

Tax Case – Immigration of an Entrepreneur

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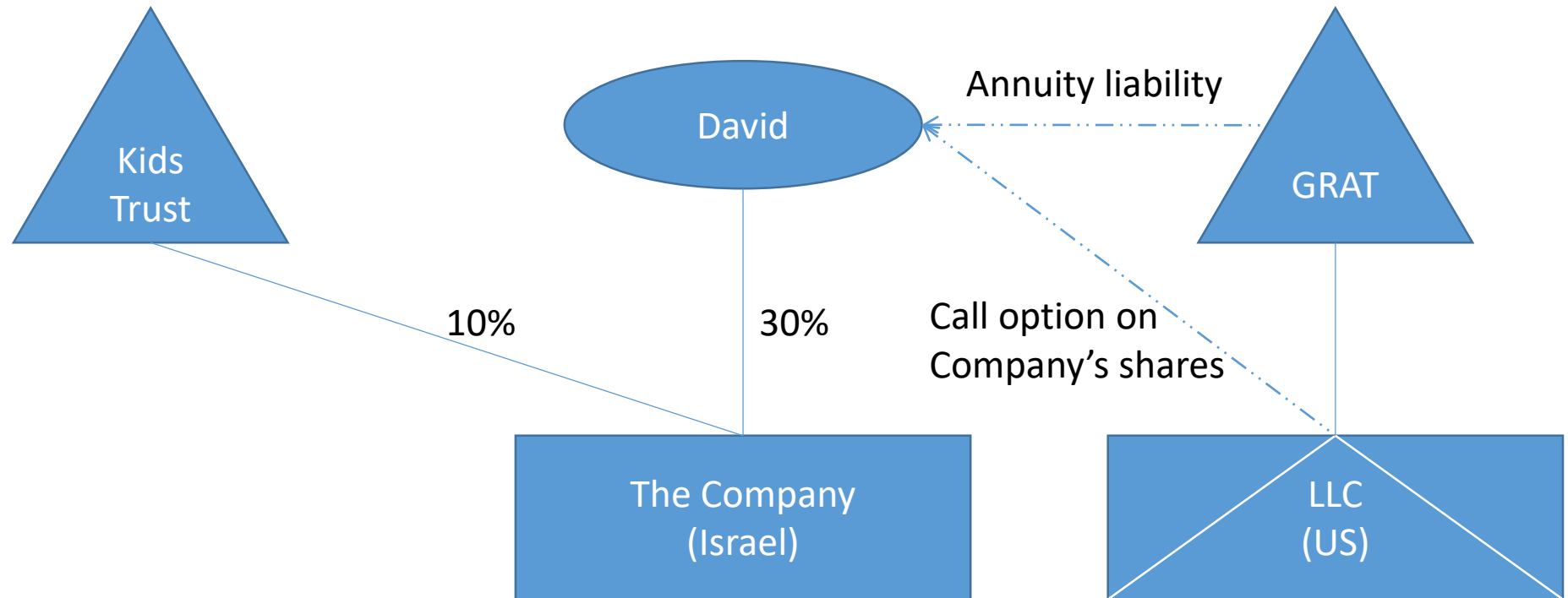
Introduction

- Overview of the case scenario and the purpose of the session
- The structure of the presentation

Background of the Case – the S structure

- David, an Israeli tax resident entrepreneur, incorporates an Israeli company on January 1, 2016.
- The company flourishes and becomes a billion-dollar company.
- David owns 40% of the shares in the company.
- In 2017, David moves to the US and terminates his Israeli tax residency.
- In 2020, David contributes 10% of his shares to a US resident trust for the benefit of his children.
- In January 2023, David granted options to a wholly-owned LLC to buy all of his shares in the company.
- David contributed the rights in the LLC to a Grantor Annuity Trust. The trust is required to pay David annuity equals to the value of the LLC over a period of 2 years following the contribution.
- In January 2024 the company received an acquisition offer from a US traded company. The acquisition allowed flexibility between cash and shares acquisition.
- David approached us, and his US tax advisors, and asked for a tax planning to minimize the tax liability on the transaction.

Background of the Case – the Structure



	Kids Trust	GRAT
Settlor	David	David
Trustee	Wife (US)	Sister (US)
Beneficiaries	Wife and kids	

Background of the Case – David

- David terminated his Israeli residency on 31 December, 2017.
- In January 2024, when the acquisition offer was received, David was on a business trip in Asia after spending approximately 10 days in the US in 2024.
- David's family lives in New Jersey, US .
- David insists on letting his children finish the 2024 school year in New Jersey.
- David can move, on his own, to anywhere in the world. However, he wishes to return to the US in the foreseen future.

Legal Framework – Capital Gains Tax in Israel

- The definition of residency for Israeli tax purposes.
- Capital gains tax applicable to residents vs. non-Israeli residents.
- Exemptions applicable to non-Israeli tax residents who sell shares in Israeli companies.
- Does your country implement a substantive or a quantitative residency test?
- Does it impose tax on non-residents generating capital gains in the country?

