

CANADIAN TAX *Highlights*

Pre-Immigration Planning for US Transfer Taxes

In addition to very challenging income tax issues, an individual contemplating a move to the United States will encounter an entirely new and significant transfer tax regime--for example, the maximum US estate tax rate is currently 45 percent. Planning opportunities may be lost if appropriate steps are not taken before US residence is established.

The tests for establishing US residence differ for US income tax and US transfer tax purposes. For income tax purposes, with some exceptions, a person is a US resident if he has a permanent resident visa (green card), satisfies the "substantial presence" test, or makes a first-year election under Code section 7701(b)(1)(A). For the purposes of the US transfer tax (gift, estate, and generation-skipping transfer tax), "residence" means "domicile," which is determined by considering multiple factors, including (1) the time the person spent in the United States; (2) the value of his US residence; (3) the location of his "near and dear" items; (4) his affiliations with clubs, churches, and other organizations; and (5) his visa status. Often, no one factor is determinative.

Unlike a US resident, who is subject to transfer tax on transfers of any assets, a non-resident alien (NRA) is subject to US gift tax only on transfers of US-situs assets, which, for gift tax purposes, means real or tangible personal property situated in the United States at the time of the transfer. A gift of intangible property by an NRA is not subject to US gift tax. The generation-skipping transfer tax applies to taxable transfers that skip a generation (for example, a gift from an individual to his grandchild), unless US gift tax does not apply. Like the gift tax, US estate tax applies only to US-situs assets, but the definition is broader in this context: not all intangible property is exempt, and thus a USco's shares and the debt obligations of a US person, the United States, a state, or any political subdivision (with certain narrow exceptions) are deemed to have a US situs. Bank deposits are not deemed to have a US situs. Thus, an NRA has a window of opportunity before immigration to benefit from the transfer tax rules for NRAs.

An NRA can use various strategies to minimize US transfer taxes before becoming a US resident.

- An outright gift of non-US-situs assets may be attractive in its simplicity, but it may not be practical if, for example, the intended donee is a minor. Outright gifts to adult children or other donees have little downside from a planning perspective.
- An individual may create an irrevocable trust funded with assets in excess of what he thinks necessary for his personal needs and comforts. The settlor cannot be a beneficiary or hold any strings that would make the gift incomplete for gift tax purposes or cause the assets' inclusion in his estate under Code sections 2035 to 2038. The trust may be a grantor or non-grantor trust, foreign or domestic. From an income tax perspective, the benefits of a trust are limited, and thus professional tax advice is critical before a trust is settled; however, the gift, estate, and generation-skipping transfer tax benefits can be substantial.
- If, before immigration, an individual is a settlor, beneficiary, or fiduciary of a trust, he should consider renouncing any powers that may have unintended tax consequences. For example, if the individual has the right to remove a trustee and appoint any substitute, it is advisable to amend the trust instrument to require that the substitute be an independent trustee so that the trustee's powers are not attributed to the individual. If this change is made before the individual becomes a US resident, there should be no transfer tax consequences related to the amendment or disclaimer. Powers of appointment and beneficial interests should also be examined to minimize or avoid the inclusion of trust assets in the individual's estate for US estate tax purposes.