

RIMÔN



5 Things You Forgot (Or Don't Know) About International Estate Planning

Southern Arizona Estate Planning Council

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Brent W. Nelson

Partner | Rimon, P.C. | Tucson



Overview

- 1. Who *Is* Your Client?**
- 2. Gift Tax Traps**
- 3. Estate Tax Traps**
- 4. Income Tax Surprises**
- 5. Foreign Wills**
- 6. (Bonus) Foreign Currency**



Who *Is* Your Client?

- US Tax system operates in **two opposite universes**:
 - Citizens and Residents
 - Non-Resident Non-Citizens (NRNCs)



Who *Is* Your Client?

Citizens (Income and Transfer Tax)

- **Born or naturalized in U.S.**
- **Born outside of U.S. if:**
 - Citizen parents, **one resident** in U.S. prior to birth
 - Citizen and national parents, citizen present in U.S. for **1 year**
 - Citizen parent, present in U.S. for **1 year**, born in **U.S. possession**



Who Is Your Client?

Citizens (Income and Transfer Tax)

- **(Continued) Born outside of U.S. if:**
 - **Unknown parentage and in U.S.** under age 5 until shown before age 21 to have not been born in U.S.
 - Citizen and alien parents, citizen parent **in U.S. for 5 years** (includes foreign service), at least **2 years after age 14**
 - Born **before 5/24/34** to alien father and citizen mother, mother resided in U.S. prior to person's birth

8 U.S.C. § 1401



Who *Is* Your Client?

Residents (Income Tax)

- **Non-Citizen** who:
 - Is a Lawful Permanent Resident
 - Fails Substantial Presence Test
 - Elects to be a resident

IRC § 7701(b)(1)(A)



Who /s Your Client?

Residents (Income Tax)

- **Lawful Permanent Resident** = green card holder until:
 - Abandoned
 - Rescinded
- IRC § 7701(b)(6)



Who /s Your Client?

Residents (Income Tax)

- **Substantial Presence Test** = 183 days present in U.S.:
 - At least 30 days present in current year
 - Count all days in current year, 1/3 days in 1st prior year, 1/6 days in 2nd prior year
 - All days in U.S. count, **with few exceptions**

IRC § 7701(b)(3), (6)

