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by
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Over the past six years, Congress has enacted in relatively quick succession the Tax Reform Act of 1976[1] (1976 TRA), the Revenue Act of 1978[2] (1978 Act), the Foreign Investment in Real Property Tax Act of 1980[3] (FIRPTA), the Economic Recovery Act of 1981[4] (ERTA) and the Tax Equity and Fiscal Responsibility Act of 1982[5] (TEFRA). These taxing acts as well as numerous other less publicized legislative changes enacted during the same period have had a significant collective impact on the manner in which aliens, both resident and nonresident, are subjected to United States tax. This, in turn, has had an enormous impact on tax planning for the nonresident alien (NRA) who contemplates investing in or becoming a resident of the United States.

The purpose of this Article is to survey the broad subject of tax planning for the alien who intends to become a U.S. resident.[6] More

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1. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976).
2. Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (1978).
3. Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499, 94 Stat. 2682 (1980).
4. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (1981).
5. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (1982).
6. I.R.C. §§ 864, 871. An alien is an individual who is neither a citizen nor a national of the United States under the Constitution or the Immigration and Nationality Act of 1952. *See* Pub. L. No. 82-414, 66 Stat. 280 (1952). A United States citizen is any person born or naturalized in the United States and subject to its jurisdiction. *See* Treas. Reg. § 1.1-1(c) (1974); 8 U.S.C. §§ 1401-1489. A national of the United States is either a citizen or an individual who, though not a citizen, owes permanent allegiance to the United States. *See* 8 U.S.C. § 1101(a)(22). Alienage, citizenship, and the like are beyond the scope of this article as they each are extremely complex legal concepts which rest on United States constitutional and statutory law. Nonetheless, it is important to recognize that citizenship is also a concept which may have a different, broader U.S. income tax meaning in some circumstances. Consequently, while an individual may not be a United States

particularly, it will focus on three general subject areas. First, because U.S. residence is a threshold consideration which in the first instance controls the regimen of U.S. taxation applicable to aliens, it will review the concept of residence for U.S. income, estate, and gift tax purposes.[7] Second, it will review the tax consequences of becoming a resident, again for U.S. income, estate, and gift tax purposes. Finally, it will highlight tax planning opportunities, both those which have been altered or eliminated in the plethora of recent tax legislation as well as those opportunities which remain viable or which may have emerged in the wake of this legislation.

I
UNITED STATES RESIDENCE

The United States, as a general matter, subjects its citizens and residents to taxation on their worldwide income. Similarly, it subjects them to a gift or estate tax in the event that they transfer property during their lifetime or at death. An NRA, on the other hand, is subject to a more limited regimen of U.S. taxation.[8] Thus, because residence, at least in the first instance, is determinative of the manner in which an alien will be subject to U.S. tax, it is important to identify the parameters of U.S. residence. At the same time, recognizing that residence for tax purposes is not a singular concept, residence will be examined first in the context of U.S. income taxation and, thereafter, in the context of U.S. estate and gift taxation.

A. Residence for U.S. Income Tax Purposes

The Internal Revenue Code (the Code) provides for the manner in which an NRA is subject to U.S. income, estate, and gift tax and, in the process, refers to an NRA on one hundred sixty-seven occasions. Similarly, it refers to an NRA individual one hundred fourteen times and to

citizen or national for other purposes, he may be treated as one for U.S. tax purposes. *See United States v. Rexach*, 558 F.2d 37 (1st Cir. 1977) (in which an individual who, pursuant to the provisions of 8 U.S.C. § 404(b), lost her citizenship by returning to the country of her birth and residing there three years, was held to be a United States citizen for tax purposes and was taxed accordingly because she had received and accepted the benefits of United States citizenship). *See also* Rev. Rul. 70-506, 1970-2 C.B. 1.

7. There are numerous references throughout this Article to residence and nonresidence. Unless otherwise indicated, such references are to United States residence and United States nonresidence.

8. The regimen of U.S. taxation applicable to NRAs and foreign corporations is beyond the scope of this article. In certain instances, however, it will be necessary to allude to how U.S. nonresidents are taxed. When this is necessary, every effort will be made to limit the explanation to the extent possible. For a general discussion of the U.S. taxation of NRAs and foreign corporations, *see* R. RHOADES & M. LANGER, INCOME TAXATION OF FOREIGN RELATED TRANSACTIONS (1982).

a resident alien (RA) ten times.[9] In spite of these repeated Code references to residence and nonresidence and the fact that the Code relies on the concepts which these terms embody in fixing the applicable regimen of U.S. income taxation, it does not define them. Recognizing this, the income tax regulations (the regulations) attempt to fill this void by approaching the definition of residence vis à vis nonresidence in this fashion:

> An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but, if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances.[10]

The difficulty with this purported definition is that it does not establish precise rules regarding what constitutes U.S. residence.[11] In re-

9. The Code reference to each of these terms was determined by a LEXIS search of the Internal Revenue Code. A similar check of the Treasury Regulations produced the following results: NRA-478 times; NRA individual-331 times; and RA-20 times.

10. Treas. Reg. § 1.871-2(b) (1957).

11. On March 29, 1982, the American Bar Association endorsed a proposal urging the adoption of a number of relatively precise rules for determining U.S. residency for income tax purposes. In particular, it proposed that an alien with immigrant status, *i.e.*, one admitted to the United States for permanent residence, be treated as a resident for income tax purposes unless: (1) he is present in the United States for less than 45 days during the taxable year and (2) he has not been a resident for tax purposes in either of the two immediately preceding years. Conversely, an alien without immigrant status would be treated as a resident for U.S. income tax purposes unless he has closer connections to a foreign country than the United States throughout the year or unless he is present in the United States for less than 183 days during the taxable year. In this regard, an alien admitted to the U.S. on a B, F, H, or J type non-immigrant visa (*i.e.*, those non-immigrant visas which require that an alien have a residence in a foreign country and no intention of abandoning it) will be deemed to have closer connections to a foreign country unless: (1) the Secretary or the alien proves the contrary by a preponderance of evidence, or (2) the alien was present in the U.S. for 183 days or more during each of the preceding two taxable years. A.B.A Committee on United States Activities of Foreigners and Tax Treaties, Legislative Recommendation No. 1, To Amend the Internal Revenue Code of 1954 to Provide a Definition of the Term 'Nonresident Alien Individual' for Income Tax Purposes, (1982). It is the authors' understanding that the Treasury has rejected this proposal but is working on a proposal of its own which will provide a more objective standard for determining U.S. residency.

ferring to a transient or sojourner, it appears that the regulations intend to conjure up thoughts of a temporary visitor to the United States. This apparent intention was confirmed by the Fifth Circuit Court of Appeals which analyzed a forerunner of the present regulation in this manner:

> A transient means literally one going across or passing through. Sojourner is built around the French word 'jour' meaning a day, and signifies a mere temporary presence or visit.[12]

This being true, it is clear that a temporary visit to the United States will not cause the visitor to become a tax resident. But what is a temporary visit? Is it a month; six months; a year; or is it perhaps a much longer period? The most that can be said is that the answer depends on the circumstances.

The conclusion that a temporary visit may include visits of drastically different durations is the product of the widely different administrative and judicial decisions with respect to residence which have been reached on the basis of this regulatory provision. In most cases, a temporary visit is viewed as one of extremely short duration.[13] This is not always true, however. For example, in one case, *Molnar v. Commissioner*, a Hungarian citizen present in the United States for almost three years on a visitor's visa was held by the Tax Court not to be a U.S. resident.[14] Similarly, in *Jones v. Kyle*, the Court of Appeal held that a U.S. citizen who lived and worked in Saudi Arabia for eighteen months was not a Saudi resident and, therefore, not entitled to claim exemption from U.S. income tax.[15] Moreover, in an administrative ruling, the Internal Revenue Service held that an alien businessman in the United States for eight months was not a United States resident.[16] Thus, while generally a temporary visit is one of short duration, the

12. Swenson v. Thomas, 164 F.2d 783, 784-785 (5th Cir. 1947).

13. Stallforth v. Helvering, 77 F.2d 548 (D.C. 1935), *aff'g*, 30 B.T.A. 546 (1934), *cert. denied*, 296 U.S. 606 (1935). *See also* Swenson v. Thomas, 164 F.2d 783 (5th Cir. 1947) and Fuller v. Hofferbert, 204 F.2d 592 (6th Cir. 1953), in which a presence of four years and two years respectively was held not to be temporary but, in both cases, the Internal Revenue Service opposed the result.

14. Molnar v. Comm'r, 14 Fed. Taxes (P-H) 1057, 4 Tax Ct. Rep. (CCH) 951 (1945), *aff'd*, 156 F.2d 924 (2d Cir. 1946).

15. Jones v. Kyle, 190 F.2d 353 (10th Cir. 1951). In *Jones*, the question of residence was raised in the context of whether a U.S. citizen was a resident in a foreign country and, thus, qualified to claim the income tax exemption allowed under section 116(a) of the 1939 Code. Int. Rev. Code of 1939, § 116(a). The test of residence, however, is the same and, therefore, the meaning given temporary is not altered by the context of the decision.

16. O.D. 592, 3 C. B. 128 (1920).

term itself is relative and visits of much longer duration may be held to be temporary.[17]

Much the same is true of the other limiting words of the definition. What, for example, is a "mere floating intention"? Or, what period of time is envisioned by "promptly accomplished" or an "extended stay"? In many factual settings the application of these phrases may be apparent. In others, however, the intended scope of such phrases is subject to differing opinions.[18] In short, they are intended to suggest an objective criterion against which to measure U.S. residence. They do not do so, however, because they are no more precise than residence itself. As a result, in attempting to employ them in the intended fashion, the trier of fact is left in the fairly obtuse position of judging one undefined concept in terms of another undefined concept.

Another point which should be made in the context of this regulatory definition is whether the issue of residence is an issue of law or a mixed issue of law and fact.[19] Either way, decisions made with respect to residence are subject to judicial review.[20] It also means, however, that residence is an issue which must be resolved in two stages. During the first stage, decisions are made on such matters as how long the alien has been present in the United States during the tax year, the reason for his visit, where he lived, whether his family was with him and so on. It is also during this first stage that any factual conflicts with respect to such matters are resolved. The second stage is the decision stage. It is at this stage that a decision is made on whether the facts as judged against the minimum legal requirements established for U.S. residence support a holding that the alien is a resident. In short, the law is applied to the facts as they have been found and a decision is made accordingly.

The purpose in articulating this process is to demonstrate not how the decision is made but, really, how it is not made. There is no question but that the facts are supposed to be judged in terms of the law. As already noted, however, such catch words as "transient" do not contain an identifiable standard and, without such a standard, it is just not possible to make a determination in the manner in which it is supposed to be made.[21]

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17. This observation is not intended to suggest that the holding in any of the cases referred to was incorrect. They all may have been correct but, correct or not, they seem to have expanded the scope of what was intended by temporary visit.

