INBOUND WEALTH PLANNING

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SUZANNE L. SHIER
Chief Wealth Planning and Tax Strategist/Tax Counsel

DIANA R. MYERS
Associate Tax Counsel and Wealth Planner

INBOUND WEALTH PLANNING FOR THE GLOBAL FAMILY

With the ever-evolving nature of international tax, the non-U.S. resident or non-U.S. citizen with activities in the United States (referred to as "inbound" activities) and their U.S. advisors should become aware of fundamental, international tax principles to avoid the unintended application of U.S. tax. This is of particular importance due to the extraordinarily high level of inbound wealth into the United States. It is estimated that private wealth from offshore into the United States exceeded $450 billion annually in recent years, with Latin America and Asia-Pacific representing the fastest-growing sources of investment.[1]

Determining exactly whose income, gains and assets are subject to the U.S. Federal tax system is a complex inquiry that requires a comprehensive approach without shortcuts. And, just when the general rules of international tax principles under the Internal Revenue Code (the Code) and related Treasury regulations have been reviewed and applied, an applicable international tax treaty or a new law can change everything.

A first and necessary step for any international tax overview is a discussion related to the jurisdictional reach of the U.S. income tax and the U.S. estate, gift and generation-skipping transfer (GST) tax system (collectively referred to as the U.S. transfer taxes).[2] By comparison to the tax regimes of other countries, the U.S. Federal tax system is one of the most aggressive in the world; however, effective planning for inbound activities can mitigate its effect.

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CURRENT TRENDS IN WEALTH MIGRATION

To put the discussion of inbound mobility and wealth transfer in context for planning purposes, consider the following recent trends:

- In the academic year ended May 2017, an estimated 1,078,822 foreign students studied at colleges and universities in the United States, up over 3% from the previous year and marking the eleventh consecutive year of increase. Additionally, international students added more than $39 billion to the U.S. economy in 2016.[3]
- Between 467,370 and 617,752 immigrant visas have been issued every year since 2013, with 559,536 being issued in fiscal year 2017.[4] Not surprisingly, immigrant visas are issued primarily for family sponsored preferences and immediate relatives, with the parent of a U.S. citizen sponsor at least 21 years of age being the primary basis for visa issuance.[5] Students come to study, stay and are followed by their parents.
- Additional immigrants arrive under the EB-5 Immigrant Investor Program. Foreign investors can obtain conditional visas that allow their families to live, work and attend school in the United States. To qualify, the individual must invest a minimum of $1 million in new or recently created businesses or $500,000 in businesses in rural or high-unemployment areas.[6]
- Foreign direct investment in U.S. businesses is substantial. Measured on a cumulative basis, foreign direct investments reached over $3.7 trillion at the end of 2016. The United States receives more foreign direct investment than any other country in the world, including $457 billion in 2016 alone.[7]
- Foreign investment in U.S. securities (equity and debt) is significant. As of June 30, 2017, foreign holdings of U.S. securities totaled over $18 billion. Japanese investors held the highest concentration at almost $2 billion.[8]
- Foreign buyers acquired $153 billion of U.S. residential real estate in 2017. Chinese buyers were top purchasers at $31 billion, followed by Canadian purchasers at $19 billion. Nearly half of all foreign sales were concentrated in Florida, California and Texas.[9]

U.S. INCOME TAX

U.S. income tax is imposed on its *citizens* and *residents* (specifically defined and referred to in the Code collectively as a U.S. Person) no matter where they live or move throughout the world. In addition, as set forth in § 61[10] of the Code, a U.S. Person's gross income (ordinary and capital gain) shall include all such U.S. Person's income from whatever source derived, meaning his or her *worldwide* income. This jurisdictional reach will inevitably surprise the newly-located U.S. resident who has substantial income from foreign sources, but who immigrated or relocated to the United States without proper planning.

For individuals, citizenship is determined by the U.S. Constitution, the Immigration and Nationality Act, and the related regulations and case law. U.S. resident status is determined by the Code, Treasury regulations, any applicable tax treaty and related case law.

More specifically and for U.S. income tax purposes, a resident alien is an individual who is a lawful permanent resident of the United States (a green card holder) at any time during the year, meets the "substantial presence" test or has made what is commonly referred to as a "first-year election" to be taxed as a resident alien.

An individual has a substantial presence in the United States if:

- the individual is physically present in the United States for at least 183 days during the current year; or
- is physically present in the United States for at least 31 days during the current year and the sum of (i) the days physically present in the United States during the current year, plus (ii) one-third the number of days physically present in the United States during the first preceding calendar year, plus (iii) one-sixth the number of days physically present in the United States during the second preceding year, equals or exceeds 183 days.[11] The latter test is essentially a formula to establish a threshold weighted average of 183 days over a three-year period.

There is an exception for an individual who has a tax home in a foreign country during the year and has a closer connection during the tax year to one foreign country in which they have a tax home.

For example, if an individual is present in the United States for 122 days in year one, 122 days in year two, and 122 days in year three (the current year), he or she would still have substantial presence in the United States in year three since the weighted average for the three-year period equals 183 days.

	Days	Applicable Factor	Total
Year 1	122	1/6	20 1/3
Year 2	122	1/3	40 2/3
Year 3 (Current Year)	122	1	122
Weighted Average			183

By contrast, a non-U.S. person's income is also subject to U.S. income taxation under the Code, but only to the extent the non-U.S. person's income is deemed sourced within the U.S. Code § 7701(b)(1)(B), which refers to a non-U.S. person as a non-resident alien (NRA). That section specifically defines an NRA as an individual who is neither a citizen nor a resident of the United States (within the meaning of Code § 7701(b)(1)(A)). It should be highlighted that an NRA is treated more favorably under the Code for U.S. income tax purposes as he or she is taxed on fewer categories of U.S. income and assets than U.S. Persons. This is discussed further below; however, the policy rationale for such preferential tax treatment is to encourage foreign investments in the United States. Accordingly, an NRA should carefully consider how he or she invests in U.S. markets. With proper planning, an NRA invested on a U.S. tax-efficient NRA investment platform can mitigate or eliminate U.S. income tax, as the case may be.

An NRA is taxed on U.S. fixed, determinable and periodical (FDAP) income, including interest, dividends, rent and royalties.[12] Capital gain from U.S. property other than real property generally is not taxed. However, the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) imposes a tax on the disposition of U.S. real property interests (USRPI) by foreign individuals and foreign corporations.[13] Additionally, an NRA who sells an interest in an entity treated as a partnership for U.S. Federal income tax purposes will be taxed on whatever amount of gain, if any, that is attributable to assets used in a U.S. trade or business.

If an NRA engages in a U.S. trade or business, there will be U.S. income tax consequences related to *effectively connected income* (that is, the company's business profits, commonly referred to as ECI, which may be generated within or without the United States). Also, there are possibly U.S. estate tax issues when a trade or business is established in the United States. Briefly, for the U.S. income tax to apply to a trade or business owned by an NRA, such person must have established a *permanent establishment* in the United States, either as defined under U.S. international principles or under an applicable inter-country tax treaty. This tax treaty can often be used to reduce or eliminate certain business profits subject to U.S. income tax. If, however, the NRA does not have a permanent establishment in the United States, certain revenues generated within the United States may be exempt from U.S. income tax. This is a much simplified discussion related to the issue of ECI and the taxation of an NRA's trade or business activity in the United States. However, if an NRA desires to expand his or her business footprint into the United States, it will be important to discuss the desired U.S. activity with professional tax advisors beforehand to properly understand the U.S. income tax implications and which activities may be exempt. (See summary table on the following page.)

U.S. TRANSFER TAXES

For U.S. transfer tax purposes, the United States is similarly aggressive; however, unlike most countries, the United States does not have an inheritance tax (even though the U.S. estate tax is often referred to as the U.S. *death* tax).[14] Instead, the U.S. transfer tax is imposed on the *transfer* of a decedent's U.S. *taxable estate* and not upon any particular legacy, devise or distributive share.[15] The United States will impose its transfer tax on assets under the following broad circumstances: on the worldwide assets wherever located of a U.S. citizen or U.S. domiciled individual; or on the U.S.-situate assets of a non-U.S. citizen non-U.S. domiciled person (NCND), as defined below.[16] By comparison, in an inheritance tax system the tax is usually imposed upon the recipient and the tax rate varies according to the closeness of the familial relationship.[17]

There are important differences between the U.S. transfer taxation as applied to U.S. citizens and U.S. domiciled individuals and as applied to NCNDs.

U.S. INCOME TAX SUMMARY

Type of U.S. Source Income	General U.S. Tax Treatment (Subject to Treaty Modification)
Capital Gains (except U.S. real property gains and gains from the sale of a partnership interest)	Generally excluded from U.S. tax. If the NRA was in the United States for 183 days or more during the tax year, the net gain from sales or exchanges of capital assets is taxed at 30%. Capital gains are taxed also if they are effectively connected with a trade or business in the United States during the tax year.
Dividends	Generally included as U.S. source taxable income subject to 30% withholding, unless an income tax treaty applies.
Interest from Bank Accounts	Excluded from NRA withholding tax.
Interest from Bonds or Other Debt Obligations	Taxable and subject to 30% withholding unless the portfolio interest exemption* or an income tax treaty applies.
Portfolio Interest Exemption	Excludes interest paid to NRAs on bonds and other debt obligations held for investment if: (i) The obligation identifies the payer (i.e., is in registered form); (ii) The payee is a foreign individual or entity and is the beneficial owner of income; and (iii) The foreign individual or entity provides a Form W-8 to the payer See Forms W-8BEN, 1042 and 1042-S. Other portfolio exemptions apply. See Publication 515. *This exception does not apply if the foreign investor owns 10% or more of the U.S. corporation or partnership that issued the obligation. The exemption also generally does not apply to interest tied to the issuer's receipts, sales, cash flow, income, etc. Nor does this exception apply to registered debt convertible to bearer form. The portfolio interest exemption does NOT apply to withholding under FATCA, which went into effect beginning July 1, 2014.
Capital Gains from the Sale of Real Estate	Under FIRPTA, such capital gains are taxed on a net basis. However, 15% withholding is on the gross sale price, unless seller applies for reduced certification. See Form 8288 and 8288-A.
Capital Gains from the Sale of a Partnership Interest	Gain or loss on the sale or exchange of all (or any portion of) a partnership interest will be taxed to the extent that the NRA partner would have had effectively connected income if the partnership had sold all of its assets on the date of the sale and allocated the gain to partners. The buyer of the partnership interest is required to deduct and withhold tax equal to 10% of the amount realized on the sale of the partnership interest. If the buyer fails to withhold, the partnership itself must withhold the 10% tax.
Rental Income	Income generated by the use of U.S. real estate is subject to 30% withholding. However, a special election may be made to treat U.S. real property interests as ECI so tax may be paid on only the net income (income less deductions attributable to rental income). Timely U.S. tax returns must be filed to receive the benefit of this election.
Mutual Funds (the mutual fund will designate in writing which dividends are interest-related dividends or short-term capital gain dividends)	Certain interest-related dividends and short-term capital gain dividends from U.S. issuers are excluded from U.S. tax. These exclusions were made permanent by the Protecting Americans from Tax Hikes Act of 2015 (H.R. 2029). Long-term capital gain distributions are excluded from U.S. tax. The tax-exemption for capital gain distributions does not apply to NRAs who were in the U.S. for 183 days or more.

