

# Denver Estate Planning Council-March 2018

## Basics of International Estate, Gifts and Trusts

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## Position



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## Experience

- More than 30 years of professional experience serving high net worth individuals, executives, closely held business owners, trusts, and estates with respect to income, estate, gift and generation skipping tax planning and compliance issues.



# Topics

Transfer Taxation of U.S. Citizen with international aspects

Taxation of Non U.S. Citizen

- Domiciled in U.S.
- Not Domiciled in U.S.

Trusts

Reporting/Penalties

Planning

# U.S. Citizen



# U.S. Citizen

## Gift Tax:

- Worldwide gifts are subject to tax

## Estate Tax:

- Worldwide estate is subject to estate tax

## Generation Skipping Tax:

- Applies to worldwide generation-skipping transfers
- Domicile or residence is irrelevant



## U.S. Citizen- Gift Example

Ms. Rich, a U.S. citizen, was very wealthy and maintained residences in various countries throughout the world. Ms. Rich has lived in Australia for ten years. On January 10, 2018 she made a \$20 million gift of various foreign stocks to her niece.



## U.S. Citizen- Gift Example

Ms. Rich, a U.S. citizen, was very wealthy and maintained residences in various countries throughout the world. Ms. Rich has lived in Australia for ten years. On January 10, 2015 she made a \$10 million gift of various foreign stocks to her niece.

Answer:

Because of her citizenship, Ms. Rich will be subject to gift tax.



## U.S. Citizen-Estate Example

Ms. Rich, a U.S. citizen, was very wealthy and maintained residences in various countries throughout the world. Ms. Rich has lived in Australia for ten years. On January 10, 2018, she died in an automobile wreck while driving the back roads of Italy.





## U.S. Citizen-Estate Example

Ms. Rich, a U.S. citizen, was very wealthy and maintained residences in various countries throughout the world. Ms. Rich has lived in Australia for ten years. On January 10, 2017, she died in an automobile wreck while driving the back roads of Italy.

Answer:

Because Ms. Rich is a U.S., Citizen her estate will pay U.S. estate tax on her worldwide estate.

# Non-U.S. Citizen Domiciled in U.S.

# Non-U.S. Citizen

The application of the U.S. gift and estate tax to a non-citizen depends on:

Domicile

Situs of assets

Application of Treaty



# Domicile: What does it mean?

Physical presence + Intent to remain indefinitely

Subjective test

Different than the federal income test of substantial presence



## Domicile: Treas. Reg. 20.0-1(b)(1)

A person acquires a domicile in a place by living there, even for a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.



# Domicile: Factors

Place of residence

Length of time at residence

Social and community contacts

Declarations of intent

Green card or visa



# Domicile: Factors

Bank accounts

Physicians

Motives of changing residence

Rent vs. own a home

Place of business



## Non-U.S. Citizen Domiciled in U.S.

Gifts-taxed on worldwide gifts

Estate-taxed on worldwide estate

Same unified credit as U.S. citizen

No marital deduction for gifts or bequests to non-U.S. citizen spouses





## Non-U.S. Citizen Domiciled in U.S.

Do you ask every estate planning client if they are a U.S. Citizen?

Do your files reflect that you asked the client whether they were a U.S. Citizen?

## Non-U.S. Citizen Domiciled in U.S.

Qualified Domestic Trust (QDOT) for estate tax purposes will qualify bequests to spouse for marital deduction

Section 2040(b) dealing with qualified joint interests between spouses will not apply if surviving spouse is not a U.S. Citizen. IRC Section 2056(d)(1)(B)

Gifts to non-citizen spouse eligible for \$100,000 (indexed to \$152,000 for 2018) annual exclusion

- Must be a present interest
- Would qualify for the marital deduction if made to U.S. spouse



## Non-U.S. Citizen Domiciled in U.S.

Foreign death tax credit allowed for foreign death taxes paid to other countries for property situated in that country.

