United States

Estate and Income Taxation of Non-Resident Aliens

Materials

by

Michael W. Galligan, Partner

and

Ira Olshin, Counsel

Phillips Nizer LLP

New York, New York

(212) 841-0572

mgalligan@phillipsnizer.com

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Prologue: Why Is Estate Planning For Non-U.S. Persons Important?

1. U.S. Estate Tax on Non-U.S. Estates can be very onerous:
   a. Current highest U.S. federal estate tax rate is 40% (essentially, a U.S. taxable estate is currently taxed at a 40% rate for every dollar that such taxable estate exceeds $5,490,000 (2017, indexed for inflation for years thereafter).

   b. Exemption from U.S. federal estate tax for an estate of a non-U.S. decedent is limited to $60,000. So the U.S. federal estate tax on a U.S. taxable estate of just $1,000,000 would exceed $300,000.

   c. No credit is allowed under U.S. federal estate tax law for estate or inheritance taxes paid to a non-U.S. jurisdiction on U.S. property unless provided for under a transfer tax treaty between the U.S. and such foreign jurisdiction.

   d. To obtain the marital deduction for a transfer on death to a non-U.S. citizen spouse, a QDOT trust must be established, but, it should be noted that most civil law jurisdictions do not honor—and may even discriminate against—trusts (for example, the 2011 Amended Finance Act of the Republic of France).

   e. Unless a treaty allows otherwise, the charitable estate tax deduction is limited to transfers to U.S. qualifying organizations (that is, pursuant to IRC § 2106(a)(2), no charitable estate tax deduction is available for a gift to a corporate charity unless it is a U.S. domestic charity, and no charitable estate tax deduction is available for a gift to a charitable trust unless the gift is to be used only within the U.S.). Furthermore, if the gifted property was not required to be included in decedent’s U.S. gross estate, then no charitable estate tax deduction is available even though such property was bequeathed to a U.S. charity (see IRC § 2106(a)(2)(D)).

   f. The disclosure of a decedent’s worldwide assets is required in order to claim deductions for estate administration expenses allocable to U.S. property and charitable transfers (see IRC § 2106(b)).

   g. The disclosure of a decedent’s worldwide assets is also required in order to deduct any portion of the debts of a non-U.S. decedent unless they are non-recourse.

   h. State estate tax or inheritance taxes may also apply, especially with regard to real estate that a non-resident non-citizen of the United States (“NRNC”) owns directly. IRC § 2106(a)(4) allows “state death taxes” generally to be deductible against U.S. federal estate tax on the U.S. estate of a deceased NRNC in the same proportion that the property subject to state death taxes bears to the total value of U.S. property subject to U.S. federal estate tax.
2. **Risk of Paying Unnecessary Taxes**

Without proper planning, non-U.S. clients could pay estate tax unnecessarily to United States, but have no—or insufficient—estate/inheritance tax in their own jurisdiction against which they could claim credits for the U.S. estate tax paid.

a. **Some Countries have no Estate/Inheritance or Death-Related Tax:**

   - Argentina (outside of Buenos Aires): http://www.globalpropertyguide.com/Latin-America/Argentina/Inheritance
   - Australia: http://www.globalpropertyguide.com/Pacific/Australia/Inheritance
   - China: http://www.globalpropertyguide.com/Asia/China/Inheritance
   - India: http://www.globalpropertyguide.com/Asia/India/Inheritance
   - New Zealand: http://www.dol.govt.nz/immigration/knowledgebase/item/3307

b. **Some Countries may, depending on circumstances, have generally lower rates of Estate/Inheritance Tax, especially for the inheritance of property by immediate descendants.**

   - Belgium: Highest tax rate for descendants and ascendants appears to be is 30% in the Brussels region: http://www.cfe-eutax.org/taxation/inheritance-tax/belgium
   - Brazil: Highest rate is 8%.

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http://www.globalpropertyguide.com/Latin-America/Brazil/Inheritance
• Germany: Highest tax rate for descendants and ascendants appears to be 30%:
  http://www.barandt.com/e_new_german_inheritance_tax_law.html

• Italy: The highest tax rate appears to be 8%.
  http://www.globalpropertyguide.com/Europe/Italy/Inheritance

• Netherlands: The highest rate for spouses and children appears to be 20%.
  http://blog.clvn.nl/blog/2010/09/are-you-subject-to-dutch-inheritance-tax.html

• Switzerland: Highest rate in Canton of Geneva is 26%. Highest rates in many other canons are lower.
  http://www.globalpropertyguide.com/Europe/Switzerland/Inheritance

3. **Non-tax problems that impact on U.S. estate tax planning.**

   a. Who is the “Fiduciary” or Non-U.S. “Executor? Many jurisdictions have very
      attenuated concept, if any, of “executor” to which U.S. assets can be transferred
      without U.S. probate.

      • Application of NY EPTL § 13-3.4 (“Payment or delivery of property to
        foreign fiduciaries”) is uncertain.

      • Transfer agents will often require U.S. federal “transfer certificate” and are
        generally unaware of the IRS “safe harbor” provisions under Treas. Reg. §
        20.6325-1(b)(3).

   b. Problems in making foreign testamentary documents operate on U.S. Property.³

      • Lack of familiarity by U.S. courts with notarial and other forms of civil Wills

      • Difficulty in coordinating U.S. and non-U.S. property concepts:⁴

         ❖ Universal heir vs. residuary estate

         ❖ Usufruct vs. life estate

         ❖ Lack of trust concept

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³ See Galligan, “Buying USA: Ways of Minimizing U.S. Transfer Taxes on U.S. Property Interests of Non-U.S.
Persons,” *STEP USA* (June 2007), http://www.phillipsnizer.com/pdf/Article-
STEPJournalUSASupplementIssue3Galligan.pdf. (This article is also attached to this Outline as Exhibit B).

- Holographic wills vs. Witnessed Wills
- Notarial Wills vs. Witnessed Wills

c. Possible Application of Non-U.S. Law

Subjecting assets to U.S. administration could subject intangible assets to forced heirship rules (because of U.S. choice of law rules), even though most U.S. jurisdictions do not themselves adopt compulsory inheritance rules.

4. **U.S. Federal Taxes To Which Non-U.S. Persons can Be Subject**

- Federal Estate Tax
- Federal Gift Tax
- Federal Generation-Skipping Transfer Taxes
- Federal Income and Gains Taxes

Be aware of matching or “tag along” state or municipal taxes in all these cases.

**The Scope of the Federal Estate Tax**

The estate tax under Subchapter A of Chapter 11 of Subtitle B only applies to the transfer of the estate of U.S. citizen decedents and U.S. “resident” decedents.

The estate tax on the transfer of estates of “nonresidents” who are not U.S. citizens is imposed by Subchapter B of Chapter 11 of Subtitle B and only applies to “that part of [their] gross estate (determined as provided in Section 2031) which at the time of their death is situated in the United States.”

**The Scope of the Federal Gift Tax**

The gift tax imposed by Chapter 12 of Subtitle B applies to the transfer of property by gift “by any individual resident or nonresident” with an exception for transfers of “intangible property by a nonresident not a citizen of the United States” (other than certain expatriates).

**The Scope of the Generation-Skipping Transfer Tax**

The GST Tax imposed by Chapter 13 of Chapter B applies to all “generation-skipping transfers,” including (i) direct transfers, (ii) certain trust distributions and (iii) certain trust terminations. However, by regulation § 26.2663-2(b), the GST Tax only applies to direct transfers or transfers in trust by a nonresident not a citizen of the United States that were subject in the first place to U.S. estate or gift tax.
The Scope of the Federal Income Tax

The income tax imposed by Subchapter A of Chapter 1 of Subtitle A is imposed on all married individuals, heads of household, surviving spouses, unmarried individuals, estates and trusts, and corporations.

“Nonresident Aliens”

Need to distinguish “non-resident aliens” for income tax purposes from “non-resident aliens” for transfer tax purposes:

Income Tax NRAs are generally individuals who are not lawfully admitted to the U.S. for permanent residency and do not meet the “substantial presence” test for U.S. income tax residence under IRC § 7701(b)(3).  

A foreign national is considered to be resident in the United States for U.S. federal income tax purposes (and thereby would be subject to U.S. income tax on his worldwide income) if he meets either of the “lawful permanent residence” test or the “substantial presence” test. [IRC § 7701(b)(1)(A)].

Under the lawful permanent residence test, the foreign national is considered resident in the U.S. from the day he enters the U.S. with a “green card” until the day that his “green card” status is revoked by the immigration authorities or that such status has been judicially determined to have lapsed. During the period that the foreign national maintains his “green card” status, he is considered to be resident in the U.S. for income tax purposes even if he is living at the time outside the U.S.

Under the “substantial presence” test, the foreign national is considered resident in the U.S. for U.S. income tax purposes if (1) he is present in the U.S. for at least 31 days during the current calendar year, and (2) he is present in the U.S. for a weighted average of at least 183 days over a three-year look-back period which includes the current calendar year and the two preceding calendar years (in determining the weighted average, all days present in the U.S. during the current calendar year are counted, but only one-third of the days present in the preceding year and one-sixth of the days present in the next preceding year are counted). Furthermore, in applying the “substantial presence” test, the foreign national must include any day on which he was present any time at all within the U.S.

Example One

<table>
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<th>2015</th>
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<th>2017</th>
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<tr>
<td>Calculation</td>
<td>$20\frac{1}{16}$</td>
<td>$40\frac{1}{3}$</td>
<td>$121 = 181\frac{1}{2}$</td>
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</tbody>
</table>

Example Two

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Days</td>
<td>122</td>
<td>122</td>
<td>122</td>
</tr>
<tr>
<td>Calculation</td>
<td>$20\frac{1}{3}$</td>
<td>$40\frac{2}{3}$</td>
<td>$122 = 183$</td>
</tr>
</tbody>
</table>
IRC § 872(a) limits the “gross income” of “nonresident alien individuals” (including estates and trusts pursuant to IRC § 641(b)) to only

- Gross income derived from sources within the United States that is not “ECI” income (IRC § 871(a)). This is generally taxed at a flat 30% rate (or lower treaty rate) without the allowance of deductions. But note that certain categories of U.S. investment income such as interest on qualifying U.S. bank accounts and so-called “portfolio debt” as described in IRC § 871(h) is effectively exempt from tax under IRC § 871(a) provided that such interest does not constitute ECI.

- Gross income that is “ECI” – that is, “effectively connected with the conduct of a trade or business within the United States” (IRC § 871(b)). This is taxed at graduated rates on a net basis.

  a. IRC § 882(b) applies the identical rules to “foreign corporations”

  b. Generally, no capital gains tax on disposition of U.S. intangible property and tangible personal property not ECI, owned by persons who are not U.S. citizens or U.S. income tax residents. [But see IRC § 871(a)(2) where such capital gains are subject to U.S. income taxation in the case where the NRA is present in the U.S. for at least 183 days during the year (e.g., a foreign exchange student in the U.S. under an “F” or “M” visa).]

  c. But capital gains tax is imposed on dispositions of U.S. real property interests (both direct interests in U.S. real property and U.S. corporations with substantial holdings of U.S. real property) owned by persons who are neither U.S. citizens nor U.S. income tax residents. See IRC § 897 (“FIRPTA”).

Note that there are several exceptions to the “substantial presence test” that allow certain categories of foreign nationals to avoid being treated as resident aliens even though their presence in the U.S. would satisfy the three-year look-back rule (for example, foreign government employees holding “A” visas, and, in certain instances, foreign exchange students holding “F” or “M” visas).

Further note that IRC § 7701(b)(3)(B) provides for an exception to the “substantial presence” test in the case of a foreign national who has 183 or more “deemed days” under the three-year look-back rule, but whose actual days present in the United States during the current calendar year is less than 183. The foreign national qualifies for this exception only if (1) he has a “tax home” in a foreign country for the current calendar year; (2) he has a “closer connection” with the same foreign country than he has with the U.S. for the current calendar year; (3) he does not have an application for “adjustment of status” pending at any time during the current calendar year, nor has he taken any actions to apply for a “green card”; and (4) he timely files with his U.S. income tax return, IRS Form 8840 or its equivalent disclosing to the IRS that he qualifies for the IRC § 7701(b)(3)(B) exception.

Two types of U.S.-source income are taxable under this category: 1) “fixed or determinable annual or periodical gains, profits, and income” (commonly referred to as “FDAP income”) taxed under IRC § 871(a)(1) and 2) U.S.-source capital gains, taxable under IRC § 871(a)(2), if the NRA was present in the U.S. for at least 183 days during the year of sale. (The HIRE Act of 2010 enacted the tax provisions of the so-called “Foreign Account Tax Compliance Act” (“FATCA”), which include provisions imposing U.S. withholding tax on certain “dividend equivalent” amounts paid or credited to non-U.S. persons on or after September 14, 2010.).
Discussion

Key Planning Issues:

I. What is the Citizenship of the Client?

To be treated as a non-U.S. person (and thus not subject to universal U.S. federal transfer taxes) a client cannot be a U.S. citizen.

Establishing U.S. Citizenship

A. Birth in the U.S. unless to non-U.S. diplomats.

B. Birth abroad to two U.S. citizen parents as long as one parent resided for a certain period in the U.S. or possession.

C. Birth abroad to a U.S. citizen and non-U.S. citizen depends on length of U.S. residence of U.S. citizen parent and age when such residence took place.

D. Birth of U.S. citizen to U.S. father out of wedlock requires some U.S. residence by father and legitimization or acknowledgement of paternity prior to age 18 of child.

E. Birth of U.S. citizen to mother out of wedlock requires mother to be physically present in U.S. or possession continuously 12 months before birth of child.

F. Naturalization.

G. Naturalization by parents if occurs before age 18.

H. Child Citizenship Act of 2000: at least one U.S. citizen parent and child admitted to U.S.A. as legal permanent resident if conditions are satisfied before age 18.

Helpful Reference:


Note: Citizens Resident in U.S. Possessions

U.S. citizen who acquired U.S. citizenship solely by reason of

1. being a citizen of a U.S. possession or birth or

2. residence within a U.S. possession is considered a “non-resident not a citizen of the United States” for purposes of all taxes under Subtitle B (gift, estate, GST).
II. What is Domicile of the Client?

Note: To be treated as a non-U.S. person (and therefore subject to U.S. transfer taxes only on transfers of U.S. situs property), the client cannot be domiciled in the United States.

Meaning of “United States” To be a U.S. resident for U.S. transfer tax purposes, domicile must be established in one of the States of the United States or the District of Columbia.

A. Definition of Treas. Reg. § 20.0-1

“A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom.”

1. Need intention to remain indefinitely
2. Intention to change not effective unless implemented

Thus, the definition of “domicile” clearly carries within it two necessary elements, those being (1) physical presence in a country and (2) intent to remain there indefinitely. Since physical presence is usually easy to determine, the essential element in determining domicile is whether taxpayer had intent to remain there indefinitely. The courts look to a variety of factors in gauging the intention of an individual to live in the U.S. with no definite present intention of relocating. It should be noted that while the case law provides helpful guidance, there is no bright line test in determining intent as every case has its own unique particulars and the issue of intent must be decided in the light of the facts peculiar to each case.

A typical list of factors that are considered in determining domicile include—but are not limited to—the duration of stay in the U.S. and in other countries, the relative nature, size, and cost of the individual’s residences, the location of the individual’s family, the location of the individual’s personal possessions, the location of the individual’s business interests, the place where the individual has stronger communal ties and maintains memberships in religious, professional, and social organizations, the location of bank accounts, declarations of residence or intent made in visa applications, wills, etc., and the individual’s motivations for being in the United States and being abroad

B. Notable Cases on Domicile

1. Estate of Nienhuys (47 T.C. 1149 (1952)) – Netherlands citizen declares to U.S. Immigration Authorities intent to reside permanently in U.S.A. and receives a “green card,” but is still believed to be domiciled in The Netherlands (Tax Court found the particular facts convincing that the Netherlands citizen with a U.S. green card was not living in the U.S. by choice, but rather because Germany had invaded the Netherlands and that...
he always hoped to return to The Netherlands if and when circumstances improved. He lived in a modest apartment in the U.S. though he could afford a higher-end residence which he continued to own in The Netherlands. His declaration on his visa applications were made while Germany was occupying the Netherlands).

2. **Estate of Khan** (T.C. Memo 1998-22 (1998)) – Pakistani citizen who lived his entire life in Pakistan (except for approximately seven years when he was residing in the U.S. and tending to his business and property interests which were more significant than the interests he held in Pakistan) and who died in Pakistan more than four years after he was last present in the U.S. is still found to be domiciled in the U.S. Tax Court found that, when decedent came to the U.S. on his last “tour of duty,” he entered on a permanent resident visa, obtained a “green card” and social security number, and intended to stay to tend to his more significant business interests and that, when he left for Pakistan two years later (and never to return), he did so not to abandon his “U.S. domicile” but rather only to visit his family and to resolve some business matters. The court found that decedent’s effort to obtain a U.S. re-entry permit at around the time of his departure to Pakistan was indicative that decedent did not intend to change his domicile from the U.S.

3. **Estate of Jack** (54 Fed. Cl. 590 (2002)) – Canadian citizen present in the U.S. and teaching at a California university on a temporary non-immigrant visa (in particular, a TN Temporary Professional visa) could be found to have established U.S. domicile for U.S. federal estate tax purposes despite the fact that an intent to remain permanently in the U.S. would violate the terms of his non-immigrant visa. Federal Claims Court ruled that the IRS should not be precluded from showing that decedent’s domiciliary intent changed or was other than what he previously represented to immigration officials in his visa application. (*But see, Carlson v. Reed, 249 F.3d 876 (9th Cir. 2001).*).

An important “take away” from these cases and others is that estate and tax planners must pay attention to practically every aspect of their clients’ personal and professional lives in advising them as to how a U.S. court might rule on domicile.

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7 Some other notable decisions include Estate of Paquette, T.C.Memo 1983-571 (1983); Estate of Fokker, 10 T.C. 1225 (1948); Elkins v. Moreno, 435 U.S. 647 (1978) (employees of international organization present in the U.S. on non-immigrant “G-4 visa” could still be found to be domiciled in the U.S. for U.S. federal estate tax purposes); Estate of Bloch-Sulzberger, 6 T.C.M. 1201 (1947).
C. Special Cases Where the Question of Domicile May Be Ambiguous

1. Persons who are considered domiciliaries of their country of nationality even after they have established domiciliary in different country (tax treaties).

