than 183 days during the current year, they may still be treated as a non-resident if they can prove a closer connection to another country.

This is determined through several factors including: (i) where the individual is permanently located; (ii) the location of their family or business; and (iii) where any social, political and religious connections are formed.

Some tax treaties contain "tiebreaker" provisions for individuals who are considered residents of both the US and a foreign country. An individual may claim a treaty benefit under the tiebreaker rule by claiming stronger ties with the other treaty country.

[7] Exceptions include spending less than 24 hours in the US while in transit between two foreign points, and regular commuters from Canada and Mexico.
[8] Special rules apply to the first and last years of residency.

Pre-immigration planning considerations for US income tax purposes

When a non-US individual is considering moving to the US, effective tax planning can be achieved before the individual immigrates. Some steps can be implemented in advance with the purpose of minimizing the exposure to US taxes upon becoming a US income tax resident and potentially a domiciliary.

INCOME TAX CONSIDERATIONS

Basis step-up

Prior to becoming a US income tax resident, it is important for individuals to review their appreciated assets to see if there is an opportunity to step up the basis so as not to enter the US tax system with an embedded gain. This can be accomplished in a number of ways.

For publicly traded securities owned, an individual can sell and repurchase shares to step-up the basis. The individual will have to examine the tax implications in their home country before undergoing this part of the exercise.

If a client holds an interest in a private company, there are other considerations for improving the tax treatment of the company from a US perspective. For US income tax purposes, an entity may elect to be treated as a corporation, a partnership (taxed to its owners directly) or as a disregarded entity. Such entity classification election is referred to as check-the-box (CTB) election.

A company electing to be treated as a partnership or a disregarded entity will be deemed to have made a liquidating distribution of its underlying assets to its owners on the "date of election," resulting in the basis of the assets stepping up (or down) to the value of the assets on the date of the election.

The step-up in basis of the company should be tax-neutral for US tax purposes, since gain realized by the NRA on non-US assets is not subject to US income tax.

The result is the reduction of a future realization of capital gains after the non-US individual moves to the US and becomes subject to US tax on such gains.

Accelerate income recognition

Non-US-source income earned by an NRA prior to the residence start date is not taxable by the US. Therefore, it is beneficial for the NRA to accelerate and recognize income prior to the residence start date.

Review existing structures and consider certain elections

If a non-US individual holds an interest in a foreign corporation, the individual may be exposed to US anti-deferral regimes upon becoming a US income tax resident. At that time, the now-US shareholder of the foreign corporation may be subject to US tax on a pro-rata share of both active and passive income earned by the foreign corporation, regardless of whether a dividend or distribution is paid to the individual.

The unfavorable tax consequences may be mitigated by making a CTB election to have the foreign corporation treated as a disregarded entity for US tax purposes prior to the NRA becoming a US income tax resident, or by reorganizing the ownership structure to minimize US ownership and control.

The five-year rule: Managing the timing of arrival to the US

A foreign trust with US beneficiaries created by an NRA grantor will be treated as a Grantor Trust if the non-US person becomes a US income tax resident within five years after creating the trust. Consequently, all the foreign trust's income will be taxed in the US starting on the date the individual's US tax residency begins. Income accruing in the foreign trust before such date will not be subject to US income tax, except for any US-source income.

To the extent that the NRA is able to create and fund a foreign trust more than five years before the start of their US tax residency date, the NRA could potentially be in a different tax position with respect to the trust and how its income is taxed.[9]

Residency start date

Once a non-US individual understands the US tax landscape, they, alongside their independent tax advisor, can effectively manage the days an individual spends in the US in order to avoid becoming a US income tax resident for any given year under the substantial presence test.

An individual spending less than 31 days in the US in a year will be deemed a non-resident for US income tax purposes for that year. Similarly, if they do not exceed 120 days of presence in a year, that individual will never exceed the days required to be deemed a US income tax resident under the substantial presence test.

An individual planning to relocate to the US may want to consider timing their arrival during the second part of a year to avoid triggering US income tax residency in the year of arrival. Likewise, an individual may want to avoid unnecessary trips to the US prior to their arrival date to avoid starting the clock under the substantial presence test.

If their home jurisdiction has a tax treaty with the States, the US-inbound immigrant may want to consider the opportunity to use the "closer connection" or the "tiebreaker rule" exemptions to defer US income tax resident status.

[9] Depending on the terms of the trust.

