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International Tax Issues

Agenda

- Core Concepts
- Common Inbound Planning Issues
- Common Outbound Planning Issues
- Foreign Beneficiaries of US Estates
- US Beneficiaries of Foreign Estates

Core Concepts

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Introduction

- Increasingly an international world
- No cap on immigrant visas because of exempt categories (e.g. family)
- Green cards issued in 2025 = more than 1,300,000
- Approximately 5,500,000 Americans living abroad
- Record numbers of expatriates
- Aggressive IRS

International Income Tax

- Taxation based on citizenship, residency, and territory
- Focus on individuals
- Three categories:
  - Citizens
  - Residents
  - Non-resident aliens ("NRAs")

International Income Tax

Citizens

- 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

International Income Tax

Citizens (continued)

- Unknown parentage 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

International Income Tax

Residents

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

International Income Tax

Residents (continued)

- Lawful Permanent Resident = green card holder until
  - Abandoned
  - Rescinded

International Income Tax

Residents (continued)

- 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, exceptions

International Income Tax

Residents (continued)

- **Substantial Presence Test Example**
  - In U.S. 120 days in each of three succession years
  - Doesn't fail test: 120 + 40 [120/3] + 20 [120/6] = 180 days
- ***Even non-immigrant visa holders can fail this test***

International Income Tax

Residents (continued)

- Substantial Presence Test Exceptions
  - Closer Connection Test
  - Treaty Tied-Breaker

International Income Tax

Residents (continued)

- Closer Connection Test:
  - In U.S. < 183 days in current year
  - Maintain tax home in foreign country
  - Closer connection to tax home country (or more than one foreign country)
- ***Must file Form 8840 with timely return**

International Income Tax

Residents (continued)

- Treaty Tie-Breaker (Model Treaty Art. 4):
  - Permanent home
  - Center of vital interests
  - Habitual abode
  - Citizen
  - Competent Authorities
- ***Must file Form 8833 with timely return**

International Income Tax

NRAs

- Anyone who is not a citizen or resident
- NRAs status under Closer Connection Test or Treaty Tie-Breaker does not change foreign information return status as resident (except Form 8938)

International Income Tax

Tax on Citizens and Residents

- Worldwide income
- Net investment income tax – only citizens and residents
- Special Entity Rules
- Foreign Information Returns

International Income Tax

Tax on Citizens and Residents (continued)

- **Special Entity Rules**
  - Entity categories (check-the-box regulations)
  - Automatic Corporations
  - Partnerships
  - Disregarded Entities
  - Elections between entities

International Income Tax

Tax on Citizens and Residents (continued)

- Controlled Foreign Corporations ("CFCs") =
  - foreign corporation
  - > 50% (by vote or value) of the corporation’s stock is owned by United States shareholders
  - United States shareholder = citizen or resident owning at least a 10% voting stock

International Income Tax

Tax on Citizens and Residents (continued)

- If CFC for any day during the year, then:
  - Recognize "Subpart F" income. IRC 951(a)
- If U.S. shareholder at any point in 5 year look back period, then:
  - Sale or exchange of CFC stock causes deemed dividend ("1248 Gain"). IRC 1248(a)

International Income Tax

Tax on Citizens and Residents (continued)

- Passive foreign investment company ("PFIC"):
  - Foreign corporation, and
  - At least 75% of the corporation’s gross income is passive, or
  - On average at least 50% of the corporation’s assets produce passive income

International Income Tax

Tax on Citizens and Residents (continued)

- Three methods of taxing PFICs:
  - Default
  - Qualified Electing Fund ("QEF")
  - Mark-to-Market ("MTM")

International Income Tax

Tax on Citizens and Residents (continued)

- Default PFIC Rule, IRC 1291:
  - Tax deferral permitted until: excess distribution or sell stock
  - Gain taxed at ordinary income rates, plus interest charge

International Income Tax

Tax on Citizens and Residents (continued)

- QEF Rules, IRC 1293, 1295:
  - No tax deferral
  - Currently recognize PFIC's ordinary income and capital gains
  - Previously taxed E&P not taxed on distribution
  - Normal capital gains rules on sale or exchange
  - Election made on timely filed Form 8621