18. *See, e.g.*, Weible v. United States, 244 F.2d 158 (9th Cir. 1957).

19. Bogardus v. Comm'rs, 302 U.S. 34 (1937). *Cf.* Craig v. Comm'rs, 73 T.C. 1034.

20. *Id.*

21. It may be more precise to say that there is no uniformly articulated criterion for residence. This is true because, undoubtedly, the courts which have relied on this regulatory definition of residence have done so on the basis of their own notion of what is required for U.S. residence.

This criticism notwithstanding, the regulations do more than just attempt to distinguish residence from transience; they establish the process by which the determination of residence is to be approached. They do this by directing that the alien shall be presumed to be an NRA by reason of his alienage[22] and, further, by allowing that this presumption may be rebutted upon a showing of any of the following:

a. Proof that the alien has filed a declaration of his intention to become a citizen of the United States under the naturalizations laws;[23] or

b. Proof that the alien has filed a Department of the Treasury Form 1078, Certificate of Alien Claiming Residence in the United States, or its equivalent;[24] or

c. Proof of acts and statements of the alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident.[25]

Thus, the determination of an alien's residence starts with a presumption that he is an NRA and then looks to his intention with respect to the extent and nature of his stay to determine whether that intent is such as to overcome the presumption of nonresidence. In those rare instances where an alien formally declares his intent, or where he files Treasury Form 1078 or its equivalent, this determination is made exclusively on the basis of his formal declaration of intent. In the more usual case where the alien has not declared his intention formally, it is necessary to look to his acts and statements to determine whether he intended to become a U.S. resident.

The regulations do not suggest which acts or statements are relevant or, for that matter, establish any priority in the event of a conflict. As a result, the courts which have been required to judge the issue of an alien's residence have been left to their own resources. They have responded fairly uniformly in recognizing that subjective intent in the case of residence, as in other instances where intent is relevant, is evidenced by a series of objective indicia. As a result, the courts have marshalled the facts of each particular case in an effort to isolate these objective factors.[26] Having done so, they then attribute to these factors on an ad hoc basis varying degrees of significance and, on that basis, decide the issue of U.S. residence.

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22. Treas. Reg. § 1.871-4(b) (1957).

23. Treas. Reg. § 1.871-4(c)(2)(i) (1957).

24. Treas. Reg. § 1.871-4(c)(2)(ii) (1957).

25. Treas. Reg. § 1.871-4(c)(2)(iii) (1957).

26. Budhwani v. Comm'r, 70 T.C. 287 (1978), *citing* Adams v. Comm'r, 46 T.C. 352 (1966), *acq*. 1967-2 C.B. 1; Treas. Reg. 1.871-2(b) (1957).

These factors now are collectively accepted as being determinative of United States residence. For this reason, a brief review of them is worthwhile.

Intent. Intent has been treated by numerous courts as a factor evidencing residence.[27] In spite of this judicial treatment it is better to recognize that intent is the object and not the subject of the search, *i.e.*, it is determinative of residence in that other factors evidence it and, therefore, residence or nonresidence. Nevertheless, it has been included in the list offered by most courts considering the issue of residence and, for that reason, it is included here. Having done so, this probably is an appropriate opportunity to note that an intent to reside in the United States alone is not sufficient to support a holding of residence; some physical presence in the United States also is required.[28] If, however, an alien is present in the United States, apparently even for only a brief period of time, such presence will suffice to support a holding of U.S. residence. Moreover, as the regulation referred to above suggests, it is not required that the alien's intent be to reside permanently in the United States. It is sufficient that his intent be to remain in the United States with no plan to depart. Stated differently, if he has no intention of residing elsewhere or of changing his status, that is sufficient for United States residence.

Presence in the United States. The extent of an alien's presence in the United States is the most common objective factor employed in determining an alien's intent with regard to U.S. residence. It is also one of the more important factors. The Internal Revenue Service has ruled that if an alien is physically present in the United States for one year or more, such presence will suffice both to overcome the presumption of nonresidence and to create a presumption of residence.[29] This so-called countervailing presumption is not based on statutory or other authority and, while perhaps defensible on the ground that such prolonged presence is evidence of an intent to reside in the United States,

27. *See, e.g.*, Green v. United States, 62-1 U.S.T.C. (CCH) ¶ 9343 (E.D. Mich. 1962).

28. In *Green*, the District Court held that an alien had become resident prior to the time of her arrival in the United States. This would seem to deviate from the rule that presence is required as a prerequisite of U.S. residence. In fact, however, in *Green*, there was subsequent physical presence and the issue was limited to one of timing, *i.e.*, whether the taxpayer was resident on the first day of the year and, therefore, entitled to file a joint tax return. *See* Jellinek v. Comm'r, 36 T.C. 826 (1961), *acq*. 1 C.B. (Part I) 4 (1964); Adams v. Comm'r, 46 T.C. 352. (1966), *acq*. 2 C.B. 1 (1967).

29. Rev. Rul. 69-111, 1969-2 C.B. 150; Rev. Rul. 64-1285, 1964-2 C.B. 184. I.R.S. Pub. 519 (1979) at 2.

it is far from conclusive.[30] Moreover, various courts have held (and it would seem correctly) that physical presence alone, even for an extended period of time, is not sufficient to establish residence for U.S. income tax purposes.[31] Thus, while physical presence is significant and while, in most cases, extended presence will correctly evidence an intent to reside in the United States and, therefore, U.S. residence, it still must be examined in the context of the other factors, some of which may explain or mitigate the impact of such extended presence and, in doing so, compel a contrary determination.

Nature, extent, and reasons for temporary absence from foreign home. It is not necessary to determine in which country an alien is resident in order to hold that for income tax purposes he is not a U.S. resident. The issue is one of U.S. residence and because such residence is compatible with dual residence, a holding that an alien is resident elsewhere does not preclude his being a U.S. tax resident. Still, the nature, extent, and/or reason for an alien's absence from his foreign home may support transience rather than residence, particularly when viewed in conjunction with his reason for being in the United States.[32] Moreover, temporary absence from a foreign home is, or may be, the corollary of presence in the United States. Thus, in some instances, these two factors should be considered together in determining residence.

Visa classification. The concept of residence for immigration purposes is distinct from the concept of residence for tax purposes and, for that reason, an alien may be a resident for immigration purposes but not for tax purposes or vice versa.[33] Consequently, an alien's visa classification is not determinative of his status as a resident for U.S. tax purposes. Nevertheless, the two do overlap in some not clearly defined

30. I.R.S. Letter Ruling 7723001, Mar. 1, 1977, would seem to require, in the absence of exceptional circumstances, that the stay in the United States be legal in order for the countervailing presumption of residence to arise and possibly for the presumption of nonresidence to be rebutted. *But see* I.R.S. Letter Ruling 7818006, Jan. 23, 1978, which holds that the presumption of nonresidence may be rebutted even though the alien's presence in the United States is illegal; *cf.* Rev. Rul. 80-209, 1980-2 C.B. 248 (illegal alien a U.S. resident at date of death for purposes of U.S. federal estate tax).

31. Sanford v. Comm'r, 27 T.C.M. (CCH) 266 (1968); Constantinescu v. Comm'r, 11 T.C. 37 (1948), *acq*. 1948-2 C.B. 1; Jamvold v. Comm'r, 11 T.C. 122 (1948), *acq*. 1948-2 C.B. 2.

32. Brittingham v. Comm'r, 66 T.C. 373 (1976), *aff'd on other grounds*, 598 F.2d 1375 (5th Cir. 1979).

33. In Hechavarria v. United States, 374 F. Supp. 128 (S.D. Ga. 1974), the District Court for the Southern District of Georgia held that tax and immigration laws are complementary. It may be that Hechavarria gives undue credence to an alien's visa classification and, while it can be criticized for doing so, it cannot be criticized for recognizing that in certain instances an alien's visa classification is strong evidence of his intent.

way and, as a result, visa classification may be evidence of the alien's intent, purpose, and activity.[34]

This overlap is most evident in the case of an alien who has applied for and possibly received an immigrant visa, *i.e.*, one which allows him to stay in the U.S. permanently. In applying for such a visa, it is customary to express an intention to remain in the U.S. permanently and once granted, the alien usually does just that. Consequently, the application for such a visa, while not conclusive of tax residence, is certainly strongly indicative of an intent to reside in the United States.[35]

The opposite conclusion usually follows from an alien's admission to the United States on a nonimmigrant visa. Such a visa usually limits the alien's stay to a definite period. It also usually restricts what he may do while present in the United States. As a result, the regulations recognize that an alien admitted on a nonimmigrant visa is not a United States resident absent exceptional circumstances.[36] One example of this kind of situation is where an alien seeks permanent residence. His visa may suggest some limitation but his actions in attempting to free himself of those limitations evidence an intent to reside.[37] Similarly, an alien who is admitted as a political refugee frequently will enter on a nonimmigrant visa. It usually is clear, however, that, due to his circumstance, his intention is to remain in the U.S., if not permanently, at least for more than just a temporary period.[38]

An Alien's own statements. A number of courts have held that statements made by an alien to the immigration authorities either at the time he enters the United States or at some later date may be considered as evidence of residency for U.S. income tax purposes.[39] Similarly, an alien often makes statements concerning his place of residence to other governmental agencies or a will, trust, deed, or other legal instrument. These statements also may reflect on an alien's intention

34. Rev. Rul. 58-144, 1958-1 C.B. 260; Brittingham v. Comm'r, 66 T.C. 373, *aff'd on other grounds*, 598 F.2d 1375 (5th Cir. 1979). MacLean v. Comm'r, 73 T.C. 1045 (1980); Ermogeni v. Comm'r, 35 T.C.M. (CCH) 870 (1976); Schumacher v. Comm'r, 32 B.T.A. 1242 (1935). *See also* Comm'r v. Nubar, 185 F.2d 584 (4th Cir. 1950), *cert. denied*, 341 U.S. 925 (1951); I.R.S. Letter Ruling 7723001, Mar. 1, 1977 and I.R.S. Letter Ruling 7818006, Jan. 23, 1978, concerning alien illegally present in U.S.

35. Brittingham v. Comm'r, 66 T.C. 373 (1976), *aff'd on other grounds*, 598 F.2d 1375 (5th Cir. 1979).

36. Treas. Reg. § 1.871-2(b) (1957); Constantinescu v. Comm'rs, 11 T.C. 37 (1948), *acq*. 1948-2 C.B. 1.

37. Marsman v. Comm'r, 205 F.2d 335 (4th Cir. 1953); Wriedt v. Comm'r, 6 T.C.M. (CCH) 144 (1947).

38. *See* Rev. Rul. 64-149, 1964-1 (Part I) C.B. 233; Rev. Rul. 61-118, 1961-1 C.B. 5; Rev. Rul. 57-331, 1957-2 C.B. 11.