STATE-RELATED CONSIDERATIONS

In addition to the above items, it is important for the US-inbound immigrant to consider the application and impact of the legal framework of the state where the individual is wishing to relocate. Some relevant considerations to review include: (i) the tax rules and applicable tax rates in a given state (e.g., income tax, sales tax, estate/inheritance tax); (ii) property rights (e.g., types of ownership of real estate recognized in that state); and (iii) marital rights (e.g., whether the state is an equitable distribution state or a community property state may impact the way assets will be divided in case of a divorce while residing in that state).

As an example, here are US state income tax rates:[10]

California top marginal rate	13.3%
New York marginal rate (non-resident of New York City)	10.9%
New York marginal rate (resident of New York City)	14.78%
Florida	0%

Citi Private Bank and its affiliates are not tax or legal advisers. Before implementing a wealth plan, clients are advised to consult your independent legal and tax advisors in the relevant jurisdictions regarding the appropriate strategy to achieve your objectives.

[10] Information is as of November 2023 and is subject to change.

Pre-arrival planning for US transfer tax purposes

Consideration should be given to segregation of pools or "buckets" of assets to match with the needs of the US-inbound immigrant. Structures are available to assist, but knowing what to commit to each bucket is important to avoid fiscal friction. It is crucial to understand the intentions and therefore the likely impact from both the perspective of the US and the individual's home jurisdiction when residence in the US is anticipated to be only temporary.

Below is a general explanation of the most common "buckets" that US-inbound immigrants may want to consider:

BUCKET 1 – NO ACCESS

The individual may want to consider creating a foreign irrevocable trust, funded with only non-US assets and for the benefit of non-US beneficiaries only. This may be an optimal structure for someone who is planning to return home after a period of time. If structured properly, it may provide protection from US federal income tax and US federal estate tax.

Also available to support the individual's planning needs are Insurance Based Investment Products which are designed to address diversification and US reporting requirements and may offer greater portability for return to their home or third jurisdiction after their residency in the US is completed.

BUCKET 2 – SOME ACCESS

A US-inbound immigrant may want to consider creating and funding a foreign grantor trust with US beneficiaries within the five-year window prior to their relocation to the US. The trust may be irrevocable, but the grantor's spouse could be a beneficiary of the trust. The grantor will be subject to income tax on the trust's income, but the trust's capital may be protected from US federal estate tax if structured properly.

BUCKET 3 – DIRECT ACCESS

The now-US individual may want to own some assets in their personal name or through a revocable trust for their everyday and lifestyle expenses while living in the US. The income generated by this asset pool will be subject to US income tax and possibly subject to US estate tax if they are US situs assets. This strategy is generally paired with a life insurance policy held in an irrevocable trust to provide liquidity that may be needed to pay US estate tax.

Leaving the US: Expatriation and the "exit tax"

While the focus of this piece has been on planning before arriving in the US, it is important to also understand the implication of a possible exit from the US. The US imposes an expatriation tax on US citizens who renounce their citizenship as well as long-term residents[11] who give up their green cards and are "covered expatriates." A covered expatriate would be subject to a mark-to-market exit tax on their worldwide property.

To be a "covered expatriate," the renouncing person must meet one of the following three tests at the time of expatriation:

1. Asset test: Have $2 million or more in net wealth worldwide;
2. Income test: Have had an annual average US federal income tax liability of more than $190,000 (as adjusted for inflation in 2023) over the five-year tax period prior to expatriation; or
3. Compliance test: Have failed to certify full compliance with US federal income tax filing obligations for the five-year tax period prior to expatriation

It is crucial that a permanent resident who is considering giving up their green card in the future plans the timing of expatriation effectively to avoid being subject to the exit tax.

As part of the strategy to leave the US, planning for a new residency is also important. Consideration needs to be given in reviewing US-compliant structures and determining whether they are compatible with the next intended country of residence. Should a period in a third country to efficiently manage the transition be considered to enable a reorganization to take place? This can be very effective and allow for the transition between jurisdictions with very different structuring needs.

[11] For this purpose, a long-term resident is an individual who has been a green card holder for at least 8 of the 15 years preceding expatriation.

Meeting your planning needs

Moving to a new country can be daunting, especially when that new country is the US. It has a complex tax system that needs to be navigated carefully to avoid unintended costs and consequences. Without thoughtful planning well in advance, a move to the US could adversely impact the preservation of an individual or family's wealth and the ability to leave a long-lasting legacy for future generations.

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Before implementing a wealth plan, you will want to consult your independent legal and tax advisors in the relevant jurisdictions regarding the appropriate strategy to achieve your objectives.

For more information, please contact your Wealth Planner or Private Banker.

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