International Income Tax

Tax on Citizens and Residents (continued)

- MTM Rules, IRC 1296:
  - Only applies to publicly traded stock
  - No tax deferral
  - Ordinary income or loss each year based on FMV of stock at close of tax year
  - Sale or exchange of stock, then ordinary income or loss
  - Election made on timely filed Form 8621

International Income Tax

Tax on Citizens and Residents (continued)

- Foreign Information Returns:
  – Citizens and residents have significant and burdensome foreign information return obligations
  – E.g., FBAR, 8938, 5471, 8621, 3520, 3520-A, etc.
  – Civil Penalties for late filing typically start at $10,000 per violation

International Income Tax

Tax on NRAs

- NRAs are taxed in the U.S. on:
  - Income effectively connected with a trade or business, or the performance of personal services, within the United States ("ECI")
  - Fixed or determinable annual or periodic income from sources within the United States ("FDAP")
  - Special rules on real property ("FIRPTA")
  - Special withholding tax for foreign partners (“1446 Withholding”)

International Income Tax

Tax on NRAs (continued)

- ECI tax on net basis at ordinary income rates
- FDAP taxed on gross basis at 30% (withheld by payee)
- Gains from disposition of U.S. real property interests taxed as ECI under FIRPTA

International Income Tax

Tax on NRAs (continued)

- Exceptions:
  - Treaty may reduce rates or exempt income
  - Capital gains (if not in U.S. for over 182 days) (other than FIRPTA)
  - Non-business interest bearing deposit accounts
  - Portfolio interest (registered debt, not > 10% shareholder of issuer)

International Transfer Tax

- Four transfer taxes:
  - Estate Tax
  - Gift Tax
  - Generation-Skipping Transfer Tax
  - Expatriate Tax
- Three Categories:
  - Citizens
  - Residents
  - NRAs

International Transfer Tax

Residents

- A "resident" is an individual "domiciled" in the U.S.
- Unlike the income tax rules, domicile is partly objective and partly subjective

International Transfer Tax

Residents (continued)

- **Domicile:**
  - Established at birth
  - Continues until:
  - Live in U.S.
  - Intend to remain in U.S. permanently

International Transfer Tax

Residents (continued)

- Non-Immigrant Visa holders may be able to become residents (grey area)
- Treaty Tie-Breaker for dual residents (but few transfer tax treaties)

International Transfer Tax

Estate Tax on Citizens and Residents

- Tax on transfer of worldwide assets at death
- $15,000,000 Exclusion Amount (in 2026), plus DSUE Amount (defined later)
- 40% max rate

International Transfer Tax

Estate Tax on Citizens and Residents (continued)

- String Provisions (retain or release within 3 years of death):
  - 2036: possession, enjoyment, right to the income or to designate who will possess or enjoy income
  - 2037: transfer taking effect after death + reversionary interest
  - 2038: power to alter, amend, revoke, or terminate enjoyment of property (held in any capacity)
  - 2042: incidents of ownership in life insurance (held in any capacity)

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International Transfer Tax

Estate Tax on Citizens and Residents (continued)

- Deductions:
  - Marital Deduction: not for non-citizen spouse unless Qualified Domestic Trust ("QDOT")
  - Charitable Deduction: U.S. and foreign charities

International Transfer Tax

Estate Tax on Citizens and Residents (continued)

- Portability:
  - Surviving Spouse can use deceased spouse's unused Exemption Amount ("DSUE Amount")
  - Must file estate tax return (Form 706)

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International Transfer Tax

Gift Tax on Citizens and Residents

- Tax on transfer of worldwide assets during life
- $15,000,000 Lifetime Exclusion Amount (in 2026), plus DSUE Amount
- 40% max rate

International Transfer Tax

Gift Tax on Citizens and Residents (continued)

- Exclusions:
  - Annual Exclusion ($19,000 in 2026)
  - Medical and Education Expenses

International Transfer Tax

Gift Tax on Citizens and Residents (continued)

