

INTERNATIONAL ESTATE PLANNING AND COMPLIANCE REFRESHER

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PRESENTATION AGENDA

- Rules Defining U.S. and Non-U.S. Persons for Transfer Tax Purposes
- U.S. Gift and Estate Tax Considerations for U.S. vs. Non-U.S. Persons
- Property Situs Rules
- Estate Tax Treaty Considerations
- Planning Strategies
- Foreign Reporting Issues and Compliance Update

RELEVANCE

- Increasingly global economy means cross-border transactions becoming more common for business and personal reasons.
- Increased U.S. focus on cross-border arrangements to police income tax compliance (e.g., withholding on outbound payments).
- Increased emphasis on information reporting with respect to cross-border transactions and arrangement.
- Few are aware of U.S. transfer tax consequences which can be particularly onerous for non-U.S. persons with U.S. situs assets.

U.S. VERSUS NON-U.S. PERSONS

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- Effects of U.S. transfer tax rules depend on whether decedent / donor is a “U.S. person” or a “non-U.S. person”.
- “U.S. person” includes U.S. citizens and U.S. residents (as defined for transfer tax purposes).
 - U.S. resident for transfer tax purposes is one who is domiciled in the United States at the time of the gift / transfer.
 - A person acquires *domicile* by living in a specific location, even for a brief period of time, with no definite present intention of moving. Residents without the requisite intention to remain indefinitely will not constitute domiciled, nor will an intention to change domicile without actual removal effect such a change.
 - Relatively easier to become a U.S. resident for transfer tax purposes as compared with income tax purposes
 - “United States,” as used in the transfer tax context, includes only the States and the District of Columbia (*i.e.*, not Puerto Rico).

U.S. GIFT AND ESTATE TAX CONSIDERATIONS

TRANSFER TAXATION APPLICABLE TO U.S. PERSONS

- U.S. estate and gift tax is applicable on a world-wide basis to U.S. citizens and U.S. residents (subject to statutory exclusions).
- U.S. residents are subject to the same rates of transfer taxation and have available the same exclusions as do U.S. citizens.
 - Can benefit from portability
 - Annual exclusions
 - \$11.18 million applicable exclusion amount for 2018 (sunsets after 2025)
- Tax credit available against estate tax for foreign “estate, inheritance, legacy or succession tax”.
 - Absent a treaty provision, credit only available for taxes on foreign situs property.
 - Allowable credit is the **lesser** of (1) the foreign tax attributable to the property or (2) the U.S. estate tax attributable to the property.

TRANSFER TAXATION APPLICABLE TO NON-U.S. PERSONS

■ Gift Tax

- General Rule. Non-U.S. persons are subject to gift tax only on the transfer of real property and tangible personal property located in the United States (25.2511-1(b)). The gift tax does not apply to intangibles.
- Intangibles include:
 - Corporate stock – for this purpose, neither where corporation is incorporated nor the location of stock certificates is relevant (**This is a departure from the estate tax rule applicable to non-U.S. persons and presents a planning opportunity.**)
 - Debt issued by the U.S. government, U.S. corporations and U.S. individuals
 - Bank deposits (or bank accounts) – **BUT** beware the rules relating to cash.
 - Treatment of U.S. partnerships is vexingly unclear.

TRANSFER TAXATION APPLICABLE TO NON-U.S. PERSONS

- Gift Tax (cont.)
 - No unified credit for lifetime gifts
 - Unlimited marital deduction for gifts to a spouse who is a U.S. citizen
 - No marital deduction for gifts to a spouse who is a U.S. resident but not a citizen, but donor allowed annual exclusion under section §2523(i)(2) for such gifts (\$152,000 for 2018)
 - §2503(b) annual exclusion available to non-U.S. persons (currently \$15,000)
 - §2503(e) exclusion for qualified payments of tuition and medical expenses available
 - Gift splitting only allowed if both spouses are U.S. persons (citizens or residents)
 - Carryover basis rules apply for gifts made by non-U.S. persons (but basis increased by amount of non-U.S. gift tax paid on transfer)

