THE TAX GUIDE TO EB-5 INVESTMENT *in the* UNITED STATES

A foreigner desiring to invest in a U.S. business or joint venture has many goals, including privacy, liability protection and the need to minimize world-wide income and estate tax liability. EB-5 investors are also concerned with the tax planning that needs to take place before the investor is granted permanent residence status in the United States.

Privacy and Liability

It is the author's experience that most EB-5 investors are concerned with privacy from inquiries by governments, competitors and prospective plaintiffs. Privacy is attainable by acquiring U.S. assets in a name other than that of the investors. Commonly used structures include trusts (with a generic name and a third-party trustee) and legal entities (look to Delaware for true anonymity of ownership).

Corporations, limited partnerships and LLCs will afford their individual owners a liability shield for any liability arising from the assets or the business of the entity. Interests in limited partnerships and LLCs are not attachable by third-party creditors, making them a more effective asset protection vehicle than corporations.

Income Taxation of U.S. Income

The U.S. tax regime has its own jargon. An EB-5 investor is known as a "non-resident alien" ("NRA") for federal income tax purposes. An NRA is defined as a foreign person who is (1) physically present in the U.S. for less than 183 days in any given year, (2) less than 31 days in the current year, (3) physically present for less than 183 total days for a three year period (using a weighing formula), and (4) does not hold a green card. EB-5 investors are generally NRAs until they obtain their permanent residence status. For the purpose of calculating the U.S. income tax liability, the NRA classification may continue to apply even following the receipt of a green card (pursuant to the residence tie break rule of an applicable tax treaty).

Income tax rules applicable to NRAs are complex. An NRA pays a flat 30 percent tax on U.S.-source "fixed or determinable, annual or periodical" ("FDAP") income that is not effectively connected to a U.S. trade or business, and which is subject to tax withholding by the payor. FDAP includes interest, dividends, royalties and rents, insurance premiums, annuity payments, etc. The rate of tax may be reduced by an applicable treaty. The income is taxed on a gross basis, with almost no offsetting deductions. Practically, this means that almost any payment made to an NRA from the United States is subject to a 30 percent tax withheld at the time of payment. The FDAP tax and withholding may be reduced or eliminated by a tax treaty.

An important exception applies to capital gains—foreigners are generally not taxable on their capital gains from U.S. sources. For this reason, a large component of pre-immigration tax planning for EB-5 investors focuses on triggering world-wide capital gains prior to the NRA becoming a U.S. taxpayer.

When an NRA has income from a U.S. trade or business ("effectively connected" income) he is taxed on that income just like any other U.S. taxpayer. U.S. trade or business has been held to include the provision of personal services in the United States, sale of products in the United States directly or through an agent, solicitation of orders from the United States and subsequent exportation of merchandise outside the United States, manufacture, maintenance of a retail store, and maintenance of corporate offices in the United States.

An NRA will be engaged in a U.S. trade or business if the NRA is an investor in an entity that is taxed as a partnership for U.S. income tax purposes, and that entity is engaging in a U.S. trade or business. Consequently, NRAs should invest either through corporations, or through LLCs that elect to be taxed as corporations.

Doing business in the United States through a corporation results in a double tax—a tax on profits at the corporate level, and a tax on dividends paid to the EB-5 investor (subject to the 30 percent FDAP withholding discussed above). When a foreign corporation does business in the United States directly (without a U.S. corporate subsidiary), the double tax is replicated through the so-called "branch profits" tax. This is an additional 30 percent tax on U.S. profits of the foreign corporation that are not reinvested in the United States.

Estate and Gift Tax

The definition of an NRA changes in the estate tax context. Here, the inquiry looks primarily at whether the foreigner intends to make the United States his domicile. This is a subjective inquiry that will take into account the length of stay in the United States, frequency of travel, size and cost of home in the United States, location of family, participation in community activities, participation in U.S. business, ownership of assets in the United States, and voting. An EB-5 investor will often find himself to be a U.S. resident for income tax purposes, but an NRA for estate tax purposes.

The estate and gift tax regime applicable to NRAs is conceptually similar to the standard transfer tax regime, but with some important practical differences. The estate tax is imposed only on the part of the NRA's gross estate that is situated in the United States at the time of death. The rate of NRA's estate tax is the same as that imposed on U.S. citizens and resident aliens, but the unified credit is only $13,000 (equivalent to about $60,000 of property value).