39. Adams v. Comm'r, 46 T.C. 352 (1966), *acq*. 1967-2 C.B. 1.

with respect to United States residence and may be considered as evidence.[40] Such statements are not conclusive, however, and, in several instances, courts have held that an alien's sworn statement that he was a U.S. resident was insufficient in and of itself to defeat his subsequent claim of nonresidence.[41] For example, in *Adams v. Commissioner*,[42] the tax court held that an alien was an NRA despite the fact that, in order to obtain state and local tax benefits and to allow his children to attend local schools, he previously had claimed to be a U.S. resident. In spite of this, such statements are important. While in some cases they may be discounted, they usually will not be ignored and, thus, will influence the ultimate determination.

Situs of an alien's home. Although a finding of residence does not require a finding that an alien have a permanent home in the United States or even a settled place of abode, it does require some degree of permanence in the United States.[43] As a result, if an alien purchases a home in the United States or leases one on a relatively long term basis, it is indicative of an intention to reside in the United States.[44] Conversely, if an alien stays in a hotel while present in the United States or rents a place to live on a more temporary or limited basis, it usually will evidence that he is a transient and, therefore, not a resident.[45] Neither conclusion is automatic, however, and in certain circumstances the presence or absence of permanent accommodations are explainable. For example, if an alien who purchases or rents a home here also continues to maintain one or more homes elsewhere, the fact of a U.S. home is less significant than it would be if his home in the United States were his only home.

Marital status and residence of family. An alien's marital status and the place of the "residence" of his family also may be significant in determining whether he is a resident. However, since an individual may have a residence separate from that of his or her spouse or chil-

40. Farmer's Loan & Trust Co. v. United States, 60 F.2d 618 (S.D.N.Y. 1932) (Will); Goldring v. United States, 36 B.T.A. 779 (1937), *acq*. 1938-1 C.B. 12 (Trust); Patino v. United States, 13 T.C. 816 (1949), *aff'd*, 186 F.2d 962 (4th Cir. 1950) (Divorce); Bowring v. Bowers, 24 F.2d 918 (2d Cir. 1927), *cert. denied*, 277 U.S. 608 (1928) (Deed).

41. Thomas v. Comm'r, 33 B.T.A. 725 (1935); Baer v. Comm'r, 6 T.C. 1195 (1946); Friedman v. Comm'r, 37 T.C. 539 (1961); Ermogeni v. Comm'r, 35 T.C.M. (CCH) 870 (1976); Sutton v. United States, 79-1 U.S.T.C. ¶ 9293 (E.D. Tenn. 1979), *aff'd*, 81 U.S.T.C. (CCH) ¶ 9145 (6th Cir. 1980).

42. 46 T.C. 352 (1966), *acq*. 1967-2 C.B. 1.

43. Jellinek v. Comm'r, 36 T.C. 826 (1961), *acq*. 1964-1 (Part I) C.B. 4; Ceska v. Cooper, 15 T.C. 757 (1950), *acq*. 1951-1 C.B. 2; Swenson v. Thomas, 164 F.2d 783 (5th Cir. 1946).

44. Bowring v. Bowers, 24 F.2d 918 (2d Cir.); Rose v. Comm'r, 16 T.C. 232, 236 (1951), *acq*. 1951-1 C.B. 3.

45. Thorsell v. Comm'r, 13 T.C. 909 (1949).

dren, the fact that an alien's immediate family may be resident in the United States is not itself determinative of the residence of the alien. As one court noted in this context, there is no requirement of absolute geographic celibacy; it is possible for an alien to be a nonresident for U.S. tax purposes and for his spouse and/or children to be RAs or, even, citizens.[46] Nevertheless, as a practical matter, if an alien's family is resident in the U.S., it will be viewed as evidence of his own residence, unless he is able to demonstrate an intent to reside away from his family.[47]

Situs of clothing and personal belongings. The place where an alien maintains his clothing and personal belongings also may be indicative of residence.[48] If an alien maintains clothing and personal articles in more than one place, however, this factor is neutralized.[49]

Participation in community activities. If an alien becomes involved in social and cultural activities in the United States, and by doing so, becomes a part of the community, it usually will indicate U.S. residence.[50] Learning English, joining U.S. social clubs, establishing U.S. religious affiliation and donating to U.S. charities, are all indicative of community participation and involvement.[51] At the same time, a conclusion of residence is not always justified by such involvement. In particular, a finding that an alien also is involved in community activities in a foreign jurisdiction may minimize the otherwise strong suggestion of residence that such participation here conveys.

The foregoing factors are not the only ones which have been considered by the courts in determining residence. Other, usually less significant factors, including whether an alien has acquired a U.S. driver's license, registered his car in the U.S., obtained a U.S. telephone listing, established a U.S. bank account, paid U.S. taxes, or invested in U.S. securities or in an U.S. business, have all been considered in one or more cases to be relevant.[52] No doubt there are others as well. In the

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46. Adams v. Comm'r, 46 T.C. 352 (1966), *acq*. 1967-2 C.B. 1.

47. Craig v. Comm'r, 73 T.C. 1034 (1980; Rose v. Comm'r, 16 T.C. 232 (1951), *acq*. 1951-1 C.B. Schumacher v. Comm'r, 32 B.T.A. 1242 (1935), *acq*. XV-2 C.B. 21.

48. Escobar v. Comm'r, 68 T.C. 304 (1977), *acq. in result* 1978-2 C.B. 2; Jellinek v. Comm'r, *acq*. 36 T.C. 826 (1961), *acq*. 1964-1 (Part I) C.B. 4; Rose v. Comm'r, 16 T.C. 232 (1951).

49. Adams v. Comm'r, 46 T.C. 352 (1966), *acq*. 1967-2 C.B. 1.

50. Sochurek v. Comm'r, 300 F.2d 34 (7th Cir. 1962); Baehre v. Commissioner, 15 T.C. 236 (1950), *acq*. 1951-1 C.B. 1; Weible v. United States, 244 F.2d 158 (9th Cir. 1957); Harvey v. Comm'r, 10 T.C. 183 (1948), *acq*. 1948-1 C.B. 2; Lemery v. Comm'r, 54 T.C. 480 (1970), *acq*. 1970-2 C.B. xx; I.R.S. Letter Ruling 7740001, Apr. 27, 1977.

51. Hamer v. Comm'r, 22 T.C. 343 (1954), *acq*. 1954-2 C.B. 4.

52. Swenson v. Thomas, 164 F.2d 763 (5th Cir. 1947); Foster v. Comm'r, 24 T.C.M. (CCH) 1268 (1965); Beisinger v. Comm'r, 27 T.C.M. (CCH) 725 (1968); Brittingham v. Comm'r, 66 T.C. 373 (1976), *aff'd on other grounds*, 598 F.2d 1375 (5th Cir. 1979).

final analysis, all of these factors may be consistent with either residence or nonresidence and, in most instances, some will point in the direction of residence and others in the direction of nonresidence. It is only when they are weighed against each other that the determination can be made as to whether the alien is a U.S. resident.

To this point, the discussion of residence has been in the context of actual residence. In certain circumstances, however, an NRA *i.e.*, for these purposes, an individual who would be held not to be a resident by reference to these factors, may elect to be treated as a U.S. tax resident.[53] In particular, an NRA (or an alien who is an NRA at the beginning of the year but a resident at the end) who is married to a U.S. citizen or resident may elect to be taxed as a U.S. resident, provided his spouse joins in the election. This election to be treated as a U.S. resident is not an election to be treated as such for all tax purposes. Specifically, the Code provides that the election is effective only for the tax purposes of Chapters 1 (sections 1-1399), 5 (sections 1491-1494) and 24 (sections 3401-3404) of the Code. This being true, it is not clear whether aliens who make such an election will be affected by provisions found elsewhere in the Code.

B. *Residence for U.S. Estate and Gift Tax Purposes*

A determination similar to the one required with respect to residence for U.S. income tax purposes is required with respect to whether an alien is or was a resident for U.S. gift or estate tax purposes. Unlike residence for U.S. income tax purposes, however, residence for estate and gift taxation purposes means domicile.[54] Thus, for purposes of the U.S. estate tax, a resident decedent is a decedent who was domiciled in the United States. And, for purposes of the U.S. gift tax, a resident is an alien who was domiciled in the United States at the time of the gift.

This is not intended to suggest that residence is the equivalent of domicile. As discussed above, residence generally involves living in a particular locality for more than a mere transitory period with an intent to reside there. In contrast, domicile requires physical presence in a particular place coupled with an intent to make that place a fixed and permanent home. As a practical matter, an individual's domicile often is his residence but not always and, in principle, it is possible for an individual to be domiciled in one place and resident in another. Moreover, while it is possible for such an individual to have only one domicile (different jurisdictions may reach different conclusions with respect

53. I.R.C. §§ 6013(g)-6013(h) (1982).

54. Treas. Reg. § 30.0-1(b) (1961) and Treas. Reg. § 25.2501-1(b) (1958). Farmers Loan & Trust Co. v. United States, 60 F.2d 618 (S.D.N.Y. 1932); Fifth Avenue Bank of New York, Ex Rel (Fisher Est.), 36 B.T.A. 534 (1937), *acq*. 1937-2 C.B. 9.

to the place of his domicile), he may have several residences, none of which is his domicile, or have no residence at all.[55]

The estate tax regulations describe how domicile is acquired or changed in this manner:

> A person acquires a domicile in a place by living there, for even a brief period of time, with no definite, present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.[56]

Thus, as with residence for income tax purposes, both physical presence and intent are required. In the case of domicile, however, it is not merely an intent to remain in the United States which is required but an intent to remain here indefinitely.[57]

Notwithstanding that the character of the required intent is different from that required for U.S. income tax purposes, the approach taken to determine such intent is the same. Thus, a court faced with the task of determining a decedent's or donor's domicile will look to many of the same objective factors it considers in an income tax setting.[58] The only difference is that instead of looking at them as evidence of an intent sufficient to cause the alien to be resident for U.S. income tax purposes, it will look at them as evidence of an intent to be domiciled in the United States.[59] Consequently, an alien may be resident for U.S. income tax purposes while not resident (domiciled) for estate or gift tax purposes.[60]

II

THE TAX CONSEQUENCES OF BECOMING A RESIDENT

In general an NRA is subject to U.S. income tax only on U.S. source "interest, dividends, salaries, wages, rents, premiums, annuities, compensation, remuneration, emoluments and other fixed or determinable annual or periodical gains, profits and income" (FDAP income)

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55. Stallforth v. Comm'r, 30 B.T.A. 546 (1934), *aff'd* 77 F.2d 548 (D.C. Cir. 1935), *cert. denied*, 296 U.S. 606 (1935); White v. Comm'r, 22 T.C. 585 (1954).