***Even non-immigrant visa holders can fail this test**



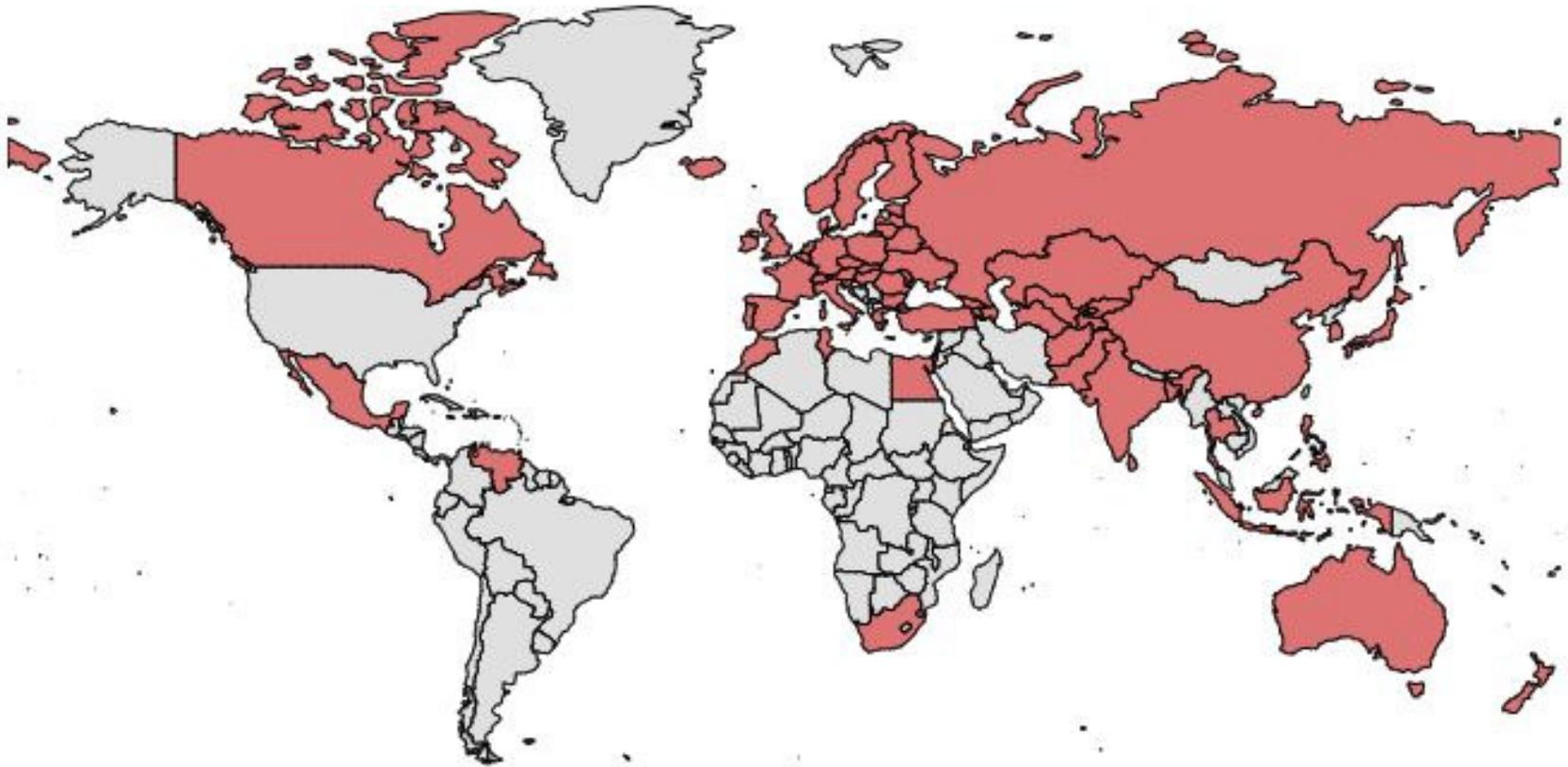
Who *Is* Your Client?

Residents (Income Tax)

- **Exceptions to Substantial Presence Test:**
 - Closer-Connection Test (IRS Form 8843)
 - Treaty Tie-Breaker (Tax Return + IRS Form 8833) (69 Income Tax Treaties)



Who *Is* Your Client?





Who *Is* Your Client?

Residents (Transfer Tax)

- A “resident” for transfer tax purposes is a U.S. citizen or an individual “**domiciled**” in the U.S. Treas.
- Domicile =
 - moved to U.S. (objective)
 - with intent to stay permanently (subjective)

Reg. §§ 20.0-1(b)(1), 25.2501-1(b)



Who *Is* Your Client?

Residents (Transfer Tax)

- **Non-Immigrant Visa** holders may be able to become residents (grey area) (see Rev. Rul. 80-209 and *Carlson v. Reed*, 249 F.3d 876, 880 (9th Cir. 2001))
- **Treaty Tie-Breaker**, but only 15 transfer tax treaties



Who *Is* Your Client?

NRNCs (Income and Transfer Tax)

- **Generally**, an individual who is not a citizen or a resident
- **Can include those who would be resident, but for an exception**



Who Is Your Client?

Who Cares?

Citizen/Resident	NRNC
Taxable on worldwide income	Taxable on U.S. source income
Anti-deferral rules	No anti-deferral
Reporting obligations for foreign assets	No reporting requirements (outside KYC, FATCA, CTA)
No FIRPTA	FIRPTA
Estate Tax on worldwide assets	Estate Tax on U.S. located assets
Gift Tax on worldwide gifts	Gift Tax on U.S. tangible assets
\$12.06M Estate Tax exemption	\$60,000 Estate Tax exemption
\$12.06M Gift Tax exemption	NO gift tax exemption



Gift Tax Traps

Two Common Traps

- Transfers to Non-Citizen Spouses
- Sneaky Gifts



Gift Tax Traps

First, A Few Basics

- **Intangible Property** is not subject to Gift Tax for NRNCs, regardless of where it is located
- U.S. Currency is **tangible property**

