Video Recording: HSBC Discussion with EY
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SPEAKERS

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PRESENTATION

Matthew Klein
Hello everybody.
My name is Matthew Klein and I am the head of communications for the wealth and personal banking division of HSBC. Very happy to be here today. We have a few special guests joining us from EY and as you know, EY provides a holistic approach to serving individual tax client, which includes discussing many topics covering various subject matters. You'll be hearing from Jun Li and Joe Friedlander from EY on what is most important to the clients they're working with; whose profile are similar to clients at HSBC. So quick introduction on our speakers: Jun is in America's Wealth and Asset Management sector, Co-Leader and Tax Partner in the financial services organization at Ernst & Young. He's got more than 20 years of experience serving the financial services industry including Hedge Funds, Private Equity funds, Sovereign Wealth funds, and international banks. Happy to have Jun join us today. Our next guest is Joel Friedlander. Joel is a Managing Director in EY's Private Client Services practice, specializing in individual tax compliance planning and consulting for individuals of varying levels of wealth. He also specializes in certain aspects of wealth transfer tax planning, charitable planning, and domicile planning. Very happy to have Joel here with us as well.

So, gentlemen, thank you for joining us. The first question I will throw to Jun: The pandemic that's gripped the world has geographically displaced many people. Two-part question: Who are we talking about? And what should they be thinking through the remainder of 2020?

Jun Li
Thanks, Matt.
Let me start by quickly providing a very high-level definition of what is the US person for purposes of our discussion today. A US status person is either a US citizen, a lawful permanent resident such as a green card holder, or a US tax resident and I'll come back to that in a second on the definition of that. The reason why it is important to keep in mind of the threshold definition is that US Federal Taxation is on worldwide income. No matter where the income is earned, where the services of perform, where the employer is located, and where the payment is made from. The US tax resident tests are quite complex, and many practitioners commonly referred to the Substantial Presence Test to determine if an individual is a US tax resident versus non-US tax resident. The general rule for Substantial Presence Test is whether or not an individual exceeds 182 days in the current tax year as well as other testing criteria for the prior year and second prior year. If an individual does not exceed 182 US days of presence under the Substantial Presence Test, he or she can still be subject to federal income tax on US source income and typically that includes earned income that are physically in the US, dividend from US corporations, income from real estate or property located in the US. Those are some of the basic examples of income that US source for non-US resident individuals. International business travelers who are frequently visiting the US on an extended period time, need to be mindful of the Substantial Presence Test, especially if the work arrangement itself are changing due to Covid-19 and for example, traveling outside of the US are limited due to more remote and virtual meetings. Finally, state tax rules are specific to each state, but generally speaking, resident individuals are taxed on the state based on worldwide income from the day residency begins with the exceptions of a few states

who do not tax on income. Joel, now that we got through some basic definitions on the US tax principle, let me turn it over to you on pre-immigration planning, transfer of wealth across borders, and changing domicile.

Joel Friedlander

Thanks, Jun.

So, with respect to pre-immigration planning, a lot of things to keep in mind as you're navigating through 2020, counting your days and thinking about your whereabouts in 2021. As Jun had mentioned, the US tax is non-resident aliens on specific types of income, including that is which is considered effectively connected income. And so as you're thinking about what kind of income you've triggered already in 2020, what type of assets you have overseas, it's important to keep in mind whether or not you should be accelerating any income before that moment in time where you plant your feet in the US and are otherwise taxed in the US on worldwide income. With respect to the transfer of wealth across borders, we're seeing more clients who are living in the US transferring wealth to non-US persons, married individuals, both who are one is a citizen spouse and one is a non-citizen spouse, as well as those living in the US who are receiving gifts from non US persons outside of the US. And so very often a lot of these issues don't actually have income tax consequences in terms of those who are receiving gifts. However, the Internal Revenue Code has specific and very onerous reporting requirements such as foreign trust reporting and other foreign asset reporting with respect to recipients of international gifts from non-US persons. So, for example, failure to file certain types of forms on an annual basis disclosing gifts and information received from non-US persons can result in significant interest fines and penalties. As a result, working closely with clients and making sure that they're observing this is extremely crucial. Lastly with respect to domicile planning in the United States, Covid has certainly displaced many people across the United State. Counting days in a particular location can be very important because spending too much time in one jurisdiction not only might create a statutory residency tax or a residency tax and estate you're not domiciled in, but it might also add to the state tax burden you already have in your state of domicile, creating a double taxation with no offset in credits. So very important as you're navigating through the rest of 2020, know where you've been this year, know where you are, and know where you're going. I think on that Matt like to turn it back to you to talk about some estate planning.