56. Treas. Reg. 20.0-1(b) (1961). This is not so much a definition of domicile as what is required to obtain or lose it.

57. Treas. Reg. § 20.0-1(b) (1961). Unless an intention to remain indefinitely is more precise that the counterpart language in the regulations as they relate to residence for income tax purposes, it would seem that the regulatory definition of domicile is subject to the same criticisms as those applicable to efforts to define residence. *See supra* pp. 5-9.

58. *See* Estate of Julius Bloch-Sulzberger, 6 T.C.M. (CCH) 1201 (1947); Farmers Loan & Trust Co. v. United States, 60 F.2d 618 (S.D.N.Y. 1932).

59. This difference would not seem to change the fact that unless it is known what constitutes permanent (and it is not defined), it is not possible to judge the issue. It may be, however, that this decision is less awkward than that required with respect to residence for income tax purposes.

60. Estate of Jan William Nienhuys, 17 T.C. 1149 (1952), *acq*. 1952-1 C.B. 3.

and income which is effectively connected with a U.S. trade or business.[61] U.S. source FDAP income is subject to a thirty percent withholding tax (in certain instances, U.S. tax treaty commitments reduce the rate of such tax, and, in some cases, eliminate it entirely) while income effectively connected with a United States trade or business is taxed at the usual graduated U.S. income tax rates.[62] U.S. source capital gains other than capital gains derived from the disposition of U.S. real property interests are subject to tax at the same thirty percent rate applicable to FDAP income only if the NRA is physically present in the U.S. for 183 or more days.[63] As with FCAP income, treaty obligations sometimes reduce the rate of tax or eliminate tax on U.S. source capital gains.[64] Finally, with only very limited exceptions, foreign source income, including foreign source capital gains, is not subject to U.S. income tax.[65]

An RA, on the other hand, is subject to U.S. income taxation generally in the same manner and to the same extent as a citizen. Thus, he is subject to tax on all of his worldwide income, irrespective of its source or the situs or character of the property which produces it.[66] That being so, the principal U.S. tax consequences of becoming a resident is that the alien becomes subject to an all-inclusive tax regimen instead of one which subjects him to tax only with respect to certain limited categories of U.S. source income. It is by no means, however, the only consequence of this change in status that merits attention.

A. The Anti-Avoidance Provisions

The United States, as a matter of tax policy, does not subject foreign corporations to U.S. income tax on foreign source income.[67] This is true notwithstanding that such foreign corporations are wholly or partially owned by U.S. persons, which, for this purpose, includes citizens, residents, domestic corporations, partnerships, trusts, or estates.[68] Consequently, absent preventative steps, it would be possible for such U.S. persons to avoid or at least defer U.S. income taxation on foreign

61. I.R.C. § 871(a) and (b) (1982).

62. *Id.*

63. FIRPTA subjects capital gains derived from the disposition of U.S. real property to tax as if it were effectively connected with a U.S. trade or business. I.R.C. § 897(a)(1) (1982).

64. Protocol modifying the Convention for the Avoidance of Double Taxation with respect to Taxes on Income, *signed* Sept. 17, 1965, United States-West Germany, 16 U.S.T. 1875, T.I.A.S. No. 5920, 1966-1 C.B. 360, 1 TAX. TREATIES (CCH) ¶ 3004.

65. The exception is foreign source income which is effectively connected with a U.S. trade or business. *See* I.R.C. § 864(c) (4) (1982).

66. Treas. Reg. § 1.871-1(a) (1980); Treas. Reg. § 1.1-1(b) (1974).

67. I.R.C. §§ 881-884 (1982). As is true generally of an NRA, the only exception is when such income is effectively connected with a U.S. trade or business. *See* I.R.C. § 864(c)(4) (1982).

68. *See* I.R.C. § 7701(a) (30) (1982).

source income by employing foreign corporations to undertake a variety of income generating activities. In fact, with proper and sometimes creative planning designed to take advantage of certain U.S. income tax treaties, it would be possible even to avoid or substantially reduce U.S. income tax on U.S. source income.

The United States, again as a matter of tax policy, is determined to prevent such tax avoidance and has enacted a series of anti-avoidance provisions to do so. These anti-avoidance provisions include two direct tax provisions, those dealing with the accumulated earnings tax and the personal holding company tax, and three indirect tax provisions, those dealing with foreign personal holding companies, controlled foreign corporations, and foreign investment companies.[69] One or more of these anti-avoidance provisions (often referred to collectively as the "pentapus"[70]) may affect new U.S. residents.

Accumulated Earning Tax (AE). The AE tax is a penalty tax. It is imposed in addition to ordinary income tax on any corporation, foreign or domestic, formed or availed of for the purpose of avoiding U.S. income tax to which its shareholders otherwise would be subject by accumulating income rather than distributing it as a dividend.[71] It is unique among the anti-avoidance provisions in that it is potentially applicable to any corporation, irrespective of whether such corporation has U.S. shareholders. For example, consider the tax treatment of a foreign corporation more than fifty percent of whose gross income is effectively connected with a U.S. trade or business. For U.S. income tax purposes, any dividends paid by such a corporation would be considered U.S. source income to the same extent as the ratio which its effectively connected income bears to its income from all sources. For that reason, such dividends in the hands of the corporation's shareholders would be subject to U.S. income tax.[72] Therefore, if such a corporation were to accumulate its income to allow its shareholders to avoid U.S. income tax, it would be subject to AE tax without regard to whether its shareholders were U.S. persons.

As a practical matter, a corporation's exposure to AE tax is limited when one or more of its shareholders are NRAs because, as noted, such

69. The AE and the PHC taxes are referred to as direct taxes because each is imposed directly against the corporation. This contrasts with the other anti-avoidance provisions which are indirect tax provisions in that they attack the use of a foreign corporation for tax avoidance purposes by exposing its shareholders to income tax with respect to the foreign corporation's income.

70. *See* Povell, *The Pentapus: A Survey of United States Anti-Avoidance Legislation Affecting the Use of Foreign Corporations*, in FOREIGN TAX HAVENS 19 (1974).

71. I.R.C. §§ 531-537 (1982). The tax is imposed at the rate of 27½% on the first $100,000 of accumulated taxable income and 38½% of such income in excess of $100,000.

72. I.R.C. § 861(a)(2)(A) (1982). Treas. Reg. § 1.861-3(2)(3), T.D. 7519.

shareholders are generally subject to U.S. income tax only with respect to U.S. source income. This means that, to the extent that the greater part of its income is not effectively connected with a trade or business in the United States, distribution will not trigger U.S. income taxation in the hands of its NRA shareholders and the accumulation of such income will not expose the corporation to AE tax. However, if an NRA shareholder becomes a U.S. resident, his tax exposure broadens (a resident is taxed on all income, regardless of source) and, because it does, the corporation's exposure to AE tax increases accordingly. Moreover, this is true even if all of the corporation's income is derived from foreign sources at least to the extent such income is effectively connected with a trade or business in the United States.[73]

Personal Holding Company Tax (PHC). The PHC tax, like the AE tax, is imposed in addition to the ordinary U.S. income tax on any corporation, foreign or domestic, which satisfies certain stock ownership and gross income tests.[74] More particularly, a corporation will be classified as a PHC if, at any time during the last half of its taxable year, more than fifty percent in value of its outstanding stock is owned directly or indirectly or constructively by or for not more than five individuals and at least sixty percent of its adjusted gross income is derived from such passive sources as dividends, interest, rents (in certain instances rents are excluded), royalties, personal services income, annuities, and the like.[75]

The Code does not require that the individual shareholders be U.S. residents (or citizens) in order for a corporation to be classified as a PHC. There is an important exception, however, where all the shareholders of a foreign corporation are NRAs.[76] Consequently, by becoming an RA, an NRA shareholder could cause a foreign corporation otherwise exempt from PHC tax to lose its exemption. This, in turn, could adversely effect all shareholders either because the PHC would be subject to the PHC tax or because, to avoid the tax, the corporation could be forced to distribute such of its income as may be subject to PHC tax, thereby exposing such income to income tax in the hands of its shareholders. Similarly, by becoming a resident, the beneficial im-

73. Dividends received from a U.S. corporation generally are treated as U.S. source income I.R.C. § 861(a)(2) (1982). The exception to this general rule is where less than twenty percent of the corporation's gross income is derived from U.S. sources. I.R.C. § 861(a)(2)(A) (1982).

74. I.R.C. §§ 541-547 (1982).

75. I.R.C. §§ 542-543 (1982). Generally, only U.S. source income is included for PHC purposes. However, if a foreign corporation meets the stock ownership and gross income test, its foreign source effectively connected income will be included in its gross income and, thus, will be subjected to PHC tax. *See* Dale, *Foreign Corporations Which are Personal Holding Companies of Foreign Personal Holding Companies*, in FOREIGN TAX PLANNING (1983).

76. I.R.C. § 542(c)(7) (1982).

pact of the so-called de minimus rule could be lost. This de minimus rule provides that, where ten percent or less of the stock of a PHC is held by U.S. persons, undistributed personal holding company income (the income subject to the PHC tax) is reduced proportionately to reflect such foreign ownership. As a result, if by becoming a U.S. resident an NRA individually or collectively pushes U.S. ownership of the PHC beyond the ten percent threshhold, all of its undistributed personal holding company income will be subject to PHC tax.[77]

Foreign Personal Holding Company (FPHC). The FPHC provisions of the Code subject certain of the income of an FPHC to U.S. income tax by requiring its U.S. shareholders (its actual U.S. shareholders) to include in their own gross income as a dividend a pro rata share of the FPHC's undistributed foreign personal holding company income.[78] A foreign corporation is a FPHC if (1) more than fifty percent in value of its stock is directly or indirectly owned by no more than five U.S. citizens or residents and (2) sixty percent (fifty percent in some cases[79]) or more of its gross income from all sources is FPHC income.[80] FPHC income generally includes the kind of passive income which is treated as PHC income but, in addition, also includes gains derived from the sale of stock or securities.[81]

Unlike a PHC, FPHC classification requires U.S. ownership. Thus, by becoming a U.S. resident, an NRA may cause a foreign corporation to satisfy the FPHC stock ownership test either because he alone or together with four or fewer other U.S. individual shareholders owns more than fifty percent in value of the stock. If this should happen (assuming the gross income test is satisfied also), it will affect the alien's own U.S. income tax liability as well as possibly that of other U.S. citizen/resident shareholders of the FPHC.

There is a further adverse income tax consequence associated with the ownership of stock of an FPHC. To appreciate this consequence, it is necessary to recognize that property, including corporate stock, ac-

77. I.R.C. § 545(a) (1982).

78. I.R.C. §§ 551-558 (1982). Unlike the AE and PHC tax, the FPHC, CFC, and FIC provisions do not provide for taxation at the corporate level. Instead, they provide for a tax at the shareholder level with respect to the corporation's income and, thus, in this manner, they subject the corporation's income to U.S. income tax. For this reason, these three anti-avoidance provisions are referred to as indirect taxes.