TRANSFER TAXATION APPLICABLE TO NON-U.S. PERSONS

- Estate Tax
 - U.S. real property (section 2032A special use valuation rules not available to non-U.S. persons holding farmland or business real estate)
 - U.S. situs tangible personal property
 - Stock issued by U.S. corporation and debt obligations of U.S. persons (exceptions for bank deposits and debt obligations that are eligible for portfolio interest exclusion under section 871(h))
 - Other intangibles if issued by or enforceable against a U.S. person.
 - Some authority to treat foreign partnership interests as a proportionate interest in the partnership assets if the partnership terminates upon the death of the partner.
 - Assets in a revocable trust are deemed owned by the grantor.
 - Non-U.S. decedent's interest in a domestic or foreign irrevocable trust deemed to be an interest in each asset of the trust if general power of appointment over trust assets.

TRANSFER TAXATION APPLICABLE TO NON-U.S. PERSONS

- Estate Tax (cont.)
 - Unlimited marital deduction for transfers to U.S. *citizen* spouse.
 - No marital deduction for transfers to non-U.S. *citizen* spouse unless assets are transferred to a qualified domestic trust (“QDOT”).
 - Total \$60,000 exclusion for other transfers.
 - Basis step-up rule applies with respect to assets included in the gross estate for U.S. estate tax purposes.
 - Section 2104(b) transfers – if a non-U.S. person makes an inter vivos transfer of property to a revocable trust, then such property is included in the gross estate of the non-U.S. person if the property was U.S. situs property at the time of the decedent’s death or at the time of the transfer (even if later sold prior to death and replaced with foreign situs property).

QDOT RULES

- Trust for the benefit of a surviving *non-citizen* spouse
 - The trust instrument must require that at least one trustee be either an individual citizen of the United States or a domestic corporation and that such trustee must approve of all trust distributions.
 - Distributions from the trust, except for income and hardship distributions, will be subject to an estate tax at the rate in effect at the first spouse's death.
 - The property remaining in the trust at the surviving spouse's death will be subject to U.S. estate tax at the rate in effect at the first spouse's death.
 - An election must be made for QDOT treatment on Form 706.

GST TAX

- GST Tax determined under estate and gift tax principles
 - GST tax applies to transfers by a non-U.S. person during lifetime or by a non-U.S. decedent to the extent that the transferred property is U.S. situs property for purposes of the gift tax or the estate tax, as applicable.
 - Trust distributions and terminations are subject to GST tax to the extent that the initial transfer by the non-U.S. person was a transfer at death or during life that was initially funded with U.S. situs property.

Thus, if U.S. situs property is transferred by a non-U.S. person to a trust, and that property is later re-invested in non-U.S. situs property, GST tax will still apply on a taxable distribution or termination.

PROPERTY SITUS RULES

PROPERTY SITUS RULES

- U.S. Situs Assets for Transfer Tax Purposes.
 - U.S. – based real and tangible personal property
 - Stock issued by U.S. corporation
 - Debt obligations of U.S. person except:
 - Bank deposits and portfolio obligations
 - Deposits with a foreign branch of a domestic corporation
- Revocable transfers within three years of death of U.S. situs assets subject to sections 2035 – 2038
- Exception in gift tax context for gifts of intangible assets.
 - Thus, can make lifetime gift of U.S. corporate stock but same stock will be subject to estate tax at death

ESTATE TAX TREATY CONSIDERATIONS

ESTATE TAX TREATIES

- Designed to avoid double taxation.
- In general, treaties allocate tax jurisdiction based on the location of property or the domicile of the donor / decedent.
 - Alter otherwise applicable situs rules for gift and estate tax.
 - Typically, real property and business property connected with a permanent establishment can be taxed in the situs country while other property is subject to tax in domicile country.
- Not all treaties apply to both the gift and estate tax (many countries have no gift tax).
- Most treaties are decades old and in some cases are in place with countries that no longer have transfer tax provisions in their code (*i.e.*, Austria).

ESTATE TAX TREATIES

- Current treaties in effect:
 - Australia
 - Austria
 - Denmark
 - Finland
 - France
 - Germany
 - Greece
 - Ireland
 - Italy
 - Japan
 - Netherlands
 - Norway
 - South Africa
 - Sweden
 - Switzerland
 - U.K.

