



***WEALTH SUCCESSION PLANNING:
SOUTH AFRICANS GOING TO THE USA***

YOUR KEY TO THE TAX COMMUNITY

US Residents Versus Non-US Residents for Income Tax Purposes

- The US system operates on a similar basis to the South African system:
 - US tax residents are taxed on a worldwide basis
 - Foreigners are taxed on a US source basis
- Dual US / SA residents have their tax resolved on a US/SA tax treaty basis
- Once in the US tax system on a worldwide basis, it is very hard to escape; there is often an exit tax for all gains similar to section 9H of the SA Income Tax Act

US Tax Resident Status

- US citizens are taxed on a worldwide basis regardless of tax residency
 - until citizenship is renounced; and
 - treaties provide no relief for US citizens
- If not a U.S. citizen, a person is a foreign person unless one of two tests is satisfied:
 - US green card is held (i.e. US permanent residence for immigration law purposes); or
 - substantial presence test is met (which is a 3-year day counting test)

Note: US green card residents are stuck in the same US tax system much like US citizens

Substantial Presence Test (Days)

- A person will be considered a United States resident for tax purposes under the substantial presence test for the calendar year based on physical presence.

Requirements

- 31 days during the current year, and
- 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
 - All the days you were present in the current year,
 - $\frac{1}{3}$ of the days you were present in the first year before the current year,
AND
 - $\frac{1}{6}$ of the days you were present in the second year before the current year.

Example:

Person X was physically present in the US on 120 days in each of the years 2019, 2020 and 2021. Under the substantial presence test for 2021, count the full 120 days of presence in 2021, 40 days in 2020 ($\frac{1}{3}$ of 120), and 20 days in 2019 ($\frac{1}{6}$ of 120). Since the total for the 3-year period is 180 days, Person X is not considered a resident under the substantial presence test for 2021.

Substantial Presence Test Exceptions: Simple Exceptions

- Certain days do not count such as:
 - Daily work commutes to and from Canada / Mexico (if living outside US)
 - Less than 24-hour in travel transit
 - Inability to leave the US due to a medical condition
- Certain individuals do not count such as:
 - Foreign government officials
 - Teachers
 - Students
 - Professional athletes

Foreign Closer Connection Test

- Even if a foreigner meets the substantial presence test, that person can still be treated as a non-resident alien if that person:
 - Was present in the United States less than 183 days during the year,
AND
 - Had a closer connection during the year to a foreign country in which that person had a tax home,
 - Maintained a tax home in that foreign country during the entire year,
AND
 - Had not taken steps toward, and did not have an application pending for, lawful permanent resident status (green card).

US Estate & Gift Tax Residency

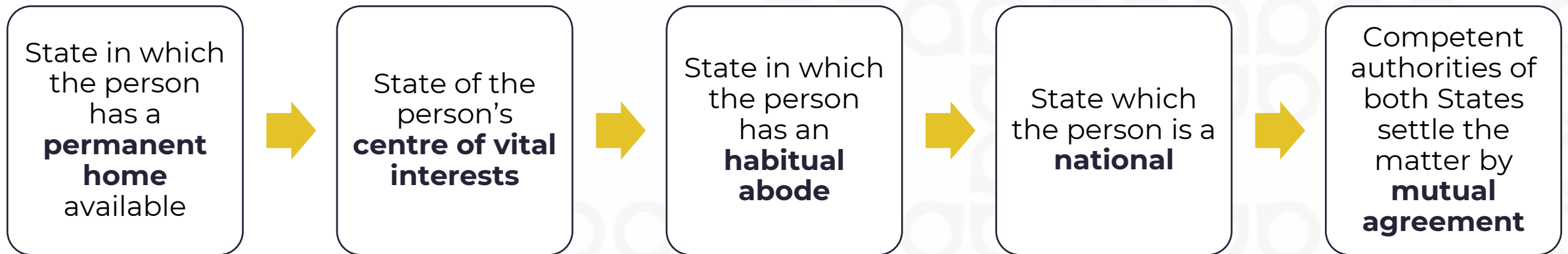
- The term “resident” in the Estate & Gift Tax context is different from the definition of “resident” in the Income Tax context.
- Residence in the Estate & Gift Tax context is based on the individual’s “domicile”.
Domicile: living within a country with no definite present intent of leaving.
- Determining domicile for Estate & Gift Tax purposes is fact specific
 - Once a non-citizen establishes the United States as their domicile, they remain a United States domiciliary until a new domicile is established.
 - If there is doubt as to the location of domicile, there is a rebuttable presumption that the decedent was domiciled within the country where he or she resided.
 - See Treas. Reg. §20.0-1(b)(1).