U.S. TRANSFER TAX SUMMARY

Category	Non-U.S. Citizen/Non-U.S. Domiciled	U.S. Citizen or U.S. Domiciled
U.S. Estate Tax	Taxed on U.S. situs assets (real, tangible, intangible)	Taxed on worldwide assets
Applicable Exclusion Amount	$60,000, subject to treaty modified prorata rules, only available for estate tax purposes, not available for lifetime gifts	$11,180,000 in 2018, available for estate, gift and generation-skipping transfer tax purposes
U.S. Gift Tax	Taxed on gratuitous transfers of U.S. situs assets (real, tangible)	Taxed on all gratuitous transfers
Annual Gift Tax Exclusion	$15,000 in 2018 Gift splitting with spouse not allowed	$15,000 in 2018 Gift splitting with U.S. citizen/resident spouse allowed
Transfers to a Non-U.S. Citizen Spouse	• No unlimited marital deduction for transfers to non-U.S. citizen spouse • Lifetime gift to non-U.S. citizen spouse, annual exclusion $152,000 in 2018 • Estate tax marital deduction for transfers to QDOT • Contribution rule for joint tenancy with non-U.S. citizen spouse; deferred gift treatment of joint tenancy in real property	

TEST FOR U.S. DOMICILE

Generally, as provided under Code § 2001(a), the U.S. transfer tax is imposed on the transfer of the estate of every decedent who is a U.S. *citizen* or U.S. *domiciled*.[18] It is important to note that the test to determine whether an individual is or was, as the case may be, U.S. *domiciled* for U.S. estate tax purposes is very different from the test to determine whether an individual is a U.S. *resident* for U.S. income tax purposes (as discussed above). In the U.S. transfer tax context, whether an individual is U.S. domiciled is a subjective facts and circumstances test, while the income tax test for a resident is a well-defined objective test set forth under Code § 7701(b)(1)(A) and the corresponding regulations.

Essentially, a U.S.-domiciled individual is an individual who has moved to the United States indefinitely with no current intentions of leaving the United States. By contrast, a non-U.S. domiciled individual refers to an individual who has no intention of remaining in the United States permanently. Such individual may be here temporarily, merely own U.S.-situate assets or simply have children living in the United States. Based on this standard, the inquiry of whether an individual is U.S. domiciled for U.S. transfer tax purposes is understandably subjective and factually based. Making this determination is important because the U.S. transfer tax regime applies different rules depending on whether an individual is classified as U.S. domiciled or non-domiciled. It is important to note that an individual could be subject to the U.S. income tax based on the objective test for U.S. tax residency, but not be subject to the U.S. transfer tax based on his or her subjective intentions.

U.S. ESTATE TAX

Code § 2031 defines a U.S. domiciled or U.S. citizen's gross estate, for U.S. estate tax purposes, as including the value at the time of death of *all* such decedent's property, real or personal, tangible or intangible, *wherever situated*.[19] The U.S. transfer tax applies to all of the U.S.-domiciled individual's assets, even if not a single asset is or has been in the United States and to a U.S. citizen's assets even where that U.S. citizen has never lived in the United States.

By contrast, the rules are quite different when applying the U.S. transfer tax regime to the transfer of U.S.-situate assets that belong to NCND individuals. The United States' estate taxation of a NCND individual is covered under Code §§ 2101-2108 and the corresponding Treasury regulations. Specifically, Code § 2101(a) provides that, except as provided in Code § 2107 (the section pertaining to expatriates), a tax is imposed only on the U.S.-situated taxable estate (meaning the gross estate less deductions, as determined under Code § 2106) of every decedent NCND.

The NCND's U.S. Gross Estate

The NCND's U.S. gross estate is essentially comprised of his or her U.S.-situate assets at the time of death. As provided by Code § 2103, and for purposes of the tax imposed by Code § 2101, the value of the gross estate of every decedent NCND shall be that part of the gross estate which, at the time of such NCND's death, is *situated* in the United States. Code § 2104 and the corresponding Treasury regulations specify that this property will include U.S. real property,[20] U.S. tangible personal property[21] and U.S. intangible personal property. Code § 2104(b) provides for an often overlooked claw-back of U.S.-situated property transferred by a NCND during life in a Code §§ 2035 to 2038 type transfer. The Code does not include a handy chart that classifies or categorizes assets; as such, what may or may not fall within the above categories is not neatly laid out in the Code. The definition of a U.S.-situate asset or what is an intangible versus tangible asset is instead gleaned from the Code, the related Treasury regulations, relevant case law and applicable provisions of the relevant country's tax treaty with the United States.[22]

It should be expressly noted that Code § 2105 provides that certain property shall not be treated as U.S.-situate property of an NCND's U.S. taxable estate, *even though physically located within the United States*. The rules relating to what is or is not a U.S.-situate asset are not intuitive. Therefore, it will always be important to research each asset to determine its character as a U.S.-situate asset for U.S. transfer tax purposes. For example, life insurance on the life of the NCND, U.S. bank accounts and works of art on loan in the United States are excluded from the NCND's U.S. taxable estate as non-U.S.-situate assets. Generally, that part of the NCND's gross estate situated outside of the United States need not be disclosed on the decedent's U.S. estate tax return unless the decedent's estate is taking certain deductions allowed under Code § 2106.

Estate Tax Deductions

Several deductions apply in the case of an NCND's estate. However, these deductions are not allowed unless the return (required to be filed under Code § 6018) includes the value at the time of death of that part of the gross estate of the NCND that is not situated in the United States. In many instances, the NCND will choose to not reveal this information and will ultimately forgo any available deductions. Privacy will trump tax savings.

The U.S. taxable estate is determined by taking the value of that part of the gross estate, which is situated in the United States at the time of death, and then (perhaps) reducing it by applicable deductions.[23] A common misunderstanding related to the value of U.S. taxable assets and investments is that an NCND owner can declare a net amount for estate tax purposes. For example, the NCND purchases U.S. real property subject to a mortgage. The NCND then mistakenly believes that only the net value of the property will count toward the value of his or her U.S. taxable estate. This generally is not the case.

Treasury Reg. § 20.2053-7 provides:

> A deduction is allowed from a decedent's gross estate of the full unpaid amount of a mortgage upon, or of any other indebtedness in respect of, any property of the gross estate, including interest which had accrued thereon to the date of death, provided the value of the property, undiminished by the amount of the mortgage or indebtedness, is included in the value of the gross estate. <u>If the decedent's estate is liable for the amount of the mortgage or indebtedness, the full value of the property subject to the mortgage or indebtedness must be included as part of the value of the gross estate.</u>

The exception to this is when the real property is subject to a *non-recourse* mortgage, *i.e.*, one in which the lender has no recourse against the borrower, but is limited to the property itself. In that case, only the net value is included in the estate.

Often foreign buyers arrange non-recourse mortgages through private means. This can work, but the mortgage must qualify as a bonafide non-recourse mortgage. The Internal Revenue Service (IRS) is sure to scrutinize any such loan documents related to a meaningful asset. Thus, an NCND who owns U.S. real property directly could reduce his potential U.S. estate tax by mortgaging the property to the greatest extent possible, persuading the lender to take a non-recourse note.

Transfers to a qualified domestic trust (QDOT) will qualify for the unlimited estate tax marital deduction. See the discussion below for a more expanded treatment of transfers to a non-U.S.-citizen spouse.

Currently, an NCND is allowed an estate tax exclusion amount of $60,000 (as provided in Code § 2107(c), *i.e.*, a *unified* credit amount of $13,000). The current U.S. estate tax exclusion amount of $11.18 million for 2018, adjusted for inflation, only applies to U.S. citizens and U.S.-domiciled individuals. An applicable treaty may provide for a prorated exclusion (based on the $11.18 million adjusted for inflation amount) for an NCND, but there still is a large difference between the exclusion amount for NCNDs and U.S. citizens and U.S. domiciled individuals.

PRACTICAL CONSIDERATION WHEN CLAIMING RELEVANT DEDUCTIONS — CAUTION

Certain available deductions relevant to the NCND's taxable estate are set out in Code § 2106 and provide benefits and planning opportunities for the NCND who is subject to U.S. estate tax on his or her U.S.-situate assets. If an NCND's estate should avail itself of these benefits, then the NCND decedent's U.S. estate can deduct a ratable share of its worldwide expenses, losses, debts and taxes that would otherwise be deductible under Code §§ 2053 and 2054. The allowable deduction will follow the proportion that the U.S. gross estate bears to the entire worldwide gross estate.[24] Yet, in many instances the *benefit* is simply not worth it,[25] especially when claiming such a deduction requires full disclosure of the NCND's worldwide assets. The idea of revealing worldwide assets to the IRS is enough to dissuade many NCNDs who consequently forgo claiming the deduct ions. The fear is that once this information is disclosed, the United States will turn over the data to the decedent's home country under one of its mutual exchange of information agreements.

U.S. GIFT TAX

While certain assets are deemed U.S.-situate assets for U.S. estate tax purposes, these same assets may not be deemed U.S.-situate assets for U.S. gift tax purposes. For the U.S. gift tax to apply to U.S.-situate assets, such assets must also be characterized as U.S. *tangible* assets. This additional criterion opens up an array of strategies for U.S. transfer tax planning.

For example, once an asset is characterized as a U.S.-situate asset, the asset will be includible in the NCND's U.S. taxable estate and subsequently subject to U.S. estate tax at decedent's death unless a specific exclusion applies. However, if the asset is properly characterized as a U.S. intangible asset, the NCND can gift the asset out of his or her U.S. estate, gift-tax free.[26] And recall, an NCND can ordinarily transfer non-U.S. situate foreign assets tax free, even to U.S. donees.

From a planning perspective, holding and transferring assets considered intangible rather than tangible can be advantageous. The nature of property at the time of a gift is of critical importance.

For U.S. gift tax purposes, the NCND is allowed the same annual exclusion amount under Code § 2503(b) ($15,000 in 2018), plus the same exclusion for the direct payment of medical and educational expenses under Code § 2503(e), and deductions for certain domestic charitable contributions under § 2522 of the Code, as U.S. individuals. However, the NCND cannot *double* any of these amounts by the common election to *split* gifts, even with a U.S. citizen or domiciled spouse.[27] The Code § 2107 estate tax exemption amount of $60,000 is not available for lifetime gifts by an NCND.

It should be noted here that the unlimited marital deduction for transfers between U.S. citizen spouses is not available to transfers to non-U.S. citizen spouses. However, a non-U.S. citizen spouse may receive an annual exclusion gift in the amount of $152,000 in 2018, adjusted for inflation. QDOT planning is only available for the estate tax, not the gift tax.

U.S. GST TAX

Briefly, the general rule related to the imposition of the GST tax provisions on a transfer by an NCND of U.S.-situate assets is as follows: Treasury Reg. § 26.2663-2 provides that a transfer by an NCND is subject to GST only to the extent that the transfer would also be subject to the U.S. transfer tax within the meaning of Treasury Reg. § 26.2652-1. While GST tax is not discussed in-depth in this piece, simply stated, any transfer by the NCND that would be subject to U.S. estate or gift tax also has potential U.S. GST tax implications. The rules here are complex. However, the Treasury regulations provide numerous examples that illustrate certain principles related to GST transfers by NCNDs. The examples are contained within Treasury Reg. § 26.2663-2(d).

It may be helpful to provide a flavor of the GST implications by example here.
Consider T, an NCND transferor; C is T's child, and GC is C's child and the grandchild of T.

EXAMPLE 1:	EXAMPLE 2:
T transfers property to GC (i.e., a skip person for GST purposes)[28] in a transfer that is subject to U.S. gift tax under chapter 12 within the meaning of Treasury Reg. § 26.2652-1(a)(2). At the time of the transfer, C and GC are NCNDs. T's transfer is subject to chapter 13 (the GST tax provisions set forth in the Code) because the transfer is subject to gift tax under chapter 12 (the gift provisions set forth in the Code).	T establishes a trust providing that trust income is payable to T's child for life and the remainder is to be paid to T's grandchild. T transfers property to the trust that has a value of $100,000 and is subject to chapter 13. T also transfers property to the trust that has a value of $300,000, but is not subject to chapter 13. The applicable fraction with respect to the trust is determined as follows: $300,000 (the value of the nontax portion of the trust) plus $100,000 (the exemption allocated to the trust)/$400,000 (the total value of the property transferred to the trust). Assuming that T has sufficient GST exemption available, and assuming T does not elect to have the automatic allocation not apply, the applicable fraction is one ($400,000/$400,000 = 1) and the inclusion ratio is zero (1 – 1 = 0).[29] This means that the entire amount is GST exempt. Note: For an NCND, most practitioners think it wise to specifically allocate one's GST exemption to such a transfer.

