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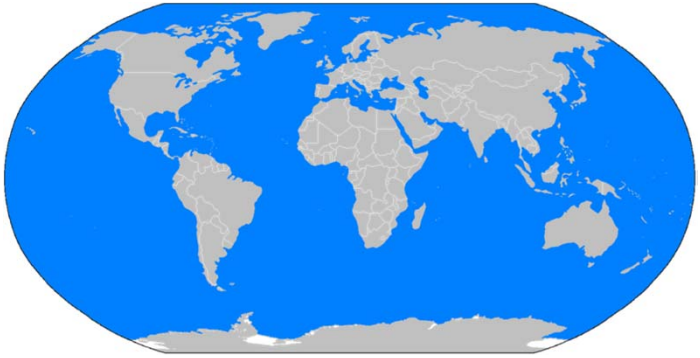

ESTATE PLANNING FOR THE INTERNATIONAL CLIENT

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Agenda

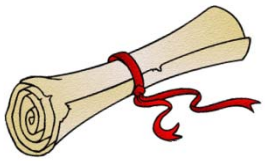
- I. Rules and Definitions
- II. Estate Planning Case Studies
- III. Questions

I. Rules and Definitions

- 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.
  - "United States," as used in the transfer tax context, includes only the States and the District of Columbia (*i.e.*, not Puerto Rico).

I. Rules and Definitions

- A) Transfer taxation applicable to U.S. persons
  - U.S. estate and gift tax is applicable on a world-wide basis to both 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
    - $5.43 million applicable exclusion amount for 2015
  - 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.

I. Rules and Definitions

- B) Transfer taxation applicable to non-U.S. persons
  - 1. **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.

I. Rules and Definitions

- **Gift tax (cont.)**
  - No unified credit for lifetime gifts
  - Gifts to spouse
    - 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 ($147,000 for 2015)
  - §2503(b) annual exclusion available to non-U.S. persons
  - Exclusion for qualified payments of tuition and medical expenses available
  - Gift splitting 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)

I. Rules and Definitions

- 2. **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.
  - Treatment of partnership interests unclear (as with gift tax rules).
  - 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.

I. Rules and Definitions

- Estate tax (cont.)
  - Unlimited marital deduction for transfers to U.S. *citizen* spouse.
  - 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).

I. Rules and Definitions

- No marital deduction for transfers to non-U.S. *citizen* spouse unless assets are transferred to a qualified domestic trust ("QDOT").

- 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.

I. Rules and Definitions

- 3. **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.

I. Rules and Definitions

- (C) U.S. vs. Foreign Trusts
  - A U.S. or "domestic" trust is any trust satisfying both the "court test" and the "control test".
  - Court test: A U.S. court is able to exercise "primary jurisdiction" over the administration of the trust.
  - Control test: One or more U.S. persons have authority to control all "substantial decisions".
    - Distribution decisions
    - Allocation of receipts to income or principal
    - Investment decisions
    - Add, remove or replace trustee

I. Rules and Definitions

- A key consideration is whether foreign trust will be a grantor or non-grantor trust.
- Considerations for foreign non-grantor trusts:
  - U.S. beneficiaries are taxed on distributions of distributable net income (DNI) including capital gains
  - U.S. beneficiaries subject to "throwback" rules with respect to distributions of undistributed net income (UNI)
  - Section 684(c) - a domestic trust that becomes a foreign non-grantor trust must recognize gain with respect to any assets that have unrealized appreciation.
  - Section 1411 net investment income tax (NIIT) not applicable to foreign non-grantor trusts (although distributions to U.S. individuals may be)
  - Considerable information reporting requirements if U.S. beneficiaries
- Rules regarding grantor trusts more limiting if grantor is a non-U.S. person.

I. Rules and Definitions

- Grantor trust status is important if have U.S. beneficiaries (avoid throwback rules).
- If grantor is not a U.S. person, only the following will cause a trust to be grantor trust under section 672(f)(2).
  - Grantor has power (exercisable solely) to revoke;
  - All distributions must be to the grantor or grantor's spouse during grantor's life;
  - Grandfathered trusts funded on or before Sept. 19, 1995 if they were then treated as grantor trusts under section 676 (power to revoke) and/or section 677 (income interest)
    - Separate accounting rules apply if both pre and post-1995 contributions were made to the trust
- Note that holder of section 678 power may be an owner, but is not a "grantor" (so the above 672(f)(2) rules do not apply).

I. Rules and Definitions

- Other Considerations For Foreign Trusts
  - Section 684(a) – transfer 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.

I. Rules and Definitions

- D) Reporting requirements

  - Form 3520
    - Receipt by U.S. person of > $100,000 from a non-resident alien or estate (special rules for gifts through intermediaries) or more than $15,358 (2014) from a foreign corporation or partnership
    - Receipt by U.S. beneficiary of any distribution from foreign trust (including uncompensated use of property)
    - Creation of foreign trust by a U.S. person or subsequent transfer to one
  - Form 3520-A annual report by foreign trust with U.S. beneficiary

I. Rules and Definitions

- D) Reporting requirements (cont.)
  - Interests in foreign trust or foreign estate reportable on Form 8938, *Statement of Foreign Financial Assets*
  - U.S. trusts are "U.S. persons" subject to FBAR reporting of foreign financial accounts.
    - 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
  - Harsh penalties for failing to file, and increased accuracy penalties under section section 6662(j) if income omission is attributable to an unreported item.

I. Rules and Definitions

- E) Transfer 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).

I. Rules and Definitions

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

II. Planning Situations

- Scenario 1: Non-U.S. person with U.S. situs assets
  - Goal is to reduce ownership of U.S. situs assets prior to death by gifting (gift tax situs rules more generous than estate tax rules (e.g., stock or debt of U.S. corporation) or selling (non-U.S. person is generally not subject to US tax on capital gains)
  - If client holds asset that is risky to give away (e.g., interest in US partnership that owns US real estate), consider establishing irrevocable US trust funded with cash. The trust could purchase the US situs asset from the client. (There would be some capital gain in this situation as a result of FIRPTA.)
  - Unlimited marital deduction for transfers to U.S. spouse – but property will then be in spouse's estate…

II. Planning Situations

- Scenario 2: Non-U.S. grantor with U.S. children / grandchildren
  - Creation of 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, 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.

II. Planning Situations

- Scenario 3: Pre-expatriation planning
  - Analysis of whether U.S. resident will be subject to covered expatriate rules as a long-term resident

    - If actually 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.

II. Planning Situations

- Scenario 4. 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).
  - Examine past transfers to irrevocable trusts as grantor could inadvertently trigger grantor trust status upon becoming a U.S. person.
  - 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

II. Planning Situations

- Scenario 4: Pre-U.S. residency planning (cont.)
  - 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.

Questions?