See GCM 36860, PLR6702141580A, PLR7737063; but see PLR8210055



Gift Tax Traps

Gifts to Non-Citizen Spouses

- **A gift to a Non-Citizen spouse is not** eligible for the Gift Tax Marital Deduction (very limited exceptions), even if spouse is a Resident
 - No QTIP Trust for Non-Citizen Spouse
 - No Gift Tax Qualified Domestic Trust (QDOT)



Gift Tax Traps

Gifts to Non-Citizen Spouses

- **Special Annual Exclusion:** present interest gifts to Non-Citizen spouse eligible for special annual exclusion. IRC 2523(i)
 - Currently is \$164,000
 - Indexed for inflation
- Marital Deduction **allowed** for rights in joint and survivor annuity



Gift Tax Traps

Sneaky Gifts for NRNC

Not a Gift	Is a Gift	Could be Gift
Any intangible	Tangible property in U.S.	Jointly owned tangible property in U.S.
Foreign currency outside U.S.	U.S. currency or checks	Electronic transfers of U.S. currency
Non-U.S. real property	U.S. real property	Joint U.S. real property
Wedding, b-day, holiday gifts outside U.S.	Wedding, b-day, holiday gifts inside U.S.	Engagement ring given in U.S.



Estate Tax Traps

Two Common Traps

- Limited Estate Tax Exemption
- Bequests to Non-Citizen Spouse



Estate Tax Traps

First, Some Basics

- NRNCs have **\$60,000** Estate Tax exemption (not indexed for inflation).
- Estate Tax only applies to a NRNC's property **situated in the U.S.**

IRC §§ 2102(b)(1), 2103



Estate Tax Traps

First, Some Basics

Always located in U.S.	Never located in U.S.
U.S. real property	Non-U.S. real property
Stock in U.S. corporations	Stock in foreign corporations
U.S. business bank accounts	U.S. non-business bank accounts
Debts owed to U.S. people	Portfolio interest loans
U.S. located tangible personal property	Art on exhibition in U.S. museum
U.S. brokerage accounts	Life insurance on NRNC decedent



Estate Tax Traps

\$60,000 Exemption

- NRNCs **can easily** have taxable estates
- **Must file** Estate Tax Return if U.S. property over \$60,000
- **Basis Consistency Rules APPLY**
 - Prop. Reg. 1.1014-10(c)(3)(i)(B): failure to report asset value on an Estate Tax Return means the asset has a **zero basis**



Estate Tax Traps

\$60,000 Exemption

- **Some tax treaties (like Canada)** allow a pro rata exemption
- Typically: Full Credit x (US Assets/Worldwide Assets)
- **DON'T ASSUME this covers it!** Do the math
- Must **timely** file Estate Tax Return and Form 8833



Estate Tax Traps

\$60,000 Exemption

- **Example:** NRNC, resident of a country with a treaty providing a proportionate Estate Tax exemption.
 - If NRNC's worldwide estate is \$15,000,000 and US property is \$1,000,000, the available credit would be:

Worldwide Estate	US Estate	Unified Credit	Treaty Credit
15,000,000	1,000,000	4,778,800	318,587



Estate Tax Traps

\$60,000 Exemption

- **Example (Continued):** But, the Estate Tax on \$1,000,000 is **\$345,800**, leaving the estate **\$27,213 short** of credit (i.e. $345,800 - 318,587$)
- Deduction for administrative expenses might resolve the shortfall



Estate Tax Traps

Bequests to Non-Citizen Spouse

- **No Estate Tax Marital Deduction** for a bequest to a Non-Citizen Spouse.
- **AND**, the assumption that each spouse contributed half of jointly held property does not apply.