PLANNING STRATEGIES TO AVOID U.S. TRANSFER TAX

KEY RULES AND DEFINITIONS

- Section 684(a) – transfer by U.S. person of appreciated property to foreign non-grantor trust will trigger gain (but not losses).
- Decanting from a U.S. trust to a foreign trust would eliminate income tax on foreign source income but will incur gain under Section 684 unless foreign trust is treated as grantor trust.
- Migration of foreign trust to U.S. will not eliminate UNI taint; will remain in the domestic trust and be subject to throwback tax when distributed.
- Foreign trusts with U.S.-source income subject to FDAP withholding or taxed on a net basis if ECI.
- Attribution of foreign trust or foreign estate ownership of foreign corporations to U.S. beneficiaries under CFC and PFIC rules triggering taxation on gains not actually received.

NON-U.S. PERSON WITH U.S. SITUS ASSETS

- If no U.S. persons are descendants, then goal is to reduce ownership of U.S. situs assets prior to death.
- Gift tax situs rules are more generous than are estate tax rules (e.g., gifts of stock or debt of U.S. corporation).
- Generally, non-U.S. person will not pay tax on capital gains – thus selling will generally not trigger U.S. income tax.
 - Exception for U.S. real property
- Transform U.S. situs tangible property into intangible property (*i.e.*, contribute to a U.S. LLC that elects to be taxed as a corporation) followed by gift of shares.
- Unlimited marital deduction for transfers to U.S. spouse – but property will then be in spouse's estate...

NON-U.S. GRANTOR WITH U.S. CHILDREN

- Create U.S. dynasty trust for U.S. beneficiaries.
 - If funded with non-U.S. situs assets, will escape gift / estate tax and also will be GST tax sheltered
 - If a U.S. trust, the trust (or beneficiaries) will pay U.S. income tax on its worldwide income (thus a tradeoff between income and transfer tax considerations)
 - Use of U.S. trust avoids throwback rules if non-grantor status desired
 - Easier compliance burden if using a U.S. trust
- Creation of foreign grantor trust, owned by non-U.S. person
 - Limited ways to ensure trust is a grantor trust
 - Mechanism to ensure trust doesn't remain foreign upon termination of grantor trust status (if U.S. beneficiaries)
 - Be aware of whether trust owns shares in CFC or PFIC.

PRE-EXPATRIATION PLANNING

- Analysis of whether U.S. person will be subject to covered expatriate rules as a long-term resident.
 - Before expatriating, ensure no “foot faults” regarding 5-year compliance history.
 - Includes information reporting, and perhaps FBARs
- Act of becoming a non-U.S. person could cause trust to migrate to foreign situs and/or lose grantor trust status, triggering 684 gain.
- Section 2801 will apply to gifts or bequests received by a U.S. person if from a covered expatriate.

PRE-U.S. RESIDENCY PLANNING

- Note differences between definitions of “resident” for income and transfer tax purposes (including treaty provisions). Delaying residence status for income tax purposes may be desirable.
- Trigger gains (and accelerate foreign-source income) prior to becoming a U.S. resident for income tax purposes (otherwise assets carry over cost basis).
- Transfer appreciated assets to foreign entities prior to becoming a U.S. person (avoid 367 / 684 gains).

PRE-U.S. RESIDENCY PLANNING

- Examine past transfers to irrevocable trusts as grantor could inadvertently trigger grantor trust status upon becoming a U.S. person (power to control beneficial enjoyment in trust).
- Foreign beneficiary of foreign trust who becomes a U.S. person
 - May trigger grantor trust status to U.S. grantor
 - May trigger throwback rules if trust is a non-grantor trust
- If plans to terminate grantor trust status, do so prior to becoming a U.S. person to avoid section 684(c) gain

PRE-U.S. RESIDENCY PLANNING

- Establish irrevocable foreign trust prior to becoming a U.S. person
 - Avoids U.S. income tax on trust earnings and assets excluded from grantor's estate
 - Creditor protection
 - Throwback rules may apply if current (or future) beneficiaries are U.S. persons
- Recognize information reporting obligations that will begin upon becoming a U.S. person. Foreign accounts, ownership of foreign entities.
- Consider impacts of becoming a long-term resident.
- Consider whether client will be subject to CFC or PFIC rules upon becoming a U.S. person.
- Consider need for estate planning documents for foreign situs property.