Treasury Reg. § 26.2663-2(a) provides rules for applying chapter 13 of the Code to transfers by a transferor who is an NCND. Every NCND is allowed an applicable GST tax exemption amount available to all taxpayers (presently $11.18 million adjusted for inflation for 2018), which is allocated as set forth in Treasury Reg. § 26.2632-1.

ESTATE AND GIFT TAX TREATIES

The United States has entered into income and estate and gift tax treaties with numerous countries. These treaties are designed to reduce or eliminate double estate taxation. These treaties become more and more important in our increasingly mobile society and with the growth of family wealth globally. Double taxation can occur when an individual dies domiciled in two countries, or is domiciled in one country and owns property in both signatory nations. Some individuals with peripatetic lifestyles are not domiciled in any one country. U.S. income and estate tax treaties incorporate tie-breaker provisions within the applicable treaties that govern these specific situations to help determine which country has primary taxing authority. An executor must disclose any tax treaty position taken on the decedent's U.S. estate tax return, as required under Code § 6114. Failure to disclose a tax treaty position can result in stiff penalties.

Once a foreign person becomes a U.S. resident for U.S. income tax purposes, or U.S. domiciled for transfer tax purposes, the individual's ability to claim benefits under a relevant income or estate tax treaty potentially comes to an end. However, the person may be required to determine his or her country of residence under the applicable treaty's tie-breaker provisions when he or she has very close ties to more than one country. (See the summary table below.)

U.S. ESTATE AND GIFT TAX TREATIES

Country	Estate Tax Treaty Only	Gift Tax Treaty Only	Combined Estate and Gift Tax Treaty	Other	Transfers made on or after	Comments	
Australia	No	Yes	No	No	12/14/1953		PR-UC
Australia	Yes	No	No	No	01/07/1954	old*	PR-UC
Austria	No	No	Yes	No	07/01/1983	new*	
Belgium	Yes	No	No	No	not yet	old	no effect
Canada	No	No	No	1995 Protocol	11/09/1995**	estate tax only	PR-UC
Denmark	No	No	Yes	No	11/07/1984	new	
Finland	Yes	No	No	No	12/18/1952	old	PR-UC
France	No	No	Yes	No	10/01/1980	new	PR-UC (Protocol)
Germany	No	No	Yes	No	01/01/1979	new	PR-UC (Protocol)
Greece	Yes	No	No	No	12/30/1953	old	PR-UC
Ireland	Yes	No	No	No	12/20/1951	old	
Italy	Yes	No	No	No	10/26/1956	old	PR-UC
Japan	No	No	Yes	No	04/01/1955	old	PR-UC
Netherlands	Yes	No	No	No	02/03/1971	new	
Norway	Yes	No	No	No	12/11/1951	old	PR-UC
South Africa	Yes	No	No	No	07/15/1952	old	
Sweden	No	No	Yes	No	09/05/1984 (through 12/31/2007)	new (terminated 01/01/2008)	
Switzerland	Yes	No	No	No	09/17/1952	old	PR-UC
U.K.	No	No	Yes	No	11/11/1979	new	

* Old or new refers to whether the treaty has the "old" situs rules or the "new" provisions that generally restrict the United States to taxing NCND's U.S. real estate and business property.

** The 1995 Protocol had retroactive effect to TAMRA. Claims for refund based upon the treaty had to be filed by November 9, 1996.

PR-UC in comments section above refers to a pro-rata unified credit provision. (The pro-rata unified credit provisions in the German and French treaties apply only to estate tax, not to gift tax.)

Source: IRS http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estate-&-Gift-TaxTreaties-(International). Undated as of April 3, 2018

ASSET COMPARISON: GIFT TAX VERSUS ESTATE TAX TREATMENT

A comparison of how certain assets are treated under the gift tax versus the estate tax regime helps to illustrate the above discussion. The applications below are interwoven to include other relevant matters that may arise.

U.S. Real Estate

- **U.S. Gift Tax** — U.S. real estate is a U.S.-situate tangible asset as provided under Treasury Reg. §§ 20.2104-1(a)(1) and 25.2511-3(b)(1) for both U.S. gift and estate tax purposes. However, U.S. real property may be held in a limited liability company or corporation, interests and shares in which are intangible assets and the lifetime transfer of which would be U.S. gift tax free. However, this planning structure is not free from concern as discussed below.
- **U.S. Estate Tax** — In order to avoid U.S. estate tax on U.S. real estate (such as a vacation home in the United States), many NCNDs will own their home through a foreign holding corporation. Thus, at death, the NCND would instead own stock in a *foreign* corporation, which is not considered a U.S.-situate asset for U.S. estate tax purposes. Using a foreign holding corporation is a common planning tool for NCNDs who plan to invest in U.S.-situate property such as U.S. real property. This is true whether the property will be held for personal use, for investment or for both. However, these asset ownership arrangements can be complex with implications beyond estate tax planning.
- **Note on Income Tax** — Under FIRPTA transfers of appreciated U.S. real property by an NRA, including a transfer to a foreign corporation, can trigger capital gains tax and withholding. An analysis of FIRPTA is beyond the scope of this discussion, but the implications of FIRPTA should be addressed in any transfer of appreciated U.S. real property by a foreign person.[30]

U.S. Situs Tangible Personal Property

Gifts and bequests of U.S. situs tangible personal property by NCND individuals are generally subject to U.S. gift and estate taxes if the property is situated in the United States at the time of the gift. Transfers made with retained interests may be brought back into the estate at death for U.S. transfer tax purposes.

Cash/Currency and Bank Deposits

- **U.S. Gift Tax** — It is generally accepted that cash or currency is a tangible asset for U.S. gift tax purposes.[31] Therefore, an NCND who transfers cash or currency from a U.S. bank account to any donee is subject to U.S. gift tax to the extent the value exceeds the annual exclusion amount. As noted above, the NCND is allowed the same annual gift exclusion as U.S. citizens and residents. However, the NCND is not allowed the $11.18 million for 2018, adjusted for inflation, lifetime gift exclusion. As a result practitioners frequently recommend that gifts of cash or currency take place outside the United States, or that such gift of cash be wired from the NCND's *non*-U.S. bank account to a U.S. donee. Note, however, that debt obligations generally are intangible assets not subject to gift tax.[32]
- **U.S. Estate Tax** — By contrast, cash held in a U.S. bank (a bank deposit account) is not a U.S.-situate asset as specifically provided under Code § 2105(b)(1) by reference to Code §§ 871(i)(3) and 871(i)(1). There is no set definition for what is or is not a U.S. bank deposit account. Therefore, it is important to analyze such deposit accounts under the relevant provisions pertaining to Code § 2105 and other guidance. Congress' general purpose behind these rules was to encourage NCNDs to make and keep deposits with domestic banks and their offshore branches. As a caveat, an NCND's deposit with a domestic bank is not subject to inclusion in his or her gross estate as long as the deposit is not effectively connected with a trade or business within the United States operated by the NCND.

Apart from the category of bank deposits, all other accounts with U.S. banks generally would be included in the NCND's gross estate. Accounts within brokerage houses do not qualify as bank deposits and, thus, are includible in the NCND's U.S. taxable estate.[33]

There is some concern that Code § 2105(b)(1) may not apply in the case of an individual who is a U.S. resident for U.S. income tax purposes, but who is not a U.S. resident, *i.e.*, considered non-domiciled in the United States, for U.S. transfer tax purposes. The circular nature of the relevant Code sections creates a potential problem: Code § 871 removes the income tax exemption on bank interest if the account owner is a U.S. resident for income tax purposes. Since the U.S. estate tax rules import Code § 871, then the argument is that the rule deeming the situs of domestic bank accounts as without the United States should not apply if the NCND is a U.S. resident for income tax purposes. This seems contrary to the Congressional intent — thus, another reason why tax policy is necessary to interpret tax application. In many instances, this issue may be clarified under applicable treaty.

Stock in a U.S. Domestic Corporation

- **U.S. Gift Tax** — In general, shares of stock in U.S. domestic corporations are considered intangibles.[34] Therefore, an NCND can transfer all such shares in a gift transfer without incurring any U.S. gift tax.[35]
- **U.S. Estate Tax** — By contrast, U.S. domestic stock owned and held by an NCND shall be deemed property situated within the United States for U.S. estate tax purposes. The location of the stock shares is irrelevant. For example, in Estate of Jan Willem Nienhuys,[36] shares of stock in a U.S. domestic corporation, whose certificates were located in the Netherlands, were determined to be property located within the United States. Note that the NCND who holds shares in such U.S. corporations is subject to the U.S. estate tax, absent an overriding treaty. For example, a U.K. citizen NCND who owns U.S. corporate stock will not be subject to U.S. estate tax on the U.S. corporate shares. This is specifically excluded by treaty. Always consider applicable income and estate tax treaties.

PRACTICAL CONSIDERATION — CORPORATE STRUCTURE TO HOLD U.S. DOMESTIC STOCK

In the case where an NCND wishes to own U.S. corporate shares (and no treaty provides a remedy) and the NCND uses a foreign corporation to hold the U.S. securities, then these U.S.-situate assets would be transformed essentially into non-U.S. situate assets as to the NCND's holdings. The NCND would no longer be considered as holding U.S.-situate assets, but foreign company shares that have a foreign situs for U.S. transfer tax purposes. However, once such U.S.-situate assets are contributed to a foreign holding corporation, it is important that the NCND respect the corporate formalities of the foreign holding corporation to avoid the IRS disregarding the entity and claiming the NCND is instead holding such U.S. assets directly. For example, these formalities were not respected in *Fillman v. United States*,[37] and certain U.S. securities were ultimately brought back into the decedent's estate for U.S. estate tax purposes. In *Fillman*, the decedent NCND owned stock in two Argentine corporations that owned stock in U.S. domestic corporations. The domestic securities were held in a custodial account at a bank, which also served as nominee.

Domestic securities were actively traded within the account and at all times the securities were held in the names of the Argentine corporations, which had complete power to deal with the securities. However, the son of the decedent had stated in U.S. and Swiss postmortem filings that the decedent NCND had been the exclusive holder of legal and equitable title to the U.S. securities with the companies acting as custodians on behalf of the decedent. The *Fillman* court regarded the facts of the case as showing that the decedent actually had beneficial ownership in each of the Argentine corporation's assets. The *Fillman* court relied on the principle enunciated in *Comm'r v. Nevius*[38] that beneficial ownership of an asset by a decedent is sufficient to warrant inclusion in the gross estate.[39]

Further, in *Estate of Oei Tjong Swan v. Comm'r of Internal Revenue*,[40] the decedent established Liechtenstein and Swiss Stiftungen (foundations) to own and hold decedent's New York situs accounts. The Second Circuit did not agree with the estate's argument that the entities were the same as foreign corporations. The *Swan* court found that the taxpayer had retained sufficient control over the ultimate enjoyment of the property up to the date of his death, such that the value of the property was includible in his U.S. taxable estate.[41] This case is important because it provides that the entity chosen offshore must qualify as a corporation for U.S. purposes in order to ensure the desired results under the estate plan.

Qualified Portfolio Debt Obligations

U.S. debt obligations issued after July 18, 1984, the interest of which qualifies as portfolio interest are deemed not to be U.S.-situate assets.[42] Thus, they are not included in the taxable estate of an NCND. Note that since the estate tax exclusion refers to the portfolio interest income tax exclusion, someone who is an NCND for estate tax purposes, but is a resident for income tax purposes may not be able to rely on the estate tax exclusion for portfolio debt obligations. The payment obligation in these instruments is paramount. It is important to ensure that payment obligations remain payable outside the United States and to non-U.S. persons. As such, gifting or transferring this obligation can potentially invalidate its status as a non-U.S. situate asset or trigger U.S. income tax.