   For example, under the U.S.-U.K. estate and gift tax treaty, a U.K. national (and domiciliary) who moves to the U.S. may still be deemed to maintain his domicile in the U.K. for a period of time after the move, at least if the U.K., under its own internal rules, considers the U.K. national to be a U.K. domiciliary for any period after his departure from the U.K. (See Article 4(2)(b) of such treaty, which provides that if such U.K. national had not been resident in the U.S. for Federal income tax purposes in 7 or more of the 10 taxable years ending with the year in which the death or transfer occurs, he may be deemed to be domiciled in the U.K. at that time.).

2. Persons who have “green cards” but who do not have an intention to remain indefinitely in the U.S.

3. Persons who have conditional “green cards”
   a. Marriage to U.S. citizen

      A foreign national’s permanent residence is conditional if it is based on a marriage that was less than 2-years old on the day such foreign national was given permanent residence. The foreign national could apply to remove the conditions on permanent residence if such foreign national is still married to the same U.S. citizen (or permanent resident) after 2 years.

   b. Foreign National present in the U.S. under an EB-5 visa.

      An EB-5 visa is a method of obtaining a green card for certain foreign nationals who invest money in the U.S. If the foreign national investor’s visa application is approved, the investor and his dependents will be granted conditional permanent residence valid for two years. Within 90 days before the conditional “green card” is set to expire, the investor must provide evidence showing that the full required investment has been made and that, as a result, a certain minimum number of jobs in the U.S. have been created or preserved or will be created within a reasonable time. If the investment fails, the foreign national must leave the U.S.

4. Former U.S. Citizens and Long-Term U.S. Residents who Expatriated

Prior to June 17, 2008, the date that the new 2008 Expatriation Rules became effective under the HEART Act:
a) Persons who renounced U.S. citizenship or gave up “green card,” are deemed to have a tax-avoidance reason for doing so (10 year application).

b) Persons who spend substantial time in U.S.A. (10 year application)

Note: Do not confuse U.S. domicile with U.S. income tax residence:

1. A “green card” holder is subject to U.S. worldwide income tax regardless of plans to stay indefinitely or to leave after future occurrence

2. Application of “days test” is mechanical except for narrow exception under IRC § 7701(b)(3)(B)

III. What Property Does A Client Own And What Is Its Nature?

A. What Are The Forms Of Ownership That Count?

1. Distinction Between Legal Title and Beneficial Ownership

   Title: Trust, Stiftung, Corporate Nominee…

   Beneficial: Trust Beneficiary, Foundation Distributee, Beneficial Owner of Assets Held in Corporate Name …

Treas. Reg. § 20.2013-5(a)

“. . . the term “property” means any beneficial interest in property, including a general power of appointment . . . over property. Thus, the term does not include an interest in property consisting merely of a bare legal title . . .”

Special Cases:

- Application of IRC § 2104(a): Stock “owned and held” by a nonresident noncitizen of the U.S. (“NRNC”) subject to U.S. estate tax only if issued by U.S. corporation. However, stock of a foreign corporation is not includible in the U.S. estate of a NRNC, regardless of whether the stock certificates are actually located within the U.S. [See Treas. Reg. § 20.2105-1(f)].

See Estate of Charania v. Shulman, 608 F.3d 67 (1st Cir. 2010), aff’g in part, 133 T.C. 122 (2009) (stock of Citigroup held subject to U.S. estate tax, undiminished by alleged community property share of surviving spouse).

American Depositary Receipts (“ADRs”), although normally issued and sold by U.S. banks are considered to have situs
outside the U.S. because they substantively are treated as shares in foreign corporations. [See PLR 200243031].

Investments in U.S. real property owned by Canadian mutual funds that were a part of NRNC decedent’s RRSP held not includible in NRNC decedent’s U.S. estate because the Canadian mutual funds were determined to have foreign situs as they were properly classified as corporations incorporated outside the United States. [See CCA 201003013].


The situs rule for stock of foreign corporations has resulted in the use of foreign holding corporations as a major estate planning tool to prevent assets of a NRNC, which would otherwise have U.S. situs if held directly, from being subject to U.S. federal estate tax. The Fillman case strongly cautions planners that more is required than simply placing U.S. situs assets in a foreign corporation. At a minimum, the corporation should be in good standing under local law and corporate formalities should be followed.

* Risk that, in certain circumstances, a transfer of U.S. stock to a foreign holding company may cause the foreign holding company (“inverted” or “surrogate foreign corporation”) to be treated under, IRC § 7874(b), as a U.S. corporation for all tax purposes under the Internal Revenue Code, notwithstanding IRC § 7701(a)(4).

- Application of IRC § 2104(b): Trusts funded with U.S. property or holding U.S. property upon death of NRNC settlor in which NRNC settlor has retained right of enjoyment or incidents of control treated as de facto nominee for U.S. assets held by trust or attributable to U.S. property with which trust was funded upon death of NRNC settlor. [See TAM 9507044 (February 17, 1995) (trust funded with U.S. property)].

* Risk that non-U.S. partnerships and non-U.S. LLCs holding U.S. assets, if otherwise qualifying as non-U.S. assets, may be considered nominees for their partners holding U.S. assets: See Matter of Strangi, TC Memo 2003-145 (2003), aff’d 417 F.3d 468 (5th Cir. 2005)
B. **What Property Does the Client Share with Others?**

1. Matrimonial Property Regimes
   a. Separate Property
   b. Community Property as to Marital Property
   c. Community Property as to All Property of the Spouses

**Special Cases:**

1. Germany: Separate Property with “Community of Surplus.”

2. New Zealand: Matrimonial Property Law.


Note: New York has adopted the New York Uniform Disposition of Community Property Rights at Death Act. NY EPTL §§ 6-6.1 through 6-6.7.

2. **Forms of Common Law Joint Ownership** (Tenants by Entirety, Joint Tenants with Survivorship) as distinguished from Tenants in Common.

   **U.S. Citizen Spouses:** Property assumed owned 50/50 for Federal Estate tax purposes.

   **Non-U.S. Citizen Spouses:**
   - One or Two Non-citizen Spouses: Property subject to estate tax based on contribution.
   - Gifts of real property: Contribution rule for gift tax purposes is applied on distribution of proceeds of sale.
   - Gifts of intangible property: Contribution rule for gift tax purposes is applied when joint interest is established.

   **See Estate of Charania v. Shulman**, 608 F.3d 67, 73 (1st Cir. 2010), aff’g in part, 133 T.C. 122 (2009) – The estate of the deceased U.K. NRNC,

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8 “Zugewinngemeinschaft.”

who owned stock of Citigroup directly, argued that one-half of the stock was owned by surviving spouse as community property, but couple did not take steps under Belgian law to declare a community property regime and U.K. precedent applicable to NRNC did not consider change of matrimonial domicile from separate property jurisdiction (Uganda) to Belgium sufficient to effect change from separate property to community property.

**Note: Non-Citizen Spouses**

- Enlarged annual exclusion for gifts of “present interests” to non-U.S. citizen spouses: The exclusion is indexed for inflation and is currently at $139,000 for 2012.

- No QDOT Trust is available for lifetime gifts to non-U.S. citizen spouses.

- If either or both spouses are NRNCs, no “gift-splitting” (attributing the gift of one spouse to both spouses to maximize utilization of gift tax exclusions and exemptions) not permitted. IRC § 2513(a)(1).

C. **What Property Owned by Client Might be Subject to Claims of Others?**

1. **“Clawback Provisions” under Forced Heirship Statutes**
   - **Spain:** No statutory limit on look-back to transfers made during lifetime (but limitations may be supplied by courts)
   - **Switzerland:** Look-back for most part, limited to five years
   - **France:** Surviving spouse may withdraw gifts made to predeceased spouse

2. **Testamentary Substitutes Under Spousal Right of Election**
   - a. Unlimited look-back (subject to enactment dates) for transfers into trust with retained interest. NY EPTL § 5-1.1-A(b)(1)(F)
   - b. One year look-back for all direct gift transfers. NY EPTL § 5-1.1-A(b)(1)(B)

   **Note:** Spousal right of election in New York is not available to spouse of non-New York domiciliary decedent unless decedent made an election to have disposition of New York property governed by New York law under EPTL § 3-5.1(h).
D. **What Property of Client Is Subject to Creditors’ Claims?**

1. In many civil law jurisdictions, heirs (absent express election to contrary) take decedent’s property, subject to unlimited liability for decedent’s debts.

2. In New York, generally, claims of creditors of decedent limited to estate assets but an heir can also be liable for debts to the extent of property received from estate for debts not satisfied from assets subject to administration (NY EPTL § 12-1.1).

IV. **Where Is Client’s Property Located?**

A. **For Purposes of Determining Applicable Inheritance Law**

1. Civil Law Tradition Generally:
   a. No Distinction Between Real and Intangible Property (No “Scission”)
   b. Applicable Law is Based on Citizenship
   c. Is the applicable law the “Whole Law” (or “Substantive Law” only)?
      - Germany (yes)
      - Italy (probably yes)
      - Spain (no – but there may be different views)
   d. “Renvoi” from the Country of Citizenship increasingly applied

2. Common Law:
   a. Distinction between real property and intangible property (“scission”)
   b. Real property governed by law where property is located
   c. Intangible Property governed by law of domicile or owner (individual or trustee); “*mobilia sequuntur personam*” ("moveable assets follow the person").

**Mixed Situations**

- France
Recognizes Scission.

Immoveable property follows law of situs.

Moveable property follows law of domicile.

Switzerland

Generally, does not recognize scission

Habitual residence rather citizenship is key factor

B. For Purposes of New York EPTL § 3-5.1(h) and EPTL § 7-1.10

Real property and tangible property located in New York


Entities organized by New York and physical documents maintained here

C. For purposes of N.Y. EPTL § 7-1.10

“Whenever a person, not domiciled in this state, creates a trust which provides that it shall be governed by the laws of this state, such provision shall be given effect in determining the validity, effect and interpretation of the disposition in such trust of:

1) Any trust property situated in this state at the time the trust is created

2) Personal property, wherever situated, if the trustee of the trust is a person residing, incorporated or authorized to do business in this State or a national bank having an office in this State.”

In re Tabbaghi’s Estate, 167 Misc. 156 (1938) (France) (validity of trust)

D. For purposes of N.Y. EPTL § 3-5.1(h)

“Whenever a testator, not domiciled in this state at the time of death, provides in his will that he elects to have the disposition of his property situated in this state governed by the laws of this state, the intrinsic validity, including the testator’s
general capacity, effect, interpretation, revocation or alteration of any such disposition is determined by the local law of this state.”

See Estate of Renard, 56 N.Y.2d 973 (1982) (bank and brokerage accounts)

E. For Purposes of U.S. Federal Gift Tax and Gift-Related GST Tax

1. Real Property Located in U.S. treated as U.S. situs. [See Treas. Reg. § 25.2511-3(b)].

   * Possibility of gifts of non-U.S. cash by NRNC intended to facilitate purchase of U.S. real property could be characterized as real property itself, under IRS “step transaction” theory. [See De Goldschmidt-Rothschild v. Commissioner, 168 F.2d 975 (2d Cir. 1948); Davies v. Commissioner, 40 T.C. 525 (1963)].

2. Tangible Personal Property located in U.S. treated as U.S. situs. [See Treas. Reg. § 25.2511-3(b)].

   * Vexed issue about funds in U.S. bank deposit accounts for U.S. gift tax purposes

   A gift by an NRA by means of a check drawn against his U.S. bank account or a wire transfer to a donee’s U.S. account may be treated as a gift of currency, in which case, it would likely be treated by the IRS as a gift of tangible personal property located in the U.S. [See Treas. Reg. § 25.2511-3(b)(4)(iv); PLR 7737063; GCM 36860 (Sept. 24, 1976); Rev. Rul. 55-143].

   An NRA who desires to make a cash gift and avoid IRS potentially characterizing it as a taxable gift should not issue a check on a U.S. bank account or wire funds from a U.S. bank account, but rather should wire funds from his offshore account to offshore accounts held by the U.S. donees or should withdraw cash from a U.S. account and give out the cash to the U.S. donees outside the U.S.

3. Intangible Personal Property with U.S. connections treated as foreign situs. For example, a gift of U.S. corporate stock by a non-resident alien is exempt from gift tax even if the stock certificate is physically located in the U.S. [See IRC § 2501(a)(2)].

F. For Purposes of U.S. Federal Estate Tax and Estate-Related GST Tax


   Note: Remember that “real property” under common law has a narrower definition than “immovable property” under civil law
2. Tangible Personal Property

Tangible Personal Property that is not being used or loaned for exhibition or related purposes and that is located in the United States has U.S. situs. [See Treas. Reg. § 20.2104-1(a)(2)].

Note: Currency is treated as tangible personal property for estate tax purposes. [See Rev. Rul. 55-143].

3. Shares of Stock of U.S. Corporations

Shares of stock issued by a U.S. “domestic” corporation (regardless of location of certificates) have U.S. situs. [See IRC § 2104(a); Treas. Reg § 20.2104-1(a)(5)].

a. IRC § 2104(a) refers to shares “owned and held” by an NRA.

b. Treas. Reg. § 20.2104-1(a)(5) omits the reference to “owned and held.”

c. Note: A transfer tax treaty may override the Code’s inclusionary rule as to stock of U.S. corporations. For example, generally, under the “modern” U.S. estate tax treaties (for example, treaties with the United Kingdom, France, Germany, and The Netherlands), the U.S.’s treaty partner has the exclusive right to tax stock in U.S. corporations where the decedent is determined to be a domiciliary of such treaty partner.10

d. For an estate of a NRNC decedent who died after 2004 and before 2012, if such NRNC decedent had owned stock of a U.S. mutual fund or “regulated investment company” (i.e., “RIC”), only the proportion of the fund invested in U.S. situs assets are subject to U.S. estate tax. IRC § 2105(d). The purpose of this rule was to provide an exemption to the estates of foreign persons who invest in certain assets through a RIC to the same extent that those assets would not be subject to the estate tax if held directly. However, for NRNC decedents dying in 2012 and thereafter, the exception of IRC § 2105(d) is no longer applicable and shares in RICs (i.e., domestic mutual funds) are fully includible in the U.S. estate of a NRNC by virtue of IRC § 2104(a).

4. Debt Obligations of U.S. Persons

Debt obligations of a U.S. person, the U.S. or a political subdivision if not treated as “outside the U.S.” by IRC § 2105 have U.S. situs.

a. In the case of NRNCs who are not U.S. income tax residents, debt obligations that have U.S. situs include:

(i) Portfolio debt issued on or prior to July 18, 1984

(ii) Debt issued by companies in which the NRNC held 10% or more of the voting power (corporation) or capital or profits interest (partnership) [IRC § 871(h)(3)(B)].

(iii) Obligations issued by state and local municipalities\(^{11}\)

(iv) Obligations subject to profitability or similar contingencies [IRC § 871(h)(4)(A)].

(v) Bearer bonds described in IRC § 163(f)(2)(B) and are issued on or after March 19, 2012.

b. In the case of NRNCs who are not U.S. income tax residents, the following debt obligations have foreign situs:

Debt obligations that are portfolio debt obligations (except for those enumerated in (i) through (v) above) are generally foreign situs, even if issued by a U.S. person, if issued after July 18, 1984. [IRC § 2105(b)(3)]. This generally applies to debt obligations if any interest thereon would be eligible for the exemption from U.S. income tax under IRC § 871(h)(1) were such interest received by the NRA decedent at the time of his death, without regard to whether the U.S. issuer has received a statement (that satisfies the requirements of IRC § 871(h)(5)) that the beneficial owner of the obligation is not a U.S. person. The term “portfolio interest” also includes interest that is paid on a non-registered obligation (like a bearer bond) that was issued before March 19, 2012 and that is described in IRC § 163(f)(2)(B). Debt obligations considered as having foreign situs, for decedents dying after August 5, 1997, also include short-term obligations (OID) with maturity dates of 183 days or less as long as any interest thereon is not effectively connected with a U.S. trade or business. [IRC § 2105(b)(4)].

\(^{11}\) Due to the technicality that the IRS § 871(h) income tax exemption only applies if interest is exempt only by virtue of IRC § 871 (but “query” whether such income is exempt under general principles of U.S. tax law).
c. In the case of NRNCs who are U.S. income tax residents, all U.S. debt obligations have U.S. situs – because U.S. income tax residents are not eligible for the exemptions described in IRC § 871(h).\(^\text{12}\)

5. Certain Deposits

a. A NRNC’s deposit with a domestic bank is not considered to have a U.S. situs as long as the deposit is not effectively connected with a trade or business conducted by the NRNC within the U.S. [IRC § 2105(b)(1)]. Additionally, a deposit in an offshore branch of a U.S. domestic bank is also deemed to have a foreign situs. [IRC § 2105(b)(2)].

Any conventional bank deposit (for example, funds in checking and savings accounts and in certificate of deposits) are considered under the above rule of IRC § 2105(b) to have foreign situs.

In PLR 200842013, the IRS ruled that annuity proceeds due a NRNC decedent, but still held by the insurance companies as of the decedent’s death, were not deemed to have U.S. situs pursuant to IRC § 2105(b)(1) and therefore were excluded from NRNC’s gross estate under IRC § 2103.

b. The following deposits have U.S. situs:

- Special deposits held by U.S. banks in a custodial capacity that are not commingled with other assets of the bank. [See Rev. Rul. 69-596].

- Deposits with brokerage houses

- Deposits with U.S. branches of foreign corporations that are engaged in the commercial banking business (and do not fit within the portfolio interest exclusion)

6. Other Intangible Property

“Intangible Personal Property, the written evidence of which is not treated as being the property itself, if it is issued by or enforceable against a U.S. resident or a domestic corporation or governmental entity.” Treas. Reg. § 20.2104-1(a)(4)

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\(^{12}\) Further details on inclusion and exclusion of debt instruments as well as on many other topics related to U.S. estate tax planning for NRNCs may be found in Michael A. Heimos, 837-3rd Tax Management Inc., Non-Citizens – Estate, Gift and Generation-Skipping Taxation.
a. “Property the written evidence of which is treated as being the property itself” was thought to include bonds for the payment of money (see Treas. Reg. § 20.2104-1(a)(3))

b. “U.S. resident” is presumably defined as U.S. domiciliary.  

c. Possible Application:
   
   (i) Partnerships
   
   (ii) Limited Liability Companies
   
   (iii) Intellectual Property Rights
   
   (iv) License rights

**Special Note on Partnerships**

(a) Often thought of as intangible personal property

(b) General partners generally have rights to terminate partnership and therefore may be seen as owning shares of the underlying partnership property

See *Sanchez v. Bowers*, 70 F.2d 715 (2nd Cir. 1934)

(c) Rev. Rul. 55-701 (situs is where partnership does business) should not be applicable

   a. Decided under superseded U.S.-UK Estate Tax Convention

   b. Treas. Reg. § 20.2104-1 was amended in 1973 and 1974 and did not adopt this rule

(d) “Look-through” rule of *Sanchez v. Bowers*, 70 F.2d 715 (2d Cir. 1934) generally applied only to general partnerships or perhaps interests of general partners in limited partnerships.