79. If a foreign corporation is a FPHC for any taxable year, the requisite percentage of FPHCI is reduced to fifty percent and remains at that level until (1) a year in which the stock ownership test is not satisfied, or (2) the foreign corporation has three consecutive years during which foreign personal holding company income is less than fifty percent of gross income. *See* I.R.C. § 552(a)(1) (1982).

80. I.R.C. § 552 (a) (1982).

81. *See* I.R.C. §§ 543, 553.

quired from a decedent usually will have as its tax basis the fair market value of such property as of the time of the decedent's death or at some later elected date.[82] This often produces a beneficial step-up in basis which allows the recipient of the inherited property to avoid income tax on unrealized gains. This opportunity for a basis step-up may not be available with respect to stock of an FPHC. More specifically, if in the year prior to the death of the decedent, the corporation was an FPHC (without regard to whether it was such in the year of death), the tax basis of the stock of such a corporation will equal the lower of the fair market value of such stock at the date of the decedent's death, or the basis of such stock in the hands of the decedent.[83]

Controlled Foreign Corporation (CFC). The CFC provisions of the Code subject certain income of a CFC to U.S. income tax by requiring the CFC's U.S. shareholders to include in their own income their pro-rata share of such income.[84] A foreign corporation is a CFC, if more than fifty percent of the total combined voting power of all classes of its stock is owned directly or indirectly by U.S. shareholders.[85] A United States shareholder is defined for this purpose to include, *inter alia*, U.S. residents, each of whom, directly, indirectly, or constructively, own ten percent or more of the total combined voting power of all classes of stock entitled to vote.[86] The income of a CFC which such a U.S. shareholder is required to include in his own gross income includes his pro rata share of the CFC's Subpart F income, as well as certain other categories of the CFC's income, including any increase in earnings invested in U.S. property.[87] Subpart F income includes: (1) income derived from the insurance of U.S. risks; (2) foreign base company income, a catch-all phrase which groups foreign base company sales, services and shipping income, foreign personal holding company income, and foreign base company oil related income; (3) income attributable to international boycotts; and (4) any bribes or illegal kickbacks.[88] As in the case of an FPHC, an NRA's becoming a U.S. resident may cause a foreign corporation to meet the CFC stock ownership test, be classified

82. I.R.C. § 1014(a)(1). *See also* I.R.C. §§ 2032-2032(A) with respect to alternate value and valuation dates.

83. I.R.C. § 1014(b)(5) (1982). This adverse consequence in some cases can be avoided by liquidating the FPHC or otherwise disposing of its stock through a foreign estate and, thereafter, distributing its assets.

84. I.R.C. § 951(a) (1982).

85. I.R.C. § 957(a) (1982).

86. I.R.C. §§ 951(b), 957(d) (1982).

87. I.R.C. § 951(a) (1982).

88. I.R.C. §§ 952-954. Because FPHC income is included as a category of foreign base company income and, therefore, Subpart F income, such income very often will be subjected to U.S. income tax even if the corporation itself is not a FPHC.

as a CFC, and thereby, trigger the consequences which follow from this classification. He can cause this on his own, if he owns the requisite voting interest himself, or together with other U.S. shareholders, if they collectively cross the fifty percent voting stock threshold.[89] When this occurs, in addition to being required to include a portion of the CFC's income in his own income on a current basis, any gain recognized on a subsequent sale or exchange of the stock of the CFC will be subject to U.S. income tax as a dividend to the extent the CFC's accumulated earnings and profits (earnings accumulated after December 31, 1962) are attributable to such stock.[90]

Foreign Investment Company (FIC). The FIC provision of the Code subjects to U.S. income tax as ordinary income any gain recognized on the disposition of stock of an FIC. For this purpose, an FIC is defined to include any foreign corporation which, at any time when more than fifty percent of its total combined voting power or more than fifty percent in value of its stock was held directly or indirectly by U.S. persons, was engaged (or held itself out as engaged) primarily in the business of investing, reinvesting, or trading in securities or was registered under the Investment Company Act of 1940.[91] The effect of this provision is that, while it may be possible to defer tax on undistributed income realized by an FIC (unless the FIC also is a CFC or FPHC and its income is subject to income tax as a result of one or the other of these anti-avoidance provisions), it is not possible to convert such income into capital gains by the expediency of liquidating the company or otherwise disposing of its stock. Moreover, it also is not possible to avoid U.S. income tax on such income by holding the stock until death because, as is true of the stock of an FPHC, the tax basis of stock of an FIC acquired from a decedent is not determined by its date of death value.[92] Instead, where a decedent owned stock in an FIC at the time of his death, its tax basis is its fair market value as of the date of death reduced by the amount of the decedent's ratable share of the corporation's post December 31, 1962 earnings and profits. Thus, FIC income reduces basis and, by doing so, insures that a subsequent sale of such stock by a U.S. person will be subject to U.S. income tax at ordinary rates.[93] As long as fifty percent or more of the stock of a foreign corpo-

89. The shares of stock of a foreign corporation owned by an NRA are not attributable under the stock attribution rules applicable to a CFC. I.R.C. § 958(b)(1) (1982).

90. I.R.C. § 1248 (1982).

91. I.R.C. § 1246 (1982).

92. I.R.C. § 1246(e) (1982).

93. If the stock is acquired by an NRA from the decedent, who then sells it, the provisions of I.R.C. § 1246 would seem to have no effect. This is true because an NRA usually would not be subject to capital gains tax (unless he were present 183 or more days) and gain on the sale of such stock is not otherwise taxable. I.R.C. § 871(a) (1982).

ration is held by NRAs, however, this FIC provision is not applicable. Thus, as is the case with a CFC and an FPHC, by becoming a U.S. resident, an alien may cause a foreign corporation to be classified as an FIC and thereby trigger the U.S. tax consequences which follow from that classification.

B. Reporting Requirements

A second tax consequence of becoming a resident is that, in addition to any U.S. income tax returns that otherwise may be required, the new RA may be obligated to file one or more information returns with respect to his ownership of stock and/or other interests in foreign corporations, partnerships, or trusts.[94] Some of the more significant of these information returns include:

Form 959. Every U.S. citizen or resident who is an officer or director of a foreign corporation must file Form 959 (Parts I and II) with respect to each U.S. person who, during his tenure as a officer or director, acquires five percent in value of a foreign corporation.[95] In addition, the U.S. shareholder himself must file Form 959 (Parts I and III) to report his ownership interest in a foreign corporation, providing it exceeds five percent in value of the stock of such corporation. Thus, if an NRA is a five percent shareholder of a foreign corporation (five percent in value) at the time he becomes a U.S. resident, he will be required to disclose his ownership interest. Similarly, if he is an officer or director of the foreign corporation, he will be required to file Form 959 in that capacity to report the acquisition of stock by U.S. persons, unless he otherwise is excused from doing so.

Form 2952. Every United States person is required to file Form 2952 with respect to each foreign corporation which he controls.[96] A U.S. person is deemed to be in control of a foreign corporation for purposes of this filing requirement if he owns, directly or indirectly, fifty percent of the total combined voting power of all classes of stock or fifty percent of the value of all classes of stock.[97]

Form 3646. Every U.S. shareholder (any U.S. person who directly or indirectly owns ten percent or more of the total combined voting power) of a CFC must file Form 3646 with respect to any foreign corporation which was a CFC for an uninterrupted period of thirty days or more during its taxable year.[98]

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94. Subsequent to completion of this article, the Internal Revenue Service announced consolidation of a number of foreign filings into Form 5471. This consolidation has not changed substantially the obligation to file or the information which must be filed. The former forms will continue to be utilized for a period of time. Ann. 83-14, 1983-6 I.R.B. 47.

95. I.R.C. § 6046 (1982); Treas. Reg. § 1.6046-1(a), T.D. 7322.

96. I.R.C. § 6038 (1982).

97. I.R.C. § 6038(d)(1) (1982).

98. I.R.C. § 964(c) (1982).

FPHC Information Returns. Every U.S. citizen or resident who is an officer, director or ten percent shareholder (ten percent in value) of an FPHC must file an information return with respect to the stock and securities of the FPHC as well as its gross income.[99]

Form 926. Every U.S. citizen, resident, domestic corporation, partnership, trust, or estate who transfers property to a foreign corporation, partnership, trust, or estate must report such a transfer on Form 926.[100] Filing is required irrespective of whether there is a tax due. Form 926 must be filed on the date of the transfer.

Foreign Partnerships. TEFRA added Section 6046A to the Code which requires every U.S. person who acquires or disposes of an interest in a foreign partnership or whose proportionate interest in such a partnership changes to file a return.[101] It is contemplated that the form and content of the required return will be prescribed by regulation. However, the Treasury has not yet issued these contemplated regulations nor otherwise indicated what the required filing will entail.[102]

The foregoing are by no means the only filing obligations which arise as a consequence of becoming a U.S. resident. For example, section 6048(a) of the Code requires every U.S. person who creates a foreign trust or transfers money or property to it, whether directly or indirectly, to file Form 3520.[103] Further, under section 6048(c) of the Code, every U.S. person who for any taxable year is treated as the owner (and thus subject to tax under section 679 of the Code) the income of a foreign trust which has a U.S. beneficiary must file Form 3520-A.[104] Similarly, every U.S. person who has a financial interest in or signature authority or other authority over bank, securities, or other financial accounts in a foreign country which exceeds $1,000 in aggregate value at any time during the taxable year must file Form 90.22-1. Moreover, all of the filing requirements carry with them very significant civil and/or criminal penalties.[105] Thus, an NRA takes on a substantial reporting obligation by becoming a resident, often one which is not generally appreciated.

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99. I.R.C. § 6035 (1982). Prior to TEFRA, only U.S. shareholders who owned fifty percent or more in value of a FPHC were required to file. This allowed for a reporting gap because a foreign corporation could be a FPHC without having a fifty percent United States shareholder.

100. This reporting requirement parallels the provisions of I.R.C. § 1491 (1982).

101. I.R.C. § 6046A (1982).

102. In Information Release No. 82-149 (December 31, 1982), the Internal Revenue Service announced that the regulations to be issued pursuant to section 6046A of the Code would allow ninety days from the date of their issuance in which to file the required information return.

103. I.R.C. § 6048 (1982); Temp. Treas. Reg. § 16.3-1, T.D. 6632.

104. I.R.C. § 6048(c) (1982); Temp. Treas. Reg. § 404.6048-1(a), T.D. 7502.

105. The penalties imposed for failure to file the various information returns vary significantly. For example, the failure to file Form 959 may result in a $1,000 fine or, in the case of a willful failure to file, imprisonment for not more than a year. I.R.C. §§ 6679, 7203 (1982). The failure to file Form 2952 may cause, in addition to other penalties, a loss of a part of the otherwise available foreign tax credit. I.R.C. § 6038(c) (1982).

