The Metropolitan
Corporate Counsel®
National Edition
www.metrocorpcounsel.com
Volume 22, No. 12 December 2014

EB-5 Visa Applicants Need Careful Tax Planning

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Immigration policy may be a sore point in Washington, DC, but one immigration program has been a resounding success. The EB-5 visa program, created by the Immigration Act of 1990, provides a fast track to a U.S. green card for foreign investors who promise to create jobs for U.S. workers. The program has the potential to be a win-win – for investors who want to become U.S. residents, for U.S. workers and for the U.S. economy.

But participation in the program comes with a price – having to manage a complex set of tax issues. If not handled correctly, the result can be excessive taxation and in some cases compliance problems.

The EB-5 visa program accelerates the green card application process for foreign nationals who invest at least $500,000 in the U.S., either directly or in government-designated "Regional Centers" that target high unemployment areas, creating at least 10 jobs for American workers. Access to the program is capped – at present, 10,000 EB-5 green cards are available every year. In 2013, 80 percent went to Chinese nationals.

The program offers participants freedom, flexibility and the quality of life that comes with U.S. residency. For many, a U.S. education is the compelling factor – children can attend U.S. colleges with family nearby.

There are challenges as well. Once they have received their EB-5 visas, investors must:

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- Report and pay taxes on their worldwide income in the U.S., filing as U.S. residents
- Meet estate and gift tax obligations
- Comply with reporting requirements of the Bank Secrecy Act

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For the applicant, this is a major change. Before receiving the EB-5 visa, most investors will have been taxed as non-resident aliens, subject to U.S. federal and state income taxes only on income from U.S. sources.

But the EB-5 visa turns the applicant into a U.S. resident, subject to U.S. federal and state income taxes on all worldwide income, no matter where earned. While credits or exclusions are sometimes available from overseas jurisdictions to avoid double taxation, the U.S. tax bill is often higher than what the individual would pay overseas.

The first challenge for EB-5 visa applicants is to avoid becoming a U.S. tax resident too early. The key factor here is the Substantial Presence Test. The formula is set up in such a way that it is possible to become a U.S. tax resident inadvertently if investors stay in the U.S. 183 days or more. The Substantial Presence Test tracks the days over the current year and preceding two years (one-sixth of the days two years ago, one-third of the days one year ago, 100 percent of the days in the current tax year). If the total is 183 days or more over the three-year period, the individual is considered a resident.

It is fairly easy to cross the line inadvertently. If the investor and his or her family took an extended vacation in the U.S., brought the children here on a lengthy college tour or traveled to the U.S. frequently on business, some portion of those days will count toward the Substantial Presence Test. Attorneys need to be careful to make sure their clients account for all such travel in the three years prior to filing the application.

Applicants will also want to consider disposing of overseas property held in their name – if they don't, income on that property will be taxable in the U.S. They may also want to consider creating a foreign trust in order to avoid U.S. estate taxes.

Once the application is accepted and the investor receives a green card, a complex series of tax obligations comes into play. The investor must file:

- Individual tax return Form 1040, reporting all worldwide income
- FinCEN Form 114, Report of Foreign Bank and Financial Accounts, if the aggregate value of foreign financial accounts exceeds $10,000 at any time during the calendar year
- Form 8938, "Statement of Specified Foreign Financial Assets," for foreign financial assets (reporting thresholds vary based on whether the taxpayer is living in the U.S. or abroad and on marital status)
- Form 5471, "Information Return of U.S. Persons with Respect to Certain Foreign Corporations," if the investor owns a controlled foreign corporation (CFC); or is an officer or director of the company and owns 10 percent or more of the total value of the stock, or owns 10 percent or more of the total voting power of the stock
- Form 3520, reporting a foreign gift received in excess of $100,000 from a foreign individual or estate

Failure to file these returns can lead to significant civil penalties and in some cases criminal prosecution.

Clearly there is a great deal for EB-5 applicants and their attorneys to think about, and engaging a tax professional early in the process will help minimize the risk of missing key issues. An investor supported by a professional team that manages tax and immigration matters with equal attention is more likely to have a positive experience with the EB-5 program.

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