Legal Framework – Israeli Exit Tax

- Israeli tax residents are subject to exit tax upon the termination of their Israeli tax residency.
 - The exit tax takes the form of a deemed sale of all the taxpayer's non-Israeli assets on the day immediately preceding the day of termination of the Israeli tax residency.
 - The tax liability can be paid immediately (FMV) or deferred to the time of realization (linear basis calculation).
 - Enforcement and reporting?
 - Entitlement to treaty benefits and foreign tax credits?
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- Is there an exit tax regime in your jurisdiction?
 - Does your jurisdiction allow for the deferral of the exit tax liability?
 - Does your jurisdiction allow crediting FTC due to another jurisdictions' exit tax?

Legal Framework – Trusts Taxation – Israel

- Tax residency of a trust.
- Taxation of an Israeli resident trust.
- Taxation of a non-Israeli resident trust.

Legal Framework – Capital Gains Tax in the US for “United States Persons”

- “United States person” IF citizen OR “resident” of the United States (or a “domestic” trust).
- “Resident” means non-citizen (a/k/a “alien”) who meets any of 3 tests (“green card” OR “substantial presence” OR “first year election”).
- “Domestic” trust IF pass court AND control tests.
- IF U.S. person THEN generally subject to tax on worldwide income and gains, regardless of source (some exceptions for territories like PR).
- As of 2024, top marginal rate on taxable (ordinary) income is 37%.
- Taxable income on gain from a sale of capital assets held for 1+ year generally qualify for a reduced top marginal rate of 20% (known as “long-term capital gain”). Certain dividends also qualify.
- Certain additions and/or exclusions may apply in the form of “net investment income” of 3.8% (a/k/a “Obamacare tax”) or “qualified small business stock” to entirely exclude some/all gain from tax.

Legal Framework – Capital Gains Tax in the US for “Non-Resident Aliens”

- “Non-resident alien” IF neither citizen NOR resident of the United States (or a trust that is not domestic, i.e., “foreign” trust).
- “Foreign” trust IF fail EITHER court OR control test.
- IF non-resident alien THEN generally subject to tax by the U.S. on U.S.-source income and certain non-U.S. source income connected with a U.S. trade or business.
- Instead of the graduated rates applicable to U.S. persons on the prior slides, a flat 30% tax generally applies to non-resident aliens, with some exceptions for capital gains, non-resident aliens connected with a U.S. trade or business, etc. Withholding at source.

Legal Framework – Estate/Gift Tax in the US for US Citizens or Residents

- U.S. income tax residency is based on a statutory framework of tests.
- U.S. estate and gift tax residency based on common law concept of “domicile,” which essentially means intent to remain.
- Intent to remain depends on number of indicia.
- Of course, IF citizen THEN automatically domiciled for purposes of the estate and gift tax.
- As of 2024, top marginal rate of 40% applies to property transferred during life (as a gift) or at death (from the estate), wherever situated, whether real, tangible or intangible.
- First USD \$13.61mm of such property exempt from the tax. It basically works as a credit of USD 5.4mm (40% on excess over USD 1mm + USD 345,800).
- Additional “generation-skipping transfer” (or GST) tax of 40% on transfers during life or at death to “skip” persons 2+ generations down
- Can defer tax through marital deduction (if spouse is U.S. citizen)

Legal Framework – Estate/Gift Tax in the US for US Non-Citizen Non-Residents

- US non-citizen non-residents (“NRNCs”) do not get USD \$5.4mm credit; instead, credit is USD \$13,000, only available against estate tax.
- NRNCs generally subject to U.S. estate tax only on assets sited in the U.S., which is mainly real and tangible property.
- Some exceptions for intangibles, such as stock in a U.S. corporations or U.S. debt obligations. Lack of clarity as to partnerships.
- Estate tax trap for assets transferred in trust sited at time of transfer OR at death IF trust includible in transferor’s estate.
- NRNCs generally subject to U.S. gift tax only on assets sited in the U.S., similar to estate tax.
- However, what is includible as intangible is narrower than estate tax. General rule is that intangibles not subject to gift tax.
- Lack of parallelism means NRNC could avoid estate tax by gifting intangibles or owning intangibles that would be subject to estate tax through a foreign corporation.

Question #1 – Payment of Israeli Exit Tax Upon the Termination of the Israeli Residency?

- Background question – did David terminate his Israeli tax residency, and if so – when?
- Pros of payment upon the termination of the Israeli tax residency:
 - The past: “clean-cut”.
 - The present: utilization of capital losses.
 - The future: appreciation and future tax exemptions.
- Cons of payment upon the termination of the Israeli tax residency:
 - Cash-flow challenges.
 - Valuation challenges.
 - Future:
 - Risk allocation.
 - Potential mitigation of Israeli tax.
- Additional significant factor – the new jurisdiction of residency and its tax laws.

Question #2 – What are the Tax Consequences of the Contribution of the S Shares to the Kids Trust?

- Israeli exit tax?
- US gift tax?
 - Ideally, David is not a “resident” (or domiciliary) of the U.S. at the time of the gift so that the entire value thereof is not subject to gift tax.
 - Were he considered a domiciliary with intent to remain in the U.S., the gift would be subject to gift tax on any amount over US D 13.61mm.
 - U.S. and Israel do not have an estate/gift tax treaty.

