



International Estate Planning - It's A Small World After All

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The United States Tax Nexus

- "Super- jurisdiction" - The U.S. subjects a transfer tax of **all assets** under the following conditions:
 - U.S. citizen or
 - U.S. domicile
- The U.S. also taxes the following assets without regard to citizenship or residency
 - Real estate
 - Closely-held business in the U.S.
 - Stock Investments incorporated in the U.S.
 - Bank accounts and personal assets physically located in the U.S.
- U.S. provides a Foreign Tax Credit for transfer taxes paid in foreign countries
 - Results in a transfer tax at the highest tax rate
- The U.S. tax nexus is superseded by Treaty



U.S. "Residency" or "Domicile"

- Citizens, persons who have established a U.S. residency (e.g., Green Card), or persons who have established a "domicile" in the U.S. are taxed on the worldwide assets.
 - Facts and circumstances basis
 - "Domicile" means acquiring a place in the U.S. to live there without a present intention of later leaving.
 - Would apply even if they have lived in the U.S. for a brief period of time

Tax Planning Strategies for the Citizen/Resident

- If Possible, Take Advantage of the Current \$5.12 Million Lifetime Exemption through Gifting over the Next Two Years.
 - \$5.12 million exclusion
 - No state gift tax (except Tennessee and Connecticut)
 - Future Appreciation of Assets
- Eliminate U.S. Tax Nexus, if any, to Foreign Beneficiaries
 - Foreign Inheritance Issues?

Estate Tax Treaties

- **To prevent double taxation, some countries have established transfer tax treaties with the U.S**
 - 19 estate and/or gift tax treaties in force
 - 57 Income tax treaties in force
- **Establish tax nexus**
 - Typically allows residence jurisdiction exclusive taxing authority
- **Pre 1966 versus Post 1966 treaties**
 - Pre-1966 driven by old situs rules – asset specific
 - Post 1966 driven by domicile, limits U.S. tax nexus

What about Nonresident Aliens?

- Treaty, if applicable, determines taxing authority.
- Absent a treaty, the U.S. taxes the following assets without regard to citizenship or residency
 - U.S. situs real estate
 - Closely-held businesses located in the U.S.
 - Stock Investments incorporated in the U.S.
 - Bank accounts and personal assets physically located in the U.S.
- **Available deductions**
 - Annual gift tax exclusion
 - Unlimited marital deduction (to a US citizen/spouse)
 - Debts attributable to the U.S. situs asset, administrative expenses
 - \$60,000 estate tax exclusion
 - **Note: Treaty countries may have nondiscrimination provision which increases exclusion to citizen/resident level**

What about Nonresident Aliens?

- Form 706NA
 - Unlimited marital deduction is available (if transferred to a U.S. citizen/spouse)
 - Deductions include debts attributable to the U.S. situs asset and administrative expenses in the U.S.
 - \$60,000 estate tax exclusion
 - Note: Treaty countries may have nondiscrimination provision which increases exclusion to citizen/resident level

Special Planning Issues

- Foreign Estate Planning and Domestic Documents
 - Need for two plans
 - Risk of Intestacy
- Community Property Countries
 - Brazil, Colombia, Dominican Republic, France, Guatemala, Mexico, Montenegro, Netherlands, Philippines, Portugal, Spain, Sweden, Venezuela
- Unique Foreign Planning Issues
 - Germany and Trust Planning
 - Foreign interpretation Health Care Powers of Attorney
 - China and the proactive probate court

The Foreign Estate Tax Conundrum – an Example

- A citizen and resident of China (unmarried) has amassed a fortune of \$20 million in China.
 - If he stays in China, there would be no estate or inheritance tax at death; however:
 - If he establishes permanent residency in the United States, then he would be subject to U.S. estate on all assets he owns, including assets held overseas.

The Foreign Estate Tax Conundrum – an Example (cont.)

	2011, 2012	2013 and thereafter
Estate Value	\$20,000,000	\$20,000,000
Less: Lifetime Exemption	5,000,000	1,000,000
Taxable Estate	15,000,000	19,000,000
U.S. Estate Tax Liability	5,250,000	7,987,400
Illinois Tax Liability	2,298,988	2,666.800
Total U.S. tax liability	\$7,548,988	\$10,654,200

Transfers Qualifying for the Unlimited Marital Deduction

- Deceased spouse must be U.S. citizen or resident at time of death
- Deceased spouse must be actually survived by the surviving spouse
- Surviving spouse must be U.S. citizen
- Deceased spouse's gross estate must include the property
- Interest in the property must pass from deceased to surviving spouse via will, intestacy, or non-probate transfer

Note: Deduction represents a deferral of the tax until the death of the surviving spouse

Assets Passing to Noncitizen spouses

- Transfers not afforded the unlimited marital deduction
- Tax free gifts are limited to \$136,000 in 2011 and \$139,000 in 2012
- Assets Transferred to Noncitizen Spouse - Creation of a Qualified Domestic Trust (QDOT)

Tax Deferral Strategy - Qualified Domestic Trust (QDOT)

- A trust used to preserve the marital deduction for property passing to a noncitizen spouse
- Trust Assets must “vest” in the surviving spouse
- Assets that require special attention
 - Qualified Plans (IRA's, 401(k)'s, etc.)
 - Jointly-held Assets
 - Presumed to be wholly-owned by the decedent!