(e) Case for applying the rule of *Blodgett v. Silberman*, 277 U.S. 1 (1928) uses the common law ‘domicile of decedent’ rule for situs of intangible property. How strong is this position?

   (i) Depends on contention that Treas. Reg. § 20.2104-1(a)(4) was not intended to apply due to the language therein suggesting that it has limited applicability

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13 Treas. Reg. § 20.2104-1(a)(7) refers by contrast, to U.S. person as defined in IRC § 7701(a)(30) for U.S. income tax purposes
(ii) Depends on contention that Treas. Reg. § 20.2104-1(a)(4) is “ultra vires” because it addresses issues not explicitly addressed by IRC § 2104.

Important Principle:

“State law creates legal interests and rights. The federal revenue acts designate what interests and rights, so created, shall be taxed.”

*Morgan v. Commissioner*, 309 U.S. 78, 80 (1940)

Therefore, only express departures from state law concepts by Federal tax law regarding situs of property should be valid.

Special Note on Limited Liability Companies

(a) In the absence of an election to the contrary, a U.S. LLC is treated for all U.S. tax purposes as a partnership if it has two or more members. Treas. Reg. § 301-7701-3(b).

(b) In the absence of an election to the contrary, a single-member LLC is disregarded.

(c) In the absence of an election to the contrary, a non-U.S. LLC is treated for U.S. tax purposes as a partnership if it has two or more members and one member does not have limited liability.

(d) LLCs generally did not exist under U.S. law in 1955 – therefore even better argument that Rev. Rul. 55-701 does not apply.

(e) *Sanchez v. Bowers* should not apply when there are no “general partners.”

(f) LLCs were still rare in early 1970’s when Treas. Reg. § 2104-1(a)(4) was last amended.

(g) Argument in favor of applying the Blodgett rule attributing situs to domicile of owner of LLC interest may be stronger than with a partnership interest.

7. Trusts

“Look-through” Rules for Trusts

(i) U.S. property transferred “in trust or otherwise” in which decedent retained an interest (under IRC §§ 2035 through 2038) at the time of death (IRC § 2104(b)).
(ii) Property (even non-U.S. property) held “in trust or otherwise” that originated from U.S. property transferred to the trust by the decedent (IRC § 2104(b)).

(iii) Non-U.S. situs share of property held by a U.S. regulated investment company (“RIC”) (2005-2011) is eligible for exclusion.

Cases and Rulings

- Swann v. Commissioner, 247 F.2d 144 (2d Cir. 1957): Stiftung treated as a U.S. trust with retained interest despite provision of U.S.-Switzerland income tax treaty treating Stiftung as corporation.

- TAM 9507044 – Trust created in 1923 with U.S. assets subject to U.S. estate tax even though assets in trust when grantor died in 1991 had non-U.S. situs.

- But see CCA 201020009 (payment of gift tax within 3 years of NRNC decedent’s death considered made under IRC § 2035(b) is not a transfer within the meaning of IRC §§ 2035 to 2038; thus such gift tax paid is not property deemed situated in the U.S. under IRC § 2104(b)).

V. What Planning Entities Work Best for Client?  

A. Corporations

1. Consider Treas. Reg. § 20.2105-1(f)

   “Shares of stock issued by a corporation which is not a domestic corporation, regardless of the location of the certificates” are treated as outside the U.S.

2. Consider whether the stock of foreign corporation must be “owned and held” by non-U.S. shareholder.


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4. Consider U.S. income tax consequences if foreign corporation holds U.S. assets directly.
   a. Corporate capital gains tax rates on sale of U.S. real property (FIRPTA)
   b. Possible branch profits tax on U.S. business activities; not applicable at least in cases where sole asset of foreign corporation is U.S. real estate that does not generate income, or where income is reinvested in the real estate, as long as corporation is liquidated soon after sale of real estate.
      If foreign corporation is in a treaty jurisdiction, treaty may provide branch profits tax relief.
   c. Possible loss of tax treaty benefits if foreign corporation is in a tax-haven jurisdiction.
5. Consider U.S. income tax consequences if direct owner of U.S. assets is U.S. corporation owned by foreign corporation.
   a. Corporate capital gains tax rates on sale of all U.S. assets
   b. No branch profits tax
   c. U.S. withholding tax on payment of dividends to foreign corporate parent, subject to reduced treaty rates depending on residence of foreign corporation; no such withholding tax if earnings are reinvested and paid out to foreign corporate parent upon liquidation of U.S. corporation after payment of U.S. capital gains tax on sale of assets it holds.
6. Consider non-U.S. income tax consequences, especially if corporation is not organized in client’s primary tax jurisdiction.
7. Consider U.S. tax consequences if corporate stock is later owned by U.S. persons:
   (a) Loss of step-up in basis for assets held by corporation
   (b) Treatment of foreign corporation if treated as CFC or PFIC
B.  **Partnerships and LLCs Qualifying as Partnerships**\(^{15}\)

1. U.S. Partnership still may be vulnerable to U.S. estate tax inclusion (Risk)
2. Foreign Partnerships may be vulnerable to U.S. estate tax inclusion if engaged in U.S. business activities (Risk)
3. Share of U.S. Capital Gains taxed at Individual Rates (Advantage)
4. Availability of IRC § 754 election to “step-up” internal basis of partner’s share of underlying assets to match the post-death external basis. (Advantage)
5. No U.S. NRA withholding tax; tax treaty benefits may be more accessible; and no branch profits tax (Advantage).
6. If primary taxing jurisdiction accepts partnership treatment, may be more acceptable to that jurisdiction (Advantage).
7. Would not be treated as CFC or PFIC if passes to U.S. owners (Advantage).

C.  **Consider Combination of U.S. LLC and Foreign Corporation**

a. LLC organized in U.S. jurisdiction could establish U.S. situs for non-tax purposes but be disregarded for U.S. tax purposes if owned by sole foreign person.

b. Corporation not owned abroad but owned by LLC would still be treated as owner of assets for U.S. tax proposes.

c. Possible approach to combining benefits of U.S. tax planning for non-U.S. person, with protection from foreign property law issues under EPTL § 3.5-1(h) and/or EPTL § 7-1.10. (See Exhibit A).\(^{16}\)
   - U.S. assets owned by non-U.S. corporation
   - Non-U.S. corporation owned by single-member N.Y. LLC
   - Single member of LLC is either:

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\(^{15}\) Note that, under Rev. Proc. 2012-7, the IRS will not issue rulings as to whether a partnership interest is intangible property for purposes of gifts by NRNCs and therefore will not be subject to U.S. gift tax, pursuant to IRC § 2501(a)(2).

\(^{16}\) For further discussion of these provisions of New York law, see Galligan, “Forced Heirship in the United States of America,” in these materials for the Eighth Annual NYSBA-STEP International Estate Planning Institute.
… Non-U.S. individual with Will directing application of N.Y. law to N.Y. property

or

N.Y. trust directing that N.Y. law govern the trust.

D. Insurance

- Wrapping U.S. property in insurance vehicles that qualify as insurance for U.S. tax purposes and where the insurance is on the life of the owner of the policy.

- Life insurance on the owner of the policy as source of funding for assets that have to be owned directly by non-U.S. person (no U.S. estate planning need for irrevocable life insurance trust because of life insurance exclusion under IRC § 2105(a)).

VI. What To Do When The Client Has Already Acquired U.S. Property In Client’s Own Name?

A. Gifts

- Lifetime gifts of intangible U.S. property, including stock of U.S. corporations, U.S. partnership interests, notes, intellectual property rights, claims are all exempt from U.S. gift tax.

- Lifetime gifts of real and tangible property located in the United States do not provide very much relief since there is no lifetime gift tax exemption for NRNCs. [IRC § 2505(a)]. Annual exclusion is available (currently $13,000 per donee) but this is not likely to be of much avail. Gift tax exclusion of educational and medical expenses may be helpful when cash gifts are made from U.S. accounts, granted some uncertainties about the characterization of funds from such accounts as tangible or intangible property, but hardly help with problems involving U.S. real estate or U.S. tangible property that a NRNC may own directly. [IRC §§ 2503(b) & (e)].

B. Exchanges of U.S. assets for stock or membership interest in a non-U.S. entity (Generally, no U.S. capital gains tax on sale or exchange of U.S. intangible property and tangible property by person who is neither U.S. citizen nor U.S. income tax resident; see also IRC § 351(a) and IRC § 721(a) non-recognition rules).

Caution: Plan to avoid potential application of IRC § 7874(b) to cause the foreign corporation to be treated as a domestic corporation for U.S. tax purposes.

IRC § 7874(b) applies where stock in a U.S. corporation is (or the U.S. assets of a U.S. corporation are) transferred to a foreign holding company whereby (1) the
U.S. corporation becomes a subsidiary of such foreign holding company (or substantially all of the U.S. assets of the U.S. corporation are now held by the foreign holding company); (2) the former shareholders of the U.S. corporation hold at least 80% of the foreign holding company’s stock by vote or value after the transfer; and (3) the foreign holding company and its “expanded affiliated group” do not have substantial business activities in the foreign country where the foreign holding company is organized.

C. U.S. Real Property Interests (“USRPI”)

- Capital Contribution of USRPI to foreign corporation subject to tax. IRC § 897(j)

- Exchange of direct interest in real property for stock of foreign corporation will trigger tax. IRC § 897(e)(1) and Temp. Reg. § 1.897-6T(b)(3).

- Possibility under certain circumstances of deferral of tax on exchange of interest in U.S. Real Property Holding Corporation (“USRPHC”) for stock of a foreign corporation. Temp Reg. § 1.897-6T(b)(1).

- Exchange of direct interest in U.S. real property or an interest in a USRPHC eligible for nonrecognition under IRC § 721 subject to potential recognition under IRC § 897(e) but Temp. Reg. § 1.897-6T(a)(3) provides:

  “For example, the exchange of a U.S. real property interest for an interest in a partnership will receive non-recognition treatment . . . only to the extent that a disposition of the partnership interest will be subject to U.S. taxation by reason of the operation of Section 897(g).”

- Another approach to Real Property: encumber real property with non-recourse debt.

**Circular 230 Disclosure:** Pursuant to U.S. Treasury Department Regulations, we are required to advise you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including attachments and enclosures, is not intended or written to be used, and may not be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.
**Exhibit A**

**U.S. NRNC Estate Planning**
Under New York EPTL Section 3-5.1(h)

**Property Disposition**

- NRNC
  - New York LLC
    - (Disposed of by the NRA’s Will governed by New York law)
  - Non-U.S. Corporation
  - Assets
    - (U.S. assets and, depending on local rules, non-U.S. assets)

**U.S. Estate Tax**

- NRNC
  - New York LLC
    - (Disregarded for U.S. tax purposes)
  - Non-U.S. Corporation
  - Assets
    - (U.S. assets and, depending on local rules, non-U.S. assets)
United States

Estate and Income Taxation of

Non-Resident Aliens

Materials

by

Michael W. Galligan, Partner

and

Ira Olshin, Counsel

Phillips Nizer LLP

New York, New York

(212) 841-0572

mgalligan@phillipsnizer.com

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Prologue: Why Is Estate Planning For Non-U.S. Persons Important?

1. U.S. Estate Tax on Non-U.S. Estates can be very onerous:

   a. Current highest U.S. federal estate tax rate is 40% (essentially, a U.S. taxable estate is currently taxed at a 40% rate for every dollar that such taxable estate exceeds $5,490,000 (2017, indexed for inflation for years thereafter).

   b. Exemption from U.S. federal estate tax for an estate of a non-U.S. decedent is limited to $60,000. So the U.S. federal estate tax on a U.S. taxable estate of just $1,000,000 would exceed $300,000.

   c. No credit is allowed under U.S. federal estate tax law for estate or inheritance taxes paid to a non-U.S. jurisdiction on U.S. property unless provided for under a transfer tax treaty between the U.S. and such foreign jurisdiction.

   d. To obtain the marital deduction for a transfer on death to a non-U.S. citizen spouse, a QDOT trust must be established, but, it should be noted that most civil law jurisdictions do not honor—and may even discriminate against—trusts (for example, the 2011 Amended Finance Act of the Republic of France).

   e. Unless a treaty allows otherwise, the charitable estate tax deduction is limited to transfers to U.S. qualifying organizations (that is, pursuant to IRC § 2106(a)(2), no charitable estate tax deduction is available for a gift to a corporate charity unless it is a U.S. domestic charity, and no charitable estate tax deduction is available for a gift to a charitable trust unless the gift is to be used only within the U.S.). Furthermore, if the gifted property was not required to be included in decedent’s U.S. gross estate, then no charitable estate tax deduction is available even though such property was bequeathed to a U.S. charity (see IRC § 2106(a)(2)(D)).

   f. The disclosure of a decedent’s worldwide assets is required in order to claim deductions for estate administration expenses allocable to U.S. property and charitable transfers (see IRC § 2106(b)).

   g. The disclosure of a decedent’s worldwide assets is also required in order to deduct any portion of the debts of a non-U.S. decedent unless they are non-recourse.

   h. State estate tax or inheritance taxes may also apply, especially with regard to real estate that a non-resident non-citizen of the United States (“NRNC”) owns directly. IRC § 2106(a)(4) allows “state death taxes” generally to be deductible against U.S. federal estate tax on the U.S. estate of a deceased NRNC in the same proportion that the property subject to state death taxes bears to the total value of U.S. property subject to U.S. federal estate tax.
2. **Risk of Paying Unnecessary Taxes**

Without proper planning, non-U.S. clients could pay estate tax unnecessarily to United States, but have no—or insufficient—estate/inheritance tax in their own jurisdiction against which they could claim credits for the U.S. estate tax paid.

a. Some Countries have no Estate/Inheritance or Death-Related Tax:

- Argentina (outside of Buenos Aires): http://www.globalpropertyguide.com/Latin-America/Argentina/Inheritance
- Australia: http://www.globalpropertyguide.com/Pacific/Australia/Inheritance
- China: http://www.globalpropertyguide.com/Asia/China/Inheritance
- India: http://www.globalpropertyguide.com/Asia/India/Inheritance
- New Zealand: http://www.dol.govt.nz/immigration/knowledgebase/item/3307

b. Some Countries may, depending on circumstances, have generally lower rates of Estate/Inheritance Tax, especially for the inheritance of property by immediate descendants.

- Belgium: Highest tax rate for descendants and ascendants appears to be is 30% in the Brussels region: http://www.cfe-eutax.org/taxation/inheritance-tax/belgium
- Brazil: Highest rate is 8%.

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http://www.globalpropertyguide.com/Latin-America/Brazil/Inheritance
• Germany: Highest tax rate for descendants and ascendants appears to be 30%:
  http://www.barandt.com/e_new_german_inheritance_tax_law.html

• Italy: The highest tax rate appears to be 8%.
  http://www.globalpropertyguide.com/Europe/Italy/Inheritance

• Netherlands: The highest rate for spouses and children appears to be 20%.
  http://blog.clvn.nl/blog/2010/09/are-you-subject-to-dutch-inheritance-tax.html

• Switzerland: Highest rate in Canton of Geneva is 26%. Highest rates in many other canons are lower.
  http://www.globalpropertyguide.com/Europe/Switzerland/Inheritance


a. Who is the “Fiduciary” or Non-U.S. “Executor? Many jurisdictions have very attenuated concept, if any, of “executor” to which U.S. assets can be transferred without U.S. probate.

  • Application of NY EPTL § 13-3.4 (“Payment or delivery of property to foreign fiduciaries”) is uncertain.

  • Transfer agents will often require U.S. federal “transfer certificate” and are generally unaware of the IRS “safe harbor” provisions under Treas. Reg. § 20.6325-1(b)(3).

b. Problems in making foreign testamentary documents operate on U.S. Property.

  • Lack of familiarity by U.S. courts with notarial and other forms of civil Wills

  • Difficulty in coordinating U.S. and non-U.S. property concepts:
     Universal heir vs. residuary estate
     Usufruct vs. life estate
     Lack of trust concept

3 See Galligan, “Buying USA: Ways of Minimizing U.S. Transfer Taxes on U.S. Property Interests of Non-U.S. Persons,” STEP USA (June 2007), http://www.phillipsnizer.com/pdf/Article-STEPJournalUSASupplementIssue3Galligan.pdf. (This article is also attached to this Outline as Exhibit B).

Holographic wills vs. Witnessed Wills

Notarial Wills vs. Witnessed Wills

c. Possible Application of Non-U.S. Law

Subjecting assets to U.S. administration could subject intangible assets to forced heirship rules (because of U.S. choice of law rules), even though most U.S. jurisdictions do not themselves adopt compulsory inheritance rules.

4. U.S. Federal Taxes To Which Non-U.S. Persons can Be Subject

• Federal Estate Tax

• Federal Gift Tax

• Federal Generation-Skipping Transfer Taxes

• Federal Income and Gains Taxes

Be aware of matching or “tag along” state or municipal taxes in all these cases.

The Scope of the Federal Estate Tax

The estate tax under Subchapter A of Chapter 11 of Subtitle B only applies to the transfer of the estate of U.S. citizen decedents and U.S. “resident” decedents.

The estate tax on the transfer of estates of “nonresidents” who are not U.S. citizens is imposed by Subchapter B of Chapter 11 of Subtitle B and only applies to “that part of [their] gross estate (determined as provided in Section 2031) which at the time of their death is situated in the United States.”

The Scope of the Federal Gift Tax

The gift tax imposed by Chapter 12 of Subtitle B applies to the transfer of property by gift “by any individual resident or nonresident” with an exception for transfers of “intangible property by a nonresident not a citizen of the United States” (other than certain expatriates).