C. International Boycotts

An NRA who becomes a resident becomes subject to a series of penalty provisions designed to discourage U.S. persons from participating in or cooperating with an international boycott.[106] The first of these requires a resident to report on Form 5713 his operations (including those of a controlled group of which he is a member) in any country or with the government, a company or a national of that country which requires as a condition of doing business within such country or with such government, company or national, participation in or cooperation with an international boycott.[107] The second subjects any income derived by a foreign corporation as a consequence of such an international boycott to U.S. income tax. More specifically, it is applicable to CFCs and operates by including international boycott income within the meaning of subpart F income.[108] Thus, even if such income is not otherwise subject to U.S. income tax, it is made taxable precisely because it is international boycott income.

D. Transfers of Appreciated Property

Sections 367 and 1491 of the Code operate in tandem with the anti-avoidance provisions described above. Instead of taxing the income of foreign or domestic corporations or taxing their shareholders with respect to the income of such corporations, however, these two Code sections address the transfers of appreciated property to foreign entities for the specific purpose of controlling such transfers. In particular, section 367(a) of the Internal Revenue Code provides that, if in connection with the exchanges, contemplated in sections 332, 351, 354, 355, 356, or 361 of the Code, there is a transfer of property to a foreign corporation, the foreign corporation's status as a corporation will be disregarded unless the Internal Revenue Service rules that the exchange was not in pursuance of a plan one of the principal purposes of which is the avoidance of federal income taxes. The ruling request must be filed within 183 days of the transfer of the property. The effect

106. For these purposes, a participant in an international boycott is defined as a person who agrees, as a condition to doing business within a particular country, not to do business in another country, or with the government, a company, or national of that country. It also includes an agreement not to do business with a U.S. company which is refusing to honor such a boycott as well as an agreement to refrain from doing business with countries, companies, etc., on the basis of race, religion, or nationality. I.R.C. § 999(b) (1978).

107. I.R.C. § 999 (1982). A controlled group is defined in section 993(a)(3) of the Code by reference to section 1563(b) of the Code. I.R.C. §§ 993(a)(3), 1563(b) (1978).

108. I.R.C. § 952(a)(3) (1978). Basically, the amount of such Subpart F income is determined by multiplying a CFC's income (other than that included in the gross income of its U.S. shareholders under section 951 of the Code or excluded from Subpart F because it is U.S. source effectively connected income) by a fraction designed to allocate such income between boycott and non-boycott operations.

of this provision is that, since each of the Code sections to which section 367 is applicable requires the transferor and/or transferee to be a corporation in order to qualify for tax deferral, without the requisite ruling the transferor will be required to recognize any gain realized as a result of the transfer. Section 1491 of the Code imposes an excise tax on the transfer of appreciated property to foreign corporations, partnerships, trusts, or estates. This excise tax is imposed on the gain realized on the transfer (less any gain recognized) and is not deductible in computing the transferor's U.S. income tax liability.

Sections 367 and 1491 of the Code are applicable only to U.S. persons. For this reason, an NRA can transfer appreciated property to foreign entities without regard to the need for a ruling or concern with U.S. income or excise tax.[109] When an NRA becomes a United States resident, however, he loses the flexibility which he otherwise has to move property in or out of foreign entities and, with it, the ability to position or reposition assets to take full advantage of favorable U.S. and foreign tax treatment.

E. Foreign Trusts

The U.S. income tax treatment of trusts, both foreign and domestic, and of their beneficiaries can be affected in a variety of ways by an NRA becoming a resident. The extent of the effect depends in the first instance on whether the trust is characterized as a grantor or non grantor trust.

Grantor Trusts. A grantor trust is ignored for U.S. tax purposes.[110] In other words, while a grantor trust has an existence separate from that of the grantor/settlor for trust administration or probate or other purposes, since the grantor has retained or reserved certain powers or interests which the tax law treats as the equivalent of ownership, the trust is treated as the alter ego of the grantor for U.S. tax purposes.[111]

109. In certain limited instances, an NRA may be required to give notice to the Treasury under section 367(b) of the Code of the kinds of exchanges described in section 367(a) of the Code even though section 367(a) is not applicable and even though any gain realized in connection with such an exchange will not be recognized by the transferor. I.R.C. § 367(b) (1982).

110. In Rev. Rul. 69-450, 2969-1 C.B. 168, the Internal Revenue Service ruled that a transfer of appreciated property to a foreign grantor trust was subject to the excise tax imposed by section 1491 of the Code. If this ruling is correct, and it is doubtful that it is, it would appear to represent an exception to the rule that grantor trusts are ignored for U.S. tax purposes.

111. Any of the following reserved powers or interests will cause a trust to be treated as a grantor trust: a reversionary interest in the trust corpus or its income if it reasonably can be expected that the same will take effect within ten years from inception (I.R.C. § 673); a right to control the beneficial enjoyment of the corpus or the income (I.R.C. § 674); one or more administrative powers including the power to sell for less than adequate consideration or to borrow without adequate interest or security (I.R.C. § 675); a power to revoke the trust (I.R.C. § 676); the right

As a result, the income, deductions, and credits which otherwise would be taken into account in computing the taxable income of the trust, are taken into account instead in computing the income of the grantor.

This means that U.S. income tax liability is determined not by reference to the status of the trust or whether it is foreign or domestic but by reference to the status of the grantor. As a consequence, if the grantor is an NRA, he will be subject to U.S. income tax with respect to the income of the trust only to the extent such income is subject otherwise to income tax in his hands. If the NRA grantor becomes a U.S. resident, however, the trust income will be treated in the same manner as his own (non trust) income. Stated differently, there is no change in the U.S. income tax treatment of the trust itself; the trust will continue to be ignored for U.S. income tax purposes but, since the grantor has become a U.S. resident, he will be subject to U.S. tax on its income.

In addition to those grantor trusts characterized as such because the settlor has reserved a prohibited power or interest, section 679 of the Code creates an entirely separate category of grantor trust.[112] Section 679, which was added to the Code by the 1976 TRA, treats a foreign trust as a grantor trust if a U.S. person, directly or indirectly, transfers property to a foreign trust which has or is treated as having U.S. beneficiaries. This characterization is applicable without regard to whether the grantor has any retained power or interest in the trust: It is sufficient that he is a U.S. person and the trust itself has a U.S. beneficiary.[113]

By becoming a resident, an NRA may trigger the U.S. tax consequences imposed by this Code provision in two ways. Firstly, if after becoming a resident he transfers property to a foreign trust with a U.S. beneficiary, he will be subject to U.S. income tax on the portion of the income allocable to the transferred property. Secondly, if he is the beneficiary of a foreign trust created by a U.S. person, his becoming a resident will cause the grantor of the trust to become subject to U.S. income tax on that part of the income of the trust allocable to the property which he transferred to it.[114]

Nongrantor Trusts. In contrast to a grantor trust, a nongrantor trust is treated as a separate entity for U.S. income tax purposes. Consequently, depending on whether such a trust accumulates its income

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to receive income currently or after accumulation or to have the same paid to the grantor's spouse or used to pay life insurance premiums on the grantor's life or that of his spouse (I.R.C. § 677).

112. I.R.C. § 679 (1982).

113. *Id*.

114. In addition to being treated as the owner of all or a part of the current income of the trust, section 679 of the Code requires the deemed grantor to include in his own gross income a portion of any undistributed net income. I.R.C. § 679 (b) (1982).

or distributes it to its beneficiaries, it either will be subject to income tax or will be allowed to pass through its U.S. income tax liability to its beneficiaries. This being true, the residence of the grantor per se is not relevant to the tax regimen which is applicable to such a trust. A change in the residence of either the trustee of a nongrantor trust or of one or more of its beneficiaries, however, may have significant United States tax consequences.

A number of factors are relevant in determining whether a trust is foreign or domestic, including the residence of the trustee,[115] the place where the trust was formed,[116] the place where it is administered,[117] the law governing the trust instrument, as well as the nationality of the grantor and beneficiary.[118] While none of these alone is controlling, the place of residence of the trustee is an extremely important factor. Consequently, by becoming a U.S. resident, an NRA trustee could cause the trust to be treated as a U.S. trust which, depending on the character of its income and the status of its beneficiaries, may have significant adverse United States tax consequences.

If it is the beneficiary of the trust who becomes a resident, his change in status may have a variety of tax consequences. The most obvious of these, of course, is that he will be subject to income tax on any income distributed by the foreign trust. Moreover, because the trust is foreign, income it distributes to a U.S. beneficiary will be subject to a series of rules not applicable to distributions received from domestic trusts.[119] For example, capital gains are included in the distributable net income of a foreign trust. More importantly, such capital gains lose their character for tax purposes with the effect that the usually favorable tax treatment applicable to capital gains is lost to the trust and its beneficiaries.[120] Furthermore, in addition to U.S. income tax, when a foreign trust distributes income which it has accumulated, such income is subject to a non deductible interest charge equal to six percent of the income tax due with respect to such income.[121]

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115. B.W. Jones Trust v. Comm'r, 132 F.2d 914 (4th Cir. 1943).

116. Rev. Rul. 60-181, 1960-1 C.B. 257.

117. B.W. Jones Trust v. Comm'r, 132 F.2d 914 (4th Cir. 1943).

118. Rev. Rul. 64-307, 1964-2 C.B. 163; Rev. Rul. 62-154, 1962-2 C.B. 148.

119. An NRA's change in residence does not trigger these consequences. He cannot avoid them, however, unless he can cause the trust situs to change, for example, to become a domestic trust. As a result, he is subjected to a harsher regimen of income tax than otherwise would be applicable were the trust a domestic trust.

120. Staff of the Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 1976-3 C.B. 1, at 237. *See also* Chopin, *The U.S. Income Tax and Foreign Trusts*, TR. & EST., Sept. 1981, at 43.

121. I.R.C. § 668(a) (1982). The interest charge plus the income tax imposed by section 667(a) of the Code cannot exceed 100% of the distribution. I.R.C. § 668(b) (1982).

F. Foreign Expropriation

In some cases, an NRA's property will be expropriated by the country of his prior residence as a consequence of his failure to return prior to the expiration of his exit visa. Such an expropriation of property ordinarily would give rise to a loss deduction for U.S. income tax purposes under section 165 of the Code.[122] In the case of an NRA who becomes a U.S. resident, however, the Internal Revenue Service has ruled that no such deduction will be allowed.[123] It did so on the alternate grounds that (1) the loss had occurred at a time prior to immigration and, therefore, prior to residence or (2) that the loss was not deductible because the requirement that there be an expectation of profit subject to U.S. income tax could not be established.