US/SA Tie Breaker Income Tax Treaty Clause (Article 4(3))

- If a person is a resident of both US and SA, the tie breaker applies as normal

Note: US citizens are always US tax residents (and possibly green card residents) with the tie breaker clause being a nullity

- In the case of a tie, look at:



Foreign Persons Required to File US Tax Returns

- There are three occasions when foreign (wholly) non-residents are required to file US tax returns
 - These foreigners have a US trade or business
 - These foreigners received passive income who improperly received money without withholding tax
 - These foreign persons are requesting a refund
- The return is a 1040NR (as opposed to a normal 1040)

US Trade or Business (Active)

- This type of income is taxed on a “net” profit basis as if earned by a US taxpayer
- Generally, when a foreign person engages in a trade or business in the United States, all income from sources within the United States connected with the conduct of that trade or business is considered Effectively Connected Income (ECI).
 - This applies whether or not there is any connection between the income, and the trade or business being carried on in the United States.
- Generally, must be engaged in a trade or business during the tax year to be able to treat income received in that year as ECI.
 - One is usually considered to be engaged in a U.S. trade or business when performing personal services in the United States.
 - Whether you are engaged in a trade or business in the United States depends on the nature of the activities.

Fixed or Determinable Annual or Periodic Income (FDAP) (Passive)

- This type of income is normally subject to a 30% gross US withholding tax
- The tax on this type of income may be reduced by a tax treaty to 15%, 10%, 5% or 0% depending on the tax treaty
- FDAP income typically includes:
 - Dividends
 - Interests
 - Royalties
 - Rents
 - Sales commissions (if not part of a US trade or business)

US Source Rules

Services	Where the services are performed
Business income: <ul style="list-style-type: none"> • Services business • Sale of inventory (if initially purchased) like a distributor or retailer • Sale of inventory produced like a manufacturer 	Where the services are performed Location where the inventory is sold Location of where the inventory is produced
Interest	Residence of the payor (debtor) paying the interest
Dividends	US company making the dividend
Rents	Location of the property (where used)
Royalties on intellectual property	Location of the rights covered
Sale of immovable property	Location of the immovable property
Sale of personal property	Tax residence of the seller
Pension distributions	Where the services are performed giving rise to the pension
Pension earnings	Location of the pension entity

Foreigners Taxed on a US Source Basis: Services and Immovable Property

- Income Tax: Services rendered in the United States are taxed in the United States, but there is a small exception
 - The foreign person must be temporarily in the US for less than 90 days;
 - The amount must not exceed \$3 000;
AND
 - The foreign person must work for a foreign employer (or a foreign office of a domestic employer)
- Income Tax and Gift & Estate Tax: US real estate
 - Taxed in the US
 - US property companies are also taxed in the United States (a company with more than 50% real property interests in terms of value)

Shares and Stock Options

- Income Tax (and CGT): The disposal of US shares / stock options
 - The sale is typically based on the income tax residence of the seller
 - An exception exists if the shares are effectively connected with a US business (fairly narrow like a US brokerage business)
- Income Tax: Dividends for US shares are subject to US withholding tax but reduced via tax treaty
- Gift & Estate Tax: The value of the shares are subject to Estate & Gift Tax

Note:

- *Payment of interest on US debt is subject to withholding tax reduced by tax treaty*
- *US debt on death is subject to Estate & Gift Tax*

Choice of Foreign Investment Methods

Direct	US tax applies to US source assets	No Limited Liability
US Company	US tax applies to all assets owned by the US company; the US shares are partially US source tax	Limited Liability
US LLC	US tax applies to US source assets	Limited Liability

Offshore Trusts

South African Trusts

- Many South Africans hold assets in South African trusts
- These funds cannot be moved into foreign trusts (Exchange Control)
- Beneficiaries of this trust
 - May be children
 - May be the parents

Foreign Drop Off Trusts

- With the relaxation of Exchange Controls, South Africans can increasingly hold assets in foreign trusts
- These trusts are typically located in low-tax jurisdictions



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