

NAEPC Webinar: Estate Planning for International Families with U.S. Ties

- **SPEAKER:**
 - Edward A. Vergara, *Dungey Dougherty PLLC, NY & CT*

Agenda

- Rules for Determining Residency
- Application of Rules to Various U.S. Investments and Activities
- Case Studies

Who's who?

U.S. Income Tax Residency – Bright Lines

- Citizenship
 - Only a handful of countries determine tax residency based on citizenship alone
- Green card
 - Applies regardless of physical presence in the United States
- Substantial Presence
 - Day count (current year + 1/3 first preceding year + 1/6 second preceding year = 183 days)
 - Day count exceptions
 - Certain diplomats
 - Certain students and teachers
 - Closer connection exception
 - Less than 183 days in current year
 - Tax home in another country
 - Requires an annual filing
 - Not available if individual has applied for green card
- Section 6013(g) election
- Income Tax Treaty can override all tests other than citizenship
 - Some subjective tests in treaties

Who's who?

U.S. Estate and Gift Tax – Subjective Test for Noncitizens

- Citizenship
- **Residence, where residence = DOMICILE**
 - “A ‘resident’ decedent is a decedent who, at the time of his death, had his **domicile** in the United States A person acquires a **domicile** in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom.”¹
 - “In general, the **domicile** of an individual is his true, fixed and permanent home and place of habitation. It is the place to which, whenever he is absent, he has the intention of returning. This general statement, however, is difficult of application. Each individual case must be decided on its own particular facts. In reviewing a claim, relevant criteria include year-round **residence**, voter registration, place of filing tax returns, property ownership, driver’s license, car registration, marital status, vacation employment, etc.”²
- **NCNR = U.S. Non-Citizen Non-Resident**

¹ Treas. Reg. § 20.0-1(b)(1), quoted in *Estate of Jack ex rel. Blair v. United States*, 54 Fed.Cl. 590, 595 (2002). See also *Mitchell v. United States*, 21 Wall. 350, 88 U.S. 350, 22 L.Ed.2d 584 (1874).

² *Vlandis v. Kline*, 412 U.S. 441, 454, 93 S.Ct. 2230, 37 L.Ed.2d 73 (1973), quoted in *Estate of Jack ex rel. Blair*, 54 Fed.Cl. 590, 596 (2002).

U.S. Investments and Activities: Compensation Income

Income Tax Considerations	Estate and Gift Tax Considerations
<p>Residents</p> <ul style="list-style-type: none">• A job is a job	<p>Citizens and Residents</p> <ul style="list-style-type: none">• A job is a job
<p>Non-Residents</p> <ul style="list-style-type: none">• U.S.-based services generally create an obligation to obtain an ITIN (if no SSN) and file complete U.S. income tax return (Form 1040NR), regardless of U.S. tax status• Note important implications for immigration status• Apportionment where services partially within and partially without United States<ul style="list-style-type: none">• Important to consider in the context of vesting equity compensation	<p>NCNRs</p> <ul style="list-style-type: none">• Equity-based compensation raises the issues highlighted on the following pages for U.S. equity after vesting

U.S. Investments and Activities: Equity in U.S. Companies

Income Tax Considerations	Estate and Gift Tax Considerations
<p>Residents</p> <ul style="list-style-type: none">• Dividends eligible for preferential tax treatment as Qualified Dividend Income• K-1 allocations from entities taxed as partnerships taxable regardless of distributions	<p>Citizens and Residents</p> <ul style="list-style-type: none">• Part of worldwide gift/estate tax base
<p>Non-Residents</p> <ul style="list-style-type: none">• Dividends subject to withholding tax at source<ul style="list-style-type: none">• Base rate is 30%• May be reduced by Treaty• No obligation to file U.S. tax return• K-1 allocations from entities taxed as partnerships taxable regardless of distributions<ul style="list-style-type: none">• Generally create an obligation to obtain an ITIN (if no SSN) and file complete U.S. income tax return (Form 1040NR), regardless of U.S. tax status	<p>NCNRs</p> <ul style="list-style-type: none">• Gift Tax<ul style="list-style-type: none">• U.S. gift tax does not apply to gifts of intangible assets, even if issued by U.S. entity• Look-through for SMLLCs and partnerships is possible• Estate Tax<ul style="list-style-type: none">• Equity in a U.S. company is a U.S.-situs assets subject to U.S. estate tax• NCNRs have exemption equivalent to \$60,000• Estate Planning<ul style="list-style-type: none">• Foreign company “blocker” is simple solution for U.S. estate protection, though it can introduce U.S. income tax complexity• Local probate may be required• Transfer Certificates may be required for financial accounts if no U.S. executor

U.S. Investments and Activities: Debt from U.S. Issuers

Income Tax Considerations	Estate and Gift Tax Considerations
<p>Residents</p> <ul style="list-style-type: none"> • Generally ordinary income • Municipal debt mostly exempt from federal tax 	<p>Citizens and Residents</p> <ul style="list-style-type: none"> • Part of worldwide gift/estate tax base
<p>Non-Residents</p> <ul style="list-style-type: none"> • Most interest exempt from U.S. taxation unless: <ul style="list-style-type: none"> • Debt is not in “registered form” • Debt is issued by related party <ul style="list-style-type: none"> • Generally 10% ownership by creditor or affiliates • Equity-like contingencies • Bank deposits exempt 	<p>NCNRs</p> <ul style="list-style-type: none"> • Gift Tax <ul style="list-style-type: none"> • U.S. gift tax does not apply to gifts of intangible assets, even if issued by U.S. entity • Note cash exception • Estate Tax <ul style="list-style-type: none"> • If debt is exempt from U.S. Income tax, it is generally exempt from U.S. Estate Tax • Estate Planning <ul style="list-style-type: none"> • Transfer Certificates may be required for financial accounts if no U.S. executor • Don’t overlook probate considerations for enforcement