For tax years after 2011, a U.S. mutual fund's underlying assets which would give rise to U.S. tax-free interest income or capital gains under Code § 871(k) for income tax purposes are no longer treated as "foreign situs assets" for estate tax purposes, and thus are includible in the taxable estate of an NCND under Code § 2105(d).

Life Insurance

Life insurance can be a very tax-efficient investment under both the inheritance tax laws of other countries as well as those in the United States. Insurance is actually an important part of any multinational estate plan.[43] The Code provides that amounts receivable as *insurance on the life of an NCND* shall not be deemed property within the United States.[44] As the Code does not limit the provision's application to policies issued by foreign insurers, the situs rule applies whether or not a domestic or foreign insurer issues the policy.

However, the applicable Treasury regulations limit the situs rule to policies based *only* upon the life of the decedent NCND. It should be noted that the Code refrains from using the term *life insurance contract* in this context, and requires that the payment merely be an *amount receivable as insurance on the life*. So it seems the requirements of Code § 7702 do not apply in the context of Code § 2105. Thus, it would appear that an NCND need not invest in Code § 7702 compliant products in order for Code § 2105 to apply.

Trust Interests

There is no definitive authority as to the treatment of beneficial trust interests held by NCNDs. It is commonly understood that one looks to the situs of the underlying assets of the trust. Thus, a common asset ownership structure in NCND planning is use of a trust holding shares of a foreign holding company, which in turn owns shares of U.S. corporations and/or U.S. real property. The situs of the underlying asset of the trust, the foreign holding company, is foreign, not U.S. If the corporate formalities are met there should be no look-through of the foreign holding company.

However, the proper sequence of purchase, corporate ownership and transfer to the trust is also important to avoid the implications of Code § 2104(b), which can claw back into a decedent's gross estate U.S.-situate property transferred to a trust in a Code §§ 2035 to 2038 type transfer during life. It is usually recommended that the foreign holding corporation purchase the U.S. real estate or U.S. company shares, and that the foreign holding corporation stock then be contributed to an appropriate trust (meaning, either a U.S. or foreign trust, as the case warrants for effective estate planning). This is because under Code § 2104(b) the character of the property may be forever tainted as U.S.-situate property if it is acquired by the NCND person directly. A lifetime contribution of the U.S.-situate property to a non-U.S. corporation controlled by the foreign person would not change the Code § 2104(b) taint because U.S.-situate Code §§ 2035 to 2038 property transfers are tested not only at the time of death, but also at the time of the *original retained interest transfer*.[45]

There may be additional benefit to having the foreign company holding corporate shares held in trust. A trust holding the shares or assets provides ease of management in the event of disability or inevitable death of the NCND. In addition, contributions to certain trusts located in favorable jurisdictions can provide for confidentiality, protect against forced heirship rules and assist with family conflicts if proper governance provisions are set forth in the governing instrument.

In summary, the scenarios outlined above illustrate that whether an asset is subject to either the U.S. estate or U.S. gift tax depends upon the character of the asset as either tangible or intangible and as either U.S.-situate or non-U.S.-situate by definition. However, assets require a case-by-case analysis. (See the summary on the next page.)

FROM A U.S. PERSPECTIVE:
GENERAL TREATMENT OF ASSETS OF NON-CITIZEN, NON-DOMICILED FOR U.S. TAX PURPOSES

Asset Class	Considered U.S. Situs for Estate Tax Purposes	Not Considered U.S. Situs for Estate Tax Purposes	Considered U.S. Situs for Gift Tax Purposes	Not Considered U.S. Situs for Gift Tax Purposes
Foreign Situs Assets		X		X
U.S. Real Property	X		X	
Foreign Real Property		X		X
U.S. Real Property Held by Foreign Corporation		X		X
U.S. Bank Deposits (checking, savings, CD)		X	X	
U.S. Brokerage Deposits	X			X
U.S. Money Market Accounts	X			X
U.S. Mutual Funds	X			X
Tangible Personal Property Located in United States	X		X	
Works of Art on Loan for Exhibition in United States		X		X
Currency/Cash Located in United States	X		X	
Stock U.S. Corporation	X			X
Stock Foreign Corporation; American Depository Receipt Foreign Corporation		X		X
Intangible Personal Property Issued by or Enforceable Against U.S. Resident, Corporation or Governmental Unit	X			X
Qualified U.S. Portfolio Debt Obligations		X		X
Proceeds of Life Insurance on the Life of a Non-Citizen Non-Domiciliary		X		X

PRE-IMMIGRATION PLANNING

An NRA or NCND is taxed differently and sometimes more favorably on assets or investments in the United States. Upon moving to the United States, these preferential tax treatments may disappear. As noted above, a U.S. Person is subject to income tax on his or her worldwide income and gains, and a U.S. domiciled individual is subject to U.S. transfer tax on his or her worldwide assets. This may indeed surprise many foreign nationals who make the move to the United States without proper planning to mitigate these unintended consequences.

Planning Considerations

Below are certain planning considerations that could potentially save the newly-relocated U.S. Person from both U.S. income tax and U.S. transfer tax. In general, the below shall serve as a guide; however, certain items will require more explanation.

Recall that NRA is an income tax-related term and NCND is a transfer tax-related term. Where both income tax and transfer tax are at issue, the following discussion uses the more general term "foreign person." A word of caution is in order here. Any U.S. tax planning should be coordinated with the individual's home country tax planning under the guidance of home country advisors so as not to cause unanticipated or unintended consequences under the laws of the home country.

Income Tax Considerations

- Consider accelerating (realize and recognize) any and all income earned by the immigrating taxpayer prior to becoming a U.S. resident. Possible income to accelerate includes compensation, pension plans, stock options, prepaid rents, royalties, dividends, interest, annuities and capital gains on appreciated assets. Note that:
  - Stock options, when exercised, usually generate ordinary income in the United States that is taxable at the top rate of 37%; the immigrating NRA may wish to check when vesting will occur.
  - U.S. rents, royalties, interest and certain dividends, under the Code are characterized as FDAP income. The immigrating NRA should consider accelerating receipt of such U.S. FDAP income. As a general rule, the gross amount of FDAP income is subject to a withholding tax at a rate equal to 30%, or a lower tax treaty rate, if applicable. The possible advantage of accelerating the receipt of FDAP income is that high income U.S. tax residents are subject to U.S. income tax at higher graduated rates, especially when subject to a corresponding state income tax. Therefore, depending on the extent of the NRA's income, it may be that 30% of gross, or a reduced tax treaty rate, if applicable, would represent a tax savings as compared to much higher U.S. Person's graduated rates on net income, plus any applicable state income tax.

  - Income can include compensation for personal or other services performed prior to the immigrating NRA becoming a U.S. tax resident. If the NRA controls a corporation, foreign or domestic, with accumulated earnings, the NRA should probably cause a distribution of its income. Assuming any dividends are treated for U.S. income tax purposes as foreign source income, the NRA will not be subject to U.S. income tax on those dividends. Moreover, by paying a dividend, the corporation will reduce its earnings and profits. Practitioners may recommend that the NRA lend or contribute a similar amount to the corporation so that the corporation can satisfy its capital needs.
  - Except for real estate, NRAs generally are not subject to Federal income tax on capital gains. Consider accelerating gain in appreciated assets belonging to the immigrating NRA prior to becoming a U.S. tax resident.

- If possible, consider electing out of installment sales treatment for U.S. income tax purposes. This may be impossible. Unless a timely election is made not to report on an installment basis, the IRS will treat the transaction as an installment sale. The immigrating NRA will recognize gain on an installment sale basis on the deferred gain. If a move to the United States is anticipated, there could be certain preemptive planning to protect the immigrating NRA against this deferred gain.

- It may be advisable to defer recognizing losses until after the immigrating NRA becomes a U.S. tax resident. These losses may be taken against gains in assets after the immigrating NRA becomes a U.S. tax resident.

- It may be advisable to defer paying deductible expenses until after the immigrating NRA becomes a U.S. tax resident.

- Review existing investment structures to determine whether there will be adverse tax impacts under U.S. tax laws. Upon becoming a U.S. tax resident, the newly-U.S. Person will be subject to U.S. income tax on worldwide income and gains, and subject to U.S. estate tax on worldwide assets. From a U.S. income tax perspective, U.S. Persons who have controlled foreign corporation interests or passive foreign investment company interests may be subject to the harsh U.S. income anti-deferral tax regime. Essentially, the United States does not like U.S. Persons accumulating income in offshore companies or trusts. As such, Congress enacted certain anti-deferral tax rules that force beneficial owners of these entities to repatriate income and pay U.S. tax. Depending on the immigrating NRAs holdings, it may be prudent to divest, gift or otherwise dispose of such an interest.

- Explore tax strategies that will step up the tax basis of assets to their fair market value so that only appreciation after becoming a U.S. tax resident will be taxable in the United States. Unlike many jurisdictions, such as Canada, the United States does not allow an immigrating NRA to adjust the tax basis of his or her property to reflect its fair market value at the time the NRA becomes a U.S. tax resident.

  - If the NRA desires to protect pre-immigration appreciation from U.S. income tax in the event of a post-immigration disposition of the property, the NRA should take affirmative steps to trigger a step-up in tax basis.
  - There are other effective strategies that can trigger basis step-up for NRA-held shares in family companies or other property. These should be explored with tax counsel prior to immigrating.
  - For example, the NRA could sell the asset, and then, to the extent desirable, re-acquire the asset. However, the NRA must be mindful of any tax on gain in his or her current jurisdiction as the current jurisdiction may have a higher tax rate. The NRA could also trigger gain in a defective reorganization pre-immigration. These are sophisticated strategies but could provide effective U.S. income tax minimization.

- Plan the proper timing of arrival into the United States. Arriving in the last half of the calendar year usually will result in NRA tax status for U.S. income tax purposes for the full year. However, a move to California, for example, and certain other states, could trigger state income tax residence in less time. Based on several examples provided specifically in the California Franchise Tax Board Publication 1100, a person immigrating to California could trigger California state income tax even if they move into California in December of the tax year. As California has a very high state income tax, an immigrating NRA may not wish to be subject to California's income tax rate of nearly 13.3% on his or her worldwide income.

Transfer Tax Considerations

- Consider transferring assets to an NCND spouse before establishing a U.S. domicile. Sometimes it is advisable for assets owned in the name of one immigrating NCND spouse to be transferred to either the other immigrating spouse or a non-immigrating spouse, as applicable. If both spouses are immigrating to the United States, after immigration, gifts to non-U.S. citizen spouses will be subject to U.S. gift tax, with the exception of the $152,000 in 2018, adjusted for inflation, annual exclusion amount relevant for non-U.S. citizen spouses. If a substantial amount of assets are to be transferred from one NCND spouse to another, these transfers should occur for U.S. gift tax purposes before the NCND spouses establish domicile in the United States.

- Determine if accelerating gift planning would be appropriate. The U.S. gift tax only applies to transfers by NCNDs of their U.S.-situate tangible property, whereas a U.S. citizen or U.S. domiciled individual's worldwide assets of any type are subject to Federal gift and estate taxes. To the extent that an immigrating NCND desires to make gratuitous transfers to third parties, the NCND should probably make these gifts before immigrating to the United States. After the gift, the NCND has removed the asset from his or her estate for U.S. estate tax purposes.

  - **U.S. Tangible Assets** — As noted above, gifts of tangible personal property located within the United States will be subject to U.S. gift tax. Thus, the immigrating NCND may wish to relocate tangible personal property outside the United States before a transfer. By moving these assets outside of the United States before the gift and before establishing U.S. domicile, this strategy may avoid U.S. gift tax implications.