Property for which the marital or charitable deduction is allowed is not eligible for foreign death tax credit



## Non-U.S. Citizen Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, has her green card and has been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. She gives \$20 million of cash to her son and \$20 million to her husband via foreign bank accounts.



## Non-U.S. Citizen Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, has her green card and has been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. She gives \$20 million of cash to her son and \$20 million to her husband via foreign bank accounts.

Answer:

Ms. Executive would be domiciled in the U.S. The gift to her U.S. Citizen husband would be eligible for the marital deduction. She would need to file a gift tax return and pay gift tax on the transfer to the son since she is taxed on worldwide gifts.



## Non-U.S. Citizen Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, has her green card and has been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. Her husband makes a \$20 million cash gift to her using offshore bank accounts.

## Non-U.S. Citizen Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, has her green card and has been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. Her husband makes a \$10 million cash gift to her using offshore bank accounts.

Answer:

Husband is a U.S. Citizen and is subject to gift tax on his worldwide gifts. The gift would not be eligible for the marital deduction since Ms. Executive is not a U.S. Citizen. An outright gift should qualify for the \$152,000 annual exclusion.



## Non-U.S. Citizen Domiciled in U.S. Example-Estate Tax

Ms. Executive, who is not a U.S. citizen, had her green card and had been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. On her death, she left her entire \$20 million estate to her Husband.



## Non-U.S. Citizen Domiciled in U.S. Example-Estate Tax

Ms. Executive, who is not a U.S. citizen, had her green card and had been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. On her death, she left her entire \$10 million estate to her Husband.

Answer:

Since Ms. Executive is domiciled in the U.S. at the time of her death she would be subject to estate tax on her worldwide estate. The bequest to her U.S. Citizen husband is eligible for the unlimited marital deduction and no estate tax would be due.



## Non-U.S. Citizen Domiciled in U.S. Example-Estate Tax

Ms. Executive, was not a U.S. citizen, had her green card and had been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. On her death, she left her entire \$20 million estate to her son.



## Non-U.S. Citizen Domiciled in U.S. Example-Estate Tax

Ms. Executive, was not a U.S. citizen, had her green card and had been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. On her death, she left her entire \$10 million estate to her son.

Answer:

Since Ms. Executive was domiciled in the U.S. at the time of her death her worldwide estate would be subject to U.S. estate tax. Her estate would be entitled to the \$11,180,000 applicable exclusion amount (unified credit).

**Non-U.S. Citizen Not Domiciled in U.S.**

## Non-U.S. Citizen Not Domiciled in U.S.

- Generally will be subject to U.S. estate tax only on assets of the decedent that have a situs in the U.S.
- Generally will be subject to U.S. gift tax only on gifts of tangible assets with situs in the U.S.
- U.S. Person receiving gift in excess of \$100,000 must report the gift (Form 3520).
- Note the distinction between gift tax and estate tax as to what is subject to the tax.
- Treaty may cause a different result
- Former US citizens and former long term green card holders will be subject to different rules depending on when expatriation occurred.

# Non-U.S. Citizen Not Domiciled in U.S. Gift Tax

- Generally only tangible personal property and real property located in the U.S. will be subject to U.S. for gift tax
- Intangible personal property will not be subject to US gift tax. IRC Section 2501(a)(2)
- Thus, for example, a gift of U.S. Corporation stock will not be subject to the U.S. gift tax

# Non-U.S. Citizen Not Domiciled in U.S. Gift Tax

- Cash as a tangible asset?
- Gift of U.S. Real Property would clearly be subject to U.S. gift tax
- Gifts are eligible for the gift tax annual exclusion and the tuition and medical exclusion.
- Gifts to Non U.S. Citizen spouses are subject to tax but are eligible for \$152,000 annual exclusion



## Non-U.S. Citizen Not Domiciled in U.S. Gift Tax

Beware, there is no exemption or unified credit amount to apply against the gift in excess of the annual exclusion. In other words, the exemption for gift tax is zero!

Do you ask every estate planning client if they are a U.S. Citizen?



# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

- U.S. Estate Tax is imposed on assets situated in the United States. IRC Section 2103.
- Stock in a United States corporation is situated in the United States. IRC Section 2104.
- Debt obligations of a U.S. person or gov't entity are situated in the United States IRC Section 2104(c) (but there are significant exceptions).

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

- Life insurance proceeds on the life of an individual who is not a U.S. Citizen and is not domiciled here is deemed not situated in the U.S. IRC Section 2105(a).
- Bank deposits in the U.S. are not situated in the United States as long as not effectively connected with U.S. trade or business IRC Section 2105(b).

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

- Bank deposit with foreign branch of U.S. Corp. or U.S. partnership if branch is in commercial banking business is not considered situated in the United States.
- Debt obligations generating portfolio interest are not considered situated in the U.S. Generally, registered debt obligations will qualify.

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

- Partnership interests? Rev Rul 55-701 situated where the predominant business of partnership is done. But isn't a partnership interest an intangible asset?
- Revocable type transfers subject to inclusion due to IRC Sections 2035-2038 will be included in gross estate if property transferred is situated within U.S. at death or at the time of the transfer! IRC Section 2104(b).

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

What if you are a beneficiary of an irrevocable trust that was created and funded by another? Beneficial interests in a trust-must first have general power of appointment. Then determination would depend on situs of trust assets. *Commissioner v. Nevius* 76 F.2d 109 (2d Cir.).

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax-Computation

Marital deduction again depends on U.S. Citizenship or Qualified Domestic Trust (QDOT).

Charitable deduction only available for bequests to U.S. charities. IRC Section 2106(a)(2). Estate must report the value at the time of death of the assets not situated in the U.S. IRC Section 2106(b).

Administrative expenses and debts are only deductible based on ratio of U.S. situs assets to worldwide assets. Thus, disclosure of worldwide assets would be required to take deduction.

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax-Computation

- Non-recourse mortgage may be deducted in full.
- Unified credit amount is \$13,000 or exemption equivalent of \$60,000.
- Credit for foreign estate tax is NOT available to Non-U.S. Citizen Not Domiciled in the U.S.



## Non-U.S. Citizen Not Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, is living in the U.S. on temporary assignment for a multi-national corporation on an L-1 Visa. She has been in the U.S. two years and expects to return to Australia at the end of her four year assignment. She rents her home in the U.S. and has a residence in Australia. She gave \$20 million of Microsoft stock to her son.



## Non-U.S. Citizen Not Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, is living in the U.S. on temporary assignment for a multi-national corporation on an L-1 Visa. She has been in the U.S. two years and expects to return to Australia at the end of her four year assignment. She rents her home in the U.S. and has a residence in Australia. She gave \$20 million of Microsoft stock to her son.

Answer:

There is no U.S. gift tax because she is not domiciled in the U.S. and she gave an intangible asset.



## Non-U.S. Citizen Not Domiciled in U.S. Example-Gift Tax

Foreign parent wires \$5 million to US child as a gift. Child is a citizen of the US. Parent is not a citizen and is not domiciled in the US. Parent is an Australian. Child plans to purchase US real estate with the \$5 million.

What are the issues?

# Non-U.S. Citizen Not Domiciled in U.S. Example-Gift Tax

Issues:

Did parent make a taxable gift?

Is parent a covered expatriate?

Is gift of cash a gift of a tangible asset in the US?

If funds were wired to an escrow account to buy US real estate for child, is this an issue?

What are taxable consequences to child?

Income tax? Gross income? Tax basis?

Gift tax? Is parent a covered expatriate? Section 2801.

Does child have reporting requirements?

## Non-U.S. Citizen Not Domiciled in U.S. Example-Estate Tax

Ms. Executive, was not a U.S. citizen, and was living in the U.S. on temporary assignment for a multi-national corporation on an L-1 Visa. She had been in the U.S. two years and had expected to return to Australia at the end of her four year assignment. She was renting her home in the U.S. and had a residence in Australia. Ms. Executive died in a boating accident. Her estate consisted of the Australia real estate worth \$500,000, cash on deposit in U.S. banks, \$100,000, life insurance of \$5 million and Microsoft stock of \$20 Million. She left the entire estate to her husband, a Australian citizen, also living in the U.S.