QDOT Planning (cont.),

- Executor of the decedent's estate must make an irrevocable election to treat the trust as a QDOT on a timely filed estate tax return (or on a late return filed no later than one year after the filing deadline);
- at least one trustee must be either a U.S. citizen or a U.S. corporation;
- no distribution from the trust is permitted unless approved by the U.S. trustee; and
- the trust must meet certain additional requirements intended to ensure that the QDOT estate tax will be paid
 - QDOT with assets over \$2 million must either have a U.S. bank as trustee or
 - post a bond or security equal to 65% of the value of assets transferred to the trust

Offshore Trusts – A Brief Legislative History

“Stop Tax Haven Abuse Act” was introduced by Sen. Levin and Sen. Obama. Among the highlights included:

- Presumption that offshore companies/trusts are controlled by the U.S. taxpayer who created them
- Take special measures against tax havens that impede U.S. enforcement
- Increase penalties on perceived unlawful tax shelters

Offshore Trusts – Planning Issues

- Typically done for asset protection
 - Debtor friendly laws that work against fraudulent conveyances
 - Limited statute of limitation for fraudulent transfer claims
 - Nonrecognition of foreign judgments
 - Create difficulty for creditors to assert claim
 1. Bond requirement
 2. Payment of creditor attorney fees if debtor prevails
- Can be designed to utilize either the estate/gift tax lifetime exclusion or the gift tax annual exclusion to transfer assets to the foreign trust
- Inappropriately marketed as a means to avoid U.S. income tax
- Can be costly to implement and maintain

Offshore Trusts – Planning concerns

- Cannot be designed to hide or conceal assets
 - There are U.S. reporting requirements for U.S. persons who make transfers to a foreign trust
 - All transfers to foreign trusts are reportable as gifts on Form 709, even if they are incomplete for gift tax purposes.
 - Notice 97-34 requires every U.S. person who creates or makes a transfer to a foreign trust or who is responsible for other "reportable events" defined in Section 6048 to report such event on Form 3520.

Offshore Trusts – Planning concerns, cont.

- Special Grantor Trust Income Tax Rules Unique to Foreign Tax Planning
 1. Sec. 679 and Grantor Trust rules
 2. Foreign Trusts and Sec 672(f)
- Choice of Offshore Jurisdictions
- Offshore Interests and IRS Disclosure Requirements

FBAR Reporting Requirements

Form TD F 90-22.1

- Applies to Foreign Financial Accounts (FFAs) with an aggregate balance greater than \$10K at any time during the year and requires annual reporting by:
 - U.S. persons who are owners of a financial interest (direct or indirect) in the FFA
 - U.S. persons with signature authority over an FFA
- Must be received by IRS by June 30
- Penalties for non-filing or late filing:
 - \$10K
 - \$100K or 50 percent if willful failure to file
 - \$500K or imprisonment if in connection with criminal violation

Foreign Trusts – Form 3520

- Filing is required by:
 - U.S. person creating a foreign trust
 - U.S. person transferring money/property to a foreign trust
 - Executor of a U.S. person who is a grantor of a foreign trust
 - U.S. person receiving distributions from foreign trusts
 - U.S. person receiving certain gifts and bequests from foreign persons.

Form 3520

■ Filing Due Date:

- U.S. decedent – due on the date the estate tax return is due or would be due if the estate were required to file a return, including extensions.
- U.S. person – due by the due date of the filer's federal income tax return, including extensions.

■ Penalties for Late Filing/Non-Filing:

- Initial Penalty: \$10K or 35 percent of gross reportable amount.
- Additional Penalty: if non-filing continues 90 days after notice of initial penalty, \$10K penalty for each month of non-filing.
- Continuing Penalty: 5 percent of the amount of the foreign gift for each month for which the failure continues up to 25 percent.
- Penalty abatement on the basis of Reasonable Cause.

Foreign Trust Transactions/Distribution

Form 3520-A

- Foreign trusts with at least one U.S. owner must file Form 3520-A annually to report distributions (including certain sales transactions, payments for services performed, and loans from the trust)

■ Filing Due Date:

- U.S. decedent – due on the date the estate tax return is due or would be due if the estate were required to file a return, including extensions
- U.S. person – due by the due date of the filer's federal income tax return, including extensions

■ Penalties for Late Filing/Non-Filing:

- Initial Penalty: \$10K or 5 percent of gross reportable amount
- Additional Penalties may be imposed, including criminal penalties for failure to file and for filing a false or fraudulent return
- Penalty abatement on the basis of Reasonable Cause

New Filing Requirement - Form 8938

- **Filing Due Date:**
 - U.S. person – due by the due date of the filer's federal income tax return, including extensions.
 - Expands disclosures of offshore assets
- **Penalties for Late Filing/Non-Filing:**
 - Initial Penalty: \$10K
 - Additional Penalty: if non-filing continues 90 days after notice of initial penalty, \$10K penalty for each month of non-filing.
 - Underpayment Penalty: 40 percent of the amount of tax related to a transaction that should have been reported on this form.
 - Civil Fraud – 75 percent penalty
 - Criminal Prosecution is possible

An Ounce of Prevention.....