- **Intangible Assets** — If the U.S. situs assets are intangible assets, the immigrating NCND can gift those assets either inside or outside the United States before changing domicile. As noted previously, gifts of intangible property are not subject to U.S. gift tax. Thus, the immigrating NCND, prior to his or her move, could gift shares in a U.S. corporation, limited liability company or limited liability partnership interest without gift tax concern.

Trust Considerations

- Consider a foreign or U.S. trust for estate planning prior to moving to the United States. There are trust strategies that will benefit the NCND for U.S. transfer tax purposes whether the NCND is immigrating to the United States, has children who are moving to the United States or simply wants to have investments in the United States on a U.S. tax-efficient investment platform (that is, an investment platform subject to a preferential tax regime for NRAs).
- For the NCND who is not immigrating, but who has immigrating children, foreign grantor trusts present an interesting planning strategy. Often, NCND parents wish to help support their children when the children move to the United States. Or, the NCND parents want to have a structure that allows for the tax-efficient succession of wealth to U.S.-based children. NCND parents commonly use a foreign grantor trust to accomplish these tax objectives. The foreign trust structure provides U.S. income tax efficiency during the NCND parents' lifetimes and provides a shield from U.S. transfer tax after the parent-grantor's death. However, if an NCND later chooses to immigrate, prior planning benefits may be affected, particularly for a change within five years of transferring property to a foreign trust.
  - **U.S. Income Tax** — The NCND parents remain the deemed owners of the underlying trust assets for U.S. income tax purposes. Qualifying a trust with a foreign grantor as a grantor trust under the grantor trust rules are more limited than for a U.S. Person by operation of Code § 672(f). But if a trust is properly structured as a grantor trust with a foreign grantor, foreign-sourced income and gains are not taxed in the United States and any U.S. investments invested on a U.S. tax-efficient NRA investment platform should be U.S. tax efficient. While the NCND parents are alive, there is little or no U.S. income tax drag at the trust level.
  - **U.S. Estate Tax** – When the NCND parents pass away, simply stated, the trust assets remain available for the benefit of the U.S.-based children; yet, these assets should escape forever the U.S. estate tax net. At this point further planning may be required for U.S. income tax purposes, unless the requisite planning is incorporated into the trust document.

- For the foreign person who is immigrating, trusts can be very useful in pre-immigration planning, but complex as well. Determining whether a trust is a foreign trust (the trust fails either the court test or the control test under Code § 7701(a)(30)(E)) or a domestic trust is essential in tax planning.
  - **Existing Foreign Trust for the Benefit of the Immigrating Foreign Person** — If there is already a foreign trust in place for the benefit of the immigrating foreign person, the immigrating person should consider accelerating current and accumulated income in the foreign trust before becoming a U.S. Person. There are harsh U.S. income tax implications if a U.S. Person receives accumulated distributions from a foreign trust.
  - **Foreign Trust for Non-U.S. Beneficiaries** — If an immigrating foreign person establishes a foreign trust solely for the benefit of non-U.S. beneficiaries and retains no powers that would cause the foreign person to be considered the deemed owner of the assets, the trust will be a separate foreign taxpayer and no U.S. income tax will be due, except on U.S. source income as previously defined. Additionally, the trust assets would not be includible in the immigrating person's U.S. taxable estate at death. If a beneficiary of the trust later becomes a U.S. Person, the foreign trust would have to exclude the beneficiary to avoid adverse U.S. income tax implications.
  - **Trust for U.S. Beneficiaries** — If the foreign person wishes to remove assets from his or her U.S. taxable estate prior to immigrating to the United States and also shield those assets from the U.S. estate tax net for future generations, the foreign person might consider gifting unlimited foreign and/or U.S. intangible assets to a trust for the benefit of his or her children who are already living in the United States. The U.S. income tax implications that arise from this scenario can be complex depending upon whether the trust is domestic or foreign, but the immigrating foreign person can achieve both U.S. income and estate tax efficiency with proper pre-immigration planning.

U.S. TRANSFER TAX SYSTEM AND THE NON-U.S. CITIZEN SPOUSE

Marital Assets and the U.S. Transfer Tax

There are limitations on gifts and inheritances from a spouse to a non-U.S. citizen spouse.[46] For example, if the donee spouse is not a U.S. citizen, the unlimited gift tax marital deduction is not available for transfers made to that spouse. But, there are planning strategies one can use to transfer significant value to the non-U.S. citizen spouse. In addition, the unlimited estate tax marital deduction otherwise allowed by Code § 2056(a), for property passing to or for the benefit of the decedent's surviving spouse, is disallowed under Code §§ 2056(d) and 2056(A), unless the surviving spouse becomes a U.S. citizen or an appropriate election is made with respect to such property passing into a trust that meets the requirements of a QDOT.

Gifts to a Non-U.S. Citizen Spouse

A donor is not allowed an unlimited marital deduction for gifts made to his or her non-U.S. citizen spouse.[47] Instead, the donor is entitled to a modified annual exclusion amount for gifts to such non-U.S. citizen spouse, currently $152,000 in 2018, as adjusted for inflation.[48] These transfers per year are not subject to U.S. gift tax, and as such, there is no U.S. gift tax return filing requirement. The Treasury regulations make clear that the citizenship or domicile of the *donor* spouse at the time of the gift is irrelevant; the inquiry is focused on the donee spouse. If the donee spouse is a U.S. citizen at the time of the gift and the other provisions of Code § 2523[49] are met, the marital deduction will be allowed regardless of whether the donor spouse is a U.S. citizen or U.S. domiciled.

Inadvertent Gifts

It is important to determine the citizenship or status of married persons when making inter-spousal transfers or titling assets or accounts. It is possible to make an inadvertent gift for which a current U.S. gift tax may be due. A common scenario is when upon marriage a husband or wife adds a non-U.S. citizen spouse to their marital home's title or to joint tenancy investment or bank accounts to be shared. Depending on the rights of the non-U.S. citizen spouse, this could be a current taxable gift. The following, related to jointly held property, illustrates some of the issues that can arise:[50]

- There is no deemed current gift on creation of the joint tenancy for real estate. The U.S. gift tax, however, is triggered upon the ultimate sale of the real property, if both spouses are currently living.
- With regard to joint accounts or other joint property, there will be a deemed gift on the purchase or titling of joint tenancy property if the non-contributing, non-U.S. citizen spouse can sever the joint tenancy and take his or her share at any time under applicable law.

Planning Options

Intra-Spousal Loans — Under Code § 7872, since a husband and wife are treated as one person for purposes of the U.S. gift loan rules, there is no imputed interest. This is a handy provision that, if used creatively, can assist in getting the non-U.S. citizen spouse necessary monies to purchase his or her interest in property, such that he or she can provide consideration. However, it is critical that the loan be treated as a proper loan and not as a gift. If it appears that the loan has been re-characterized as a gift, there may be U.S. gift tax exposure. Several factors, in addition to the existence of an interest rate, are relevant in determining whether a loan will be treated as such and not as a gift. These factors include whether there is a promissory note, fixed maturity date, consistent pattern of actual repayments, any security or collateral and whether any records were maintained by the debtor and/or the creditor in relation to the loan transaction.

Acquisition of Rights Under a Joint and Survivor Annuity — The U.S. gift tax marital deduction is available for transfers to a non-U.S. citizen spouse resulting from the *acquisition of rights under a joint and survivor annuity*.[51] By way of explanation, Code § 2523(i) specifically excludes transfers resulting from the acquisition of rights under a joint survivor annuity as described in Code § 2523(f)(6). For example, as provided in Treasury Reg. § 25.2523(i)-1(d), Ex. 2:

> Assume that donee S is the spouse of donor D and is not a U.S. citizen at the time of the gift. In 1993, D, a U.S. citizen, retires from employment in the United States and elects to receive a reduced retirement annuity in order to provide S with a survivor annuity upon D's death. The transfer of rights to S in the joint and survivor annuity is a gift by D for U.S. gift tax purposes. However, under Treasury Reg. § 25.2523(i)-1(b), the gift qualifies for the gift tax marital deduction even though S is not a U.S. citizen.
>
> Note, however, that such a transfer does not qualify if the executor irrevocably elects out of QTIP treatment. Code § 2523(f)(6), in essence, shields the value of continuing payments to a surviving spouse by providing that a donee spouse's interest in a joint and survivor annuity is generally treated as a qualifying income interest for life for purposes of Code § 2523(f)(3). This is applicable if only the donor spouse and the donee spouse have the right to receive payments before the death of the last.

Attaining U.S. Citizenship — Absent QDOT planning as discussed below, the estate tax marital deduction is disallowed under Code §§ 2056(d) and 2056A for property passing to or for the benefit of a non-U.S. citizen spouse unless the surviving spouse becomes a U.S. citizen before the decedent's estate tax return is filed and was a U.S. resident at all times after the decedent's death and before becoming a U.S. citizen.[52] However, this option is not always available. Under certain circumstances a non-U.S. citizen spouse may not be able to obtain U.S. citizenship without giving up citizenship from his or her home country. In addition, unless the non-U.S. citizen spouse had already begun the U.S. citizenship process well before the death of his or her spouse, it is highly

PRACTICAL CONSIDERATION

In the event that the non-U.S. citizen spouse desires to acquire U.S. citizenship and that is likely, then the family trust document should be drafted at the onset to provide more flexibility for the spouse who will likely become a U.S. citizen. In addition, it is important to advise the non-U.S. citizen spouse about the implications of later giving up U.S. citizenship. An onerous exit tax on inherent gains in assets could apply.[53]

unlikely that there will be time to obtain U.S. citizenship before filing the U.S. estate tax return. From start to finish, the U.S. naturalization process can take more than five years.

If the surviving spouse will obtain U.S. citizenship, it is important to take timing considerations into account. In *Estate of Liftin v. United States*, 754 F.3d 975 (C.A. Fed. June 10, 2014), *aff'g* 111 Fed. Cl. 13 (Fed. Cl., 2013), *reconsideration denied* (May 17, 2013), the spouse, on the erroneous advice of counsel, waited too long. An extension to file the decedent's estate tax return was obtained and shortly before the extended return was due the surviving spouse informed the executor of her intention to become a U.S. citizen. On advice of counsel, the executor filed a late return after the spouse became a U.S. citizen — a process that took 14 months. And the filing was delayed an additional nine months after citizenship was granted.

The IRS imposed a penalty for the late filing and denied the estate's claim for refund, losing in both the Federal Court of Claims and appeal to the Federal Circuit Court.

Transfers to a QDOT — Alternatively, a marital estate tax (not gift tax) deduction is allowed to the extent the decedent's property passes to the surviving non-U.S. citizen spouse in a QDOT. A trust must satisfy the following requirements to qualify as a QDOT under Code § 2056A:

- The trust must be an ordinary trust as defined in Treasury Reg. § 301.7701-4(a).
- The trust must be maintained under the laws of a state of the United States or the District of Columbia, and the administration of the trust must be governed by the laws of a particular state of the United States or the District of Columbia.
- The trust instrument must require that at least one trustee (U.S. trustee) be an individual U.S. citizen or a domestic corporation, subject to regulatory exceptions.
- The trust instrument must provide that no distribution (other than a distribution of income or a distribution on account of hardship) may be made from the trust unless a U.S. trustee has the right to withhold from the distribution such QDOT tax imposed on such distribution.
- The QDOT must include detailed additional requirements to ensure collection of the deferred estate tax. These requirements include governing instrument requirements for using a U.S. bank trustee, bond or letter of credit if the QDOT has assets in excess of $2 million (excluding $600,000 for a personal residence and related furnishings) and reporting requirements for QDOTs owning foreign real property if these security requirements do not apply.