# Non-U.S. Citizen Not Domiciled in U.S.

## Example-Estate Tax

Since Ms. Executive was not domiciled in the U.S. her estate would only be subject to estate tax on her U.S. situs assets

Real Estate in Australia-clearly an Australian asset

Cash Deposit in U.S. Bank, interest is not effectively connected with a U.S. trade or business-no U.S. situs

Life Insurance proceeds-no U.S. situs

Microsoft stock-U.S. domestic stock has a situs in U.S.



# Non-U.S. Citizen Not Domiciled in U.S. Example-Estate Tax

## Computation:

No marital deduction unless QDOT

Unified Credit is limited to \$13,000 (\$60,000 exemption equivalent)

Tax rates same as U.S. Citizen

Treaty?

# Foreign Trusts

# Trusts

1. Domestic Trust - IRC §7701(a)(31)(B)
2. Foreign Trust - IRC §7701(a)(30)(E)
  - ❖ Non-grantor Trust
  - ❖ Grantor Trust



# Domestic Trust v. Foreign Trust

For a trust to be domestic it must meet both tests:

1. U.S. court can exercise primary supervision over the administration of the trust (Court Test), and
2. One or more U.S. persons have the power to control all substantial decisions of the trust (Control Test)

IRC §§7701(a)(31) and (30)

# Control Test- Reg 301.7701-7(d)

- Whether and when to distribute income
- Amount of any distribution
- Selection of beneficiary
- Whether receipt is allocated to income or principal
- Whether to terminate the trust
- Whether to compromise, arbitrate or abandon trust claims
- Whether to sue on behalf of the trust or to defend suits
- Whether to remove, add, or replace trustees
- Investment decisions

# Control Test- Intricacies

- ❖ Veto Power: A veto power held by U.S. person over a substantial decision will not constitute control by U.S. person
- ❖ Control of substantial decisions: refers to control by fiduciaries and any other person who has rights with regard to the trust (e.g., grantor, beneficiary, or protector)
- ❖ Change in control: Final regs allow balance of power to be corrected within 12 months so that the trust may maintain residency

# Foreign Non-Grantor Trust

- ❖ Taxed as a nonresident alien
- ❖ The trust's income is divided into four categories for tax purposes:
  1. Foreign source income
  2. U.S. income effectively connected with a U.S. trade or business
  3. Gains from the sale of U.S. real estate
  4. Gross income derived from sources within the U.S. not effectively connected with conduct of trade/business w/in U.S.



# Outbound Transfers Of Property to Foreign Trusts



# What Would You Do If You Were the US Gov't?

# What Would You Do If You Were the US Gov't?

- ❖ Deem such foreign trusts to be grantor trusts
- ❖ Section 679
- ❖ Tax the appreciation in the property transferred
- ❖ Section 684

## Section 679(a)(1)-Deemed Grantor Trust

- ❖ A United States person who directly or indirectly
- ❖ Transfers property
- ❖ To a foreign trust (other than certain deferred compensation trusts and charitable trusts)
- ❖ Shall be treated as the owner for his taxable year of the portion of such trust attributable to such property if for such year
- ❖ There is a United States beneficiary of any portion of such trust.



# Grantor Trust - Special 5-year rule for foreign grantors- IRC §679(c)(3)

- ❖ Nonresident alien individual
- ❖ Residency start date within 5 years after transferring property to a foreign trust
- ❖ Then grantor trust rules and reporting rules apply as if transfer to trust occurred on residency start date
- ❖ Individual is taxed in an amount equal to the portion of the trust income attributable to the property transferred to the trust

# Grantor Trusts-Trusts Acquiring a US Beneficiary-Section 679(b)

- ❖ If a US person is treated as owner of a portion of a foreign trust for a specific taxable year
- ❖ And such person would have been subject to that treatment in the immediate preceding taxable year but for lack of a US beneficiary for any portion of the trust
- ❖ Then the US person is taxable on the undistributed net income as of the close of the preceding taxable year on such portion determined under IRC 679(a)

# Section 684-U.S. Transferor and Foreign Beneficiary

- ❖ In the case of any transfer of property
- ❖ By a United States person to a foreign estate or trust
- ❖ For purposes of this subtitle, such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and the transferor shall recognize as gain the excess of--
  - ❖ (1) the fair market value of the property so transferred, over
  - ❖ (2) the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.

