TAX PLANNING FOR FOREIGN INVESTORS

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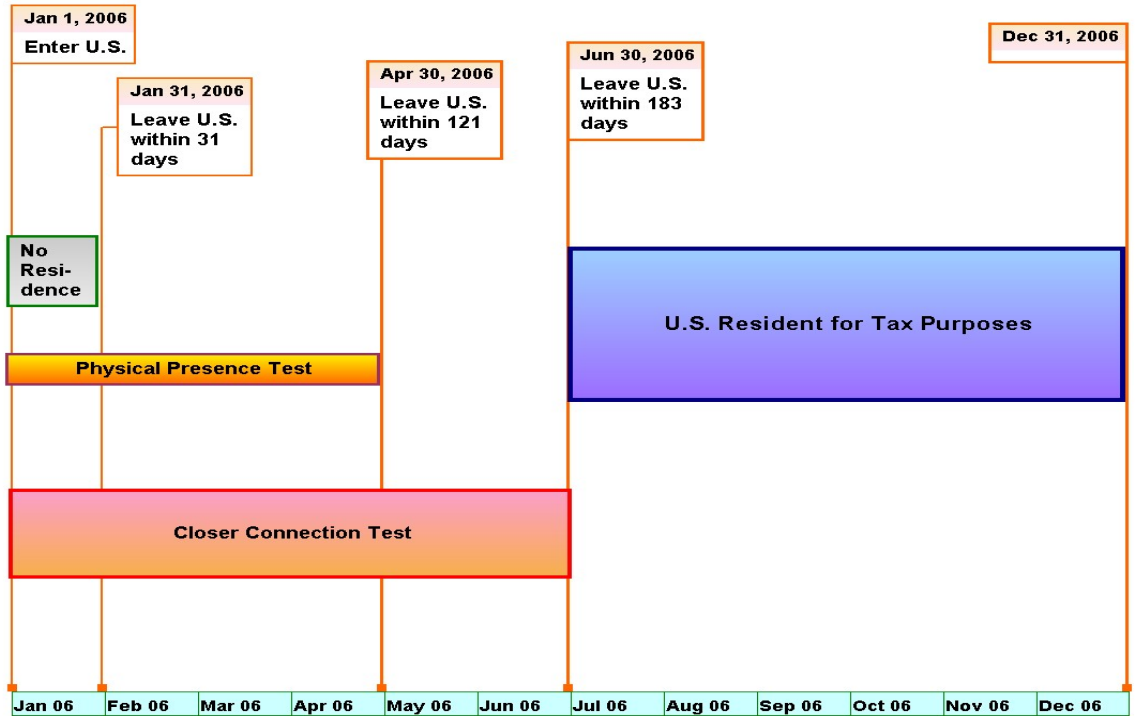


2.2. Substantial Presence Test

The substantial presence test involves totaling the days a foreign citizen is in the U.S. IRC Sec 7701(b)(3). For the substantial presence test to apply, Sam must be in the U.S. at least 31 days during the current calendar year and must be present at least 183 days (partial days are counted as whole days) during the current year plus the preceding two years under the following formula:

> Each day of the current year is counted in full; one-third of the days present in the preceding year are counted; and one-sixth of the days present in the second preceding year are counted. Therefore, Sam avoids becoming a U.S. resident by limiting his stay to 120 days annually.

Step 1: Are you present in the U.S. for at least 31 days in the current year? If yes, then proceed to Step 2. If no, then you are not a U.S. resident for tax purposes, unless you have a green card or are a U.S. citizen.

The following chart illustrates the physical presence test:

Examples	2006	2005	2004	Resident?	Explanation
	100%	1/3 days	1/6 days		
Days in U.S.	60	330	300	Yes	220 total (60+110+50)
Days in U.S.	60	270	240	No	180 total (60+90+30)
Days in U.S.	30	330	300	No	Less than 31 in present year
Days in U.S.	121	121	121	No	181.5 total (121+40.33+20.17)

Foreign citizens who are exempt from the substantial presence test include diplomats and their families; teachers and trainees; students; commuters from Mexico and Canada; persons in transit between foreign destinations who are in the U.S. for less than 24 hours; persons medically incapacitated because of a medical condition that arose while present in the U.S.; and professional athletes competing in certain charitable sporting events.

2.3. Closer Connection Test

If a foreign citizen meets the substantial presence test, he still may qualify as a non-resident under the closer connection test. IRC 7701(b)(3). Unlike the substantial presence test, the determination of whether a taxpayer has a closer connection with another country is based the individual's unique facts and circumstances. A foreign citizen, who has not applied for a green card and is in the U.S. **less than 183 days** in the current year, might retain his foreign residency if he has a tax home in a foreign country and has a closer connection to the foreign country as subjectively determined by the IRS or court. A closer connection to a foreign country involves such factors as the individual's location:

(i) of his permanent place of residence;

2007	$2,000,000	45%
2008	$2,000,000	45%
2009	$3,500,000	45%
2010	No estate tax – carryover basis rules apply	Gift-tax rate is 35%
2011	2001 estate tax law expires	Old law applies

Note: From 2002-2009, the unified exemption may be applied to $1,000,000 in taxable gifts.

Changes to the estate and gift tax law for foreign investors have raised the top tax rate from 30% to 46% percent in 2006, the identical rate applied to all U.S. taxpayers. However, the estate tax credit for foreigners remains at $13,000 (the tax on a $60,000 net estate), merely 3.0% of the $2,000,000 exclusion enjoyed by U.S. residents or citizens (see the chart). Generally, property is valued at its fair market value on the date of death or transfer.