If a trust does not meet the requirements of a QDOT it may be possible to obtain relief for extension of time to amend the trust to meet the requirements for a QDOT.[55] In order to meet the requirements for an extension of time in accordance with Treasury Reg. § 301.9100-3, the taxpayer is required to provide

CAUTION

The executor must elect QDOT treatment for the trust. An irrevocable QDOT election must be made with respect to the trust no later than one year after the due date (including extensions) for filing the decedent's Federal estate tax return.[54]

CAUTION

The QDOT rules do not prohibit the non-U.S. citizen spouse from serving as a co-trustee of the QDOT. The only mandatory role of the U.S. trustee is to withhold the QDOT tax imposed on the distributions. However, if the non-U.S. citizen spouse is a co-trustee who has the authority to control all substantial decisions of the trust (i.e., control all decisions other than mere ministerial decisions concerning the trust), and the non-U.S. citizen spouse becomes a non-U.S. resident, the QDOT may be classified as a foreign trust for U.S. income tax purposes.

evidence that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government.

The deferred U.S. estate tax is triggered under the following circumstances: (1) upon any distribution from the QDOT before the non-U.S. citizen spouse's death,[56] (2) upon the amount remaining in the QDOT at the non-U.S. citizen spouse's death[57] and (3) if the QDOT ceases to qualify as a QDOT.[58]

Distributions of income to the surviving spouse, as provided under Code § 2056A(b)(3)(A), are not subject to the U.S. deferred estate tax upon distribution, and neither are distributions for hardship as provided under Code § 2056A(b)(3)(B). Hardship distributions are distributions of principal to the surviving spouse in response to immediate and substantial financial need related to such spouse's health, support or maintenance, or the health, support or maintenance of any person the surviving spouse is legally obligated to support, unless the amount distributed may be obtained from other reasonably available sources.[59]

If the surviving spouse becomes a U.S. citizen after the QDOT is established, notice of this must be made by filing a final Form 706-QDT on or before April 15 of the calendar year following the year in which the surviving spouse becomes a U.S. citizen. Treasury Reg. § 301.9100 relief may be applied for if a timely filing is not made.[60] If Form 706-QDT is not filed or relief to allow late filing is not applied for, the trust will be taxed under the QDOT tax rules of Code § 2056A as property of the first decedent upon the death of the surviving spouse and may not be sheltered by any available applicable exclusion of the surviving spouse.

There are practical considerations before electing to use a QDOT strategy, which include: whether the non-U.S. citizen spouse intends to remain in the United States, what assets will be contributed to the QDOT and what the overall tax benefit will be considering this is a tax deferral strategy, not a tax avoidance strategy. These are uncertain times and a review of the many relevant factors, tax and non-tax, must be analyzed.

Disclaimers — An NCND spouse may use the benefits of a disclaimer under Code § 2518. This could be useful whenever a beneficiary would prefer not to receive the ownership of a particular asset or class of assets. Most foreign clients will be unaware of this planning opportunity. In civil law countries, for example, there is an instant receipt of the assets, and there is no interim probate period. This does not cause an issue for U.S. tax purposes; however, each of the qualified disclaimer rules under Code § 2518 must be complied with, including the requirement that there be no prior acceptance of any property subject to the disclaimer.

Elective Share

A surviving spouse may be entitled to an elective share of a decedent's probate estate or an "augmented estate" under applicable state law. Two questions arise when a decedent has a foreign trust in an augmented estate jurisdiction. The first is whether the augmented estate against which a spousal election may be made will include the foreign trust. The second is the extent to which any election reaching a foreign trust qualifies for the marital deduction. In what appears to be a decision of first impression, the IRS denied a marital deduction with respect to an elective share where the foreign trust was included in the augmented estate in the computation of the elective share. Under its tier system of satisfying the elective share, the applicable state law provided that a deficiency in the elective share not satisfied from other assets would by payable from the trust. Nonetheless, the share did not satisfy the "passing" requirement of Code § 2056 and the claimed marital deduction was denied.[61]

Community Property

Civil law countries commonly have a system of *community property* that deems all property acquired during a marriage to be one-half owned by each spouse. Thus, only up to one-half of the U.S.-situate properties' value can be included in the gross estate of a decedent NCND, as such properties are only half owned by the decedent NCND and the other half are owned by the NCND's spouse,[62] if the marital laws of the foreign country are equivalent to the American community property system.[63] So where an NCND domiciled in a community property country dies owning U.S.-situate property (for example, shares in a U.S. corporation), and leaves the property to his or her NCND spouse, ordinarily only one-half of the value of the property owned by the decedent is includible in the decedent's U.S. taxable estate.[64] This is because the other one-half of the value is deemed owned by the surviving spouse at the time of the decedent's death under the community property rules of the country of domicile. Note that this treatment is similar to the analysis among some U.S. states. In the handful of states that follow community property law, the decedent includes only the value of his or her one-half share of the property. In many instances a discount is allowed on the value of the decedent's one-half share of the deemed *fractional* ownership, which is taken on the U.S. estate tax return.

EXPATRIATION

On June 17, 2008, President Bush signed the Heroes Earnings Assistance and Relief Tax Act of 2008 (Heroes Act). The Heroes Act imposes a "mark-to-market" exit tax applicable to certain U.S. citizens and long-term residents who expatriate or relinquish their green cards. The exit tax applies to individuals who are "covered expatriates" who expatriate or relinquish their green cards on or after June 17, 2008. The Act also imposes a "succession tax" on U.S. citizens or residents (*e.g.*, green card holders) who receive certain gifts or bequests from covered expatriates. On October 15, 2009, the U.S. Treasury Department (Treasury) released Notice 2009-85, providing further guidance on the exit tax. On September 9, 2015, the IRS issued proposed regulations (REG-112997-10) on gifts and bequests from "covered expatriates." The IRS intends to issue Form 708, *US Return of Gifts or Bequests from Covered Expatriates*, once the proposed regulations are finalized. But for now, the regulations remain in proposed form and Form 708 has not been issued.

Covered Expatriate

The term expatriate means any U.S. citizen who formally relinquishes citizenship and certain lawful permanent residents who formally relinquish their green cards.[65] For 2018, an expatriate will be a "covered expatriate" if he or she meets an income tax liability test (an average annual net U.S. income tax of $165,000 for the five years preceding expatriation),[66] a net worth test (net worth of $2 million or more),[67] or either (i) fails to certify, under penalties of perjury, on IRS Form 8854 that he or she has been in compliance with all U.S. Federal tax laws for the five years preceding expatriation or (ii) fails to submit evidence of such compliance as the Secretary of the Treasury may require.[68]

Covered expatriates are exposed to a potential U.S. Federal income tax liability as a result of their expatriation, which primarily comes in the form of an immediate exit tax whereby the covered expatriate's worldwide property is deemed sold, and tax is paid on the resulting notional gain in excess of $711,000 (the inflation-adjusted exemption amount for 2018)[69] at the applicable capital gains rate.[70]

A covered expatriate will include in his or her exit tax base any interest in property that would have been taxable as part of his or her gross estate for U.S. Federal estate tax purposes had he or she died a citizen or resident of the United States on the day before expatriating. Generally, this is the taxpayer's worldwide property, but certain trust interests and items of deferred compensation are treated differently. A covered expatriate must obtain a fair market value appraisal of his worldwide property and attach the appraisal to his or her final U.S. income tax return. An appraisal is only required for assets for which a ready market value is not available, *e.g.*, real estate or closely held assets. Quoted market prices on the day prior to expatriation will suffice for marketable securities. A taxpayer may elect to defer the exit tax payable with respect to a particular asset, provided that security for the ultimate payment of the tax is posted and interest is paid over the deferral period.

COMPLIANCE REPORTING CONSIDERATIONS

Once an NRA immigrates to the United States, they become subject to reporting requirements relevant to U.S. Persons. These reporting requirements and disclosures may affect planning for global families who want to maintain privacy but still be U.S. compliant.

For example, grantors, trustees and beneficiaries of foreign trusts and trusts that hold foreign financial accounts are subject to specific compliance reporting requirements; donees of gifts from foreign persons also have reporting obligations. The following is a summary of various significant reporting requirements. This is an ever-changing area of the law that requires diligent attention to ongoing developments. The following discussion does not include reporting requirements with respect to interests in foreign corporations or foreign partnerships. If a foreign estate or trust has an interest in a foreign partnership or a foreign corporation, it will be necessary to separately consider the applicability of any reporting requirements with respect to those interests.

Reporting and Withholding on Distributions from U.S. Trusts to NRA Beneficiaries

A U.S. trust or estate reports the tax withheld for a foreign beneficiary on Forms 1042 and 1042-S, which are due March 15. The tax withheld that historically was required to be deposited with either a Federal Reserve Bank or an authorized financial institution is now required to be made by electronic funds transfer payment or same-day wire. The IRS no longer permits a check and deposit coupon to be presented to a bank. Deposits of the tax withheld are made quarter-monthly, monthly or annually depending on the amounts withheld.[71]

A U.S. fiduciary is required to request Form W-8BEN from a foreign beneficiary.[72] If a foreign beneficiary does not provide the W-8BEN, withholding is required at the 30% tax rate regardless of any reduced withholding rate or modified withholding rules provided by an applicable tax treaty.[73] See the Foreign Account Tax Compliance Act discussion below.

FinCEN 114, Report of Foreign Bank and Financial Accounts of U.S. Persons

If a U.S. Person has a financial interest in or signature authority over a foreign financial account, the Bank Secrecy Act[74] may require them to report the account yearly to the Department of Treasury by electronically filing a Financial Crimes Enforcement Network (FinCEN) 114, Report of Foreign Bank and Financial Accounts (FBAR).

U.S. Persons (including U.S. individuals, trusts, estates and entities) are required to file a FinCEN 114 FBAR if:

- The U.S. Person had a financial interest in or signature authority over at least one financial account located outside of the United States; and
- The aggregate value of all foreign financial accounts exceeded $10,000 at any time during the calendar year reported.

The FBAR is a calendar year report and, for taxable years beginning after December 31, 2016, must be filed on or before April 15 of the year following the calendar year being reported. Effective July 1, 2013, the FinCEN 114 FBAR must be filed electronically through FinCEN's BSA E-Filing System. The FBAR is not filed with a Federal tax return and does not replace or otherwise affect a taxpayer's obligation to file Form 8938 (discussed below). Individuals and domestic entities must check the requirements and relevant reporting thresholds of each form and determine if they should file Form 8938 or FinCEN Form 114, or both. Additionally, when the IRS grants a filing extension for a taxpayer's income tax return, it does not extend the time to file a FinCEN 114 FBAR. However, for taxable years beginning after December 31, 2015, an automatic six-month extension of time to file a FinCEN 114 FBAR (ending October 15) is available.

A U.S. person who holds a foreign financial account may have a reporting obligation even if the account produces no taxable income. A foreign financial account is a financial account located outside the United States. A foreign financial account includes, but is not limited to, a securities brokerage, savings, demand, checking, deposit, time deposit, commodity futures or options account, a life insurance policy or annuity with a cash value, and shares in a mutual fund or similar pooled fund.

In the case of a grantor trust, the U.S. grantor treated as the owner of a trust under the Code §§ 671 through 679 grantor trust rules is treated as having a financial interest in any foreign financial accounts owned or held by the trust. In the case of a non-grantor trust, a U.S. beneficiary is treated as having a financial interest in any foreign accounts owned or held by the trust if the U.S. beneficiary has a beneficial interest in more than 5% of the assets or income of the trust. However, if the trust, trustee or agent of a non-grantor trust is a U.S. person who files a FBAR disclosing the trust's foreign financial accounts, the trust beneficiary is not required to file a FBAR. In addition, the owner or beneficiary of an individual retirement account is not required to report a foreign financial account held in the individual retirement account.

Civil penalties for a non-willful failure to file are up to $10,000 per violation. Civil penalties for a willful violation can range up to the greater of $100,000 or 50% of the amount in the account at the time of the violation.[75] Although the reporting is required under the Bank Secrecy Act, not the Code, the IRS has been vested with the authority to assess the civil penalties for failure to file. Criminal penalties can range from a fine of up to $500,000 to 10 years imprisonment or both. There have been a series of offshore voluntary disclosure initiatives with varying requirements and penalty waivers.

Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts (Form 3520)

Form 3520 is used by U.S. Persons to report certain transactions with foreign trusts, ownership of foreign trusts under the grantor trust rules and receipt of certain large gifts or bequests from foreign persons.

Form 3520 is required to be filed under a number of circumstances. A U.S. Person is required to file Form 3520 for a calendar year if during the year:

- He/she is the "responsible party" for reporting a "reportable event" or held an outstanding obligation of a foreign trust (or of a person related to the trust) that they treated as a "qualified obligation;"
- He/she is a U.S. Person who is treated as the owner of any part of the assets of a foreign trust under the grantor trust rules;
- He/she is a U.S. Person who received a distribution from a foreign trust, either directly or indirectly, or a related foreign trust held an outstanding obligation they issued (or an obligation of a person related to them) that they treated as a qualified obligation;
- He/she is a U.S. person who received more than a $100,000 gift or bequest from an NRA or a foreign estate or received gifts of more than $10,000, indexed for inflation ($16,076 in 2018) from foreign corporations or foreign partnerships; or
- He/she is a U.S. person who received a gift (or bequest) of more than the annual gift tax exclusion amount ($15,000 in 2018) from a "covered expatriate."

There are limited exceptions to filing with respect to tax-exempt trusts, transactions for fair-market value, compensation for services and similar transactions.

Form 3520 is due when the income tax return is due, including extensions (or when Form 706 is due in the case of a U.S. decedent).

The penalties for failure to file Form 3520 are significant. The initial penalty is the greater of (i) $10,000 or (ii) 35% of the gross value of any property transferred to a foreign trust that is required to be reported, 35% of the gross value of distributions from a foreign trust that is required to be reported, or 5% of the gross value of the portion of a trust's assets treated as owned by a U.S. person that is required to be reported. In the case of the failure to report large gifts or bequests from foreign persons, the penalty is 5% of the value of the gift per month, up to 25%. These penalties may be waived if the failure to file was for reasonable cause and not willful neglect.[76] An additional accuracy-related penalty may be imposed for undisclosed foreign financial asset understatements.[77] This penalty may be waived if a person can show reasonable cause for the failure to report and the person acted in good faith.[78]

Annual Information Return of Foreign Trust with a U.S. Owner (Form 3520- A)

Form 3520-A is the annual information return of a foreign trust with a U.S. owner. The form provides information about the trust, the U.S. person who is treated as an owner under the grantor trust rules of Code §§ 671 through 679 and the U.S. beneficiaries. A foreign grantor "trust" is required to file the form and provide annual statements to the U.S. owner and U.S. beneficiaries (technically, a trust is not an entity and cannot file — it is the trustee who files). The U.S. owner is responsible for either seeing that the trust files, or filing in its place. Filing is required by March 15. If a foreign grantor trust fails to file a required return or furnish correct statements to a U.S. grantor and beneficiary, the U.S. owner is subject to an initial penalty of the greater of $10,000 or 5% of the gross value of the portion of the assets of the trust treated as owned by him.[79] The U.S. owner also may be subject to additional penalties, including penalties for undisclosed foreign financial asset understatements.[80] Penalties may be waived if the failure to file was due to reasonable cause and not willful neglect.

Annual Information Return of Foreign Owned Disregarded Entities. Owner (Forms 1120 and 5472)

On December 19, 2016, the IRS issued final regulations that impose new tax reporting and record keeping requirements on a U.S. entity that is wholly owned, either directly or indirectly, by a non-U.S. person and that is disregarded for Federal income tax purposes (a "DRE").[81] A non-U.S. person includes a foreign trust.[82]

Each foreign owned DRE must file IRS Form 5472 with respect to each related party with which the DRE has had any reportable transaction during the taxable year.[83] A related party is any direct or indirect 25% foreign shareholder of the DRE.[84] A reportable transaction is broadly defined to include sales, purchases, and loans, as well as amounts paid or received in connection with the formation or dissolution of the entity.[85]

The new regulations apply to taxable years of DREs that begin on or after January 1, 2017, and that end on or after December 13, 2017. The DRE has the same taxable year as its non-U.S. owner if the non-U.S. owner has an obligation to file a U.S. tax return. If the non-U.S. owner does not have a U.S. tax return filing obligation, then the DRE's taxable year is a calendar year unless otherwise provided in forms, instructions, or published IRS guidance. Thus, for a DRE with a taxable year that begins on January 1, 2017, and that ends on December 31, 2017, the DRE must meet the new reporting and record keeping requirements for its 2017 calendar year taxable year. A DRE with a taxable year that runs from January 30, 2017, to January 30, 2018, also likely will have to meet the new reporting and record keeping requirements for its 2018 fiscal year taxable year.

FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA) AND STATEMENT OF SPECIFIED FOREIGN FINANCIAL ASSETS (FORM 8938)

No current discussion of foreign persons, foreign trusts, foreign assets and taxation is complete without at least a passing mention of FATCA. A comprehensive discussion of FATCA is beyond the scope of this paper. Following, however, are some highlights.

Objective of FATCA

The objective of FATCA is to reduce tax evasion by U.S. individuals with respect to income from financial assets held outside the United States, by inducing "foreign financial institutions" (FFIs) to report U.S. owners to the IRS. FATCA imposes a 30%

withholding tax on certain payments to FFIs (including banks, brokers, custodians and investment funds) that fail to comply with FATCA.

Final FATCA Rules

FATCA is a component of the HIRE Act, which was enacted by the U.S. Congress and signed into law by President Obama on March 18, 2010, and added Chapter 4 of Subtitle A to the Code. The Treasury and IRS issued an initial set of regulations under FATCA on January 17, 2013. On July 12, 2013, the IRS released Notice 2013-43 providing a revised timeline for implementation of the FATCA requirements. Technical corrections to the 2013 FATCA regulations were also published on September 9, 2013. On February 20, 2014, the IRS and Treasury issued proposed and temporary regulations, which make a number of changes and clarifications to the FATCA rules. On September 19, 2015, the IRS released Notice 2015-66 extending the time that certain FATCA transitional rules will apply. Finally, on January 6, 2017, the IRS and Treasury issued final regulations concerning information reporting by FFIs with respect to U.S. accounts and withholding on certain payments to FFIs and other foreign entities (the FATCA regulations). Temporary regulations issued in 2014 were adopted as modified.

Form 8938 for U.S. Taxpayers

Form 8938 was new for tax years beginning after March 18, 2010 (effectively, the 2011 tax year for calendar year individual taxpayers). The purpose of this form is to report the ownership of specified foreign financial assets if the total value of those assets exceeds the statutory reporting threshold. The reporting requirement was enacted as part of FATCA provisions of the HIRE Act. Form 8938 reporting is in addition to, not in place of, any required FinCEN 114 FBAR reporting.

Form 8938 must be filed by persons who are required to file a U.S. income tax return and who are one of the following: a U.S. citizen, a U.S. resident alien, a non-resident alien who elects to be treated as a resident alien to file a joint income tax return, or a non-resident alien who is a bona fide resident of American Samoa or Puerto Rico. The thresholds for filing are as follows:

Status	Foreign Financial Assets
Living in the United States and either unmarried or married filing separate returns	More than $50,000 on the last day of the tax year or more than $75,000 at any time during the year
Living in the United States and married filing a joint return	More than $100,000 on the last day of the tax year or more than $150,000 at any time during the year
Living abroad and either unmarried or married filing separate returns	More than $200,000 on the last day of the tax year or more than $300,000 at any time during the year
Living abroad and married filing a joint return	More than $400,000 on the last day of the tax year or more than $600,000 at any time during the tax year

Additionaly, certain U.S. corporations, partnerships, and trusts that are considered formed or availed of for the purpose of holding specified foreign financial assets must file Form 8938 if the total value of those assets exceeds $50,000 on the last day of the tax year or $75,000 at any time during the tax year.

The assets required to be reported are financial accounts maintained by a foreign financial institution and stock or securities issued by a non-U.S. person that are held for investment, any interest in a foreign entity (including a trust) and any financial instrument or contract with an issuer or counterparty that is not a U.S. Person. Assets held by a U.S. custodian are not required to be reported on Form 8938. In addition, a foreign financial asset is not required to be reported on Form 8938 if the asset is required to be reported (and is reported) on a timely filed Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts), Form 5471 (Information Return of U.S. Persons with Respect to Certain Foreign Corporation), Form 8621 (Information Return by Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund), or Form 8865 (Return of U.S. Persons with Respect to Certain Foreign Partnerships). However, a person is required to identify on Form 8938 the forms on which he or she reported the assets and how many of the forms he or she filed and is required to include the value of the assets reported elsewhere to determine whether the person meets the applicable filing threshold for Form 8938.

For purposes of Form 8938 filing, a person generally is deemed to be the owner of assets held in a grantor trust of which he or she is treated as the owner under the grantor trust rules. The beneficiary of a foreign non-grantor trust or a foreign estate is required to report his or her interest if he or she knows of the interest or has reason to know of the interest based on information that is readily available to him or her. A person will be deemed to know of his or her interest if he or she received a distribution from a trust. If a person is the beneficiary of a foreign trust, the maximum value of his or her interest in the trust is the sum of (i) the value of the cash or other property distributed to him or her during the year, and (ii) the actuarial valuation of his or her *right* as a beneficiary to receive mandatory distributions as of the last day of the tax year. If a person has an interest in a foreign estate, the maximum value of the interest is the fair market value of the interest as of the last day of the tax year. The treatment of contingent and discretionary interests remains to be fully addressed.

Form 8938 is attached to and is required to be filed by the due date of a person's annual income tax return, including extensions. There is a $10,000 fine for failure to file Form 8938, and if the failure continues for more than 90 days after the IRS mails a notice of failure to file, an additional penalty of up to $50,000.

FACTA for Withholding Agents

The FATCA regulations will apply broadly to any withholding agent as well as any FFI. However, an FFI in a country that has entered into an intergovernmental agreement (IGA) based on "Model 1" will be required to comply with their jurisdiction's own set of rules, which in some cases may vary from and override the FATCA regulations. The Model 1 IGA establishes a framework for FFIs to report directly to their own tax authorities, followed by an automatic exchange of such information under existing tax treaties or Tax Information Exchange Agreements with the IRS.

FFIs located in jurisdictions that have entered into an IGA based on a second model of the IGA (Model 2) will be permitted under local law to comply with the terms of an FFI agreement with the IRS, including reporting directly to the U.S. government. Model 2 FFIs will therefore be required to implement FATCA by following the provisions of the FATCA regulations, except to the extent expressly modified by their IGA. As of April 2018, 113 juridictions have IGAs with the United States that either have been signed or are treated as being effective from the U.S. perspective.

The obligations imposed on FFIs under the IGAs vary in important respects from those described in the FATCA regulations. The details of requirements for financial institutions in countries that have signed an IGA will be addressed in the local law implementing the IGA, which adds an additional layer of complexity to the FATCA regime.

FATCA Withholding and Forms W-8 for NRAs

Payments subject to withholding under FATCA in the event of FATCA non-compliance include types of U.S.-source FDAP income that are excluded from withholding under the existing provisions of Code § 1441 applicable to NRAs (NRA withholding), for example:

- Portfolio interest;
- Bank deposit interest paid by non-U.S. branches of U.S. banks;
- Gross proceeds from the sale of U.S. securities (beginning January 1, 2019); and
- "Foreign passthru payments" (beginning on the later of (a) January 1, 2019 or (b) the date of publication of final regulations defining the term foreign passthru payments).