- Deductions:
  - Marital Deduction: not to non-citizen spouse, no QDOT
  - Special Annual Exclusion of $194,000 (in 2026)
  - Charitable Deduction: U.S. and foreign charities

International Transfer Tax

GST Tax on Citizens and Residents

- 40% tax on transfers subject to Estate Tax or Gift Tax to:
  - Skip Persons (2 or more generations below transferor)
  - Trusts with only skip persons as beneficiaries
- $15,000,000 Exemption Amount (in 2026)
- ***No Portability***

International Transfer Tax

Expatriate Tax on Citizens and Residents

- 40% tax on transfers to citizens, residents, domestic trusts, electing foreign trusts, from:
  - Covered Expatriates
  - Foreign Trusts that received gifts or bequests from Covered Expatriates (not electing foreign trusts)

International Transfer Tax

Expatriate Tax on Citizens and Residents (continued)

- Covered Expatriate = give up citizenship or long-term permanent residency and any of:
  - $211,000 average annual net income (5 year look back) (in 2026)
  - $2,000,000 net worth
  - Fail to file Form 8854

International Transfer Tax

Estate Tax on NRAs

- 40% tax on transfers at death on property situated within the U.S.
- $60,000 Exemption Amount
- No portability
- Marital Deduction: same as citizen or resident
- Charitable Deduction: only U.S. charities
- Transfer Tax Treaty

International Transfer Tax

Estate Tax on NRAs (continued)

- Property situated within the U.S.:
  - Stock in U.S. corporations
  - U.S. real property
  - IRC 2104(b): String Provision + U.S. property
- Property NOT situated within the U.S.:
  - Non-business interest-bearing deposit accounts
  - Life insurance
  - Portfolio interest

International Transfer Tax

Section 2104(b)

- Applies to transfer in trust "or otherwise"
- Can be non-trust transfers
  - Transfer of property
  - Transfers to entities (significant non-tax purpose?)

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International Transfer Tax

IRC 2104(b)

NRA retains String Provision power over Trust		
Funded with U.S. situs property?	Yes: trust is tainted	No: trust not tainted
No U.S. situs property at NRA's death	All included in gross estate	None included in gross estate
U.S. situs property at NRA's death	All included in gross estate	U.S. situs property included in gross estate

International Transfer Tax

Gift Tax on NRAs

- 40% tax on transfers during life on tangible property situated within the U.S.
- No Lifetime Exemption, but exclusions apply
- Marital Deduction: same as citizen or resident
- Charitable Deduction: only U.S. charities
- Transfer Tax Treaty

International Transfer Tax

GST Tax on NRAs

- Similar to citizens and residents
- NRAs have $15,000,000 Exclusion Amount

Foreign Trusts

Types of Trusts

- Income Tax treatment depends on type of trust and beneficiaries
- Grantor vs. Non-grantor
- Foreign vs. Domestic

Foreign Trusts

Foreign vs. Domestic

- Foreign trust = every trust unless both:
  - Court Test: a court within the United States has primary supervision over the trust administration
  - Control Test: one or more United States persons has authority to control all substantial decisions of the trust
- Domestic trust = not a foreign trust

Foreign Trusts

Income Tax on Foreign Trusts

- Foreign grantor trust
  - The owner of the trust property is taxed
- Foreign non-grantor trust
  - Taxed as an NRA
  - ECI can be passed out to beneficiaries (not FDAP)
  - Throwback rules apply to U.S. beneficiaries

Foreign Trusts

Special Rules

- Rules favor foreign non-grantor trust or U.S. ownership of foreign grantor trusts
- IRC 672(f)(2) and (5): limit foreign grantor trusts
- IRC 679(a)(1): U.S. donor treated as owner of foreign trust with U.S. beneficiaries
- IRC 679(a)(4): trusts created within 5 years of immigration

Foreign Trusts

Special Rules (continued)

- Other important rules:
  - IRC 679(a)(5): domestic trust becomes foreign trust, then donor treated as making transfer to foreign trust
  - IRC 684(a): deemed sale on outbound transfer to foreign non-grantor trust

Important Treaty Provisions

- Income Tax Treaties can change these rules
- Important provisions include:
  - Income from Real Property
  - Dividend and interest rate of tax
  - Gain on real property
  - Pensions