G. Tax Treaties

The United States is party to a number of bilateral tax conventions or treaties.[124] These tax treaties are intended to avoid double taxation by allocating priorities between the contracting states with respect to the right to tax certain kinds of income and by providing for tax credits when the same income is subject to tax in both jurisdictions. In certain instances, these tax treaties provide for reduced withholding tax rates and, in others, for an exemption from U.S. income tax on U.S. source income.[125] When an NRA, who in the past has enjoyed the benefits of such a treaty either because he was resident in the treaty country or otherwise able to bring himself within its scope, becomes a U.S. resident, he loses his access to the treaty. As a consequence, he will be subject to tax in the United States as if there were no such treaty. The RA will be entitled, however, to claim the benefits of such a treaty as a U.S. resident and, as a result, may be entitled to reduced foreign withholding or other benefits with respect to foreign source income.

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122. I.R.C. § 165 (1982).

123. Rev. Rul. 80-17, 1980-1 C.B. 45.

124. At present there are thirty-five ratified treaties and several others in various stages of the ratification process.

125. *See, e.g.*, Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, *signed* Dec. 31, 1975, United States-United Kingdom, T.I.A.S. No. 9682, 1980-1 C.B. 394, 2 TAX TREATIES (CCH) ¶ 8107, (*entered into force* Apr. 25, 1980) (eliminates witholding tax on interest income). *See also* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, *signed* Mar. 8, 1971, United States-Japan, 23 U.S.T. 967, T.I.A.S. No. 7365, 1973-1 C.B. 630, 1 TAX TREATIES (CCH) ¶ 4391 (*entered into force* July 9, 1972) (exempts certain types of capital gains from taxation).

III
PLANNING OPPORTUNITIES BEFORE ARRIVAL

An alien who becomes a resident, in most instances, is prepared to accept the U.S. tax and other consequences which accompanies his change in status. At the same time, however, most aliens are anxious to minimize the impact of these consequences to the extent possible and, as a general rule, can do so with proper tax planning. Some of the more important planning opportunities are discussed below.

A. Acceleration of Income

As noted previously, the United States subjects its residents to income tax on their worldwide income. An NRA who becomes a U.S. resident is subject to tax on his worldwide income as of the time he becomes a resident. He is not subject to tax, however, on such income prior to becoming a resident.[126] For this reason, one of the more important tax planning opportunities involves the acceleration of the realization of income so that such income will be realized prior to the time the NRA becomes a resident and, for that reason, subject to U.S. income tax.

Generally, this involves collecting outstanding amounts that may be due for personal or other services. In some cases, however, much more can be done. For example, if an alien controls a corporation, foreign or domestic, with accumulated earnings, he should cause it to distribute its income. Assuming such dividends are treated for U.S. tax purposes as foreign source income, the NRA will not be subject to U.S. income with respect to such dividends. Moreover, by paying a dividend, the corporation will reduce its earning and profits. This, in turn, may favorably affect the income tax treatment of subsequent distributions. Thus, such distributions are desirable even if it is necessary for the NRA subsequently to lend or contribute a similar amount to the corporation so that it may meet its capital needs. Similarly, an NRA contemplating U.S. residence also should realize foreign capital gains and, assuming he has not been present in the U.S. 183 days or more, non-real estate U.S. capital gains.[127] Finally, if possible, he should cause foreign trusts of which he is a beneficiary to distribute current and accumulated income to him.[128]

126. This is different from the treatment of NRAs who elect residence status under section 6013(a) or 6013(b) of the Code. I.R.C. §§ 6013(a), -6013(b) (1982).

127. Capital gains derived from the disposition of U.S. real estate will be subject to U.S. income tax irrespective of the length of the NRA's presence in the U.S. and, therefore, it may better to delay realization of real estate gains. I.R.C. § 897 (1982).

128. This is available only to cash basis taxpayers. Obviously, with accrual basis taxpayers, acceleration of income will be of minimal advantage.

Depending on circumstances, it also may be advisable to accelerate receipt of U.S. source FDAP income. As a general rule, the gross amount of such income is subject to withholding tax at a rate equal to thirty percent. The possible advantage of accelerating the receipt of such income is that residents are subject to U.S. income tax at graduated rates of up to fifty percent of the taxable income, a net amount calculated by deducting certain expenses, contributions, losses, and the like. Therefore, depending on the extent of the alien's income, it may be that thirty percent of gross will represent a tax saving as compared to fifty percent of taxable income.[129]

B. Installment Sales

Under the new installment sale reporting provisions of the Code, installment sale reporting is automatic, subject to a taxpayer's right to elect not to report his gain on the installment basis.[130] This is exactly the opposite of the former installment sale reporting rule which required affirmative action if a taxpayer wished to report gain on an installment basis.[131] In terms of an NRA who has sold qualifying assets at a gain prior to becoming a U.S. resident in a transaction which would have qualified for installment treatment, this rule change may have unintended adverse tax consequences. This results from the fact that, unless a timely election is made not to report on an installment basis, the United States will treat the transaction as an installment sale and, for that reason, require the NRA to recognize gain on an installment basis. Thus, an NRA who becomes a U.S. resident will be subject to U.S. income tax with respect to that part of any deferred gain received subsequent to his becoming a resident.

To avoid this result, it is essential that, prior to becoming a resident, an NRA take whatever steps are required to elect out of installment sale treatment. Unfortunately, it is not yet clear how this can be accomplished. The Code requires the election to be made on or before the due date prescribed by law for filing the taxpayer's income tax return for the taxable year in which the disposition occurs.[132] In most cases, however, an NRA will not have filed a U.S. income tax return

129. The corollary of accelerated income is deferral of deductions and losses which otherwise would be deductible until such time as the NRA becomes a U.S. resident. For the most part, an NRA is taxed on a gross basis and, therefore, such deductions are of little income tax value. Once he becomes a U.S. resident, however, this changes and, if such items of expense are deductible otherwise, they may be available to reduce U.S. taxable income. This is particularly true of long term capital losses. *See generally* Cates, *Pre-Immigration Tax Planning for U.S.-Bound Nonresident Alien*, U.S. TAXATION OF INTERNATIONAL OPERATIONS (P-H) ¶ 15,508, at 108.

130. I.R.C. §§ 453(a), 453(d) (1982).

131. SENATE FINANCE COMM., REPORT ON INSTALLMENT SALES REVISION ACT OF 1980, Pub. L. 96-471, § E, 96th Cong. 2d Sess. (1980).

132. I.R.C. § 453(a) and (d).

for the year of sale because, not being a U.S. resident, he would not have been required to do so. Consequently, if this Code provision is applied literally, the NRA will lose the right to elect out of installment treatment and will be subject to U.S. income tax on the deferred gain.[133]

Notwithstanding this, it is clear that Congress did not intend to expose an alien to income tax under such circumstances.[134] Rather, it intended that the Treasury would prescribe regulations on making of the requisite election so that an NRA finding himself in the circumstances described above would be able to elect out of installment sale treatment. Since these regulations have not yet been promulgated, however, it is important that the NRA pay particular attention to past installment sales so that they may be dealt with in accordance with whatever approach the Treasury finally does adopt to carry out the stated Congressional intent.

C. Basis

Unlike some taxing jurisdictions such as Canada, the United States does not allow an NRA to adjust the tax basis of his property to reflect its fair market value as of the time he becomes a resident. In other words, the act of becoming a resident is not itself an event which causes basis to be adjusted. Therefore, if an NRA desires to protect pre-immigration appreciation in assets U.S. income tax in the event of a post immigration disposition of such property, he will be required to take affirmative action to cause a step-up in tax basis.

One means by which this can be accomplished is for the NRA to sell his appreciated assets and, then, to the extent desirable, to reacquire them. Assuming that the NRA is an NRA at the time of such a sale, that the gain is either foreign source gain or non-real estate capital gain and that the NRA has not been present in the U.S. 183 or more days, the gain will not be subject to U.S. income tax.[135] The tax basis of the newly acquired (reacquired) asset will be its cost. In short, by selling and then repurchasing an asset, the alien will have stepped-up his tax basis in what, if properly planned and timed, should be a non-taxed transaction.

There are two caveats with respect to this approach. First, if the NRA is a resident or citizen of a country which itself will tax the gain, he must be careful to time the sale in such a manner as to ensure that it

133. *See, e.g.*, Rev. Rul. 65-297, 1965-2 C.B. 152.

134. SENATE FINANCE COMM., *supra* note 129.

135. Since the asset will have been dispensed of at a gain, there is no requirement that the NRA wait any specified time period prior to reacquiring it. *See* Rev. Rul. 55-62, 1955-1 C.B. 212. *Cf.* the treatment of wash sales of stocks and securities under I.R.C. § 1091 (1982).

occurs after he has abandoned foreign residence but before he becomes a U.S. resident. Because this can be difficult if abandonment of foreign residence is followed immediately by U.S. residence, it often is advisable for the NRA to establish a temporary presence in a third country, a tax haven, prior to becoming a U.S. resident and, while there, to dispose of his appreciated properties.

The second caveat is the sale must be a real one. A sham sale is always subject to attack by the Internal Revenue Service.[136] Therefore, when selling low basis assets, it is essential that the sale be genuine, *i.e.*, legally enforceable, and that there be no side agreement or obligation to repurchase or to otherwise reverse the transaction. This is less likely to be a problem with publicly traded securities than with other assets. For this reason, it may be advisable not to reacquire the same assets if alternatives are available. If it is not possible, it is probably appropriate to proceed but only with extreme caution and a careful awareness of the risks.

D. Transfers to Foreign Entities

In discussing the United States tax consequences of becoming a U.S. resident, it was noted that both sections 367 and 1491 of the Code are applicable to transfers of appreciated property to certain foreign entities. It also was noted that these two Code sections are applicable only to U.S. persons. For this reason, if it is desirable for an NRA to arrange or rearrange the ownership of his foreign (in some cases, domestic) property, he should do so prior to becoming a U.S. resident. For example, it is not uncommon for an NRA who is immigrating to the United States to provide for one or more family members who will not accompany him. This, in turn, often involves the creation or funding of a foreign situs trust. If he funds such a trust after becoming a U.S. resident, the transfer of appreciated property will be subject to the nondeductible excise tax imposed by section 1491 of the Code. It also could subject him to a U.S. gift tax. By creating and/or funding the trust prior to becoming a U.S. resident, however, both the excise tax and the gift tax can be avoided.[137]

Similarly, if an NRA wishes to transfer assets to a foreign corporation or to reorganize one or more foreign corporations and he delays doing so until after having become a resident, the provisions of either sections 367(a) or 367(b) of the Code may be applicable and one or the

136. Higgins v. Smith, 308 U.S. 473 (1940); DuPont v. Comm'r, 118 F.2d 544 (3rd Cir. 1941); Rand v. Helvering, 77 F.2d 450 (8th Cir. 1935).

137. It is important to remember the grantor trust rules in this context. If the NRA creates a grantor trust, he will be subject to U.S. income tax with respect to its income after becoming a U.S. resident. Therefore, particular care must be taken to guard against this result.

other is likely to force him to include in gross income an amount equal to any unrealized gain as of the time of the transfer. As a general matter, this tax can be avoided by completing the transfer prior to becoming a U.S. resident. Therefore, particular attention should be given to the question of the structuring of appreciated assets, and, if transfers are desirable, they should be undertaken wherever possible before the NRA becomes an RA.

