<u>Are You Contemplating U.S. Income Tax Residency Status</u>? <u>If so, Plan Accordingly</u>

By: Michael Rosenberg

In most cases, a non-U.S. citizen who is contemplating a permanent move to the U.S. will likely meet with U.S. tax counsel prior thereto in order to obtain an understanding of the complex and far-reaching U.S. tax regime. In its simplest terms, a non-U.S. citizen can be classified as a U.S. income tax resident alien ("RA") in one of two ways, i.e., by obtaining U.S. immigration lawful permanent resident alien so-called "Green Card" status or by spending a certain number of days in the U.S. during a 3-year period. This second test, known as the Substantial Presence Test ("SPT"), is a 3-year weighted average percentage test, it is somewhat complex, it contains numerous special rules and exceptions, and any individual currently spending time in the U.S. or contemplating a more permanent move to the U.S. should make certain that he or she understands each aspect of the SPT as a failure to do so can prove extremely costly and onerous.

An extremely important provision amongst the many RA provisions is the determination of the individual's <u>residency starting date</u>. Solely for the purpose of administrative ease, and not with the intention of explaining herein every aspect of the RA definition (that definition has been thoroughly analyzed in prior editions of *Caribbean Today*), assume the following:

> T, a non-U.S. citizen/non-Green Card holder who will begin spending more significant time in the U.S. in 2007, has been offered the opportunity from his Caribbean technology company ("TECHCO") to become the CEO of TECHCO's new Florida start-up subsidiary or affiliate ("FLACO"). T has never previously spent more than a week at the most in the U.S. on a yearly basis. T accepts the Florida employment opportunity, he visits Florida from January 5th – January 12th (8 days) in order to find the right place for him and his family to live, the right school for his children, the right church or synagogue for his and his family's religious needs, the right parks, clubs, shopping and other facilities, etc., and T does so while still maintaining all of his everyday contacts and connections in his home country.
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> After finding the "perfect place," T returns to his home country and later comes to Florida again sometime in July and from the date of his arrival in July through December 31, 2007, T and his family spend 180 days in the United States. T's FLACO employment opportunity will run through December 31, 2010 as both he and TECHCO believe that by then, FLACO will be ready for an initial public offering and T can return to TECHCO in the Caribbean.
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> Suppose further that T originally purchased shares in TECHCO when it was a start-up company, which shares cost him $100,000 but that said shares are now worth $5,100,000. In March of 2007, T, in contemplation of his move to the U.S., sells his TECHCO shares and realizes a gain of $5 Million. Suppose further

> that T's gain is not subject to income tax in his own country (it may or may not be and that is a question for foreign counsel, but this supposition is made solely for illustrative purposes). Assuming as I have that prior to 2007, T has never spent more than a few days a year in the U.S., and assuming T does not have a Green Card when he comes to the U.S. in 2007, his status as an RA versus a U.S. income tax nonresident alien will be determined under the SPT. For SPT and RA purposes, T will have spent 188 days in the U.S. in 2007; however, if T can prove that he maintained closer connections to, and a tax home in, his Caribbean home country during the 8 days he spent in Florida in January 2007, T's residency starting date would be the first day in July and his $5 Million gain from the March sale of his TECHCO shares would be U.S. income tax-free!

As oftentimes occurs, sometime on or close to April 15, 2008 (the due date for T's 2007 U.S. Individual Income Tax Return, Form 1040), T will visit a certified public accountant ("CPA") in order to timely file his return. Among the data T will likely provide to the CPA will be documentation reflecting the sale of T's Caribbean company shares and because T will be an RA for 2007 as a result of his meeting the SPT (i.e., in this case, T will have spent more than 182 days in the U.S. in 2007 which is one way, BUT NOT THE ONLY WAY T may be found to have met the SPT), and if T and the CPA are not aware of the residency starting date rules and the special de minimis rule which in T's case would exclude his initial visit in January for residency starting date purposes, he will likely be advised to pay the U.S. 15% long-term capital gains tax on his $5 Million gain from the sale of those shares!

The above illustration reflects only one of many fine points which must be understood by any non-U.S. citizen/non-Green Card holder spending time in the U.S. or contemplating spending time in the U.S. as by merely reviewing the illustration above, by simply "missing" one of many complex provisions, T's cost would be $750,000! In the event T may be subject to tax in his home country on the gain from his sale of the TECHCO shares, he must make certain that both his Caribbean tax advisors and his U.S. tax advisors properly coordinate any credits he may be entitled to. T should not assume anything and instead should make sure he is properly counseled in advance.

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