Matthew Klein

Fantastic, thank you both.

So, our next question: Writing a will is an integral part of wealth planning. Our Wealth Advisors work with many of our clients and their legal advisers to prepare wills to distribute their wealth. So, I'll go to you Joel first. What are the things to be thinking about when it comes to estate planning from a tax perspective?

Joel Friedlander

So, I think a couple of the key things to first consider from an estate planning perspective for both US and non-US taxpayers, is one to recognize what types of the, what types of individuals are involved. Are you purely dealing with US persons? Do you have non-US persons making gifts? Do you have non-US persons who might be the recipient of gifts? Right now, many individuals are focused on maximizing their gifting exemptions both from a US and non-US perspective because we're in a current very low interest rate and low value environment. The pandemic has knocked market conditions and created conditions where values are very low and as a result individuals can transfer gifts with embedded valuation discounts, and maybe even other discounts such as lack of liquidity, lack of marketability, and lack of control to other individuals using less of their current lifetime exemption, which for a US person is $11,580,000 and maximize more gifting down the road. With respect to interest rates, the current interest rates right now are extremely low based on the intra-family loan rates that the IRS requires be used for loans to family members, trusts are such as children, parents etc. And so the extent you've already maximized the amount that you're allowed to gift, which is $15,000 per person on an annual basis up to a lifetime $11,580,000 per US persons consider whether or not you want to loan assets out of your estate, while that doesn't necessarily reduce your value of your estate from an estate tax perspective, it does mitigate future growth on that tax base because now the assets will hopefully grow outside of your estate at a much greater rate than the interest rate charged on that note. The last thing to consider is generation-skipping transfer tax. Many people are commonly focused on current gifts to let's say the next generation, so parents to children for example, but think about dynasty trust. Think about that next generation, especially in the magnitude of non-US persons making gifts to US persons. When a non-US person is making a gift to a US person via trust while that non-US person is alive, there might not be onerous tax consequences. But once that non-US person passes and now you might be dealing a regarded entity, a non-far non-grantor trusts for US tax purposes, there could very well be some significantly complex tax issues to address and therefore dealing with a domicile trust stay safe - Delaware trust for example - may very well help from generation-skipping transfer tax perspective. So as you think about a couple of things that our clients are focused on, its maximizing their lifetime exemption – the $11,580,000 that I spoke about – it's leveraging that we're in a low interest rate environment and making loans where they can to lever up assets and have them grow further outside of their estate. It's taking advantage of the current market conditions which might allow for further evaluation discounts on pushing appreciation out of their estate and the rebound on those assets happening out of their estate, and it's maximizing generation-skipping transfer tax which in turn allows you not just to focus on how much you can give to that next generation, but for future generations to have. And so, with that, Jun any further thoughts on the estate planning front?

Jun Li

Joel, I think those are all great points and I think you know not going to really try to you know, recap some of those points, but for the audience keep in mind and TCJA doubled the estate tax exemption for single and married couple, but this is only for 2018 through 2025, which you which is the point that you had on earlier, and then absolutely given the low interest rate and low value environment, definitely a lot to consider, but respect to legacy planning. Back to you Matt.