Common Inbound Planning

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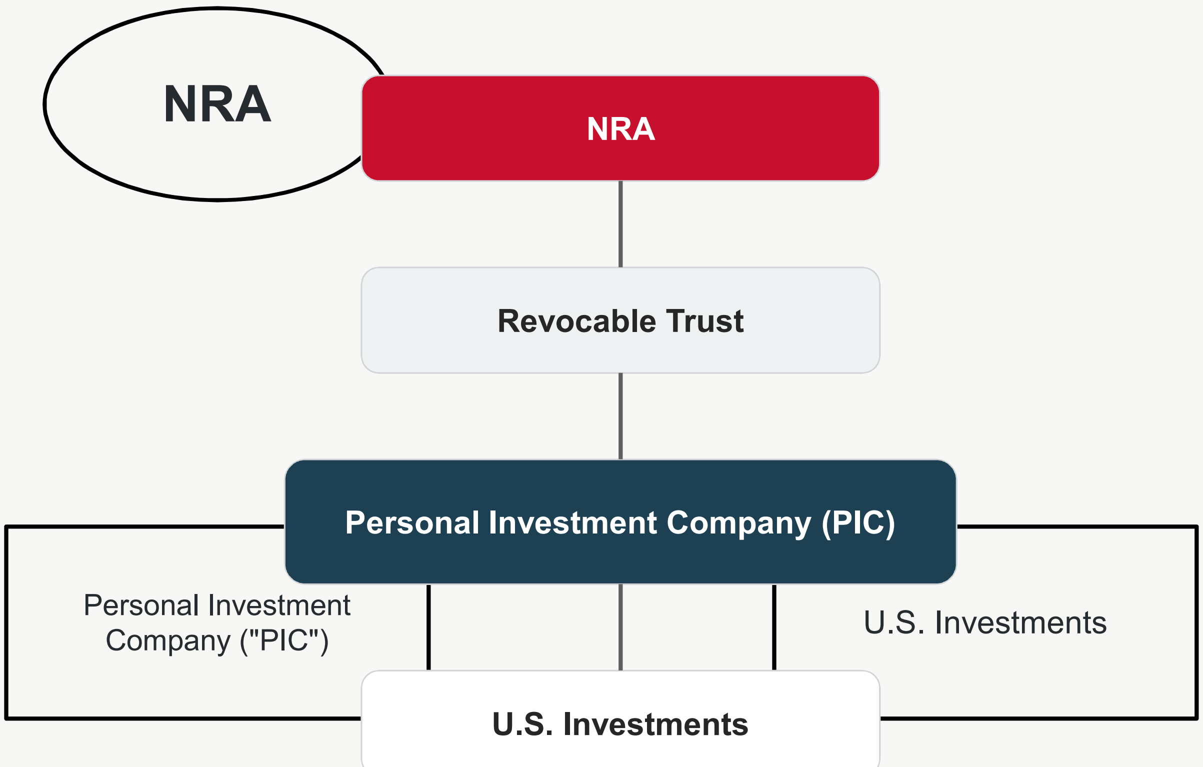
Inbound Transfers

Goals

- Limit or eliminate U.S. income tax
- Limit or eliminate U.S. transfer tax (especially Estate Tax)
- Control succession of assets

Inbound Transfers



Inbound Transfers

Intangible Property

- FDAP on income streams (unless exclusion, like portfolio interest)
- Potential capital gain exclusion
- May not be included in estate (bank deposits, portfolio interest, life insurance)
- No gift tax

Inbound Transfers

Intangible Property (continued)

- Planning:
  - Gift to reduce estate
  - Sell and re-invest in non-income and non-estate taxable assets
  - Consider holding via PIC for succession planning purposes

Inbound Transfers

Tangible Personal Property

- FDAP on income streams
- Potentially no capital gains on sale
- Included in gross estate
- Subject to gift tax

Inbound Transfers

Tangible Personal Property (continued)

- Planning:
  - Sell (if no capital gains) and re-invest in non-income and non-estate taxable assets
  - Acquire through PIC to avoid estate tax and for succession planning purposes