The Scope of the Generation-Skipping Transfer Tax

The GST Tax imposed by Chapter 13 of Chapter B applies to all “generation-skipping transfers,” including (i) direct transfers, (ii) certain trust distributions and (iii) certain trust terminations. However, by regulation § 26.2663-2(b), the GST Tax only applies to direct transfers or transfers in trust by a nonresident not a citizen of the United States that were subject in the first place to U.S. estate or gift tax.
The Scope of the Federal Income Tax

The income tax imposed by Subchapter A of Chapter 1 of Subtitle A is imposed on all married individuals, heads of household, surviving spouses, unmarried individuals, estates and trusts, and corporations.

“Nonresident Aliens”

Need to distinguish “non-resident aliens” for income tax purposes from “non-resident aliens” for transfer tax purposes:

Income Tax NRAs are generally individuals who are not lawfully admitted to the U.S. for permanent residency and do not meet the “substantial presence” test for U.S. income tax residence under IRC § 7701(b)(3).\(^5\)

\(^5\) A foreign national is considered to be resident in the United States for U.S. federal income tax purposes (and thereby would be subject to U.S. income tax on his worldwide income) if he meets either of the “lawful permanent residence” test or the “substantial presence” test. [IRC § 7701(b)(1)(A)].

Under the lawful permanent residence test, the foreign national is considered resident in the U.S. from the day he enters the U.S. with a “green card” until the day that his “green card” status is revoked by the immigration authorities or that such status has been judicially determined to have lapsed. During the period that the foreign national maintains his “green card” status, he is considered to be resident in the U.S. for income tax purposes even if he is living at the time outside the U.S.

Under the “substantial presence” test, the foreign national is considered resident in the U.S. for U.S. income tax purposes if (1) he is present in the U.S. for at least 31 days during the current calendar year, and (2) he is present in the U.S. for a weighted average of at least 183 days over a three-year look-back period which includes the current calendar year and the two preceding calendar years (in determining the weighted average, all days present in the U.S. during the current calendar year are counted, but only one-third of the days present in the preceding year and one-sixth of the days present in the next preceding year are counted). Furthermore, in applying the “substantial presence” test, the foreign national must include any day on which he was present any time at all within the U.S.

Example One

Non-Resident

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Days</td>
<td>121</td>
<td>121</td>
<td>121</td>
</tr>
<tr>
<td>Calculation</td>
<td>20 1/16</td>
<td>40 1/3</td>
<td>121 = 181 1/2</td>
</tr>
</tbody>
</table>

Example Two

Resident

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Days</td>
<td>122</td>
<td>122</td>
<td>122</td>
</tr>
<tr>
<td>Calculation</td>
<td>20 1/3</td>
<td>40 2/3</td>
<td>122 = 183</td>
</tr>
</tbody>
</table>
IRC § 872(a) limits the “gross income” of “nonresident alien individuals” (including estates and trusts pursuant to IRC § 641(b)) to only

- Gross income derived from sources within the United States that is not “ECI” income (IRC § 871(a)). This is generally taxed at a flat 30% rate (or lower treaty rate) without the allowance of deductions. But note that certain categories of U.S. investment income such as interest on qualifying U.S. bank accounts and so-called “portfolio debt” as described in IRC § 871(h) is effectively exempt from tax under IRC § 871(a) provided that such interest does not constitute ECI.

- Gross income that is “ECI” – that is, “effectively connected with the conduct of a trade or business within the United States” (IRC § 871(b)). This is taxed at graduated rates on a net basis.

  a. IRC § 882(b) applies the identical rules to “foreign corporations”

  b. Generally, no capital gains tax on disposition of U.S. intangible property and tangible personal property not ECI, owned by persons who are not U.S. citizens or U.S. income tax residents. [But see IRC § 871(a)(2) where such capital gains are subject to U.S. income taxation in the case where the NRA is present in the U.S. for at least 183 days during the year (e.g., a foreign exchange student in the U.S. under an “F” or “M” visa).]

  c. But capital gains tax is imposed on dispositions of U.S. real property interests (both direct interests in U.S. real property and U.S. corporations with substantial holdings of U.S. real property) owned by persons who are neither U.S. citizens nor U.S. income tax residents. See IRC § 897 (“FIRPTA”).

Note that there are several exceptions to the “substantial presence test” that allow certain categories of foreign nationals to avoid being treated as resident aliens even though their presence in the U.S. would satisfy the three-year look-back rule (for example, foreign government employees holding “A” visas, and, in certain instances, foreign exchange students holding “F” or “M” visas).

Further note that IRC § 7701(b)(3)(B) provides for an exception to the “substantial presence” test in the case of a foreign national who has 183 or more “deemed days” under the three-year look-back rule, but whose actual days present in the United States during the current calendar year is less than 183. The foreign national qualifies for this exception only if (1) he has a “tax home” in a foreign country for the current calendar year; (2) he has a “closer connection” with the same foreign country than he has with the U.S. for the current calendar year; (3) he does not have an application for “adjustment of status” pending at any time during the current calendar year, nor has he taken any actions to apply for a “green card”; and (4) he timely files with his U.S. income tax return, IRS Form 8840 or its equivalent disclosing to the IRS that that he qualifies for the IRC § 7701(b)(3)(B) exception.

Two types of U.S.-source income are taxable under this category: 1) “fixed or determinable annual or periodical gains, profits, and income” (commonly referred to as “FDAP income”) taxed under IRC § 871(a)(1) and 2) U.S.-source capital gains, taxable under IRC § 871(a)(2), if the NRA was present in the U.S. for at least 183 days during the year of sale. (The HIRE Act of 2010 enacted the tax provisions of the so-called “Foreign Account Tax Compliance Act” (“FATCA”), which include provisions imposing U.S. withholding tax on certain “dividend equivalent” amounts paid or credited to non-U.S. persons on or after September 14, 2010.).
Discussion

Key Planning Issues:

I. What is the Citizenship of the Client?

*To be treated as a non-U.S. person (and thus not subject to universal U.S. federal transfer taxes) a client cannot be a U.S. citizen.*

Establishing U.S. Citizenship

A. Birth in the U.S. unless to non-U.S. diplomats.

B. Birth abroad to two U.S. citizen parents as long as one parent resided for a certain period in the U.S. or possession.

C. Birth abroad to a U.S. citizen and non-U.S. citizen depends on length of U.S. residence of U.S. citizen parent and age when such residence took place.

D. Birth of U.S. citizen to U.S. father out of wedlock requires some U.S. residence by father and legitimization or acknowledgement of paternity prior to age 18 of child.

E. Birth of U.S. citizen to mother out of wedlock requires mother to be physically present in U.S. or possession continuously 12 months before birth of child.

F. Naturalization.

G. Naturalization by parents if occurs before age 18.

H. Child Citizenship Act of 2000: at least one U.S. citizen parent and child admitted to U.S.A. as legal permanent resident if conditions are satisfied before age 18.

Helpful Reference:


Note: Citizens Resident in U.S. Possessions

U.S. citizen who acquired U.S. citizenship solely by reason of

1. being a citizen of a U.S. possession or birth or

2. residence within a U.S. possession is considered a “non-resident not a citizen of the United States” for purposes of all taxes under Subtitle B (gift, estate, GST).
II. What is Domicile of the Client?

Note: To be treated as a non-U.S. person (and therefore subject to U.S. transfer taxes only on transfers of U.S. situs property), the client cannot be domiciled in the United States.

Meaning of “United States” To be a U.S. resident for U.S. transfer tax purposes, domicile must be established in one of the States of the United States or the District of Columbia.

A. Definition of Treas. Reg. § 20.0-1

“A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom.”

1. Need intention to remain indefinitely

2. Intention to change not effective unless implemented

Thus, the definition of “domicile” clearly carries within it two necessary elements, those being (1) physical presence in a country and (2) intent to remain there indefinitely. Since physical presence is usually easy to determine, the essential element in determining domicile is whether taxpayer had intent to remain there indefinitely. The courts look to a variety of factors in gauging the intention of an individual to live in the U.S. with no definite present intention of relocating. It should be noted that while the case law provides helpful guidance, there is no bright line test in determining intent as every case has its own unique particulars and the issue of intent must be decided in the light of the facts peculiar to each case.

A typical list of factors that are considered in determining domicile include—but are not limited to—the duration of stay in the U.S. and in other countries, the relative nature, size, and cost of the individual’s residences, the location of the individual’s family, the location of the individual’s personal possessions, the location of the individual’s business interests, the place where the individual has stronger communal ties and maintains memberships in religious, professional, and social organizations, the location of bank accounts, declarations of residence or intent made in visa applications, wills, etc., and the individual’s motivations for being in the United States and being abroad.

B. Notable Cases on Domicile

1. Estate of Nienhuys (47 T.C. 1149 (1952)) – Netherlands citizen declares to U.S. Immigration Authorities intent to reside permanently in U.S.A. and receives a “green card,” but is still found to be domiciled in The Netherlands (Tax Court found the particular facts convincing that the Netherlands citizen with a U.S. green card was not living in the U.S. by choice, but rather because Germany had invaded the Netherlands and that
he always hoped to return to The Netherlands if and when circumstances improved. He lived in a modest apartment in the U.S. though he could afford a higher-end residence which he continued to own in The Netherlands. His declaration on his visa applications were made while Germany was occupying the Netherlands).

2. **Estate of Khan** (T.C. Memo 1998-22 (1998)) – Pakistani citizen who lived his entire life in Pakistan (except for approximately seven years when he was residing in the U.S. and tending to his business and property interests which were more significant than the interests he held in Pakistan) and who died in Pakistan more than four years after he was last present in the U.S. is still **found to be domiciled in the U.S.** Tax Court found that, when decedent came to the U.S. on his last “tour of duty,” he entered on a permanent resident visa, obtained a “green card” and social security number, and intended to stay to tend to his more significant business interests and that, when he left for Pakistan two years later (and never to return), he did so not to abandon his “U.S. domicile” but rather only to visit his family and to resolve some business matters. The court found that decedent’s effort to obtain a U.S. re-entry permit at around the time of his departure to Pakistan was indicative that decedent did not intend to change his domicile from the U.S.

3. **Estate of Jack** (54 Fed. Cl. 590 (2002)) – Canadian citizen present in the U.S. and teaching at a California university on a temporary non-immigrant visa (in particular, a TN Temporary Professional visa) **could be found to have established U.S. domicile for U.S. federal estate tax purposes** despite the fact that an intent to remain permanently in the U.S. would violate the terms of his non-immigrant visa. Federal Claims Court ruled that the IRS should not be precluded from showing that decedent’s domiciliary intent changed or was other than what he previously represented to immigration officials in his visa application. (But see, Carlson v. Reed, 249 F.3d 876 (9th Cir. 2001)).

An important “take away” from these cases and others is that estate and tax planners must pay attention to practically every aspect of their clients’ personal and professional lives in advising them as to how a U.S. court might rule on domicile.

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Some other notable decisions include Estate of Paquette, T.C.Memo 1983-571 (1983); Estate of Fokker, 10 T.C. 1225 (1948); Elkins v. Moreno, 435 U.S. 647 (1978) (employees of international organization present in the U.S. on non-immigrant “G-4 visa” could still be found to be domiciled in the U.S. for U.S. federal estate tax purposes); Estate of Bloch-Sulzberger, 6 T.C.M. 1201 (1947).
C. Special Cases Where the Question of Domicile May Be Ambiguous

1. Persons who are considered domiciliaries of their country of nationality even after they have established domiciliary in different country (tax treaties).

For example, under the U.S.-U.K. estate and gift tax treaty, a U.K. national (and domiciliary) who moves to the U.S. may still be deemed to maintain his domicile in the U.K. for a period of time after the move, at least if the U.K., under its own internal rules, considers the U.K. national to be a U.K. domiciliary for any period after his departure from the U.K. (See Article 4(2)(b) of such treaty, which provides that if such U.K. national had not been resident in the U.S. for Federal income tax purposes in 7 or more of the 10 taxable years ending with the year in which the death or transfer occurs, he may be deemed to be domiciled in the U.K. at that time.).

2. Persons who have “green cards” but who do not have an intention to remain indefinitely in the U.S.

3. Persons who have conditional “green cards”
   a. Marriage to U.S. citizen

A foreign national’s permanent residence is conditional if it is based on a marriage that was less than 2-years old on the day such foreign national was given permanent residence. The foreign national could apply to remove the conditions on permanent residence if such foreign national is still married to the same U.S. citizen (or permanent resident) after 2 years.

b. Foreign National present in the U.S. under an EB-5 visa.

An EB-5 visa is a method of obtaining a green card for certain foreign nationals who invest money in the U.S. If the foreign national investor’s visa application is approved, the investor and his dependents will be granted conditional permanent residence valid for two years. Within 90 days before the conditional “green card” is set to expire, the investor must provide evidence showing that the full required investment has been made and that, as a result, a certain minimum number of jobs in the U.S. have been created or preserved or will be created within a reasonable time. If the investment fails, the foreign national must leave the U.S.

4. Former U.S. Citizens and Long-Term U.S. Residents who Expatriated

Prior to June 17, 2008, the date that the new 2008 Expatriation Rules became effective under the HEART Act:
a) Persons who renounced U.S. citizenship or gave up “green card,” are deemed to have a tax-avoidance reason for doing so (10 year application).

b) Persons who spend substantial time in U.S.A. (10 year application)

**Note:** Do not confuse U.S. domicile with U.S. income tax residence:

1. A “green card” holder is subject to U.S. worldwide income tax regardless of plans to stay indefinitely or to leave after future occurrence

2. Application of “days test” is mechanical except for narrow exception under IRC § 7701(b)(3)(B)

### III. What Property Does A Client Own And What Is Its Nature?

#### A. What Are The Forms Of Ownership That Count?

1. Distinction Between Legal Title and Beneficial Ownership

   **Title:** Trust, Stiftung, Corporate Nominee…

   **Beneficial:** Trust Beneficiary, Foundation Distributee, Beneficial Owner of Assets Held in Corporate Name …

   Treas. Reg. § 20.2013-5(a)

   “. . . the term “property” means any beneficial interest in property, including a general power of appointment . . . over property. Thus, the term does not include an interest in property consisting merely of a bare legal title . . .”

   **Special Cases:**

   - Application of IRC § 2104(a): Stock “owned and held” by a nonresident noncitizen of the U.S. (“NRNC”) subject to U.S. estate tax only if issued by U.S. corporation. However, stock of a foreign corporation is not includible in the U.S. estate of a NRNC, regardless of whether the stock certificates are actually located within the U.S. [See Treas. Reg. § 20.2105-1(f)].

   See Estate of Charania v. Shulman, 608 F.3d 67 (1st Cir. 2010), aff’g in part, 133 T.C. 122 (2009) (stock of Citigroup held subject to U.S. estate tax, undiminished by alleged community property share of surviving spouse).

   American Depositary Receipts (“ADRs”), although normally issued and sold by U.S. banks are considered to have situs
outside the U.S. because they substantively are treated as shares in foreign corporations. [See PLR 200243031].

Investments in U.S. real property owned by Canadian mutual funds that were a part of NRNC decedent’s RRSP held not includible in NRNC decedent’s U.S. estate because the Canadian mutual funds were determined to have foreign situs as they were properly classified as corporations incorporated outside the United States. [See CCA 201003013].


The situs rule for stock of foreign corporations has resulted in the use of foreign holding corporations as a major estate planning tool to prevent assets of a NRNC, which would otherwise have U.S. situs if held directly, from being subject to U.S. federal estate tax. The Fillman case strongly cautions planners that more is required than simply placing U.S. situs assets in a foreign corporation. At a minimum, the corporation should be in good standing under local law and corporate formalities should be followed.

* Risk that, in certain circumstances, a transfer of U.S. stock to a foreign holding company may cause the foreign holding company (“inverted” or “surrogate foreign corporation”) to be treated under, IRC § 7874(b), as a U.S. corporation for all tax purposes under the Internal Revenue Code, notwithstanding IRC § 7701(a)(4).

- Application of IRC § 2104(b): Trusts funded with U.S. property or holding U.S. property upon death of NRNC settlor in which NRNC settlor has retained right of enjoyment or incidents of control treated as de facto nominee for U.S. assets held by trust or attributable to U.S. property with which trust was funded upon death of NRNC settlor. [See TAM 9507044 (February 17, 1995) (trust funded with U.S. property).].

* Risk that non-U.S. partnerships and non-U.S. LLCs holding U.S. assets, if otherwise qualifying as non-U.S. assets, may be considered nominees for their partners holding U.S. assets: See Matter of Strangi, TC Memo 2003-145 (2003), aff’d 417 F.3d 468 (5th Cir. 2005).
B. **What Property Does the Client Share with Others?**

1. Matrimonial Property Regimes
   
   a. Separate Property
   
   b. Community Property as to Marital Property
   
   c. Community Property as to All Property of the Spouses

**Special Cases:**

1. **Germany**: Separate Property with “Community of Surplus.”\(^8\)

2. **New Zealand**: Matrimonial Property Law.

3. **United States**: Spousal Right of Election.

Note: New York has adopted the New York Uniform Disposition of Community Property Rights at Death Act. NY EPTL §§ 6-6.1 through 6-6.7.

2. **Forms of Common Law Joint Ownership** (Tenants by Entirety, Joint Tenants with Survivorship) as distinguished from Tenants in Common.

   **U.S. Citizen Spouses**: Property assumed owned 50/50 for Federal Estate tax purposes.

   **Non-U.S. Citizen Spouses**:

   One or Two Non-citizen Spouses: Property subject to estate tax based on contribution.

   Gifts of real property: Contribution rule for gift tax purposes is applied on distribution of proceeds of sale.

   Gifts of intangible property: Contribution rule for gift tax purposes is applied when joint interest is established.\(^9\)

   See Estate of Charania v. Shulman, 608 F.3d 67, 73 (1st Cir. 2010), aff’g in part, 133 T.C. 122 (2009) – The estate of the deceased U.K. NRNC,

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\(^8\) “Zugewinnungseinschafft.”

who owned stock of Citigroup directly, argued that one-half of the stock was owned by surviving spouse as community property, but couple did not take steps under Belgian law to declare a community property regime and U.K. precedent applicable to NRNC did not consider change of matrimonial domicile from separate property jurisdiction (Uganda) to Belgium sufficient to effect change from separate property to community property.

Note: Non-Citizen Spouses

- Enlarged annual exclusion for gifts of “present interests” to non-U.S. citizen spouses: The exclusion is indexed for inflation and is currently at $139,000 for 2012.

- No QDOT Trust is available for lifetime gifts to non-U.S. citizen spouses.