# Section 684-U.S. Transferor and Foreign Beneficiary

Exceptions: transfer by U.S. person or transferor treated as the owner under IRC §671; so major exception to application of Section 684 would be Section 679 Grantor Trusts.

Beware: When the grantor trust status terminates a deemed contribution to a foreign trust occurs.

Death but not if basis adjustment under §1014(a)  
Grantor loses US person status and 672(f) applies

# Section 684-U.S. Trust Transforms Into Foreign Trust.

If a domestic trust becomes a foreign trust, the trust is treated as having transferred all its assets to a foreign trust - IRC §684(c)



# Inbound Distributions From Foreign Trusts

# Inbound Trusts

- ❖ IRC §672(f) denies grantor trust status to trusts with non-U.S. grantors unless:
  1. the grantor retains the right to revoke the trust; or
  2. the only amounts permitted to be distributed from the trust during the grantor's life are amounts distributable to the grantor or his/her spouse

# Foreign Non-Grantor Trust

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- ❖ The trust's income is divided into four categories for tax purposes:
  1. Foreign source income
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  3. Gains from the sale of U.S. real estate
  4. Gross income derived from sources within the U.S. not effectively connected with conduct of trade/business w/in U.S.



# Foreign Non-grantor Trusts: Distributions to US Persons

- ❖ Throwback Rules-Accumulation Distributions
- ❖ Intended to require the trust's beneficiary to pay approximately the same tax whether the trust distributes its income currently or accumulates its income and distributes it in a later year
- ❖ Does not apply to distributions of current income.



# Foreign Non-grantor Trusts: Distributions to US Persons

- ❖ Accumulation Distributions
- ❖ Capital gains in prior years taxed as ordinary income
- ❖ Accumulations distributions tax
- ❖ Interest charge