Moreover, FATCA withholding may not be reduced or eliminated simply by making a treaty claim on a Form W-8. Where an account holder is not FATCA-compliant, full 30% FATCA withholding will apply. When FATCA withholding is required, the withholding agent does not impose withholding under the existing NRA rules. Conversely, where an account holder is FATCA compliant, FATCA withholding will not apply and withholding under the existing NRA withholding rules will apply (subject to treaty rates). The IRS Forms W-8 reflect allow the payee to certify status under both the NRA withholding rules and the FATCA withholding rules, so one form covers both withholding regimes.

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT COMMON REPORTING STANDARD

The Organisation for Economic Cooperation and Development (OECD) determined in 2014 that the concept of FATCA should be extended on a global basis to provide an automatic exchange under a Common Reporting Standard (CRS) of ownership and asset information to combat tax evasion on a global scale. As of March 2018, more than 100 participating jurisdictions have adopted CRS.

CRS has a broad scope across three dimensions designed to prevent its circumvention:

- Financial institutions required to report under CRS include banks, custodians, brokers, certain collective investment vehicles and certain insurance companies.
- The accounts financial institutions are required to report include accounts held by individuals and entities, including trusts and foundations. Passive entities are required to report on the individuals who ultimately control the entities ("controlling persons").
- The financial information required to be reported includes all types of investment income, account balances and sales proceeds from financial assets.

Although the United States is a member of the OECD, to date it has not adopted CRS, likely because it receives under FATCA all of the inbound tax information that it needs and does not want the IRS to incur the expense of forwarding all of the CRS-compelled data to each of the participating jurisdictions.

CONCLUSION

The confluence of the global economy, international investment and personal mobility in the modern day has resulted in a wealth and tax planning landscape that is dynamic, to say the least. Planning even within familiar U.S. borders increasingly requires an awareness of the implications of cross-border family relationships, investments, trusts and entities.

ENDNOTES

1. "U.S. Fact Sheet," U.S. Dept. of Commerce – SelectUSA, https://www.selectusa.gov/FDI-in-the-US.
2. This paper is limited in scope to a discussion of the U.S. Federal tax regimes. However, it should be mentioned that many U.S. states also impose, in some combination, an income tax, an estate tax and an inheritance tax. Also, it should be noted that in most cases international tax treaties do not apply for state tax purposes, unless the treaty specifically references the state.
3. "Open Doors 2017 — Report on International Educational Exchange," Institute of International Education, in partnership with the Bureau of Educational and Cultural Affairs, U.S. Dept. of State, http://www.iie.org/opendoors.
4. "Report of the Visa Office 2017," U.S. Dept. of State — Bureau of Consular Affairs, https://travel.state.gov/content/travel/en/legal/visa-law0/visa-statistics/annual-reports/report-of-the-visa-office-2017.html.
5. *Id.*
6. "Immigrant Investor Visas," U.S. Dept. of State — Bureau of Consular Affairs, https://travel.state.gov/content/travel/en/us-visas/immigrate/immigrant-investor-visas.html english/immigrate/types/Immigrant-Investor-Visas.html.
7. "U.S. Fact Sheet," available at https://www.selectusa.gov/FDI-in-the-US.
8. "Foreign Portfolio Holdings of U.S. Securities," U.S. Dept. of Treasury, https://www.treasury.gov/resource-center/data-chart-center/tic/Pages/fpis.aspx.
9. "2017 Profile of International Activity in U.S. Residential Real Estate," National Association of REALTORS® (July 18, 2017).
10. All further "Section" or "§" references herein are to the Code or the Treasury regulations promulgated thereunder.
11. Treasury Reg. § 301.7701(b)-1(a).
12. The sourcing rules determine whether the gross amount of FDAP paid to foreign persons is subject to U.S. income tax. (Code §§ 871(a)(1) and 881(a)). These rules also are of interest to the payor of the income since, if the income is taxable, the payor generally is required to withhold and deposit the tax associated therewith as required under Code §§ 1441 and 1442.
13. A USRPI is more than just the real estate itself. A USRPI includes a U.S. Real Property Holding Company (USRPHC) which, pursuant to Code § 897(c)(2), is defined as any corporation in which the fair market value of its USRPI equals or exceeds 50% of the sum of the fair market values of its: (1) USRPIs; (2) its interests in real property located outside the United States; and (3) other assets used or held for use in a trade or business. Code § 1445 broadens the tax net and requires that the withholding tax under Code § 1445(a) apply to all foreign persons disposing of USRPIs. For these purposes, a foreign person is defined to include: a nonresident alien individual as defined under Code § 7701(b)(1)(B); a foreign corporation that has not made an election under Code § 897(i); a foreign partnership; a foreign trust; and a foreign estate. (Treasury Reg. § 1.897-9(T)(c)).

14. It should be noted that several U.S. states do have inheritance tax regimes. In implementing any effective estate plan, such state's respective inheritance tax laws should be incorporated therein.

15. Treasury Reg. §20.0-2.

16. Code § 2101(a).

17. *Id.*

18. Treasury Reg. § 20.0-1(b)(1).

19. The qualifiers "real," "personal," "tangible" and "intangible" have significance that will be further discussed herein. These become relevant when contrasting U.S. estate tax to U.S. gift tax implications for the non-U.S. domiciled individual's transfer of U.S.-situate assets.

20. Treasury Reg. § 20.2104-1(a)(1).

21. Treasury Reg. § 20.2104-1(a)(2)(property of an NCND that is situated in the United States includes tangible personal property located in the United States except certain works of art on loan for exhibition. Code § 2105(c) provides that works of art owned by an NCND are not deemed property within the United States if such works of art are:

    (1) imported into the United States solely for exhibition purposes;

    (2) loaned for such purposes to a public gallery or museum, no part of the net earnings of which inures to the benefit of any private stockholder or individual; and

    (3) at the time of the death of the owner, on exhibition, or enroute to or from exhibition, or in such a public gallery or museum. Unless the above exception is met, works of art that are physically located in the United States (such as in the home owned by the NCND) will be taxed as U.S.-situate property in the NCND's U.S. taxable estate).

22. While the gross estate is limited to U.S.-situate property, the gross estate is based on the same rules that apply to the estates of U.S. citizens and residents. For example, property includible under Code §§ 2035 through 2038, is property *deemed to be situated* in the United States if it were situated in the United States either at the time of gift or at the time of the donor/decedent's death.

23. Code § 2106(a).

24. Code § 2106(a)(1); Treasury Reg. § 20.2106-2.

25. In these instances it will be important to run a calculation to discern the actual U.S. estate tax savings.

26. It is important to point out that this rule does not apply in most instances for those individuals who expatriated under the new expatriation rules. In addition, the principles contained in Code §§ 2035 through 2038 still apply; thus, any retained interests can bring these assets back into the NCND's U.S. taxable estate.

27. Code § 2513(a)(1).
28. The basic GST concepts are not discussed.
29. The Code § 2642 inclusion ratio determines the extent to which the property affecting a generation-skipping transfer is subject to the GST tax. Each donor has an exemption from GST tax that can be allocated to transfers during life or at death. The amount of exemption allocated to a transfer determines the inclusion ratio of each property.
30. In some circumstances an election to be treated as a domestic corporation may be desirable to avoid FIRPTA, but the election will not change the corporation's classification for U.S. estate tax purposes.
31. Treasury Reg. § 25.2511-3(b)(4)(iv).
32. Treasury Reg. § 25.2511-3(b)(4).
33. See *Ogarrio's Est. v. Comm'r*, 337 F.2d 108 (D.C. Cir. 1964); *Rosenblum v. Anglim*, 135 F.2d 512 (9th Cir. 1943). Note that the IRS follows this position; See Rev. Rul. 65-245, 1965-2 C.B. 379; Rev. Rul. 56-421, 1956-2 C.B. 602.
34. Code § 2501(a)(2).
35. Treasury Reg. § 25.2511-3(b)(3).
36. 17 T.C. 1149 (1952), *acq.*, 1952-1 C.B. 3.
37. 355 F.2d 632 (Ct. Cl. 1966).
38. 76 F.2d 109 (2d Cir. 1935).
39. *Id.* at 115.
40. 247 F.2d 144 (2d Cir. 1957).
41. *Id.* at 148.
42. Code § 2105(b)(3).
43. HAUSER, *supra* note 6, 2-13.
44. Code § 2105(a).
45. Code § 2104(b).
46. Code § 2523(a).
47. Code § 2523(i)
48. Code § 2523(i)(2) and Treasury Reg. § 25.2523(i)-(1)(c).
49. Code § 2523 is the applicable provision governing gifts to U.S. citizen spouses generally.
50. Code § 2056(d)(1)(b).
51. Code §§ 2523(i) and 2523(f)(6).
52. Code § 2056(d)(4).

53. The rules related to expatriation are discussed below.

54. Code § 2056A(d); Treasury Reg. § 20.2056A-3(a).

55. PLR 201421006 (issued Feb. 11, 2014, released May 23, 2014).

56. Treasury Reg. § 20.2056A-5(b)(1).

57. Treasury Reg. § 20.2056-5(b)(2).

58. Treasury Reg. § 20.2056-5(b)(3).

59. Treasury Reg. § 20.2056A-5(c)(1).

60. See PLRs 201406003 (issued Sept. 13, 2013, released Feb. 7, 2014; 201431004 (issued April 16, 2014, released Aug. 1, 2014; 201431019 (issued April 10, 2014, released Aug. 1, 2014).

61. CCA 201416007 (issued Nov. 6, 2013, released April 18, 2014).

62. See *Est. of Vandenhoeck Est. v. Comm'r*, 4 T.C. 125 (1944).

63. Nunez, *supra* note 66, § 16.40A.

64. See also *Est. of Lepoutre v. Comm'r*, 62 T.C. 84 (1974).

65. IRC § 877A(g)(2). The recent Tax Court case, *Topsnik v. Commissioner*, 146 T.C. No. 1 (Jan. 20, 2016), illustrates that a taxpayer must formally abandon his Green Card in order to effectively expatriate. The court held that the taxpayer's "informal" abandonment of his Green Card was ineffective and thus the taxpayer remained subject to U.S. tax. Accordingly, affirmative steps are necessary to abandon your U.S. lawful permanent residence status.

66. IRC § 877(a)(2)(A). This amount is indexed for inflation and is $165,000 for 2018.

67. IRC § 877(a)(2)(B).

68. IRC § 877(a)(2)(C).

69. Rev. Proc. 2013-35.

70. 85 IRC § 877A(a).

71. Payments of the tax withheld are made quarter-monthly, monthly or annually depending on the amounts withheld. If the amount withheld is less than $200 in the taxable year, the payment is made when the agent files the annual 1042 form. If the withholding agent has withheld between $200 and $2,000 at the end of any month, the payment is made 15 days after the end of the month. If the withholding agent has withheld $2,000 or more at the end of any quarter-monthly period, the payment must be made three banking business days after the end of the quarter-monthly period. Quarter-monthly periods fall on the 7th, 15th, 22nd and last day of each month.

72. A Form W-8 is only valid for three calendars years after the year of receipt. A change in circumstances that makes the form incorrect (i.e., a change of address to a different country with different treaty reductions or a change of address to the United States), will invalidate the form at any time.
73. Treasury Reg. § 1.1441-6. The foreign beneficiary may also need to acquire a taxpayer identification number from the IRS in order to claim certain treaty benefits. See Treasury Reg. § 1.1441-6(c)(2).
74. 31 USC § 5314; 31 C.F.R. 103.
75. *Williams*, CA 4 07/20/2012 110 AFTR2d ¶2012-5639.
76. Code § 6677.
77. Code § 6662(b)(7).
78. Code § 6662(j).
79. Code § 6677.
80. Code § 6662(j).
81. T.D. 9796, 2017-3 I.R.B. 380.
82. Treas. Reg. § 1.6038A-1(f)(4).
83. Treas. Reg. § 1.6038A-2(a)(1).
84. Treas. Reg. § 1.6038A-1(d)(1).
85. Treas. Reg. § 1.6038A-2(b)(3) and (4).

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