- If either or both spouses are NRNCs, no “gift-splitting” (attributing the gift of one spouse to both spouses to maximize utilization of gift tax exclusions and exemptions) not permitted. IRC § 2513(a)(1).

C. What Property Owned by Client Might be Subject to Claims of Others?

1. “Clawback Provisions” under Forced Heirship Statutes

   Spain: No statutory limit on look-back to transfers made during lifetime (but limitations may be supplied by courts)

   Switzerland: Look-back for most part, limited to five years

   France: Surviving spouse may withdraw gifts made to predeceased spouse

2. Testamentary Substitutes Under Spousal Right of Election

   a. Unlimited look-back (subject to enactment dates) for transfers into trust with retained interest. NY EPTL § 5-1.1-A(b)(1)(F)

   b. One year look-back for all direct gift transfers. NY EPTL § 5-1.1-A(b)(1)(B)

Note: Spousal right of election in New York is not available to spouse of non-New York domiciliary decedent unless decedent made an election to have disposition of New York property governed by New York law under EPTL § 3-5.1(h).
D. **What Property of Client Is Subject to Creditors’ Claims?**

1. In many civil law jurisdictions, heirs (absent express election to contrary) take decedent’s property, subject to unlimited liability for decedent’s debts.

2. In New York, generally, claims of creditors of decedent limited to estate assets but an heir can also be liable for debts to the extent of property received from estate for debts not satisfied from assets subject to administration (NY EPTL § 12-1.1).

IV. **Where Is Client’s Property Located?**

A. **For Purposes of Determining Applicable Inheritance Law**

1. Civil Law Tradition Generally:
   a. No Distinction Between Real and Intangible Property (No “Scission”)
   b. Applicable Law is Based on Citizenship
   c. Is the applicable law the “Whole Law” (or “Substantive Law” only)?
      - Germany (yes)
      - Italy (probably yes)
      - Spain (no – but there may be different views)
   d. “Renvoi” from the Country of Citizenship increasingly applied

2. Common Law:
   a. Distinction between real property and intangible property (“scission”)
   b. Real property governed by law where property is located
   c. Intangible Property governed by law of domicile or owner (individual or trustee); “*mobilia sequuntur personam*” ("moveable assets follow the person").

**Mixed Situations**

- France
• Recognizes Scission.
• Immoveable property follows law of situs.
• Moveable property follows law of domicile.

• Switzerland

• Generally, does not recognize scission
• Habitual residence rather citizenship is key factor

B. For Purposes of New York EPTL § 3-5.1(h) and EPTL § 7-1.10

• Real property and tangible property located in New York


• Entities organized by New York and physical documents maintained here

C. For purposes of N.Y. EPTL § 7-1.10

“Whenever a person, not domiciled in this state, creates a trust which provides that it shall be governed by the laws of this state, such provision shall be given effect in determining the validity, effect and interpretation of the disposition in such trust of:

1) Any trust property situated in this state at the time the trust is created
2) Personal property, wherever situated, if the trustee of the trust is a person residing, incorporated or authorized to do business in this State or a national bank having an office in this State.”

In re Tabbaghi’s Estate, 167 Misc. 156 (1938) (France) (validity of trust)

D. For purposes of N.Y. EPTL § 3-5.1(h)

“Whenever a testator, not domiciled in this state at the time of death, provides in his will that he elects to have the disposition of his property situated in this state governed by the laws of this state, the intrinsic validity, including the testator’s
general capacity, effect, interpretation, revocation or alteration of any such disposition is determined by the local law of this state.”

See Estate of Renard, 56 N.Y.2d 973 (1982) (bank and brokerage accounts)

E. For Purposes of U.S. Federal Gift Tax and Gift-Related GST Tax

1. Real Property Located in U.S. treated as U.S. situs. [See Treas. Reg. § 25.2511-3(b)].

   * Possibility of gifts of non-U.S. cash by NRNC intended to facilitate purchase of U.S. real property could be characterized as real property itself, under IRS “step transaction” theory. [See De Goldschmidt-Rothschild v. Commissioner, 168 F.2d 975 (2d Cir. 1948); Davies v. Commissioner, 40 T.C. 525 (1963).].

2. Tangible Personal Property located in U.S. treated as U.S. situs. [See Treas. Reg. § 25.2511-3(b)].

   * Vexed issue about funds in U.S. bank deposit accounts for U.S. gift tax purposes

   A gift by an NRA by means of a check drawn against his U.S. bank account or a wire transfer to a donee’s U.S. account may be treated as a gift of currency, in which case, it would likely be treated by the IRS as a gift of tangible personal property located in the U.S. [See Treas. Reg. § 25.2511-3(b)(4)(iv); PLR 7737063; GCM 36860 (Sept. 24, 1976); Rev. Rul. 55-143].

   An NRA who desires to make a cash gift and avoid IRS potentially characterizing it as a taxable gift should not issue a check on a U.S. bank account or wire funds from a U.S. bank account, but rather should wire funds from his offshore account to offshore accounts held by the U.S. donees or should withdraw cash from a U.S. account and give out the cash to the U.S. donees outside the U.S.

3. Intangible Personal Property with U.S. connections treated as foreign situs. For example, a gift of U.S. corporate stock by a non-resident alien is exempt from gift tax even if the stock certificate is physically located in the U.S. [See IRC § 2501(a)(2)].

F. For Purposes of U.S. Federal Estate Tax and Estate-Related GST Tax


   Note: Remember that “real property” under common law has a narrower definition than “immovable property” under civil law
2. Tangible Personal Property

Tangible Personal Property that is not being used or loaned for exhibition or related purposes and that is located in the United States has U.S. situs. [See Treas. Reg. § 20.2104-1(a)(2)].

Note: Currency is treated as tangible personal property for estate tax purposes. [See Rev. Rul. 55-143].

3. Shares of Stock of U.S. Corporations

Shares of stock issued by a U.S. “domestic” corporation (regardless of location of certificates) have U.S. situs. [See IRC § 2104(a); Treas. Reg § 20.2104-1(a)(5)].

a. IRC § 2104(a) refers to shares “owned and held” by an NRA.

b. Treas. Reg. § 20.2104-1(a)(5) omits the reference to “owned and held.”

c. Note: A transfer tax treaty may override the Code’s inclusionary rule as to stock of U.S. corporations. For example, generally, under the “modern” U.S. estate tax treaties (for example, treaties with the United Kingdom, France, Germany, and The Netherlands), the U.S.’s treaty partner has the exclusive right to tax stock in U.S. corporations where the decedent is determined to be a domiciliary of such treaty partner.10

d. For an estate of a NRNC decedent who died after 2004 and before 2012, if such NRNC decedent had owned stock of a U.S. mutual fund or “regulated investment company” (i.e., “RIC”), only the proportion of the fund invested in U.S. situs assets are subject to U.S. estate tax. IRC § 2105(d). The purpose of this rule was to provide an exemption to the estates of foreign persons who invest in certain assets through a RIC to the same extent that those assets would not be subject to the estate tax if held directly. However, for NRNC decedents dying in 2012 and thereafter, the exception of IRC § 2105(d) is no longer applicable and shares in RICs (i.e., domestic mutual funds) are fully includible in the U.S. estate of a NRNC by virtue of IRC § 2104(a).

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4. Debt Obligations of U.S. Persons

Debt obligations of a U.S. person, the U.S. or a political subdivision if not treated as “outside the U.S.” by IRC § 2105 have U.S. situs.

a. In the case of NRNCs who are not U.S. income tax residents, debt obligations that have U.S. situs include:

(i) Portfolio debt issued on or prior to July 18, 1984

(ii) Debt issued by companies in which the NRNC held 10% or more of the voting power (corporation) or capital or profits interest (partnership) [IRC § 871(h)(3)(B)].

(iii) Obligations issued by state and local municipalities\(^{11}\)

(iv) Obligations subject to profitability or similar contingencies [IRC § 871(h)(4)(A)].

(v) Bearer bonds described in IRC § 163(f)(2)(B) and are issued on or after March 19, 2012.

b. In the case of NRNCs who are not U.S. income tax residents, the following debt obligations have foreign situs:

Debt obligations that are portfolio debt obligations (except for those enumerated in (i) through (v) above) are generally foreign situs, even if issued by a U.S. person, if issued after July 18, 1984. [IRC § 2105(b)(3)]. This generally applies to debt obligations if any interest thereon would be eligible for the exemption from U.S. income tax under IRC § 871(h)(1) were such interest received by the NRA decedent at the time of his death, without regard to whether the U.S. issuer has received a statement (that satisfies the requirements of IRC § 871(h)(5)) that the beneficial owner of the obligation is not a U.S. person. The term “portfolio interest” also includes interest that is paid on a non-registered obligation (like a bearer bond) that was issued before March 19, 2012 and that is described in IRC § 163(f)(2)(B). Debt obligations considered as having foreign situs, for decedents dying after August 5, 1997, also include short-term obligations (OID) with maturity dates of 183 days or less as long as any interest thereon is not effectively connected with a U.S. trade or business. [IRC § 2105(b)(4)].

\(^{11}\) Due to the technicality that the IRS § 871(h) income tax exemption only applies if interest is exempt only by virtue of IRC § 871 (but “query” whether such income is exempt under general principles of U.S. tax law).
c. In the case of NRNCs who are U.S. income tax residents, **all** U.S. debt obligations have U.S. situs – because U.S. income tax residents are not eligible for the exemptions described in IRC § 871(h).\(^\text{12}\)

5. Certain Deposits

a. A NRNC’s deposit with a domestic bank is not considered to have a U.S. situs as long as the deposit is not effectively connected with a trade or business conducted by the NRNC within the U.S. [IRC § 2105(b)(1)]. Additionally, a deposit in an offshore branch of a U.S. domestic bank is also deemed to have a foreign situs. [IRC § 2105(b)(2)].

Any conventional bank deposit (for example, funds in checking and savings accounts and in certificate of deposits) are considered under the above rule of IRC § 2105(b) to have foreign situs.

In PLR 200842013, the IRS ruled that annuity proceeds due a NRNC decedent, but still held by the insurance companies as of the decedent’s death, were **not** deemed to have U.S. situs pursuant to IRC § 2105(b)(1) and therefore were excluded from NRNC’s gross estate under IRC § 2103.

b. The following deposits have U.S. situs:

- Special deposits held by U.S. banks in a custodial capacity that are not commingled with other assets of the bank. [See Rev. Rul. 69-596].

- Deposits with brokerage houses

- Deposits with U.S. branches of foreign corporations that are engaged in the commercial banking business (and do not fit within the portfolio interest exclusion)

6. Other Intangible Property

“Intangible Personal Property, the written evidence of which is not treated as being the property itself, if it is issued by or enforceable against a U.S. resident or a domestic corporation or governmental entity.” Treas. Reg. § 20.2104-1(a)(4)

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\(^{12}\) Further details on inclusion and exclusion of debt instruments as well as on many other topics related to U.S. estate tax planning for NRNCs may be found in Michael A. Heimos, *837-3rd Tax Management Inc.*, **Non-Citizens – Estate, Gift and Generation-Skipping Taxation.**
a. “Property the written evidence of which is treated as being the property itself” was thought to include bonds for the payment of money (see Treas. Reg. § 20.2104-1(a)(3))

b. “U.S. resident” is presumably defined as U.S. domiciliary.  

c. Possible Application:
   (i) Partnerships
   (ii) Limited Liability Companies
   (iii) Intellectual Property Rights
   (iv) License rights

Special Note on Partnerships

(a) Often thought of as intangible personal property

(b) General partners generally have rights to terminate partnership and therefore may be seen as owning shares of the underlying partnership property

See Sanchez v. Bowers, 70 F.2d 715 (2nd Cir. 1934)

(c) Rev. Rul. 55-701 (situs is where partnership does business) should not be applicable
   a. Decided under superseded U.S.-UK Estate Tax Convention
   b. Treas. Reg. § 20.2104-1 was amended in 1973 and 1974 and did not adopt this rule

(d) “Look-through” rule of Sanchez v. Bowers, 70 F.2d 715 (2d Cir. 1934) generally applied only to general partnerships or perhaps interests of general partners in limited partnerships.

(e) Case for applying the rule of Blodgett v. Silberman, 277 U.S. 1 (1928) uses the common law ‘domicile of decedent’ rule for situs of intangible property. How strong is this position?
   (i) Depends on contention that Treas. Reg. § 20.2104-1(a)(4) was not intended to apply due to the language therein suggesting that it has limited applicability

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13 Treas. Reg. § 20.2104-1(a)(7) refers by contrast, to U.S. person as defined in IRC § 7701(a)(30) for U.S. income tax purposes
or

(ii) Depends on contention that Treas. Reg. § 20.2104-1(a)(4) is “ultra vires” because it addresses issues not explicitly addressed by IRC § 2104.

**Important Principle:**

“State law creates legal interests and rights. The federal revenue acts designate what interests and rights, so created, shall be taxed.”

*Morgan v. Commissioner,* 309 U.S. 78, 80 (1940)

Therefore, only express departures from state law concepts by Federal tax law regarding situs of property should be valid.

**Special Note on Limited Liability Companies**

(a) In the absence of an election to the contrary, a U.S. LLC is treated for all U.S. tax purposes as a partnership if it has two or more members. Treas. Reg. § 301-7701-3(b).

(b) In the absence of an election to the contrary, a single-member LLC is disregarded.

(c) In the absence of an election to the contrary, a non-U.S. LLC is treated for U.S. tax purposes as a partnership if it has two or more members and one member does not have limited liability.

(d) LLCs generally did not exist under U.S. law in 1955 – therefore even better argument that Rev. Rul. 55-701 does not apply.

(e) *Sanchez v. Bowers* should not apply when there are no “general partners.”

(f) LLCs were still rare in early 1970’s when Treas. Reg. § 2104-1(a)(4) was last amended.

(g) Argument in favor of applying the Blodgett rule attributing situs to domicile of owner of LLC interest may be stronger than with a partnership interest.

7. **Trusts**

“Look-through” Rules for Trusts

(i) U.S. property transferred “in trust or otherwise” in which decedent retained an interest (under IRC §§ 2035 through 2038) at the time of death (IRC § 2104(b)).
(ii) Property (even non-U.S. property) held “in trust or otherwise” that originated from U.S. property transferred to the trust by the decedent (IRC § 2104(b)).

(iii) Non-U.S. situs share of property held by a U.S. regulated investment company (“RIC”) (2005-2011) is eligible for exclusion.

Cases and Rulings


- TAM 9507044 – Trust created in 1923 with U.S. assets subject to U.S. estate tax even though assets in trust when grantor died in 1991 had non-U.S. situs.

- But see CCA 201020009 (payment of gift tax within 3 years of NRNC decedent’s death considered made under IRC § 2035(b) is not a transfer within the meaning of IRC §§ 2035 to 2038; thus such gift tax paid is not property deemed situated in the U.S. under IRC § 2104(b)).

V. What Planning Entities Work Best for Client?\(^{14}\)

A. Corporations

1. Consider Treas. Reg. § 20.2105-1(f)

   “Shares of stock issued by a corporation which is not a domestic corporation, regardless of the location of the certificates” are treated as outside the U.S.

2. Consider whether the stock of foreign corporation must be “owned and held” by non-U.S. shareholder.


4. Consider U.S. income tax consequences if foreign corporation holds U.S. assets directly.
   
a. Corporate capital gains tax rates on sale of U.S. real property (FIRPTA)
   
b. Possible branch profits tax on U.S. business activities; not applicable at least in cases where sole asset of foreign corporation is U.S. real estate that does not generate income, or where income is reinvested in the real estate, as long as corporation is liquidated soon after sale of real estate.

   If foreign corporation is in a treaty jurisdiction, treaty may provide branch profits tax relief.

   c. Possible loss of tax treaty benefits if foreign corporation is in a tax-haven jurisdiction.

5. Consider U.S. income tax consequences if direct owner of U.S. assets is U.S. corporation owned by foreign corporation.
   
a. Corporate capital gains tax rates on sale of all U.S. assets
   
b. No branch profits tax
   
c. U.S. withholding tax on payment of dividends to foreign corporate parent, subject to reduced treaty rates depending on residence of foreign corporation; no such withholding tax if earnings are reinvested and paid out to foreign corporate parent upon liquidation of U.S. corporation after payment of U.S. capital gains tax on sale of assets it holds.

6. Consider non-U.S. income tax consequences, especially if corporation is not organized in client’s primary tax jurisdiction.

7. Consider U.S. tax consequences if corporate stock is later owned by U.S. persons:
   
   (a) Loss of step-up in basis for assets held by corporation
   
   (b) Treatment of foreign corporation if treated as CFC or PFIC
B. Partnerships and LLCs Qualifying as Partnerships\(^{15}\)

1. U.S. Partnership still may be vulnerable to U.S. estate tax inclusion (Risk)

2. Foreign Partnerships may be vulnerable to U.S. estate tax inclusion if engaged in U.S. business activities (Risk)

3. Share of U.S. Capital Gains taxed at Individual Rates (Advantage)

4. Availability of IRC § 754 election to “step-up” internal basis of partner’s share of underlying assets to match the post-death external basis. (Advantage)

5. No U.S. NRA withholding tax; tax treaty benefits may be more accessible; and no branch profits tax (Advantage).

6. If primary taxing jurisdiction accepts partnership treatment, may be more acceptable to that jurisdiction (Advantage).

7. Would not be treated as CFC or PFIC if passes to U.S. owners (Advantage).

C. Consider Combination of U.S. LLC and Foreign Corporation

a. LLC organized in U.S. jurisdiction could establish U.S. situs for non-tax purposes but be disregarded for U.S. tax purposes if owned by sole foreign person.

b. Corporation not owned abroad but owned by LLC would still be treated as owner of assets for U.S. tax proposes.

c. Possible approach to combining benefits of U.S. tax planning for non-U.S. person, with protection from foreign property law issues under EPTL § 3.5-1(h) and/or EPTL § 7-1.10. (See Exhibit A).\(^{16}\)

- U.S. assets owned by non-U.S. corporation
- Non-U.S. corporation owned by single-member N.Y. LLC
- Single member of LLC is either:

\(^{15}\) Note that, under Rev. Proc. 2012-7, the IRS will not issue rulings as to whether a partnership interest is intangible property for purposes of gifts by NRNCs and therefore will not be subject to U.S. gift tax, pursuant to IRC § 2501(a)(2).