U.S. Investments and Activities: U.S. Real Estate

Income Tax Considerations	Estate and Gift Tax Considerations
<p>Residents</p> <ul style="list-style-type: none"> • Loss limitation rules • Always gives rise to local filing requirement 	<p>Citizens and Residents</p> <ul style="list-style-type: none"> • Part of worldwide gift/estate tax base • Estate Planning <ul style="list-style-type: none"> • Local probate will be required if owned in individual name
<p>Non-Residents</p> <ul style="list-style-type: none"> • U.S. real estate generally produces “effectively connected income” <ul style="list-style-type: none"> • Full U.S. tax return (and ITIN) required • Capitalization strategies can significantly impact effective tax rate on return 	<p>NCNRs</p> <ul style="list-style-type: none"> • Gift Tax <ul style="list-style-type: none"> • U.S. gift tax applies to transfers of U.S. real estate • Look-through for pass-through entities is possible • Estate Tax <ul style="list-style-type: none"> • U.S. estate tax applies to U.S. real estate held directly or through U.S. holding companies • Foreign corporation should be effective “blocker”, but income tax and reporting considerations are important • With foresight, trust planning can be an effective solution • Life insurance may provide allow for a simplified and income tax efficient holding structure • Estate Planning <ul style="list-style-type: none"> • Local probate will be required if owned in individual name

CASE STUDY: U.S. Student

Facts	Traps for the Unwary	Planning Opportunities
Jonathan, a non-U.S. person from a wealthy family in Chile, is excited to be attending a prestigious university in the United States	<ul style="list-style-type: none">• U.S. sourcing rules may create a U.S. tax exposure for certain capital gains• Substantial compliance with visa requirements can be independently examined by the IRS• Very low exemption for U.S. assets (\$60,000)	<ul style="list-style-type: none">• So long as Jonathan complies with the requirements of his visa (which generally will prohibit gainful employment), he should not be subject to U.S. income tax or reporting obligations for non-U.S. assets
Jonathan has an opportunity to invest in and join a start up with some of his classmates	<ul style="list-style-type: none">• Immigration status• No more student visa - U.S. tax payment and reporting obligations on worldwide assets• Equity from investment or incentive compensation subject to U.S. Estate Tax at death with very limited exemption (\$60,000)• U.S. probate required for U.S. equity interests	<ul style="list-style-type: none">• Jonathan may be NCNR well after commencing employment, which would provide significant flexibility to structure estate planning• Capital gains from the sale of U.S. shares generally tax-free after departure

CASE STUDY: U.S. Spouse

Facts	Traps for the Unwary	Planning Opportunities
<p>Jonathan, a non-U.S. person from a wealthy family in Chile, will be attending a prestigious university in the United States</p>	<ul style="list-style-type: none"> • U.S. sourcing rules may create a U.S. tax exposure for certain capital gains • Substantial compliance with visa requirements can be independently examined by the IRS 	<ul style="list-style-type: none"> • So long as Jonathan complies with the requirements of his visa (which generally will prohibit gainful employment), he should not be subject to U.S. income tax or reporting obligations for non-U.S. assets
<p>Jonathan falls in love with Beth, and they marry and settle down in the United States after college</p>	<ul style="list-style-type: none"> • No more student visa - U.S. tax payment and reporting obligations on worldwide assets <ul style="list-style-type: none"> • Can have significant implications for a closely-held family business • No marital deduction for gift or inheritance from Beth to Jonathan <ul style="list-style-type: none"> • Enhanced annual exclusion • QDOT required for marital estate tax deduction • No 50/50 presumption for jointly held assets when surviving spouse is non-citizen <ul style="list-style-type: none"> • U.S. spouse assumed 100% owner except as proven otherwise • Home-country assets will be probated in home country, and may be subject to forced heirship 	<ul style="list-style-type: none"> • Best to avoid direct inheritance of foreign assets by Jonathan

CASE STUDY: The Vanguard

Facts	Traps for the Unwary	Planning Opportunities
<p>Jonathan's family own a successful conglomerate of businesses developing and selling products containing copper. They are interested in exploring the U.S. market, and have decided collectively that Jonathan will move to the United States to lead the charge.</p>	<ul style="list-style-type: none">• Residency Start Date<ul style="list-style-type: none">• Generally the first day in calendar year that substantial presence test is satisfied<ul style="list-style-type: none">• 10-day exception• Taxation on worldwide income after residency start date• Foreign asset reporting after residency start date• CFC/PFIC implications	<ul style="list-style-type: none">• Residency start date• Pre-immigration planning<ul style="list-style-type: none">• Note IRS Section 679 limits pre-immigration income tax planning with trusts• Life insurance as relatively simple solution for U.S. estate taxable assets• Avoid direct inheritance