Question #3 – What are the Tax Consequences of the Grant of the Options?

- Israeli capital gains tax?
- Israeli exit tax?
 - For sake of discussion: Israeli exit tax upon exercise of the options?
- US taxes?

Question #4 – What are the Tax Consequences of the Contribution of the LLC to the GRAT?

- Israeli capital gains tax or exit tax?
- The GRAT tax planning:
 - Capital gains tax at contribution.
 - Gift tax at contribution?
 - Future estate tax advantages?

Question #5 – What are the Tax Consequences of a Straight-Forward Cash Transaction?

- **Assumptions:**
 - The Israeli exit tax was not paid before the transaction.
 - The cash consideration expected to be received by David is USD 500m.

- **David's Israeli tax consequences:**

- **Linear basis calculation of the exit tax:**

$$\frac{\text{Years of holding as Israeli resident}}{\text{Total holding years}} = \frac{2}{9}$$

- **Capital gains calculation:**

$$(\text{Consideration} - \text{Cost basis}) = (500m - 0) = 500m$$

- **Exit tax liability:**

$$(\text{Capital gains} * \text{linear basis}) * 33\% = \left(500m * \frac{2}{9}\right) * 33\% = \sim 37m$$

Question #5 – What are the Tax Consequences of a Straight-Forward Cash Transaction? (*Cont'd*)

- David's US tax consequences:
 - We assume David is a resident income taxpayer based on either green card or substantial presence since 2017; thus, some/all of the USD 500mm gain may qualify for long-term capital gain at top marginal rate of 23.8%.
 - Otherwise, subject to rates for ordinary income at 40.8% (37% + 3.8%). Query whether U.S.-Israel income tax treaty would allow deduction of USD 37mm Israel *exit tax* against U.S. *capital gains tax*.
- Can David terminate his US residency prior to the sale?
 - Depends on a number of factors, first of which is whether David's residency in U.S. is as a "lawful permanent resident," commonly known as green card holder.
 - If so, then the U.S. exit tax may apply to David if 8 of his past 15 years were as a green card holder in the U.S.
 - Assuming David does not count as a green card holder subject to the exit tax, he could potentially avoid U.S. income tax on the sale; however, if David returns to the U.S. within 3 years of terminating his residency, the U.S. could deem him a taxpayer for the intervening years and tax the gain (whether this latter rule remains in force is unclear post-2008).
- Is there an advantage in leaving NJ (without his family) to Florida?
 - Yes, at least to avoid NJ income tax, although that, too, is a question of domicile (if David's family remains in NJ).
- Where should the consideration be deposited?

Question #5 – What are the Tax Consequences of a Straight-Forward Cash Transaction? (Cont'd)

- Contribution of shares to charity – before or after the transaction?

	Israeli tax perspective	US tax perspective
Before	No capital gains tax. FMV credit. Exit tax trigger?	Deduction of FMV – limited donee.
After	Capital gains tax liability. Exit tax trigger.	More flexibility

- The Kids Trust's Israeli tax consequences:
 - Reporting liability?
 - Tax liability?
 - Exit tax for the trust/David?
- The Kids Trust's US tax consequences:
 - We assume grantor trust, thus David picks up the gain

Question #6 – What are the Tax Consequences of a 100% Shares Transaction?

- **Assumptions:**
 - The Israeli exit tax was not paid before the transaction.
 - The share consideration expected to be received by David is USD 500m – in publicly traded shares.
- **David's Israeli tax consequences:**
 - Is there a capital gains tax event?
 - Possible tax event deferral (roll-over)?
 - Exit tax liability?
 - Cash-flow considerations?
- **David's US tax consequences:**
 - Similar tax consequences to cash transaction.
 - For sake of discussion: assume David is non-resident alien? Are the capital gains exempt if not effectively connected with U.S. trade/ business?
- **The Kids Trust's US tax consequences:**
 - Similar tax consequences to cash transaction, again with assumption that Trust is grantor trust as to David.

Question #6 – What are the Tax Consequences of a 100% S shares Transaction? (*Cont'd*)

- Possible US tax planning involving contribution of shares and/or migration out of the US.
- Should David leave the US prior to the transaction?
 - Kids Trust – capital gains tax?
 - Kids Trust – exit tax?
 - In other words, the only way for the trust to avoid paying U.S. income tax would be for it to be or become a foreign trust, assuming the gain isn't U.S. source, which then raises its own host of U.S. income tax issues, e.g., deemed realization on domestic-to-foreign, foreign throwback tax, etc.
- Is there an advantage to exercising the LLC's options before the sale?
 - Israeli tax perspective.
 - US tax perspective.
- What are the tax consequences of future sale of the consideration shares?
 - Israeli exit tax?
 - US FTC for Israeli exit tax paid by David, if paid at the share-for-share transaction?
 - US FTC for Israeli exit tax paid by David, if paid at sale of the consideration shares?
- Is there an advantage for David to move back to Israel after the share-for-share transaction?