\(^{16}\) For further discussion of these provisions of New York law, see Galligan, “Forced Heirship in the United States of America,” in these materials for the Eighth Annual NYSBA-STEP International Estate Planning Institute.
… Non-U.S. individual with Will directing application of N.Y. law to N.Y. property

or

N.Y. trust directing that N.Y. law govern the trust.

D. **Insurance**

- Wrapping U.S. property in insurance vehicles that qualify as insurance for U.S. tax purposes and where the insurance is on the life of the owner of the policy.

- Life insurance on the owner of the policy as source of funding for assets that have to be owned directly by non-U.S. person (no U.S. estate planning need for irrevocable life insurance trust because of life insurance exclusion under IRC § 2105(a)).

VI. **What To Do When The Client Has Already Acquired U.S. Property In Client’s Own Name?**

A. **Gifts**

- Lifetime gifts of intangible U.S. property, including stock of U.S. corporations, U.S. partnership interests, notes, intellectual property rights, claims are all exempt from U.S. gift tax.

- Lifetime gifts of real and tangible property located in the United States do not provide very much relief since there is no lifetime gift tax exemption for NRNCs. [IRC § 2505(a)]. Annual exclusion is available (currently $13,000 per donee) but this is not likely to be of much avail. Gift tax exclusion of educational and medical expenses may be helpful when cash gifts are made from U.S. accounts, granted some uncertainties about the characterization of funds from such accounts as tangible or intangible property, but hardly help with problems involving U.S. real estate or U.S. tangible property that a NRNC may own directly. [IRC §§ 2503(b) & (e)].

B. **Exchanges of U.S. assets for stock or membership interest in a non-U.S. entity**

(Generally, no U.S. capital gains tax on sale or exchange of U.S. intangible property and tangible property by person who is neither U.S. citizen nor U.S. income tax resident; see also IRC § 351(a) and IRC § 721(a) non-recognition rules).

**Caution:** Plan to avoid potential application of IRC § 7874(b) to cause the foreign corporation to be treated as a domestic corporation for U.S. tax purposes.

IRC § 7874(b) applies where stock in a U.S. corporation is (or the U.S. assets of a U.S. corporation are) transferred to a foreign holding company whereby (1) the
U.S. corporation becomes a subsidiary of such foreign holding company (or substantially all of the U.S. assets of the U.S. corporation are now held by the foreign holding company); (2) the former shareholders of the U.S. corporation hold at least 80% of the foreign holding company’s stock by vote or value after the transfer; and (3) the foreign holding company and its “expanded affiliated group” do not have substantial business activities in the foreign country where the foreign holding company is organized.

C. U.S. Real Property Interests (“USRPI”)

- Capital Contribution of USRPI to foreign corporation subject to tax. IRC § 897(j)

- Exchange of direct interest in real property for stock of foreign corporation will trigger tax. IRC § 897(e)(1) and Temp. Reg. § 1.897-6T(b)(3).

- Possibility under certain circumstances of deferral of tax on exchange of interest in U.S. Real Property Holding Corporation (“USRPHC”) for stock of a foreign corporation. Temp Reg. § 1.897-6T(b)(1).

- Exchange of direct interest in U.S. real property or an interest in a USRPHC eligible for nonrecognition under IRC § 721 subject to potential recognition under IRC § 897(e) but Temp. Reg. § 1.897-6T(a)(3) provides:

  “For example, the exchange of a U.S. real property interest for an interest in a partnership will receive non-recognition treatment . . . only to the extent that a disposition of the partnership interest will be subject to U.S. taxation by reason of the operation of Section 897(g).”

- Another approach to Real Property: encumber real property with non-recourse debt.

Circular 230 Disclosure: Pursuant to U.S. Treasury Department Regulations, we are required to advise you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including attachments and enclosures, is not intended or written to be used, and may not be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.
Exhibit A

U.S. NRNC Estate Planning
Under New York EPTL Section 3-5.1(h)

Property Disposition

NRNC

New York LLC
(Disposed of by the NRA’s Will governed by New York law)

Non-U.S. Corporation

Assets
(U.S. assets and, depending on local rules, non-U.S. assets)

U.S. Estate Tax

NRNC

New York LLC
(Disregarded for U.S. tax purposes)

Non-U.S. Corporation

Assets
(U.S. assets and, depending on local rules, non-U.S. assets)
MAJOR U.S. TAX TYPES OF DISCLOSURE FOR U.S. INDIVIDUAL TAXPAYERS WITH NON-U.S. SOURCE INCOME AND INVESTMENTS: FORMS AND POTENTIAL TAX REGIMES

Michael W. Galligan
Partner, Phillips Nizer LLP
New York City, New York

A. Interests in non-U.S. financial accounts where the aggregate maximum value of such accounts exceeds $10,000 at any time during the calendar year — FINCEN Form 114 – commonly referred to as the “FBAR” form

1. Direct ownership of interests in non-U.S. financial accounts (broadly defined – not limited to “bank accounts”)

2. Indirect ownership – some examples where U.S. owner/beneficiary must also include accounts owned by an entity
   - Corporation in which U.S. Person owns directly or indirectly more than 50% of voting power or share value
   - Grantor trusts
   - Trust in which U.S. person has a greater than 50% present beneficial interest in the assets or income of the trust

3. Signature authority over non-U.S. financial accounts

   “Signature authority” is the authority of an individual (alone or in conjunction with another individual) to control the disposition of assets held in a foreign financial account by direct communication (whether in writing or otherwise) to the bank or other financial institution that maintains the financial account.

B. Interests in specified foreign financial assets (e.g., non-U.S. financial accounts, securities and entities) – IRS form 8938

1. Unmarried taxpayers: total value of such assets is more than $50,000 at end of tax year or more than $75,000 on any day during tax year

2. Married filing jointly: total value of such assets is more than $100,000 at end of tax year or more than $150,000 on any day during tax year

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1 The information in this presentation is provided for educational purposes only and does not constitute the rendering of tax, legal, or other advice from Phillips Nizer LLP or any of its members. The information in this presentation should not be used as a substitute for obtaining competent tax or legal advice from an experienced licensed attorney with whom you have entered into an attorney-client relationship.
3. **Married filing separately:** same as unmarried taxpayers

4. Note that thresholds are higher for U.S. taxpayers residing outside the USA

   - **Filing other than a joint return:** total value of such assets is more than $200,000 at end of tax year or more than $300,000 on any day during tax year

   - **Married filing jointly:** total value of such assets is more than $400,000 at end of tax year or more than $600,000 on any day during tax year.

IRS form 8938 pertains to

   - Any financial account held at a foreign financial institution (but not if held at U.S. branch of such institution)

   - Stock or securities issued by non-U.S. persons

   - Interest in a foreign entity

   - Cash value life insurance or annuity contracts issued by non-U.S. persons

   - Financial instrument with issuer or counterparty who is not a U.S. person.

C. Interests in non-U.S. mutual funds and other forms of so-called “passive foreign investment companies” (“PFICS”) – IRS form 8621

   A foreign corporation is a “PFIC” if it satisfies either of the following two tests:

   1. **Asset test:** 50% or more of the average value of the foreign corporation’s gross assets consist of assets that would produce passive income; or

   2. **Income test:** 75% or more of the foreign corporation’s gross income is passive as generally defined in accordance with the foreign personal holding company income rules.

D. Interests in “controlled foreign corporations” (“CFCs”) — IRS form 5471 (Category 5 filer) (Subpart F income and earnings invested in U.S. property)

   1. A foreign corporation is a “CFC” where more than 50% of value or voting power of such corporation is owned collectively by “United States Shareholders”

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2 The IRS recently revised the reporting requirements for Form 8938 to provide that a U.S. income tax resident who, on the last day of the taxable year, is considered a non-U.S. resident because he or she has claimed, based on the provisions of a U.S. income tax treaty, to be a resident of the Treaty partner, is not required to file a Form 8938 with respect to the portion of the tax year he or she is treated, for U.S. income tax purposes, as a resident of the other country, as long as he or she has filed a U.S. Non-Resident Return (Form 1040NR or Form 1040NR-EZ) for such period.
2. “United States Shareholder” is a U.S. person who directly, indirectly, or constructively owns 10% or more of the voting power of the foreign corporation.

E. Interests in certain other foreign corporations – IRS form 5471

1. A U.S. person who is an officer or director of a foreign corporation in a year in which any U.S. Person (a) acquired stock causing such person to own 10% or more of the value or voting power of such corporation or (b) acquired an additional 10% or more of the value or voting power of such corporation - (Category 2 filer)

2. A U.S. Person who during the year being reported (a) acquired stock causing such person to own 10% or more of the value or voting power of a foreign corporation or (b) acquired an additional 10% or more of the value or voting power of a foreign corporation - (Category 3 filer)

3. A non-U.S. Person who during the year being reported became a U.S. person while meeting the 10% foreign corporation stock ownership requirement – (Category 3 filer)

4. A U.S. Person who during the year being reported disposed of stock of a foreign corporation causing such person’s stock ownership in such corporation to fall below 10% - (Category 3 filer)

5. A U.S. Person who had “control” of a foreign corporation for an uninterrupted period of at least 30 days during such corporation’s annual accounting year ending within such U.S. person’s taxable year. (“Control” means ownership of more than 50% of the value or voting power of foreign corporation) – (Category 4 filer).

6. A U.S. Person who qualifies as a U.S. Shareholder of a CFC (see D (1)&(2) above for definitions - (Category 5 filer).

F. Interests in certain foreign partnerships – IRS Form 8865

1. “Control” of a foreign partnership by U.S. person (“control” means ownership of more than 50% interest) – (Category 1 filer)

2. Ownership by U.S. person of 10% or greater interest in foreign partnership when such partnership is collectively “controlled” (as defined above) by U.S. person(s) owning at least 10% interest – (Category 2 filer)

3. Contribution of property by U.S. Person to a foreign partnership, after which (a) U.S. person owns at least 10% interest in such partnership or (b) the value of the property contributed (taking into account value of certain contributions made within prior 12-month period) exceeds $100,000 – (Category 3 filer) (note: additional separate Category 3 filing would be required if partnership later disposed of the contributed property while the U.S. person was still a partner)
4. Additional occasions when U.S. person acquires or ceases to hold a 10% interest in a foreign partnership – (Category 4 filer).

G. Interests in certain foreign disregarded entities (“FDES”) – IRS form 8858

An “FDE” is an entity that is organized under non-U.S. Law and that is disregarded as an entity separate from its owner for U.S. Income tax purposes, including a non-U.S. entity that has elected under U.S. “check the box” regulations to be disregarded.

1. Legal ownership by a U.S. person of an FDE

2. U.S. person that is either a Category 4 or 5 filer of Form 5471 with respect to a foreign corporation that is the “tax owner” of an FDE

3. U.S. person that is either a Category 1 or 2 filer of Form 8865 with respect to a foreign partnership that is the “tax owner” of an FDE.

The “tax owner” is the person that is treated as owning the assets and liabilities of the FDE for U.S. income tax purposes.

H. Interests in or relationship to certain foreign trusts – IRS Form 3520

A “foreign trust” is any trust (whether established under U.S. or non-U.S. law) whereby (a) a non-U.S. court has primary supervision over the administration of the trust or (b) a non-U.S. person has authority to control a substantial decision about the trust.

1. U.S. person who is treated as an owner of a foreign grantor trust under sections 671 through 679 of the U.S. Internal Revenue Code (the “U.S. grantor trust rules”) – IRS Form 3520

2. U.S. person who received or is deemed to receive a distribution from a foreign trust – IRS Form 3520

3. U.S. person who is the “responsible party” for reporting a “reportable event” that occurred with respect to a foreign trust during the tax year being reported — IRS Form 3520.

I. Foreign grantor trust having U.S. owner pursuant to the U.S. grantor trust rules – trustee of such trust must file IRS Form 3520-a.

J. U.S. person who transfers or is deemed to transfer property to a foreign corporation – IRS Form 926.

K. U.S. person who receives certain gifts or inheritance from a non-U.S. person – IRS Form 3520.

L. U.S. person having certain beneficial interests in certain Canadian registered retirement plans – IRS form 8891.
M. Complete IRS Form W-9 (or provide equivalent information) to foreign financial institutions in which U.S. investor has accounts or holdings to facilitate completion of IRS Form 8966 or equivalent under any relevant FATCA-related intergovernmental agreement.

March 17, 2017
INTERNATIONAL ESTATE PLANNING FOR UNITED STATES CITIZENS

By Michael W. Galligan,*
Partner, Phillips Nizer LLP

In Consultation With: An International Group of Experts* *

For decades, if not for almost a century, it was widely assumed that any U.S. citizen who owned property or who resided outside the United States should have a separate Will for each jurisdiction in which the U.S. citizen resided or owned property. This assumption made sense in an era when each national legal system operated in apparent sovereign separation from other countries, with full discretion whether to enforce the judgments of other nations’ courts and full liberty to decline to enforce other nations’ tax laws. But the landscape has changed, especially after the end of the Cold War in 1989 and the terrorist attacks of September 11, 2001. As the European Union encompasses more and more countries, the respect generally granted to the judicial judgments and decisions of other countries, especially within Europe continues to increase;¹ similar developments are afoot in Latin America.² Perhaps, even more importantly,

¹ Commonly referred to as “the Brussels Regime,” all members of the European Union are now subject to the Brussels I Regulation (officially the Council Regulation (EC) No 44/2001 of 22 December 2000) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. The Brussels I Regulation follows and incorporates the provisions of the 1968 Brussels Convention and the 1988 Lugano Convention dealing with the same issues. The so-called “Brussels IV Regulation,” which becomes effective in August of 2015, introduces a new regime for the choice of succession law in all countries of the European Union save England, Ireland and Denmark and offers new opportunities for U.S. citizens to elect to have the law of a U.S. jurisdiction apply to the succession of their property, to the extent they own property in Europe or to the extent their succession is otherwise subject to the jurisdiction of one or more of the participating countries of the European Union.

² Major initiatives include the Inter-American Convention On Extraterritorial Validity Of Judgments And Arbitral Awards (Montevideo, 1979) and the "Inter-American Convention On Jurisdiction In The International Sphere For

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** Argentina: Diego Fissore; Australia: David Russell; Austria: Friedrich Schwank; Belgium: Jacques Malherbe; Brazil: Alexandre Lindenbojm; Canada: Timothy G. Youdan and Carl MacArthur; Chile: José Maria Eyzaguirre Garcia; China: Hao Wang; Costa Rica: Alejandro Antillon; Denmark: Jørn Qviste; Finland: Sami Tuominen; France: Jean-Marc Tirard; Germany: Christian von Oertzen; Hong Kong: Thomas Lee; India: Vibhu Bakhru; Ireland: Paraic Madigan; Israel: Alon Kaplan and Shai Dover; Italy: Antonio Marsaglia; Japan: Masatami Otsuka; Korea: Woo Taik Kim; Mexico: Luis Gerardo del Valle Torres; Monaco: William Easun; Netherlands: Ineke Koole; New Zealand: John Hart; Panama: Alvaro Aguilar Alfi; Philippines: Grace P. Tan; Poland: Szymon Gostynski & Jerzy Gawel; Russia: Maxim Barashev and Kirill Shcherbakov; Singapore: Ong Sim Ho; South Africa: Hymie Reuvin Levin and Gwynneth Rowe; Spain: Florentino Carreño and Jorge Hernandez; Sweden: Roger Persson Österman; Switzerland: Edgar Paltzer; Taiwan: Nigel N.T. Li, Josephine Peng & J.C. Liu; Ukraine: Dmitri Seletski; United Arab Emirates: Daniel Greenwald and Rasha Haloub; United Kingdom: Mark Summers. Any errors are of course the sole responsibility of the author.
countries seem increasingly willing to bind themselves to mutual exchange information and even assist in enforcing each other’s tax laws as well as participate in multilateral security initiatives for which “tax evasion” ranks almost equally with money-laundering and terrorism as an evil to be defeated.³

I. Why A Unified Estate Plan Is Necessary

Even before these recent changes in the international climate, there are – and always have been - good practical reasons to organize an international estate plan to ensure that all property of a U.S. citizen could pass, directly or indirectly, under one comprehensive Will or Will substitute. To rely, without good reason, on multiple Wills is to court disaster: one Will may accidentally revoke another; the proper formalities for each relevant jurisdictions may not be followed; lack of clarity about the situs of particular properties may leave it unclear as to which Will governs what property. Even practitioners who focus mainly on domestic planning advise their clients to hold property outside the state of their domicile through limited liability companies or revocable trusts. This basic piece of common sense does not cease to apply when one crosses the borders of the United States!

But even more important reasons exist for seeking to integrate an international estate plan than the dangers of faulty drafting and duplicative estate proceedings:

1. The Need to Be Able To Use Trusts. The trust is the workhorse of U.S. estate planning. Most applicable exclusion, marital deduction, and charitable deduction planning is unthinkable without trusts. Lifetime planning transfers such as QPRTS, GRATS and GRITS and sales to grantor trusts depend self-evidently on the law of trusts. But many of the most important countries in the world view trusts differently: Under German law, transfers to trusts under German Wills violate public policy, while transfers to non-German trusts under non-German instruments incur gift and inheritance tax at the highest marginal tax rates. Switzerland

³ The “Forty Recommendations” of the Financial Task Force (established by the G-7 Summit in Paris in 1989) include "Measures To Be Taken by Financial Institutions and Non-Financial Businesses and Professions to Prevent Money Laundering and Terrorist Financing” and “Institutional and Other Measures Necessary in Systems for Combating Money Laundering and Terrorist Financing.”

The Extraterritorial Validity Of Foreign Judgments” (La Paz, 1984), as well as, for the Mercosur countries (Argentina, Brazil, Paraguay and Uruguay), the “Protocol of Cooperation and Jurisdictional Assistance on Civil, Commercial, Labor and Administrative Matters” (Las Leñas, 1992).
recognizes trusts but looks through the trust to the underlying grantor or beneficiary for income tax purposes. The trust is not an institution fully incorporated in the internal law of any country in continental Europe, save Liechtenstein; in none of these countries can transfers to a trust be credited toward the share that a surviving spouse and children are required to inherit from their deceased spouse or parent. Japan has trusts but trusts still do not satisfy mandatory inheritance requirements for surviving spouses and children. England, the birthplace of modern trusts, does not have mandatory inheritance in the tradition of the civil codes: nonetheless, the tax treatment of transfers to trusts under the Finance Act of 2006 does not accord with U.S. tax concepts: for example, transfers of English property to a revocable trust may trigger an inheritance tax charge of twenty percent.

But the problems do not stop with the uncertain status of the trust throughout much of the world.