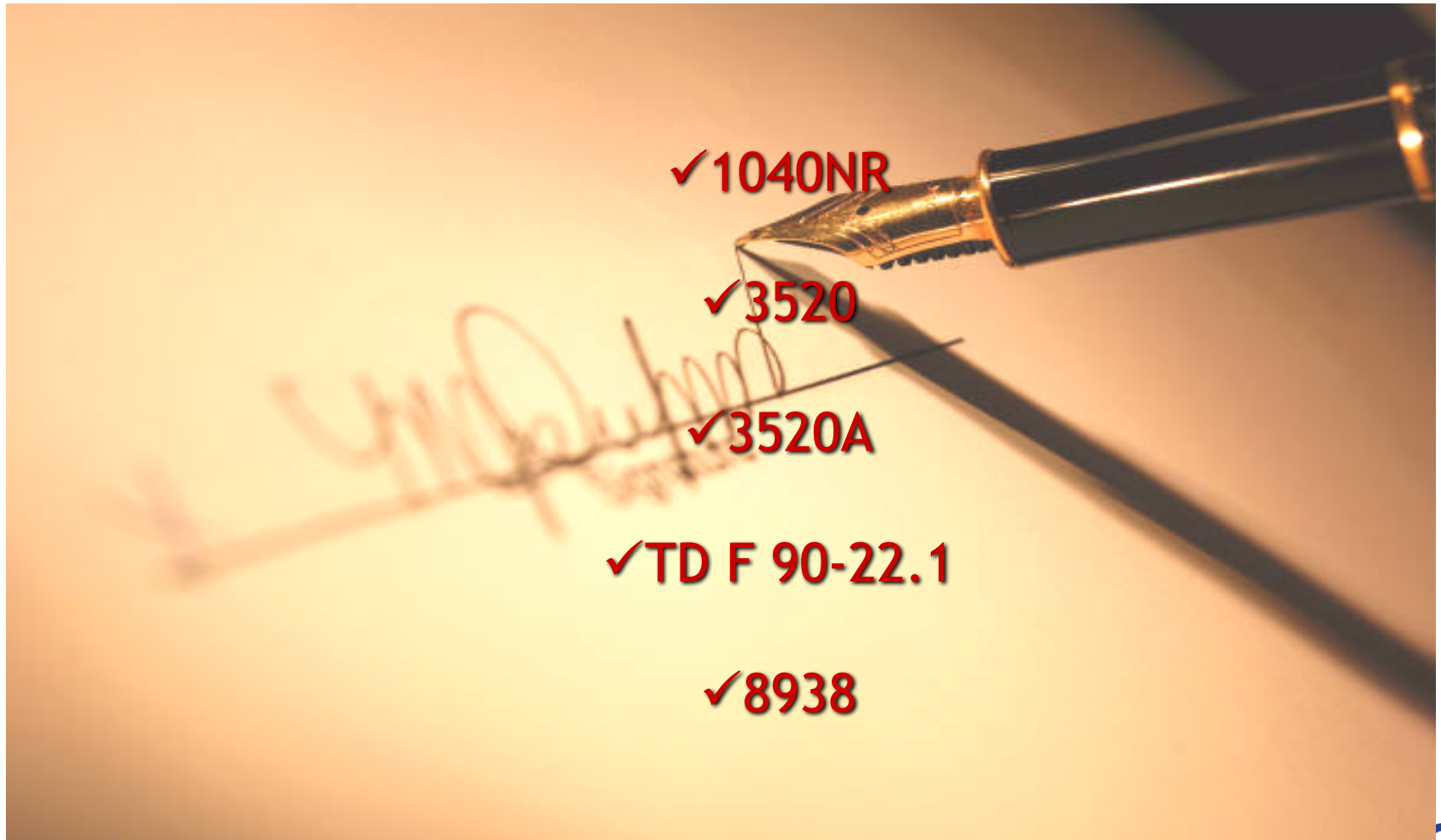
# Income Taxation of Foreign Trust

<u>Transferor</u>	<u>Beneficiary</u>	<u>Applicable IRC Sec</u>
Foreign	Foreign	§641, §651, §661, 671
U.S.	Foreign	§684
U.S.	U.S.	§679
Foreign	U.S.	§§665-668



- Compliance Requirements Related to Foreign Grantor and Non-Grantor Trusts Receipt of Foreign Gifts/Inheritances by U.S. Persons

# Foreign Trust Reporting



# Foreign Trust Reporting Form 3520

## Reportable Acts:

- ❖ U.S. Person Creates a Foreign Trust
- ❖ U.S. Person Makes an Indirect/Direct Transfer to a Foreign Trust
- ❖ U.S. Citizen/Resident Owner of a Foreign Trust (for Income Tax Purposes) dies
- ❖ U.S. Citizen/Resident owner of a Foreign Trust Whose Gross Estate Included any Portion of a Foreign Trust Dies
- ❖ U.S. Person Makes a Gratuitous Transfer of Money or Property to a Foreign Trust

**Filing Due Date: Generally April 15**

# Form 3520 - Penalties

Not timely filed or information is incomplete or incorrect:

- ❖ 35% of the gross value of any property transferred to a foreign trust for failure by a U.S. transferor to report the transfer
- ❖ 35% of the gross value of the distributions received from a foreign trust for failure by a U.S. person to report the receipt of the distribution, or
- ❖ 5% of the amount of certain foreign gifts for each month for which the failure to report continues (not to exceed a total of 25%)