- **IRS Reopens Voluntary Disclosure Program**
 - Maximum penalty is 27.5% of assets (was 25% last year)
 - Participants must file all original and amended tax returns
 - Must include payment for back taxes and interest for up to eight years, as well as
 - paying accuracy-related and/or delinquency penalties.

Foreign Estate Planning Opportunities

- Delaware Trust Planning
 1. Asset protection
 2. Trustee fiduciary protection
- Private Placement Life Insurance
 - Insurance carrier established domestically
 - Foreign assets held under a domestic wrapper

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Form 8938 Reporting – Does it apply to you?

On Dec. 21, 2011, the IRS released new information about Form 8938 (Statement of Specified Foreign Financial Assets), which must be attached to the annual return of certain individual taxpayers to report specified foreign financial assets for tax year 2011. Form 8938 must be filed by taxpayers with specific types and amounts of foreign financial assets or foreign accounts. Covered taxpayers that fail to file Form 8938 will be subject to various penalties. The Form 8938 filing requirement was enacted in 2010 to improve tax compliance by U.S. taxpayers with offshore financial accounts. Detailed information is available on the [Foreign Account Tax Compliance Act page of irs.gov](http://www.irs.gov).

The following questionnaire is designed to help you determine if you need to complete this form. You are required to file the Form 8938 if you answer yes to the following two questions.

1. Do you have ANY of the following foreign financial assets?

- Financial accounts maintained at foreign financial institutions
- Foreign Retirement accounts
- Direct ownership of stock in a foreign corporation
- Foreign life insurance products
- Foreign partnership interests
- Foreign hedge funds
- Foreign private equity funds
- Foreign deferred compensation arrangements
- Beneficial interests in foreign trusts or estates

2. Do you meet the following reporting threshold?

- If you live in the United States, you must file if the **AGGREGATE VALUE** of foreign financial assets are:
 - Single / Married Filing Separately
 - Greater than \$50,000 on last day of tax year **OR** greater than \$75,000 at anytime during tax year
 - Married Filing Jointly
 - Greater than \$100,000 on last day of tax year **OR** \$150,000 at anytime during tax year
- If you live in a Foreign Country, you must file if **AGGREGATE VALUE** of foreign financial assets are:
 - Single / Married Filing Separately
 - Greater than \$200,000 on last day of tax year **OR** \$300,000 at anytime during tax year
 - Married Filing Jointly
 - Greater than \$400,000 on last day of tax year **OR** \$600,000 at anytime during tax year

If you answered yes to both questions, please provide us the following information (if applicable) for each foreign financial asset:

- Description of Asset
- Identifying Number or Other Designation
- Date Acquired / Opened
- Date Disposed / Closed
- Jointly Owned with Spouse? Yes _____ No _____ N/A _____
- Name of Financial Institution where account is maintained
- Address of Financial Institution where account is maintained
- Foreign currency in which asset is denominated
- Exchange rate used to convert to US dollars
- Source of exchange rate

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Country	Separate Estate	Separate Gift	Combined E&G	Other	Signed	Transfers made on or after:	Comments
Australia	No	Yes	No	No	53/05	12/14/53	PR-UC
Australia	Yes	No	No	No	53/05	01/07/54	old *
Austria	No	No	Yes	No	82/06	07/01/83	new *
Belgium	Yes	No	No	No	54/05	not yet	old
Canada	No	No	No	1995 Protocol	95/03	11/09/95 **	estate tax only
Denmark	No	No	Yes	No	83/04	11/07/84	new
Finland	Yes	No	No	No	52/03	12/18/52	old
France	No	No	Yes	No	78/11	10/01/80	new
Germany	No	No	Yes	No	80/12	01/01/79	new
Greece	Yes	No	No	No	50/02	12/30/53	old
Ireland	Yes	No	No	No	49/09	12/20/51	old
Italy	Yes	No	No	No	55/03	10/26/56	old
Japan	No	No	Yes	No	54/04	04/01/55	old
Netherlands	Yes	No	No	No	69/07	02/03/71	new
Norway	Yes	No	No	No	49/06	12/11/51	old
South Africa	Yes	No	No	No	47/04	07/15/52	old
Sweden	No	No	Yes	No	83/06	09/05/84 (through 12/31/07)	new (terminated 01/01/08)
Switzerland	Yes	No	No	No	51/07	09/17/52	old
U.K.	No	No	Yes	No	78/10	11/11/79	new

* old or new refers to whether the treaty has the "old" situs rules, or the "new" provisions that generally restrict the U.S. to taxing nonresident aliens' 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 11/09/96.

"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.)