INTERNATIONAL COMPLIANCE UPDATE

REPORTING REQUIREMENTS

IRS Form	Reporting Obligation	IRC Section
Form 5471	U.S. persons who control, own >10% or are officers or directors of foreign corporation	§ § 6038, 6046
Form 926	Transfers to foreign corporations	§ 6038B
Form 8865	U.S. persons who control or own >10% of foreign partnerships	§ 6046A
Form 8858	Foreign single member disregarded entity	§ § 6038, 6038B
Form 8621	Shareholder of PFIC	§ 1298(f)
Form 5472	U.S. corporations with a 25% foreign shareholder	§ 6038A
Form 8938	Ownership of specified foreign financial assets	§ 6038D
Forms 3520 / 3520-A	Dealing with foreign trusts	§ 6048

REPORTING REQUIREMENTS

- Form 3520
 - Creation of foreign trust by a U.S. person or subsequent transfer to one
 - Receipt by U.S. beneficiary of any distribution from foreign trust (including uncompensated use of property)
 - Receipt by U.S. person of > \$100,000 from a non-resident alien or estate (special rules for gifts through intermediaries) or more than \$15,797 (2017) from a foreign corporation or partnership
- Form 3520-A annual report by foreign trust with U.S. owner under sections 671-679 (foreign grantor trusts)
- Interests in foreign trust or foreign estate reportable on Form 8938, *Statement of Foreign Financial Assets*.

REPORTING REQUIREMENTS

- FBAR (Foreign Bank Account Report)
 - U.S. persons with financial interest or signature authority over offshore financial account
 - Not a tax form; different SOL rules
 - Applicable to U.S. trusts
 - Note that a trust may be U.S. trust for FBAR purposes (with a reporting requirement) but a foreign trust for income tax purposes (for example, if it has a foreign trustee)
 - U.S. person who is the grantor or who has > 50% beneficial interest may be required to file FBAR with respect to trust's foreign accounts
 - Extremely harsh penalties for compliance failures

CONSEQUENCES OF COMPLIANCE FAILURES

- Penalties for failing to provide information or filing forms
 - Failure to file penalties (e.g., 35% of reportable amounts on Form 3520; 50% of account balance for FBAR willful failures)
 - Reasonable cause exceptions to Title 26 and FBAR penalties (ordinary business care and prudence)
 - Penalty mitigation guidance for FBAR penalties
 - IRC § 6501(c)(8) part of 2010 HIRE Act:
 - Limitations period for assessment of “any tax” expires three years after filing international information returns (including those unrelated to the information return if no reasonable cause).
 - Could reach as far back as 2006 (earliest year that was still open under § 6501 when provision was enacted). See *CCA 201206014*.
 - IRC § 6501(e) – six year limitations period for omissions >\$5,000 attributable to “specified foreign financial asset” (reportable on Form 8938)

CONSEQUENCES OF COMPLIANCE FAILURES

- Penalties for failing to provide information or filing forms (cont.)
 - IRC § 6662(j)(3) – 40% accuracy-related penalty on underpayment which is attributable to any transaction involving an undisclosed foreign financial asset. Applies to:
 - Form 5471
 - Form 8865
 - Form 8858
 - Form 8938
 - Forms 3520 / 3520A
 - Form 926

OPTIONS FOR UNDISCLOSED FOREIGN FINANCIAL ASSETS AND INCOME

- Do nothing / quiet disclosure
- Delinquent FBAR submission procedures
- Delinquent international information return submission procedures (statement of facts describing reasonable cause)
- Streamlined filing compliance procedures
 - Foreign
 - Domestic
- Offshore Voluntary Disclosure Program
 - Announced termination date of Sept. 28, 2018



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