Matthew Klein

Thank you, gentlemen. Great information there.
So, our next question: Clients often ask us about document retention and varying levels of risk. This question I'll direct to you first Jun. In terms of the IRS or respective state tax authorities, what issues are you seeing come up most frequently with your clients and as they potentially manage around an audit? Jun, do you want to take that first?

Jun Li

Sure, sure. And I'm sure that Joel was going to echo what I'm going to do what I'm going to start first with the audience is having proper documentation is critical on tax controversy-related matters. So, first for non-US tax residents: if they are frequent travel into the US. please be mindful of the Substantial Presence Test that's highlighted earlier. For non-US tax residents with investments in the US, such as stock or real estate, most US withholding agents will require IRS form W8, so it is important to provide those with voting certificates in a timely manner including any treaty claims. This will allow the withholding agent to withhold the correct amount of taxes on US source income outsource. For US tax residents with foreign financial account and foreign assets, there are significant penalties for failure to file these informational returns, such as F Bar and US investors in a foreign partnership of foreign corporations. Finally, I also highlight for self-employed business owners, there are increased focus on employee versus contractor status, so having the proper analysis done upfront and documented will be particularly helpful unemployment tax related matters. There are other fringe benefit pitfalls for self-employed business owners such as improper establishment to 401k and matching for the owners as well as qualification of the retirement plan itself are important considerations. So, Joel, let me turn it over to you on what else you're seeing.

Joel Friedlander

Yeah, so overall, we're seeing an increased level of scrutiny from the IRS in varying areas. One in particular where we get questions very often is, what kind of documentation do I need for charitable gifting purposes? So many of our clients are philanthropic and give all sorts of assets, whether it's clothing, whether it's household items, whether it's cash, or marketable securities to charitable organizations. However, in receipts that are contemporaneously provided to you at the moment the donation is made or within a short period of time when the donation is made and making sure that the receipt is complete, is very important. The IRS is gone through a very rigorous role of following strict scrutiny and although clients of ours have made valid charitable contributions, the IRS there has been Present Case Law where the IRS is overturned those deductions based on the receipt not being filled out properly – based in the forms not being filled up properly. So, it's important that you work to make sure that you have the right documentation in place. The same thing goes for domicile planning. Many states for example will say that you can't if you cannot prove that you were not in the state, we will assume that you were in this state. So, making sure that you can show your ins and outs. Obviously, airplane tickets are very easy. Passport stamps are very easy but be mindful about where your credit cards are being swiped. Where your tolls are being paid. Where your cell phones are being reused. Remember, cell towers pull signals. So, as you're managing your days between multiple jurisdictions, whether it's within the US or outside of the US, getting an audit file together now is extremely important. And the last thing I would say on the audit front is that if you have changed your domicile recently don't wait until you get the notification from the Internal Revenue Service or a particular state authority to start going back and putting together your audit documentation file. You should be putting it through at the date of move, which means securing cost basis for any real estate that was sold so that there's no question is to capital gains or losses that might be reported on the disposition. There's no question as to when you physically plant your feet in that new domicile, and therefore you can better challenge any questions from the IRS with state tax authorities with respect to audit. We're seeing more and more increase on foreign asset reporting as Jun mentioned and then lastly just quickly because of the pandemic and where we are, we may see a lot of individuals trying to claim the home office deduction this year. Be mindful of the fact that they Tax Cuts and Jobs Act at the end of 2017 eliminated the 2% portfolio deduction with the legislation being passed which included the unreimbursed employee expense. So while partners in partnerships, self-employed individuals may very well be able to take advantage of deduction such as the home office deduction to the absence the extent of a bona fide office and certain rules put in place with respect to employer-employee, most employees will not qualify for a home office deduction this year so you should use caution as you're moving throughout the rest of this year and to next year as you're completing your taxes. And with that, Matt, I'll turn it back to you.

Matthew Klein

Wow, thank you both. A lot of valuable information there. Thank you for taking the time today to share your experience and insights with us. We hope everybody tuning in enjoys the valuable content that we provided and please remember we're here to help and support you to make smart decisions. And with that we'll sign off. Thank you.