Inbound Transfers

Real Property

- FIRPTA + Outbound Corporate Rules
- Portfolio Interest and debt
- Branch Profits Tax
- Gain and withholding exceptions
  - Personal Residence
  - 871(d) and 882(d) Elections (W-8ECI)

Inbound Transfers

Real Property (continued)

- **Outbound Corporate Rules (this is jumping ahead but pertinent)**
  - §367 generally disallows non-recognition on transfers to foreign corps without gain recognition agreement
  - No non-recognition in foreign-to-foreign transfer under FIRPTA (unless 897(i) Election)

Inbound Transfers

Real Property (continued)

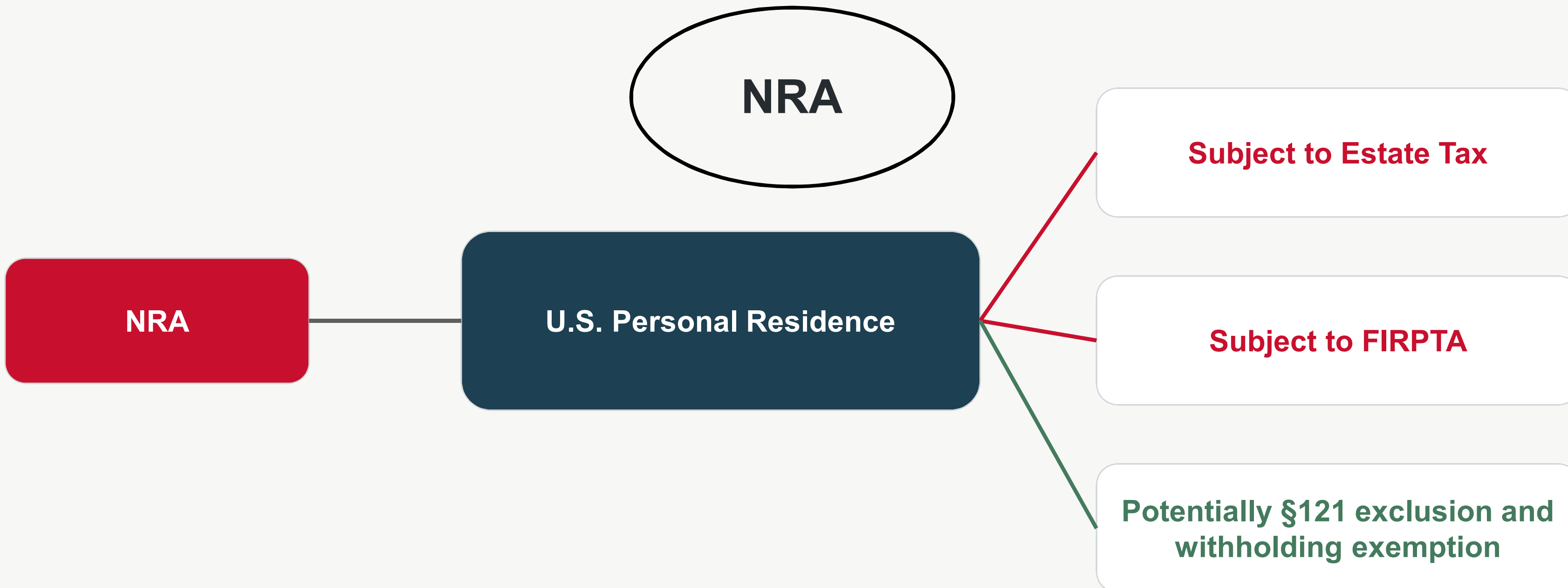
- Creditors
  - Interest in real property held solely as a creditor not subject to FIRPTA
  - No equity kickers
  - Right to acquire property under deed of trust permitted
  - NOT, seller financing unless waive installment method