2. Discordance Between U.S. Law and Non-U.S. Law. Most countries in the world (including many common law countries as well as most civil and Sharia law countries) think very differently than the United States about inter-generational wealth transfers, inheritance, family and creditor protection, how wills are made and implemented. Here are some resulting areas of concern:

(a) Community Property. To prepare an estate plan, one must know the nature and extent of the property for which one is planning: Under the law of China, South Africa and Taiwan, as well as most countries in continental Europe and virtually all countries in Latin America, spouses own property “in community” unless they have expressly adopted another marital property regime such as separation of property. This means that a married U.S. citizen client may not have as much property to dispose of as the client thought! Moreover, a married U.S. citizen from a non-community U.S. state who purchases a residence or a business in a community property country might effectively be making a gift of one-half of the property to the non-purchasing spouse at the time of the acquisition. This could create significant U.S. gift and estate tax issues if the non-purchasing spouse is not a U.S. citizen. Conversely, there may also be significant planning opportunities when the purchasing spouse is neither a U.S. citizen nor a U.S. domiciliary.
(b) **Mandatory Inheritance.** Virtually every country in Latin America, continental Europe, the Middle East (except Israel) and important countries in Asia (including Japan, Korea and Taiwan) require that spouses, descendants and sometimes parents inherit, or have a claim to, a portion of or interest in their decedent’s property, regardless of what the decedent’s will may provide; in countries where Sharia law applies, this requirement can even extend to siblings. These shares can apply to as much as three-fourths of a decedent’s property. Furthermore, lifetime transfers must often be added back for purposes of determining the value of the putative “reserve” for division among mandatory heirs. Sharia law, at least as applied in the United Arab Emirates, forbids a testator from leaving the “free” portion (one-third) of an estate to beneficiaries entitled to a share of the two-thirds mandatory portion. Mandatory or “forced” heirship rules perhaps have the greatest potential for playing havoc with a U.S. estate plan. Few circumstances can deal a more devastating blow to a typical plan for a U.S. married couple to defer estate taxes until the death of the surviving spouse than a provision of a non-U.S. jurisdiction that requires a non-U.S. citizen spouse or child (whether U.S. or not) to inherit large amounts of property outright upon the death of the first spouse to die.

In parallel fashion, most of the major common law countries such as England (only in the case of the English domiciliaries), Ireland, Canada, Australia and New Zealand - allow a Will to be reformed after a decedent’s death to provide for the support of family members and care providers who can establish need for post-mortem support or an equitable share in a decedent’s property, while China provides that family members who were supported by the decedent should share in the estate. While not as likely to ruin a proper U.S. estate plan as mandatory inheritance rules of “civilian” countries, the risks are still there.5

(c) **Unlimited Liability.** Under the law of Japan, Korea and Taiwan, as well as many countries in Europe and Latin America, heirs are deemed to inherit property from a deceased person immediately upon death, without a common law estate administration (thus the

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4 In Switzerland, for example, transfers made in the five years prior to death and transfers made with an intent to deprive an heir of a reserve portion must be added back. Other countries have no necessary limit on the duration of the “look-back” period.

5 That this article looks for ways to protect a U.S. citizen’s estate plan from being defeated by mandatory inheritance rules or other pre-emptive inheritance provisions does not in any way imply that these inheritance rules are wrong as a matter of policy. Avoidance of the application of these rules, however, is generally required in order to construct an estate plan consistent with current U.S. property and tax concepts.
distinction between common law “probate” and civil law “succession”) but the corollary is that heirs assume liability to creditors of their decedent even if the liabilities exceed the value of the inherited property. Usually, an election can be made to limit this liability to the value of the assets actually inherited, which then gives rise to something akin to a common law estate administration. But the time limits on making this election are often very short – one month in Switzerland, three months in Japan, Korea and Taiwan – and failure to make a timely decision is not easily repaired.6

(d) Conflicts of Laws. Wrapped around all of these issues is the challenge of knowing with reasonable certainty the law that will apply to a U.S. client’s testatorial plan in the first place. Through the first half of August, 2015, the main options have been nationality with regard to all property (e.g., Austria, Germany, Italy, Japan, Poland, Spain, Sweden, Taiwan): residence with regard to all property (e.g., Argentina, Brazil, Denmark, Finland, Switzerland), domicile with regard to all property (e.g., Chile, United Arab Emirates7); situs for immovable property and domicile/residence for moveables (e.g., Belgium, Canada, Costa Rica, France, Israel, Russia, South Africa); situs for real property and domicile for personal property (Australia, Canada, Ireland, New Zealand and the United Kingdom), situs for real property and shares of companies and domicile for other moveables (e.g., China and Ukraine), situs for real property and nationality for everything else (Monaco). Beginning in mid-August of 2015, all countries of the European Union other than England, Ireland and Denmark will make a decedent’s habitual residence the principal criterion of what law governs a succession while allowing for a voluntary choice of the law by a testator of the law of the testator’s law of nationality as an alternative. The diverse ways in which non-U.S. courts apply “foreign law” is a great source of uncertainty. Do they apply only the “substantive law” or the “whole law?” If the whole law, do they accept a referral back (“remission”) to their own laws or a referral to (“transmission”) the laws of a third country? To what extent will they entertain a “foreign court” or “double remission” approach? The next worse thing to the derailment of a U.S. estate plan by

6 China limits the liability of heirs to the assets of the succession but any renunciation of an inheritance governed by Chinese law – whether for U.S. tax planning or other reasons – must be exercised within only two months of the decedent’s death.

7 In the United Arab Emirates inheritance matters are subject to the jurisdiction of the religious (Sharia) courts, for whom civil and common law choice-of-law concepts are relatively novel, and which therefore, in practice, generally apply Sharia law across the board.
discordant non-U.S. property and inheritance rules is the derailment of the plan by a failure to correctly identify the proper law of the country that will apply to estate property or an unforeseeable change in the “private international law” of the country that has to make that decision.

(e) Inheritance Taxes. Many countries have inheritance taxes, sometimes with rates of tax that approach and in certain cases even exceed U.S. rates: Belgium, Chile, Dominican Republic, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea, Netherlands, Norway, Poland, South Africa, Taiwan, Ukraine, United Kingdom, and Venezuela. Canada and Peru each have income taxes that serve as an inheritance tax substitute. Some Brazilian states and Swiss cantons also impose inheritance tax. In most cases, these taxes would be applied on a worldwide basis if a U.S. citizen died a domiciliary or resident of the relevant jurisdiction. Interesting exceptions are Chile, which taxes non-Chilean property of a U.S. citizen resident in Chile if the non-Chilean property was acquired with Chilean source funds, and Taiwan, which taxes the non-Taiwanese property of a Taiwanese national. While having no Mexican inheritance tax, Mexican states have transfer taxes that would apply to transfers of real property by reason of death.

The estate tax credit for “foreign death taxes” under IRC Section 2014 covers “foreign” inheritance taxes imposed on “foreign” property. The rules for determining if property is “foreign” for credit purposes generally follow the IRC Section 2105 rules for determining if U.S. property owned by a non-U.S. person is exempt from U.S. estate tax because it is located outside of the United States. But reliance on the credit is not always satisfactory because the United States only credits taxes paid to the United States on the property taxed abroad while the country abroad may tax property eligible for the U.S. marital or charitable deductions. Moreover, the Section 2014 credit does not apply to “foreign” taxes on property located in the United States. Some relief for U.S. citizens or beneficiaries in this situation is provided by “modern” U.S. estate tax treaties with such countries as France, Germany, Netherlands and the United Kingdom and by the Income Tax Treaty with Canada. The “older” estate tax treaties with Finland, Greece, Ireland, Italy, Japan, South Africa and Switzerland may also afford protection depending on the circumstances. But there is no such treaty protection for
U.S. citizens who reside in such countries with significant worldwide inheritance taxes as Belgium, Chile, Korea, Philippines, Poland, Turkey, Ukraine and Venezuela.

II. How To Create A Unified Estate Plan

This article focuses on a strategy of converting a client’s non-U.S. property into U.S. property by employing a U.S. entity – particularly a U.S. limited liability company – to hold all non-U.S. property owned by a U.S. citizen domiciled in the United States and, in some instances, all U.S. as well as non-U.S. property owned by a U.S. person domiciled abroad. The purpose is to unify a U.S. citizen’s estate plan so that U.S. planning documents will govern all non-U.S. property and minimize as much as possible the ability of discordant non-U.S. property and tax rules to undermine the integrity of the U.S. estate plan. As discussed below, the first step in international planning for U.S. citizens should be to consider this “holding company” approach and then to supplement it with other measures to the extent that it cannot stand on its own.

1. Characteristics of the Limited Liability Company. A limited liability company has great legal and tax flexibility under U.S. law. From a tax perspective, a single-owned LLC is completely disregarded for U.S. tax purposes (absent an election to be treated as a corporation) and, if there are two or more owners, treated as a partnership (in the absence of an election to be treated as a corporation). Thus, one can avoid the two-tiered system of taxation associated with C corporations and also the exclusion of the underlying assets from cost basis “step-up” at a shareholder’s death, which, absent careful planning, may preclude underlying assets of a S corporation as well as assets of a C corporation from this important benefit. In the case of a multi-member LLC, the ability to make a basis “step up” election under IRC Section 754 also allows persons who inherit membership interests a measure of tax-deferral with respect to sales of LLC assets after a decedent’s death.

2. Effect of a Unified Plan: Results from International Estate Planning Survey. In preparation for this article, a survey was conducted among leading non-U.S. succession and tax law counsel in some of the most important countries with which U.S. citizens own property or live, including Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, China, Costa Rica, Denmark, Finland, France, Germany, Hong Kong, India, Ireland, Israel, Italy, Japan, Korea, Mexico, Monaco, Netherlands, New Zealand, Panama, Philippines, Poland, Russia, Singapore,
On the basis of this survey, it appears that effectively converting the non-U.S. assets of a U.S. citizen to U.S. assets by interposing a U.S. LLC between the U.S. citizen and the non-U.S. assets often reduces or even eliminates the applicability of non-U.S. property, succession and tax law principles that would interfere with the smooth application of the U.S. citizen’s estate plan. When the use of a U.S. holding company does not afford complete protection from discordant non-U.S. inheritance and tax rules, the U.S. estate plan can still be protected by assuring that favorable non-U.S. choice of law principles are fully exploited, utilizing pre-mortem and post-mortem renunciations in the non-U.S. jurisdictions, having all heirs join in an inheritance or succession agreement enforceable in the United States, and/or carefully drafting the dispositions under the U.S. planning documents to encourage maximum cooperation by the heirs with the U.S. citizen’s estate plan.

(a) Permissibility of Transfers of Non-U.S. Assets to U.S. LLC. Of the jurisdictions surveyed, Australia, Belgium, Brazil, Canada, Chile, Costa Rica, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Korea, Mexico, Monaco, Netherlands, New Zealand, Panama, Russia, Spain, Sweden, the United Kingdom, Ukraine and the United Arab Emirates generally permit a home owned by a U.S. citizen to be transferred to a U.S. LLC. Transfers of a home in Australia require the approval of the Treasurer (easily granted); transfers of real property in areas near the borders of Argentina and Brazil require administrative approval; neither individuals nor non-Chilean entities can own real property near Chilean borders. In Costa Rica, the LLC would need to appoint a legal representative to act for and represent the LLC before the Costa Rican public registry and all other Costa Rican legislation related to real property must be duly followed. Administrative approval is also required for transfers of real property near Mexican borders or the Mexican coast, which must generally be held in the first instance by a Mexican trust or, if for commercial purposes, by a Mexican entity whose corporate parent can be a US LLC. Transfers of homes in Austria require provincial approval, which are reviewed more intensively in the Alpine regions; Denmark imposes some restrictions on transfers to non-EU entities; transfers of homes in Korea require a report to a government bureau. In Poland, an official permit would be required, with evidence of

8 Copies of the survey, responses and related correspondence are on file at the offices of Phillips Nizer LLP.
the LLC’s owner’s ties to Poland. A U.S. LLC, like any other non-Philippine person, may effectively hold only an interest in a condominium, as long as Philippine persons own at least 60% of the property. To own real property in South Africa, a U.S. LLC must interpose a South African company. A U.S. LLC cannot generally own a home in China without establishing a representative office in China, a relatively easy hurdle to overcome; interposition of a Hong Kong or a Singapore company could also be considered. As to Singapore, the approval of the Minister of Law is required other than for apartments in buildings governed by specific Planning Act schemes. For Taiwan, the ability of a U.S. citizen to own non-agricultural real property—and, thus the ability to transfer it to a U.S. LLC—depends on whether the U.S. citizen’s home state permits Taiwan citizens to own property in that state (apparently the case in 43 states). Transfers of homes in Switzerland and India to a U.S. LLC are currently more difficult because of general limitations on foreign ownership of real estate.

All the surveyed countries permit transfers of tangible property owned by a U.S. citizen to a U.S. LLC, on condition that works of art are not “national patrimony” (Italy), “of historical significance” (Poland), subject to a state option to purchase unique works of art (Denmark). A U.S. LLC may own works of “cultural value” located in Russia or Ukraine but may not be able to move the works permanently outside of either country.

The great majority of the surveyed jurisdictions permit transfers of business interests owned by a U.S. citizen to a U.S. LLC. In Argentina, Brazil, Japan, Korea and Ukraine, a U.S. LLC owning a local company would have to register the U.S. ownership with local authorities and a government permit is often required in the case of Poland. If a U.S. citizen resides in South Africa, transfers of South African business interests would be subject to approval by the foreign exchange authority (“ExCon”). Transfers of shares of certain commercial and professional Monaco companies require government consent. While there are no express provisions of Russian law prohibiting non-Russian ownership of Russian business entities, the September 1999 legislation on foreign investment must be followed. Taiwan permits transfer of Taiwanese companies upon approval of a business plan by Taiwan’s Investment Commission.
(b) Impact on Non-U.S. Community Property. Of the surveyed countries, each of Belgium, Brazil, Chile, China, Costa Rica, Denmark, France, Italy, Mexico, Netherlands, Philippines, Russia, South Africa, Spain, Sweden, Switzerland and Ukraine has some form of community property as its default regime for regulating property ownership by spouses. However, in some countries such as Belgium, Sweden and Switzerland, local community property rules generally apply only when at least the U.S. citizen spouse and sometimes both spouses resided in the country at the time of marriage or when the property was acquired; in the Philippines, the rules do not apply if both spouses are non-Philippine citizens even if Philippine residents. In a number of countries, including Chile (real estate only), Italy, Russia, South Africa, Sweden (real estate only) and Taiwan, the consent of both spouses appears to be required to effect the transfer of community property to an LLC. Even with such consent, the community property regime may simply adhere to the U.S. LLC interests for which the non-U.S. property was exchanged, at least in community property states like California, New Mexico or Texas and states such as New York that have adopted the Uniform Community Property Rights at Death Act.

(c) Impact on Non-U.S. Inheritance Regimes. Of the surveyed countries, all but India, Israel and South Africa (in the latter two countries, save for an exception for spousal maintenance) have at least some rules regarding inheritance that are inconsistent with U.S. inheritance rules. Here, one must carefully consider whether the U.S. citizen will be considered by a U.S. jurisdiction to be its domiciliary and whether any non-U.S. jurisdiction might consider the U.S. citizen to be its domiciliary or resident. One must also consider whether the non-U.S. property was first acquired by the U.S. citizen personally or by the LLC.

(i) Effectiveness of Transfers to U.S. LLC. A transfer to a U.S. LLC of property with a situs in a non-U.S. jurisdiction owned by a U.S. citizen considered by that same jurisdiction to be domiciled or resident in the United States appears to afford protection from the application of discordant inheritance rules in the following jurisdictions: Australia, Belgium, Brazil, China (excepting real property and business interests), Costa Rica, Denmark, France, Germany, Ireland (possibly excepting real property), England and Wales, Mexico, Switzerland.

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9 In Costa Rica, community property rules only become effective upon the dissolution of a marriage or civil union.
Monaco, Netherlands, Panama, Poland (as long as the transfer is a sale and not a gift), Russia, Switzerland (except for real property), Taiwan and the United Arab Emirates.\textsuperscript{10} In addition to the protection afforded in these countries, protection appears to be afforded by all of the countries just mentioned as well as in the following jurisdictions when the property is first acquired by the LLC rather than by the US citizen: Canada, Finland, Ireland (for real property as well), Italy, Japan, Philippines, Poland and Sweden. As a practical matter, transfers of property to a U.S. LLC with a situs in other jurisdictions that have mandatory inheritance rules may still afford protection in these jurisdictions because judicial proceedings, which are not common in the administration of a succession, may be required to enforce these rules on property not owned in the decedent’s own name.

In the case of a U.S. citizen domiciled or resident in a non-U.S. jurisdiction, the protection afforded by a U.S. LLC is often less, especially if the situs country applies the law of domicile or residence to the inheritance of intangible assets, because the inheritance of the U.S. citizen’s LLC interest would then be governed by the law of the non-U.S. country where the U.S. citizen is considered most likely domiciled or resident. But here, local “private international law” may help: Switzerland allows a non-Swiss national, even if a Swiss resident, to elect to have national law apply to Swiss as well as non-Swiss property.\textsuperscript{11} Each of Poland, Spain and Sweden applies nationality law to its residents but does not necessarily apply its own law even when nationality law would defer to the law of residency (technically, “accept remission or ‘renvoi’”), so that U.S. law could still apply to all property of a Spanish or Swedish national, even Spanish or Swedish real property.\textsuperscript{12} In the case of Italy, which follows the nationality principle but accepts remission, a U.S. citizen may be able to achieve the same result by directing in his or her Will that remission should not apply.\textsuperscript{13} Transfer of Brazilian property owned by a U.S. citizen residing in Brazil to a U.S. LLC would cause Brazilian rules not to apply to it.

\textsuperscript{10} As noted above, jurisdiction over inheritance, in the UAE, is lodged in the Sharia courts and these courts may be more easily persuaded to ignore the formal rules of UAE “secular” law.

\textsuperscript{11} Belgium has a similar rule as long the law of nationality cannot deprive an heir of a reserved portion.

\textsuperscript{12} For a helpful discussion of the relevant Spanish case law, see David Hayton, European Succession Law (London) at 456-457.

