International Inbound

The immigrants, who came in 1970s and 1980s, and even in early 1990s, did not have the luxuries of today's immigrants, who could bring with them sizeable assets. Worldwide income taxation and estate/gift taxation was of little concern, as most of these new immigrants did not have the wealth nor income to be concerned.

However, due to prosperity or catch up by their home countries, the new immigrants face different issues when coming to US, namely US income and estate taxation. Once a new immigrant is considered to be a US resident, for US tax purposes, he/she is now subject to worldwide income taxation and their assets overseas are now subject to US estate and gift taxes.

The pivotal element of US taxation is the definition of residency, which will be explained in more details. I will, however, focus my discussion on the tax implications to US residents and non-resident alien in the US.

Under the US tax law, if a person stays for more than 183 days in the US, he or she will be considered a US resident. Once a foreigner is considered to an US resident, he/she is considered to be US taxpayer, just like US green card holder (permanent resident) and US citizen.

Once a foreigner is considered to be a US taxpayer, worldwide income needs to be reported to the US government. In addition, if he or she is a California resident, then a worldwide income must also be reported to the California government.

For many foreign businessmen doing business in the US, counting the number of days in the US becomes very important, to avoid US (federal) government or California (state) government income taxation. The objective in counting the number of days is to avoid being US resident or US taxpayer. If a foreigner (non US permanent resident or citizen) stays less than 183 days in a given year, then he/she would be considered to be a nonresident alien for US tax purposes.

The advantages of being nonresident alien, for US tax purposes, include following:

1. Only US sourced income need to be reported to the federal government (worldwide income won't be required to be reported),
2. State income tax could be avoided entirely,

3. Foreign bank accounts don't need to be reported to US, and
4. Except for US real estate, nonresident aliens may be able to avoid US gifts and estate tax.

Since counting 183 days is a mechanical process, foreigners can easily avoid being US resident (for tax purposes). It is important to remember that 183 days is also measured over three year period, as such, if a foreign stays in the US for more than 120 days per year during this three year period, he/she may be considered to be US resident for US tax purposes.

For those who are US resident or US taxpayer, worldwide income must be reported and taxes computed on the worldwide income. However, any foreign income taxes paid, on the overseas income, can be claimed as foreign tax credit, which reduces US income taxes. Foreign tax credit mechanism ensures that US taxpayers pay taxes at no more than US tax rate on worldwide income, which also means that it eliminates double taxation.

Unlike federal income tax rules, most states do not have foreign tax credit mechanism. As such, for state income tax purposes, there could be double taxation on the same income.

One of the most commonly asked questions by Asian immigrants is whether key money is income, for US tax purposes. Key money is an obligation to payback or a debt. In the US, a debt is not an income, unless it is forgiven. However, the income generated from key money is income for US tax purposes. For example, if key money is deposited in a foreign bank and interest income is earned, then the interest income must be included as income. Most foreign banks withhold local country income tax on the interest income, if they become aware that the accountholder is a US resident or citizen. Similarly, ifkey money is invested in foreign stocks, then related dividend and capital gain or loss need to be reported in the US income tax return.

If key money is invested in foreign insurance products, with investment element, or in foreign mutual funds, then you are facing a very complex taxing mechanism, called Passive Foreign Investment Company, Inc. or "PFIC" rules. In a nutshell, the growth of the investment would be taxed immediately in the US. This is bad since the money could be tied up for a number of years, but you still have to pay US tax currently. This result is intentional created by the US government. Most US insurance products, with investment elements, are allowed income deferral benefits, also referred to as qualified

plans, meaning you don't pay tax on the growth of the investment, until you draw out the funds. This income deferral benefit is not offered to foreign insurance products.

All taxable US brokerage and mutual funds generate form 1099 each year, which shows interest, dividend and capital gain generated from their investments. Qualified US retirement accounts, such as IRAs and 401(k) plan, do not generate form 1099 but the plan sponsor or third party administrator have the responsibility of reporting the activities with the retirement account. However, foreign mutual funds do not generate form 1099, as such, the US government does not know how much income was generated from the mutual funds. As such under US tax law, foreign mutual funds are treated as PFIC, which trigger either a current taxation on the growth of the investment or very complicated reporting requirements. In either case, the US government is discouraging US taxpayers from investing in foreign mutual funds.

On business payments made from the US, you should consult with your tax advisor, so that you are taking all of the benefits available in the US income tax treaty. Unlike personal payments, business payments generate tax deduction in the US, as such US government puts numerous requirements to get this benefit, including the requirement to withhold tax on the payments, considered to be US source income. There are no restrictions on personal payments made to foreign countries from the US.

The area of international taxation is full of minefields for the unwary. You should always consult with your tax advisor so that you don't accidentally become subject to international tax penalty mechanism, which were created to block US taxpayers from sending funds overseas to evade US income taxes.