IRC § 2040(b), 2056(d)(1)



Estate Tax Traps

Bequests to Non-Citizen Spouse

- **TWO KEY EXCEPTIONS:**
 - Property left in a QDOT
 - Surviving spouse becomes a U.S. citizen before the Estate Tax Return is due and was always a Resident (for transfer tax purposes) from date of death until becomes a U.S. citizen

IRC § 2056(d), Treas. Reg. § 20.2056A-1(a), (b)



Income Tax Surprises

- Becoming a Citizen or Resident
- Becoming a NRNC



Income Tax Surprises

Becoming a Citizen or Resident

- Becoming a Citizen or Resident can be jarring
- Citizens and Residents pay tax on their **worldwide income**



Income Tax Surprises

Becoming a Citizen or Resident

- Citizens and Residents subject to **anti-deferral rules** for:
 - Interests in controlled foreign corporations (CFCs) and passive foreign investment companies (PFICs). IRC §§ 951, 1291
 - Beneficial interests in foreign non-grantor trusts (Throwback Rules). IRC §§ 665-668



Income Tax Surprises

Becoming a Citizen or Resident

- **Burdensome reporting.** Some of the forms are:
 - FinCen 114, “Foreign Bank Account Report”
 - Form 8938, “Statement of Specified Foreign Financial Assets”
 - Form 3520, “Annual Return to Report Transactions With Foreign Trusts and Receipts of Certain Foreign Gifts”
 - Form 3520-A, “Annual Information Return of Foreign Trusts With a U.S. Owner”
 - Form 5471, “Information Return of U.S. Persons With Respect To Certain Foreign Corporations”
 - Form 8621, “Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund”
 - Form 8865, “Return of U.S. Persons With Respect to Certain Foreign Partnerships”