E. Avoiding the Pentapus

As has been discussed, the anti-avoidance provisions of the Code are designed to prevent U.S. tax avoidance. For that reason, an NRA who owns an interest in a foreign (or in some cases, a domestic) corporation should consider taking steps to avoid the U.S. tax consequences which these anti-avoidance provisions will cause him after he becomes a U.S. resident. Some of the possibilities for doing so will now be examined.

An NRA can reduce his stock holdings to such an extent that he will no longer cause the corporation to run afoul of one or more of the anti-avoidance provisions. For example, if an NRA owns shares in a foreign corporation which would become a CFC at the time he becomes a U.S. resident, he can transfer all or part of those shares to a relative who will continue to be a U.S. nonresident.[138] This obviously is not always a satisfactory solution; NRAs are no more anxious than others to give up control of their assets. However, when loss of control is not an impediment because there is no attribution of stock from an NRA individual, this is one means of maintaining control of the entity within the family unit while possibly avoiding CFC classification. Moreover, even where it is not possible to avoid CFC classification, it still may be desirable for the NRA to transfer all or part of his stock to limit the amount of the CFC's tainted income for which he will be subject to U.S. income tax.

An NRA also may be able to restructure the income of foreign corporations which will be affected by his change in status. For example, in the case of a foreign corporation which is or will become a CFC, this may be possible by reducing the extent of its foreign base company income so that such income does not exceed ten percent of the CFC's gross income. If this is possible, the de minimus rule of section 954(b)(3) of the Code will be applicable and, as a result, no part of the

138. This, of course, assumes the actual transfer of ownership and control of such stock and not merely some nominee arrangement which for U.S. tax purposes would have no effect whatever.

CFC's gross income will be treated as foreign base company income.[139] Similarly, in the case of a foreign corporation which otherwise might be an FPHC, it may be possible to avoid FPHC status by reducing FPHC income below the threshold level. This may be done either by merging the FPHC with a company with significant levels of active gross income, (rents from real property or shipping income are particularly suited for this task) or, alternatively, if such a corporation already has some active income, by stripping certain of its assets to reduce its passive income.

A third possible alternative for dealing with the pentapus as it applies to foreign corporations is to liquidate the foreign corporation and reincorporate it in the United States.[140] This technique is not entirely satisfactory because it does nothing to continue the U.S. tax deferral previously available. Moreover, the new U.S. company still may be classified as a PHC and, therefore, subject to the penalty tax imposed on such corporations. Nevertheless, if an alien cannot deal with the anti-avoidance provisions by reducing his stock ownership or restructuring the corporation's income, liquidation-reincorporation may be the only alternative. Further, because CFC, FPHC, and FIC status all carry with them tax consequences beyond just the U.S. tax treatment of current income, liquidation may be desirable to ensure a full step up in basis at the time of death (assuming appreciation) or capital gains treatment in the event of the sale of stock of such a company.

F. The Tax Year and Method of Accounting

Taxable income is computed on the basis of a taxpayer's taxable year.[141] This means that every taxpayer must have a taxable year. As a general rule, an individual's taxable year is the calendar year but he may adopt as his taxable year a fiscal year or a 52-53 year.[142] The advantage of such an election is that it speeds up the availability of advantages not otherwise available to NRAs, such as the right to file a

139. I.R.C. § 954(b)(3) (1982). In this regard, it is important to remember that while this de minimus rule is applicable to foreign base company income, foreign base company income is not the only type of either Subpart F income or, for that matter, the only type of tainted income which a U.S. shareholder may be required to include in his own gross income. *See* I.R.C. § 951 (1982). Therefore, the opportunity which this de minimus rule offers is limited.

140. It is important to be aware that the Internal Revenue Service may attempt to characterize the liquidation reincorporation transaction as a "D" reorganization. *See* I.R.C. § 368(a)(1)(D); Bittker & Eustice Federal Taxation of Corporations and Shareholders, ¶¶ 11.05 and 14.54 (1971). In the event of such a characterization, the NRA would not get a step-up in basis; his basis in the old corporation would be substituted for his basis in the new corporation. The new corporation similarly would be affected in that the old corporation's basis in its assets as well as its earnings and profits will carry over to the new U.S. corporation. *See* I.R.C. § 358 (1982).

141. I.R.C. § 441(a) (1982).

142. I.R.C. § 441(b), 441(f), and 441(g).

joint income tax return or to include his first tax year in the base period should he wish to compute his income tax liability in later years by income averaging.[143]

In order to elect a fiscal year or other taxable year, an NRA must be able to demonstrate that the tax year selected corresponds to his annual accounting period and that he maintains his books accordingly.[144] More importantly, the alien must be a new taxpayer which requires that he not previously have been obligated to file a U.S. income tax return.[145] If he was required to file a U.S. tax return in a year prior to becoming a U.S. resident and if he did not then elect a year other than a calendar year, he will not be able to do so at the time of becoming a U.S. resident unless he secures the consent of the Internal Revenue Service.[146]

Just as the new United States taxpayer must elect a taxable year, he also must elect a method of accounting.[147] The cash basis is usual but not required and the accrual method of reporting income, as well as other methods, is specifically recognized.[148] What is not clear is whether the new taxpayer must continue his historical method of accounting or whether he is free to establish new books upon arrival in the United States.[149] It would seem that the latter ought to be possible and, if it is, in some circumstances it could offer an opportunity for U.S. income tax planning.

G. Real Estate Transactions

Until FIRPTA, gain from the disposition of U.S. real estate was treated in the same fashion as other gains realized by an NRA or a foreign corporation and taxed accordingly. After the enactment of FIRPTA, however, an NRA is subject to income tax on the disposition of U.S. real property interests as if such gains were effectively con-

143. An NRA can file a joint tax return if he makes an election under Section 6013(g) of the Code. If he makes such an election, however, he is treated as a resident for the whole of the tax year with the risk that income which otherwise would not be subject to U.S. income tax will be subject to tax. With the adoption of a fiscal year, however, the NRA's income during the period prior to his residence will not be subject to U.S. tax as the price for gaining the right to file a joint return. *See* I.R.C. §§ 1301-1305 (1982) with respect to income averaging.

144. I.R.C. § 441(g); Treas. Reg. § 1.441-1(b)(3), T.D. 7767.

145. Treas. Reg. § 1.441-1(b)(3).

146. *Id.* In I.R.S. Letter Ruling 7844042, Apr. 25, 1978, the Internal Revenue Service ruled that an NRA who had no U.S. source income prior to coming to the U.S. and, thus, was not subject to U.S. income tax, nevertheless was "in existence" for purposes of Treas. Reg. 1.441-1(b)(3) and, therefore, not entitled to elect a fiscal year. It reversed this position, however, in Rev. Rul. 80-352, and, as a result, it would appear that an NRA under such circumstances can elect a noncalendar taxable year. Rev. Rul. 80-352, 1980-2 C.B. 160.

147. I.R.C. § 446 (1982); Treas. Reg. § 1.446-1, T.D. 7285.

148. I.R.C. § 446(c) (1982).

149. *See generally* Rev. Rul. 80-352, 1980-2 C.B. 160; Letter Ruling 7844042, *supra* note 146.

nected with a U.S. trade or business.[150] Additionally, FIRPTA drastically limits an NRA's access to the nonrecognition provisions of the Code with the effect that an NRA often will be taxed on the disposition of a U.S. real estate interest under circumstances where a U.S. resident might be entitled to defer income tax. As a result, in planning for an NRA's immigration to the U.S., it may be preferable to delay disposition of U.S. real estate interests until after his becoming a resident.

One example of a situation in which it may be desirable to wait until an NRA has become a resident is where he contemplates an exchange of U.S. real estate for foreign real estate. If an NRA exchanges U.S. real estate for foreign real estate while he is an NRA, the transaction will be a taxable one and the gain realized, the difference between fair market value of the U.S. property at the time of the exchange and the NRA's tax basis in the property, will be recognized. However, if this same exchange is accomplished by the alien after he becomes a U.S. resident, he will be entitled to defer (or eliminate) the gain realized as a "like-kind" exchange under section 1031 of the Code until such time as he disposes of the foreign real property.[151]

H. Estate and Gift Tax

Unlike the situation which exists in connection with U.S. income tax, the opportunity for pre-immigration estate or gift tax planning is extremely limited because a gross estate of a U.S. resident (domiciliary) includes the value of his property, regardless of its character or where it is situated.[152] The same is true of gifts made by residents of the United States; all of his gifts are subject to the U.S. gift tax.[153] As a consequence, the only opportunity to avoid U.S. estate tax is if the NRA is willing to reduce the extent of his estate prior to becoming a resident. To the extent that the property to be transferred does not include U.S. real estate or U.S. situs personalty, the NRA should transfer such prop-

150. I.R.C. § 897 (1982).

151. I.R.C. § 1031 (1982). The fact that nonrecognition provisions such as section 1031 of the Code are available to U.S. residents and not NRAs has occasioned some tax planners to suggest that an alien should become a resident as a means of avoiding the tax consequences of FIRPTA. What is contemplated is that the NRA would become a U.S. resident, exchange his U.S. property interest for foreign property and thereafter abandon his U.S. residence. As an NRA, he then could dispose of the foreign realty free of U.S. income tax. Similarly, it also may be possible to liquidate a U.S. real estate company which owns U.S. real estate as a part of this process. *See* I.R.C. § 333 (1982). Rather obviously, this may not be practical in the case of the NRA who either is not mobile or, if mobile, would be exposed to U.S. income tax on other income as a result of becoming a U.S. resident. Nevertheless, where the circumstances are appropriate, this may be a means of avoiding the impact of FIRPTA that neither Congress nor the Treasury has yet addressed.

152. I.R.C. § 2031 (1982).

153. I.R.C. § 2501(a) (1982).

erty prior to his becoming a U.S. resident. This will allow him to reduce his estate and to do so without U.S. gift tax or other U.S. tax consequences. The exception to this rule is if he intends to make a gift of U.S. real estate or U.S. situs personal property. Such transfers would be subject to U.S. gift tax but, since the unified credit is not available to an NRA, he should wait until after he becomes a U.S. resident to transfer such property.[154]

IV
CONCLUSION

The foregoing is necessarily a broad review of the principal tax consequences associated with U.S. residence. Even this broad review should indicate, however, that U.S. residence carries with it significant exposure to U.S. taxation. At the same time, it is possible with proper planning to steer a path which will minimize the risks that these exposures entail. It also is possible, however, with proper planning, to secure for the NRA about to become a U.S. resident significant advantages not available to U.S. residents.

154. *See* I.R.C. § 2505(a) (1982) which limits the unified credits to transfers by gifts to those made by U.S. citizens or residents.