With proper planning, these harsh results may be avoided. For example, U.S. real estate owned by an NRA is subject to the U.S. estate tax, but not if owned through a foreign corporation (foreign assets are not subject to U.S. estate taxes). Even if the real estate is already owned by the NRA it may be beneficial to pay an income tax today on the transfer of the real estate to a foreign corporation (usually treated as a sale) to avoid the estate tax in the future. As with most other international tax subjects, an applicable tax treaty may reduce or eliminate U.S. estate tax.

An NRA donor is not subject to U.S. gift taxes on any gifts of non-U.S. situs property to any person. Thus, an EB-5 investor can wire any sum of money to a relative or friend in the United States and neither party would be subject to the gift tax. U.S. citizens and residents must report gifts from a NRA, in excess of $100,000 on Form 3520.

Gifts of assets located in the United States are subject to gift taxes, with the exception of intangibles, which are not taxable. The gift of an intangible, wherever situated, by an NRA is not subject to gift tax. Shares in U.S. corporations and interests in partnerships or LLCs are intangibles. Consequently, real estate owned by the NRA through a U.S. corporation, partnership or an LLC may be removed from the NRA's U.S. estate by gifting entity interests to foreign relatives, gift tax-free.

Estate tax planning for NRAs is commonly accomplished through the use of (1) foreign corporations to own U.S. assets, or (2) the gift tax exemption for intangibles to remove assets from the United States. Planning for EB-5 investors would include moving assets to family members and irrevocable trusts prior to meeting the estate tax NRA test.

Ownership Structures

An EB-5 investor can acquire U.S. assets using several alternative ownership structures. The investor's goals and priorities dictate the type of structure that is used. Each alternative has its own advantages and disadvantages—there is no perfect structure.

Direct ownership of U.S. assets is simple and is either not subject to tax or is subject to only one level of tax on the disposition. The disadvantages of the direct investment are: no privacy, no liability protection, the obligation to file U.S. income tax returns, and if owned at death, the asset may be subject to U.S. estate taxes.

Under an LLC/LP structure, the NRA acquires the asset through an LLC or a limited partnership. The LLC may be a disregarded entity or a tax partnership for U.S. income tax purposes. This is an improvement over the direct ownership structure, because this structure provides the NRA with privacy and liability protection and allows for lifetime transfers that escape the gift tax. The obligation to file U.S. income tax returns, and the possibility for U.S. estate tax on death, remain.

Investment through a domestic corporation (including an LLC taxed as a corporation) will afford privacy and liability protection, allow lifetime gift tax-free transfers, and obviate the investor's need to file U.S. income tax returns.

There are three disadvantages to the ownership of U.S. assets through a domestic corporation: (1) federal and state corporate income tax at the corporate level will add a second layer of tax, (2) dividends from the domestic corporation to its foreign shareholder will be subject to the 30 percent FDAP withholding, and (3) the shares of the domestic corporation will be included in the U.S. estate of the foreign shareholder.

Ownership of U.S. assets through a foreign corporation offers the following advantages: (1) liability protection, (2) no U.S. income tax or filing requirement for the foreign shareholder, (3) shares in the foreign corporation are non-U.S. assets and are not included in the U.S. estate, (4) dividends are not subject to U.S. withholding, (5) no tax or filing requirement on the disposition of the stock, and (6) no gift tax on the transfer of shares of stock.

The disadvantages of using the foreign corporation are: (1) corporate level taxes (just like with the domestic corporation), because the foreign corporation will be deemed engaged in a U.S. trade or business; and (2) the foreign corporation will be subject to the branch profits tax (a separate 30 percent tax that applies in certain cases), the largest disadvantage of the ownership of U.S. assets through a foreign corporation.

Because the branch profits tax is often not reduced or eliminated by a treaty, the most advantageous structure for the ownership of U.S. assets by the EB-5 investor is through the hybrid foreign corporation-U.S. corporation structure. Here, the investor owns a foreign corporation, which in turn owns a U.S. LLC taxed as a corporation. This structure affords privacy and liability protection, escapes U.S. income tax filing requirements, avoids U.S. estate taxes, allows for gift tax-free lifetime transfers and avoids the branch profits tax. Distributions from the U.S. subsidiary to the foreign parent are subject to the 30 percent FDAP withholding (may be reduced by a treaty), but the timing and the amount of such dividend is within the investor's control.

Conclusion

There are multiple considerations and structures available to EB-5 investors and no structure is perfect. Each structure presents its own advantages and disadvantages which require analysis in light of the investor's objectives and priorities. ★

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