# Foreign Trust Reporting Form 3520-A Foreign Grantor Trust

Form 3520A must be filed for each foreign grantor trust of the taxpayer

Filing Due Date: Generally March 15

Fairly involved form because it requires income and balance sheet reporting



# Form 3520A - Penalty

Not timely filed or information is incomplete or incorrect:

❖ 5% of the gross value of the end of the year assets of the trust



# Pre-Immigration Planning Prior to Becoming a U.S. Resident

## What Should An Advisor Do When A Client is Moving to the U.S.?

- Review existing revocable and irrevocable trusts established in his/her home country and funded by the client and/or third parties on his/her behalf
- Examine trusts for income and gift tax consequences
- Examine trusts to determine whether any powers retained would cause inclusion in the client's taxable estate after immigration\*
- Examine the status of corporations owned by trusts



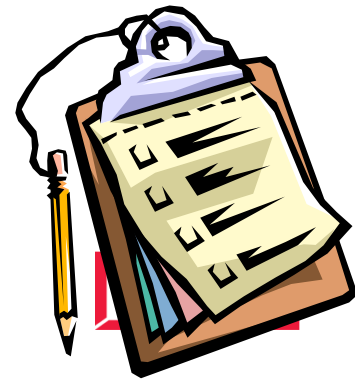
# What planning opportunities are available to minimize any future estate tax exposure

## Consider Pre-immigration Transfers/Agreements

- a. Gifts to third parties (consider gifting non-U.S. situs assets)
- b. Gifts to spouse pre-immigration
- c. Gifts of U.S. situs property\*
- d. Establishing an irrevocable trust

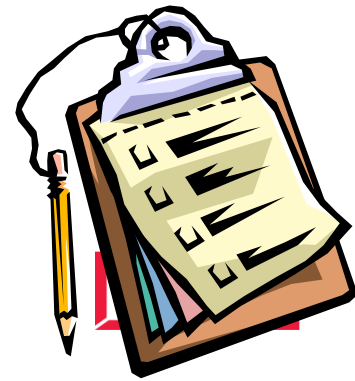
## Planning for Executive Moving to US-Not Domiciled; Pre-arrival

- ✓ Review treaty provisions
- ✓ If possible, make inter-spousal transfers to equalize the estates
- ✓ Consider transferring U.S. situs investments to a foreign corporation
- ✓ Consider using preferred stock and partnership freezes and split interest purchases with non-U.S. situs property
- ✓ Lease rather than buy a residence or automobile
- ✓ If a residence is purchased, consider maximum financing
- ✓ Avoid ownership of U.S. situs property



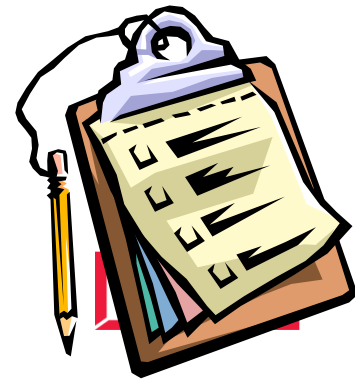
# Planning for Foreign Executive Moving to US- Not Domiciled

- ✓ Avoid or limit intra-family transfers of tangible property and real estate
- ✓ Consider transferring cash in a brokerage account to a bank deposit
- ✓ Consider acquiring U.S. life insurance coverage to offset potential U.S. estate taxes
- ✓ Consider setting up a Qualified Domestic Trust (QDOT)
- ✓ Consider adopting a U.S. domicile



# Planning for Executive Moving to US that Will Be US Domiciled

- ✓ If married, review marital property ownership and properly title property for U.S. purposes. (Avoid joint tenancies)
- ✓ Observe local law standards on property acquired after arriving in the U.S (common law property v. community property)
- ✓ Consider assigning life insurance to an irrevocable trust
- ✓ Draw a U.S. will to provide for a QDOT trust
- ✓ Consider adding a “by-pass” trust to both wills
- ✓ Avoid transfers (gifts) in excess of \$152,000 (adjusted by inflation) per year to a non-citizen spouse
- ✓ Make gifts before becoming a domiciliary





## General Disclaimer:

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