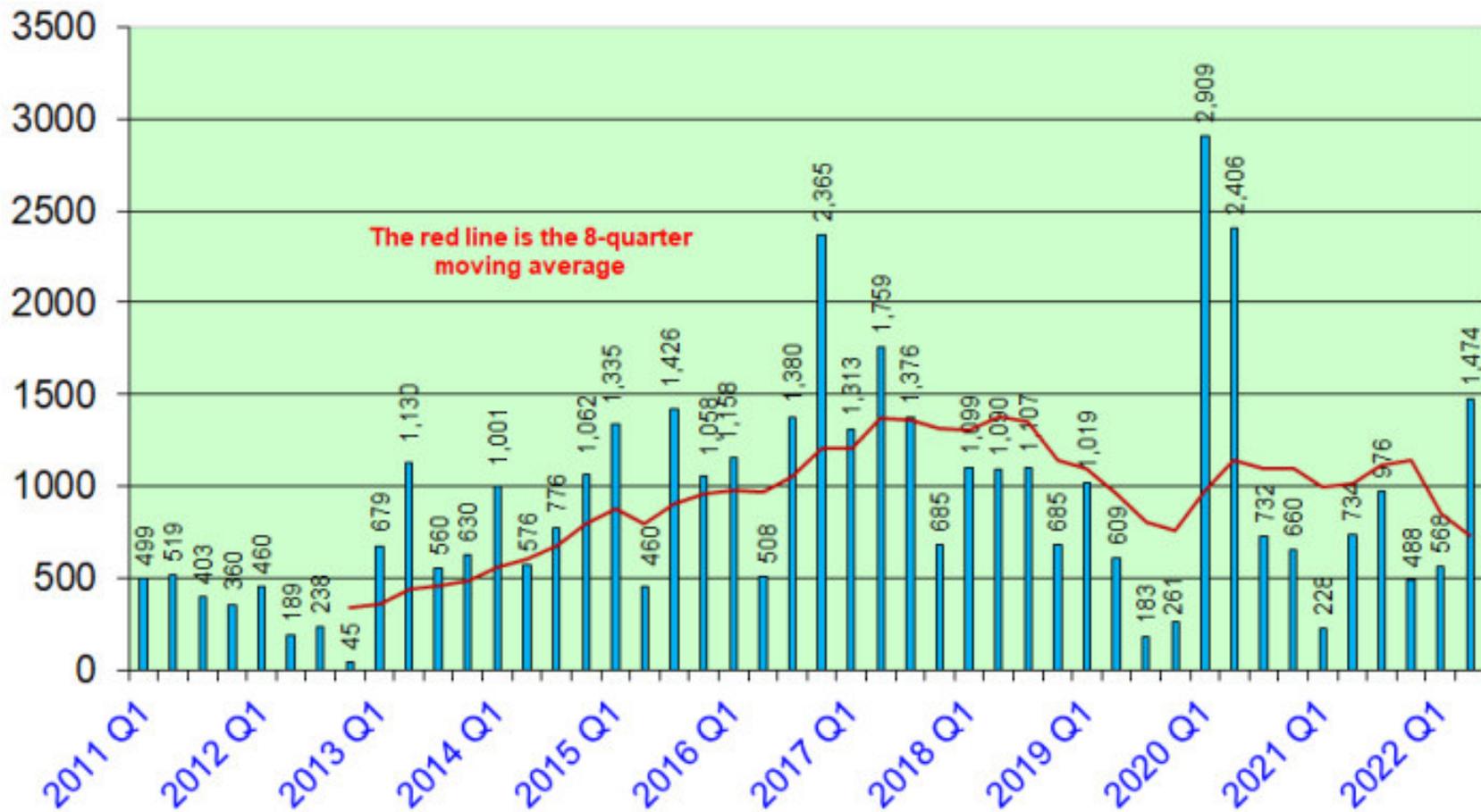


Income Tax Surprises

Becoming a NRNC

- **Expatriation Tax: every Covered Expatriate**
 - Deemed to sell all their assets upon expatriation
 - Subject to IRC 2801 inheritance tax
- IRC § 877A(a), (g)(1), 2801(a)

Number of Published Expatriates Per Quarter 2011 to Q2 2022



Source: U.S. Treasury Department
 Andrew Mitchel LLC



Income Tax Surprises

Becoming a NRNC

- **Covered Expatriate** = citizen or long-term resident who
 - Annual **net income tax** over 5 previous years of \$178,000 (indexed for inflation)
 - Net worth of \$2,000,000 or more (not indexed for inflation)
 - Does not file Form 8854



Income Tax Surprises

Becoming a NRNC

- **Long-Term Resident** = resident for 8 of last 15 years
- **Expatriation** = relinquish citizenship or terminate long-term residency
- **Can exclude up to \$767,000 of gain** (indexed for inflation)

IRC §§ 877A(a), (g)(4), (g)(5), 877(e)(2)



Income Tax Surprises

Becoming a NRNC

- **Why Expatriate?**
 - May avoid Expatriation Tax (with planning)
 - Only taxed in U.S. on U.S. source income
 - Stop burdensome information return reporting
 - Avoid Estate Tax at death on non-U.S. assets
 - Difficulty transacting foreign business as Citizen (due to FATCA, bank regulations)



Income Tax Surprises

Becoming a NRNC

- **Avoid IRC § 7701(b)(10) trap:** If a Resident becomes a NRNC, and then becomes a Resident again **within three years** of becoming NRNC, taxed as if **NEVER CHANGED STATUS**



Foreign Wills

- Should a NRNC Have a U.S. Will?
- Should a Citizen or Resident have a Foreign Will?



Foreign Wills

- **If multiple Wills**, carefully avoid mutually revoking other Wills
- Also, avoid conflicts in scope of geographical coverage of each Will



(Bonus) Foreign Currency

- **Generally, personal transactions in foreign currencies generate ordinary gains and losses if more than \$200**
- **Mortgages** on personal residences in foreign currency are particularly problematic
- Unless mortgage expenses are deductible under IRC 162 or 212, must treat paying off mortgage as separate transaction



(Bonus) Foreign Currency

Example

- Acquire residence in Italy
- \$1 = €1
- Put € 100,000CD down, finance € 850,000CD
- Sell for €1,000,000 when exchange rate is \$1 = €0.95



(Bonus) Foreign Currency

Example (continued)

- Gain on sale of house is:
 - $(1,000,000/0.95) - (950,000/0.95)$
 - $1,052,632 - 1,000,000 = \$52,632$
- Loss on repaying mortgage is:
 - $850,000 - (850,000/0.95)$
 - $850,000 - 894,737 = (\$44,737)$

See Rev. Rul. 90-79



(Bonus) Foreign Currency

Example (continued)

- If, the dollar had strengthened against the Euro, then paying off the mortgage would generate a **gain**



Questions?

Contact Information

Brent W. Nelson

Rimon, P.C.

One South Church

Suite 1200

Tucson, AZ 85701

520-979-3839

brent.nelson@rimonlaw.com

Social: @wealthandlaw

Podcast: Wealth and Law



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