Inbound Transfers

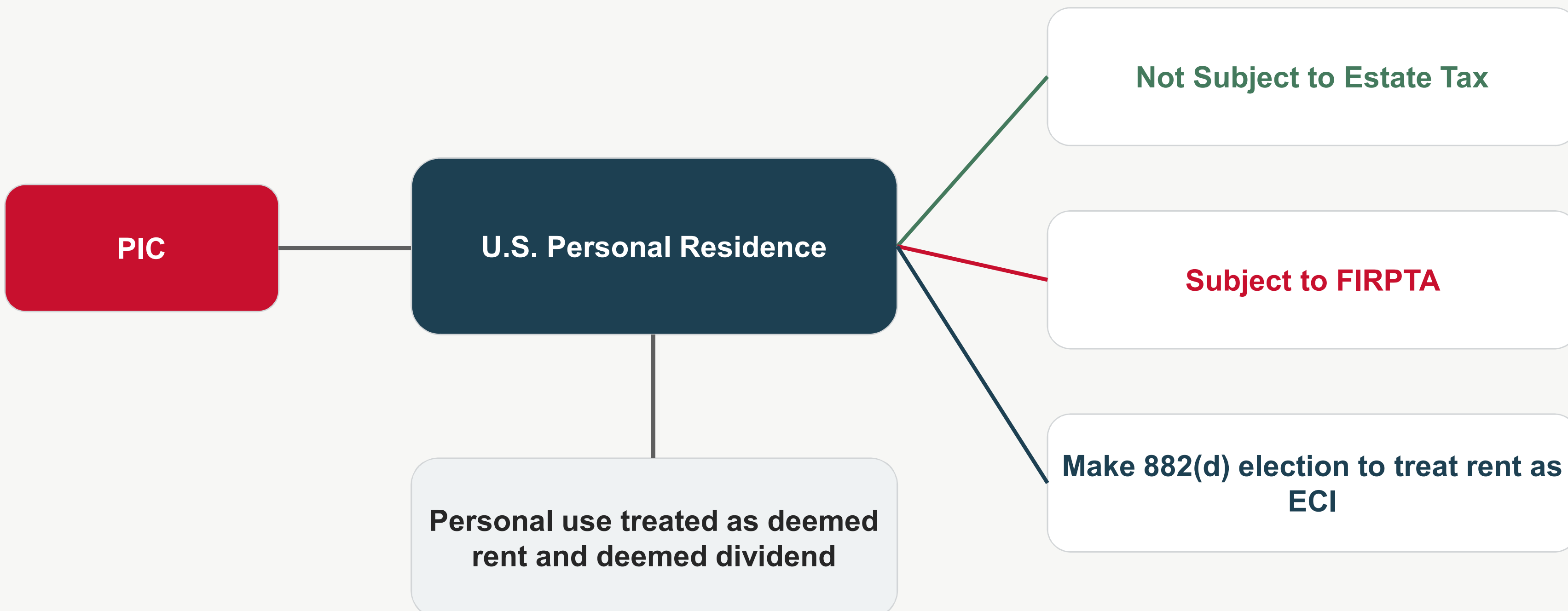
Real Property (continued)

- Branch Profits Tax ("BPT")
  - 30% tax on foreign corporation's ECI (with some adjustments)
  - BPT is in addition to other tax on ECI

Inbound Transfers



Inbound Transfers



Inbound Transfers

PIC

PIC — Cash for Portfolio Interest Debt — U.S. C Corporation — U.S. Real Property Interests

Real P
nteres

Not subject to Estate Tax

Not subject to FIRPTA

Pre-Immigration Planning

Foreign Trusts

- 5-Year rule limits non-grantor foreign trust planning
- Avoid IRC §2104(b)
- Foreign trust may not want to invest in U.S. sources, so need to avoid grantor trust status

Pre-Immigration Planning

Foreign Retirement Plans

- IF they can be divested, divest prior to immigration—BUT this is UNLIKELY
- Can Plan be modified to make it non-discriminatory or NRA not a HCE?
- Prepare for harsh rules after immigration

Pre-Immigration Planning

CFCs and PFICs

- Divest potential CFC and PFIC interests
- Consider indirect ownership
- Consider hidden CFCs/PFICs: e.g. annuities, life insurance

Pre-Immigration Planning

Foreign Non-Grantor Trusts

- If the trust will have U.S. beneficiaries:
  - Draft or reform to give Trustee authority to cleanse accumulated income, or
  - Draft or reform to prevent accumulated income