3.1. Residency Qualifications

U.S. citizens and residents are taxed on their worldwide assets. Therefore, one must first determine whether a non-U.S. citizen will be **considered a resident** for estate tax purposes.

Note: The definition of "residency" for estate and gift taxes differs from that determining income taxes, and certain treaty provisions may affect the determination of residency. Regs. §25.2501-1(b) contains the definition of domicile for estate and gift tax purposes.

"Residency" for estate tax purposes involves the **concept of domicile**: Did the foreigner intend to remain in the United States permanently? Salient factors include: (i) filing of U.S. tax returns and any visa applications; (ii) length of stays in the United

4.2. Inbound and Outbound Gifts

Tax-Trap - Example: A U.S. taxpayer gifts stock worth $200,000 to a non-U.S. taxpayer who then sells the stock at a gain and shortly thereafter transfers the sales proceeds to the U.S. taxpayer as a gift. Will this work?

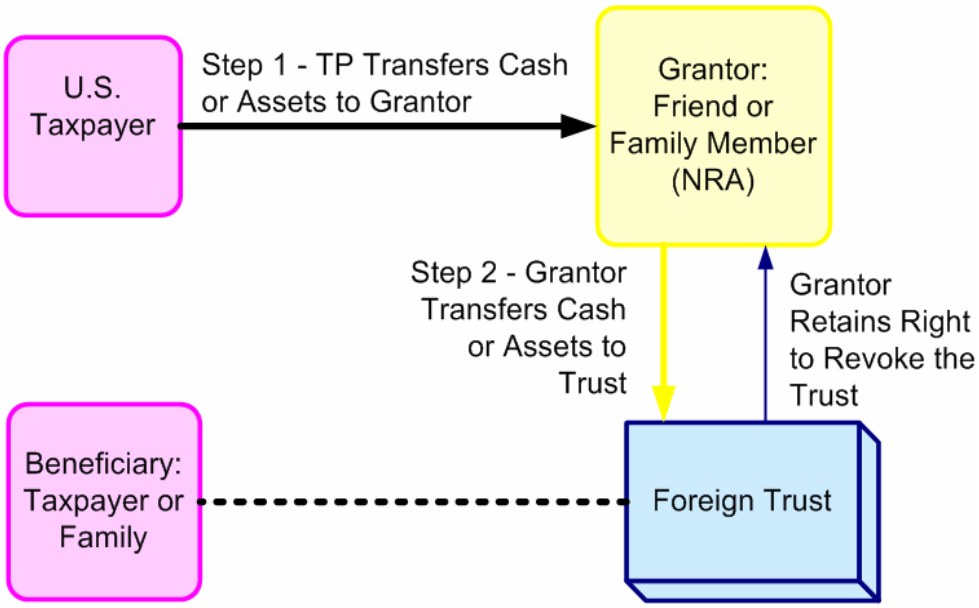
Note: A foreigner does not pay a capital gains tax on the stock sale, and gifts from a foreigner are generally free of gift tax.

This sounds like a clever way to eliminate capital gains taxes on the stock, but there are two issues: First, the U.S. taxpayer will incur a tax on the transfer because the gift exceeded $12,000. The annual gift-tax exclusion permits a gift of $12,000 ($24,000 for a married couple), in money or property, per person each calendar year. Therefore, the U.S. transferor will either pay the tax or reduce the "applicable exemption amount" for gifts (worth $1.0 million) by $188,000 ($200,000 less the $12,000 annual gift tax exclusion).

Tax Planning Tip: If the transferor gifts stock when the value is low, pre-initial public offering (IPO) stock, for instance, the number of shares that can be transferred without adverse gift-tax consequences is maximized. For instance, if the shares are worth $1, then 12,000 shares may be gifted; if the shares are worth $10, then only 1,200 shares may be transferred under the annual exclusion.

Second, if the foreigner sells the stock and immediately "gifts" the profits back, IRS may claim there was no gift; instead, the IRS may assert that the foreigner acted as the taxpayer's "agent" and the actual selling party was the taxpayer who must report the gain.

IRS and the courts look to the **substance of any transaction and not just the form** (see the Economic Substance memo in the appendix). Because the taxpayer



There are two exceptions to the rule that treats the U.S. taxpayer as the owner of property transferred to a foreign trust: (i) gifts of $12,000 or less, per year (the annual gift tax exclusion); and (ii) sale of assets at the fair market value. Under this second exception, property may be sold using a deferred payment (the trust signs a promissory note) under certain conditions.

5.1. Foreign Grantor Trust Rules

Structuring a transaction that meets the foreign grantor trust rules under IRC Sec. 672(f) is advantageous since the foreign grantor (NRA grandmother in our example) is the person who owes taxes on the income and gains generated by the trust, and not the beneficiary (the U.S. taxpayer in our example). Because the foreign grantor is taxed on the income and gains, any distributions of income by the trust to the beneficiary are considered gifts by the foreign person directly to the beneficiary.

Under the gift-tax rules, gifts by a foreign person of property located outside the U.S. or intangible property having a U.S. source are tax-free to the beneficiary, although there is an abbreviated reporting requirement for gifts of $100,000 or more per calendar year received from an individual donor. See Notice 97-34 (in the appendix) for details on