Common Outbound Planning

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Outbound Transfers

Corporations and Partnerships

- Generally no non-recognition on transfers to foreign corporation
- Technically non-recognition on transfers to foreign partnerships, but IRS has targeted

Outbound Transfers

Covered Expatriates

- Avoid being a covered expatriate
  - Lower average net income
  - Reduce net worth
- **FILE FORM 8854**
- Perhaps refuse gifts or bequests from covered expatriates
- Change residency before gift or bequest from covered expatriate

Outbound Transfers

Foreign Trusts

- Avoid unintended events that cause gain recognition:
  - Death of U.S. grantor of foreign grantor trust
  - Conversion of domestic non-grantor trust to foreign trust on change of trustee
- Closely monitor Court and Control Tests

Repatriation

- NRA (former resident) who becomes resident within 3 years of becoming NRA must pay U.S. income tax on U.S. income as if resident in intervening years. IRC 7701(b)(10)
- Closely monitor Substantial Presence Test
- Wait at least 3 years before becoming resident again

Repatriation

Violate 7701(b)(10):

Violate 7701(b)(10)

Year 1	Years 2–3	Year 4
Resident	**NRA**	**Resident**
Taxed as resident	Year 2–3 Tax on U.S. income and CG	Taxed as Resident

Avoid 7701(b)(10)

Year 1	Years 2–6	Year 7
Resident	**NRA**	**Resident**
Taxed as resident	Year 2–6 Tax as NRA on FDAP and ECI	Taxed as Resident

Foreign Beneficiaries of US Estates

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What to do with Foreign Beneficiaries?

- Not always **bad**!
  - Only taxable on FDAP and ECI
  - Subject to FIRPTA, but no other capital gains tax
- DNI Rules apply,
  - FDAP withholding at the estate/trust level
  - Non-real estate capital gains in DNI are tax free to foreign beneficiaries

What to do with Foreign Beneficiaries?

Traps for the Unwary

- **An exchange** of estate/trust interests
  - Subject to FIRPTA
  - Possibly subject to 1446 Withholding on partnership
- **Subsequent tax risk** for foreign beneficiary
  - FIRPTA
  - Estate Tax (especially Latin American beneficiaries!)

What to do with Foreign Beneficiaries?

Traps for the Unwary

- **Foreign partner** in partnership
  - Increased compliance for partnership
  - 1446 Withholding obligations
- **Sneaky Compliance Issue** – Form 5472 for 25% owned US entities (including disregarded entities)
  - Ownership is direct or indirect (constructive ownership under Sec. 318)

What to do with Foreign Beneficiaries?

Traps for the Unwary

- **Home Country Gift or Inheritance Tax**
  - **Germany**: has own gift tax and income tax—trusts are a problem
  - **France**: has own inheritance and income tax, trusts are a tax and **reporting** problem
  - **Mexico**: new income tax law is ambiguous about trusts, may have Mexican residency if trustee is Mexican
  - **Canada**: has deemed disposition tax, Canadian trustee can cause trust to be Canadian resident

US Beneficiaries of Foreign Estates

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What to do with US Beneficiary of Foreign Estate?

- **COMPLIANCE IS HIGH**:
  - FBAR
  - Form 3520 to report foreign inheritance over $100,000
  - Form 8938
  - Entity forms:
    - Form 5471 for controlled foreign corporations
    - Form 8621 for passive foreign investment companies
    - Form 8858 for interests in foreign partnerships

What to do with US Beneficiary of Foreign Estate?

- **Divest CFC and PFIC Shares**
- **Indirect ownership of CFCs**
  - Discretionary trusts are a challenge
  - May not be indirect ownership
- **Make timely PFIC elections!**
  - QEF election
  - MTM election

What to do with US Beneficiary of Foreign Estate?

- **Foreign estates**
  - Taxed as NRAs for U.S. income tax purposes
  - No throwback tax
- **Foreign Trusts**
  - **Throwback taxes possible for accumulated income**
  - Decant, reform, divide, domesticate?

Questions?

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