\textsuperscript{13} See, Article 13, Law of May 31, 1995, No. 218, discussed by Hayton, at 331-332. This should be the case where the relevant U.S. jurisdiction would not accept remission (“renvoi”) or would otherwise honor such a provision.
(ii) **Supplemental Measures.** In cases where a transfer of local assets to a U.S. LLC does not completely exempt the property from local inheritance rules, the transfer may help accomplish the desired result. In some jurisdictions, transfers of “reserve” property to a U.S. LLC would be voidable but not void. In many jurisdictions, an heir who claims to be disadvantaged by a pre-mortem transfer must take affirmative steps to assert claims against transferred property in the courts of that jurisdiction. In Argentina, for example, a court may consider such circumstances as whether the transfer to the LLC was for adequate and full consideration: when the assets were directly acquired by the LLC, an Argentine court is less likely to set aside the transfer. In some jurisdictions, a court may also take into account the degree to which, as a practical matter, the disposition of the assets of the LLC in a U.S. citizen’s testamentary plan are as generous to an heir as the enforcement of a mandatory heirship share would be.

When a transfer of non-U.S. assets to a U.S. LLC does not afford unquestionable protection from local inheritance rules, a second and even a third “line of defense should be applied,” such as an agreement by the beneficiaries of the US estate, as a condition to their inheriting under the U.S. plan, not to challenge any of the transfers to the U.S. LLC nor to require that the transfers be added back in any local “reserve” calculation and to sign any local instruments of renunciation that may be necessary to fulfill this purpose. Most countries surveyed have provisions for post-mortem renunciation of statutory shares and several countries—Austria, Denmark, Finland, Germany, Poland, Sweden, Switzerland and Taiwan—even allow for pre-mortem renunciations of forced or mandatory inheritance shares.

An even stronger line of defense would be to include an in terrorem clause in the U.S. Will that would disinherit any beneficiary who chose to try to enforce rights under non-U.S. law that violate the estate plan. An alternative, especially in states that disfavor in terrorem clauses, would be to condition legacies under a U.S. Will, whether outright

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14 A renunciation of forced heirship rights generally serves a different purpose than a “qualified disclaimer” under U.S. tax concepts. Presumably, in most instances, the consideration for renouncing a forced heirship right - usually asset protection and the discharge of moral as well as legal obligations to family members - will satisfy the IRC requirement of “full and adequate consideration” to avoid any U.S. gift tax liability.

15 Russia only allows for renunciation of property inherited through the non-compulsory or “free” share and beneficiaries of a renunciation must generally be those eligible for mandatory shares from the renouncing party.
or in trust, on cooperation in the post-mortem implementation of the U.S. plan. Such conditions should be enforceable in any U.S. jurisdiction (except possibly Louisiana) on the basis that a beneficiary would have no legal right to compel a legacy from the decedent and therefore the decedent can impose any condition that does not violate public policy. Conditional bequests are not generally contrary to public policy in the United States and it is U.S. courts to which estate fiduciaries as well as beneficiaries of a U.S. citizen would be looking to enforce the terms of U.S. planning documents.

(d) **Impact on Unlimited Liability.** Of the surveyed countries, the following provide that persons who inherit property from a decedent generally inherit unlimited personal liability for their decedent’s unsatisfied debts: Argentina, Austria, Belgium, Chile, France, Germany, Italy, Japan, Korea, Netherlands, Poland, Spain, Switzerland and Taiwan. Some countries—including Belgium, Germany, Italy, Spain, Switzerland and Taiwan—do not apply this principle if, under their choice of law rules, their own law does not apply to a decedent’s succession. Thus, the efficacy of a transfer of assets in any of these jurisdictions to a U.S. LLC would depend on the extent to which such a transfer would protect the assets from the reach of the inheritance rules of that jurisdiction.

(e) **Impact on Inheritance Taxes.** Of the surveyed countries, the following impose meaningful inheritance or inheritance-related taxes: Belgium (regional), Brazil (state level), Canada, (deemed capital gains tax), Chile, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Korea, Monaco (not on transfers to spouses, descendants and ascendants), Netherlands, Philippines (‘‘estate tax’’), Poland, South Africa, Spain, Switzerland (cantonal with total exemption for spouses and exemptions or low rates for descendants), Taiwan, Ukraine and United Kingdom.

(i) **U.S. Citizen “Domiciled” or “Resident” in the United States.** It appears that transfers by a U.S. citizen of assets located in the following jurisdictions to a U.S. LLC should cause the assets not to be subject to that jurisdiction’s inheritance taxes, at least if the US citizen is not considered by that jurisdiction to be its domiciliary or resident (or, in the case of Taiwan, a national): Belgium, Brazil (unless an heir is a Brazilian resident or the transferred assets are mainly real estate), Canada, Chile, Denmark, Finland (unless heir is a
Finnish resident or asset is Finnish real estate or Finnish real estate company interest), France (only for moveable assets), Germany (as long as the LLC qualifies as a corporation for German tax purposes and an heir is not a German resident), Ireland (as long as an heir is not an Irish resident), Italy (if interests in the LLC are not solely owned by the decedent), Japan (unless an heir is a Japanese resident), Korea (but subject to a “clawback” for some transfers made within the previous five years), Monaco, Netherlands (as long as the assets of the LLC do not consist principally of Netherlands real property), Philippines, Poland, South Africa, Spain (in certain cases for immoveable assets only as long as an heir is not a Spanish resident), Taiwan, Ukraine (as long as an heir is not a Ukrainian resident) and the United Kingdom. The same exclusion appears to apply to local real property transfer taxes on the inheritance of Mexican real property.

As explained above, the U.S. estate credit under IRC Section 2014 may be useless if there is no U.S. tax against which to apply the non-U.S. tax payment. When there is a U.S. tax, the effective non-U.S. tax rate on the non-U.S. property may be higher than the effective U.S. rate. By removing the property from taxation in the non-U.S. country, one may be able to avoid the non-U.S. tax entirely.

(ii) **U.S. Citizen Residing Abroad.** The estate of a U.S. citizen residing in one of the above-mentioned countries could be subject to inheritance tax on all property, including U.S. property. A beneficiary of that U.S. citizen who resides in one of these countries other than Brazil could be subject to inheritance tax on inherited U.S. property as well as inherited property located in that country. As mentioned above, the Section 2014 credit does not cover non-U.S. taxes on U.S. property and the United States does not have estate tax treaties with many countries, including, of the surveyed countries that tax inheritances, Belgium, Chile, Denmark, Korea, Philippines, and Ukraine. Denmark, Chile, Korea and the Philippines have their own foreign death tax credits, each of which measures appears to effectively provide a credit against local tax for the U.S. estate tax on U.S. property; Belgium gives a credit for non-Belgian taxes on non-Belgian real property. For countries like the Ukraine, in order to claim the benefit of the Section 2014 credit for non-U.S inheritance/estate taxes on U.S. property, one may have to consider placing the U.S. assets in a special holding company organized under the laws of the country where a U.S. citizen resides in order to convert the U.S. assets in to non-U.S.
assets eligible for the credit. The special holding company could still be owned by the U.S. LLC at least as long as the U.S. citizen is the only member of the LLC, thus preserving the unity of the estate plan, and the jurisdiction of a U.S. court over the administration of all estate assets.

3. **Income Tax Issues** As mentioned earlier, a decision to adopt a strategy of organizing all non-U.S. assets of a U.S. citizen to a U.S. LLC can only be made after taking into account all U.S. as well as non-U.S. tax consequences of the transfers and the tax treatment of the U.S. LLC once the transfers have been completed. From a U.S. tax point of view, the U.S. LLC would be disregarded as long as the U.S. citizen is the sole owner or as a partnership if there are two or more owners, absent a check-the-box election to the contrary. Among the surveyed countries, the LLC would or could be treated as a pass-through entity in France and Switzerland, much as in the United States. Germany looks to several different factors to determine if an entity should be taxed as a corporation or as a partnership: The limited liability feature of the LLC makes it more likely to be treated as a corporation but placing a limit on the duration of the LLC might help to avoid that result. Similar considerations may apply for Austria and Korea.

(a) **When LLC Is Treated as Corporation under Non-U.S. Tax Rules.** In the following countries, it appears the LLC would be taxed as (or like) a permanent establishment at corporate tax rates: Argentina (for income from Argentine real estate), Australia, Austria (for income from Austrian real estate), Belgium, Brazil, Canada, Costa Rica, Denmark, France, Germany, Netherlands, Ireland, Israel, Japan, Russia, South Africa (with respect to South African business interests), Spain (depending on nature of activities in Spain), Sweden, Ukraine and the United Kingdom. In the case of a solely-owned LLC classified as a corporation by the non-U.S. jurisdiction, the United States disregards the foreign characterization of the LLC as much as it does its US status as a separate legal entity. As a result, the taxes paid by the LLC to the non-U.S. jurisdictions should be treated as paid by the U.S. citizen owner and therefore fully creditable against the U.S. citizen’s taxes on the same income. If the LLC had more than one

16 Under Article 25 of the Ukraine Income Tax Treaty, which governs all types of taxes, Ukraine should not impose higher inheritance taxes on a U.S. person holding Ukrainian property than it does on a Ukrainian person.

17 To avoid the application of Germany’s forced heirship rules, however, it is advisable for the LLC to be treated as a corporation.
member, the non-U.S. taxes should be similarly allocated to the LLC members for credit purposes.

However, other issues need to be considered: For example, if a country taxes the U.S. LLC at a higher rate of taxation than that to which a U.S. citizen or the members of an LLC is subject, there could be an additional cost. Corporate rates of tax in most of the surveyed countries do not exceed 35% but withholding or similar taxes on dividends and distributions imposed by jurisdictions such as Germany, South Africa and Spain could push the effective tax rate above U.S. rates, unless, as is the case with Chile, the corporate tax is credited against the withholding tax. Excess foreign tax should not be creditable against U.S. income tax unless the U.S. citizen has other non-U.S. source income that is taxed at a lower rate than the U.S. tax in the same year an eligible carry-over year. The imposition of a VAT tax by a jurisdiction such as the Ukraine could also push the effective tax rate above 35% and, in any event, VAT tax is not generally creditable for U.S. income tax purposes.

(c) Coping with Possible Non-U.S. Capital Gains Taxes. Some countries may impose a capital gains tax on the transfer to a U.S. LLC of real property that the U.S. citizen acquired in his or her own name before transferring the assets to the LLC: these include Argentina (nominal rate of 1.5%), Australia (but not if U.S. citizen is only shareholder), Canada (if the LLC is treated as a corporation), China, Denmark (except for a home), Finland, France, Germany, Ireland, Japan, Philippines, Poland, Russia, South Africa, Spain, Sweden, Switzerland (cantonal) and Taiwan. A transfer of real property in Italy or Monaco would incur various registration or transfer taxes and duties but no gains tax. A transfer of Spanish real property would be subject to transfer and stamp duties of 7%. A transfer of Brazilian real property would incur a transfer tax of 2% to 6% but no capital gains tax as long as the property transferred to the LLC is capitalized at cost rather than market value. Netherlands imposes 6% transfer tax and

18 Note that some countries, such as Belgium, Germany, Ireland and the United Kingdom (when the owner is a U.K. resident) may tax rent-free use of a home owned by a U.S. LLC that is treated as a corporation on an imputed income basis.

19 The mention of France and Italy in this sentence prescinds from the argument suggested in Part II(3)(a) above (especially material to which Footnote 17 is attached) that, under the recent Protocol to the United States-France Income Tax Treaty and the recent United States-Spain Competent Authority Agreement, taxing a transfer by a U.S. resident of an interest in French or Spanish real property to a U.S. LLC should not give rise to French or Spanish capital gains tax because such a tax would be inconsistent with the “pass-through” nature of the U.S. LLC under U.S. tax law.
Singapore and Hong Kong impose stamp duties in of up to 3% and 3.75% respectively. It cannot be emphasized too much that in virtually all these instances no such capital gains or transfer taxes would be imposed if the non-U.S. real property were purchased directly by the LLC. The transfer of business assets of some countries to a U.S. LLC may also incur gains or transfer taxes, including interests in Canada, Denmark, Philippines and Sweden. Again, initial acquisition of such non-U.S. business interests by the U.S. LLC would avoid these taxes. Contribution of retail or industrial real property in Mexico, assuming no capital gain taxes are incurred by virtue of the United States-Mexico Competent Authority Agreement, may still give rise to a 15% value added tax, which, with proper planning, may be eligible for a subsequent Mexican credit or refund.

If one is dealing with a jurisdiction with which the United States does not have an income tax treaty or the relevant treaty does not adequately address the tax treatment of pass-through entities owned by U.S. persons, a transfer of non-U.S. assets to a U.S. LLC by a U.S. citizen may trigger a non-U.S. gains tax that will not be an event of recognition for U.S. income tax purposes and, therefore, no U.S. income tax credit for the foreign tax would be currently available. In that event, one could consider having the U.S. LLC form a wholly-owned subsidiary in the non-U.S. country. Since the LLC is a disregarded or pass-through entity, the contribution of the non-U.S. assets to the non-U.S. subsidiary would trigger U.S. capital gains tax against which the capital gains tax paid to the non-U.S. country could be claimed as an income tax credit. The cost basis for gains tax purposes would have been “stepped up” in both countries to the value on the date of the transfer. Once the transfer was complete, the U.S. citizen or LLC could make an election to have the subsidiary treated for U.S. income tax purposes as a partnership and any subsequent sale of the property could then be taxed in both countries at the same time with a parallel increase in basis and a U.S. credit for the tax paid to the other country.20

20 I wish to acknowledge the contribution of my partner, Tiberio (“Tibi”) Schwartz, to the thinking reflected in this paragraph. In some cases, payment of the non-U.S. gains tax when no U.S. credit is available may still be tax efficient where a non-U.S. country has no special exemption for U.S. capital gains tax on real property passing at death and no “step-up” in cost basis. The U.S. citizen would be effectively pre-paying the non-U.S. gains tax that heirs would have to pay upon a sale of the property after the U.S. citizen’s death, with funds that would otherwise be subject to U.S. estate tax on the U.S. citizen’s death.
4. **Alternative Holding Entities.** If it is determined that using a wholly owned U.S. LLC as a holding entity would have adverse capital gains tax or other tax consequences, serious inquiry should be made about the utility of a partnership, including a limited partnership as a holding entity, to accomplish the unitary estate planning objectives for which this article advocates. The use of partnership to accomplish this result appears to have some promise in Austria, Ireland and the United Kingdom and may, with appropriate adjustments, work in other jurisdictions as well.

For property located in a common law jurisdiction, the trust may be another alternative, but, at least in the United Kingdom, there may be a mismatch between the U.S. and U.K. tax rules even more serious than with an LLC. The status of trusts in China, Japan and Korea deserve monitoring. A U.S. trust might be able to act as an owner of property in civil law jurisdictions that have ratified or are expected to ratify the Hague Convention on the Recognition of Trusts (Italy, Luxemburg, Monaco, Netherlands and Switzerland) as well as countries such as Austria, Belgium and France, which, in their internal law, now recognize trusts organized in common law countries as having legal status.

III. **Final Word - When More Than One Will Must Be Used**

In some cases, organizing the disposition of all the non-U.S. assets of a U.S. citizen under one Will or as part of a U.S. holding entity may not be feasible. Take real property in Italy: heirs of Italian real property are exempt from Italian capital gains tax on the sale of the property.\(^{21}\) If the heirs are U.S. persons, there will be no U.S. gains tax on pre-mortem appreciation. Transferring the Italian real property to a U.S. LLC might jeopardize the Italian gains tax exclusion. In this case, the U.S. Will could still direct the disposition of the Italian property, even if Italian court proceedings would be required to enforce the Will. As already noted, Italy is one of the few “civilian” countries that have ratified the Hague Convention on the Recognition of Trusts; transfer of Italian real property to a testamentary trust under a U.S. Will

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\(^{21}\) Israel has a similar exemption for the sale of inheritance on Israeli real property interests used as a residence.
may be feasible if the U.S. Will directs that U.S. law should apply and that Italy should not “accept remission.”

In the event recognition of the U.S. will in a non-U.S. jurisdiction would be difficult or a non-U.S. jurisdiction would apply its own law and thereby endanger the dispositions under a U.S. will, the measures identified above as “second lines of defense” such as inheritance agreements, non-U.S. inheritance renunciations, in terrorem clauses and conditional bequests must play a primary role, even if resort to a non-U.S. will must be made. Great care must be taken to ensure that any non-U.S. will is properly coordinated with the U.S. will. U.S. clients need to clearly understand that U.S. counsel must be consulted when any property is acquired abroad and when any non-U.S. testamentary instruments are executed. As emphasized above, the effectiveness of a U.S. holding company strategy is often greater when the U.S. entity has made the initial acquisition of non-U.S. property and, in such cases, resort to a non-U.S. will should not be necessary. But, whatever the circumstances, any acquisition of non-U.S. property and any execution of a non-U.S. will must always invite review of the U.S. will and revision and re-execution of the U.S. estate planning documents after the non-U.S. transactions are complete.

- March, 2015

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22 See Section II (c)(i) and footnote 12 above.
U.S. Residence: A Tale of Two (or More) Definitions

BY MICHAEL W. GALLIGAN AND IRA C. OLSHIN

The concept of “U.S. residence” is of critical importance to both U.S. immigration law and U.S. tax law, but the meaning of U.S. residence (and the correlative consequences of not being a U.S. resident) under each area of law can be significantly different. These differences present both potential traps for the unwary and potential planning opportunities for the informed.

Residence From an Immigration Perspective. On the immigration side, a distinction is made between U.S. permanent residents and legal non-immigrants. A U.S. permanent resident (i.e., a holder of a U.S. “green card”) is treated as a legal immigrant and has the ability to reside in the United States without restriction for an unlimited time period. On the other hand, legal non-immigrants or non-residents, in many cases, have restrictions on the amount of time they can reside and/or work in the United States and must conform to other conditions associated with non-immigrant status.

The most significant categories of those who can stay and work as legal non-immigrants in the United States are holders of H-1B visas (principally, specialty occupation workers), L-1 visas (intracompany transferees), E visas (treaty traders and investors), and O-1 visas (aliens of extraordinary ability in the sciences, arts, education, business or athletics). Holders of H-1B visas are generally subject to a six-year maximum period during which they can work and live in the United States. Holders of L-1A visas (intracompany executives or managers) and L-1B visas (intracompany transferees with specialized knowledge) are limited to seven and five-year stays in the United States, respectively. There is no absolute bar on the time that an individual in E status or O-1 status can remain in the United States as long as such individual renews status periodically. E visas have to be renewed every five years; O-1 visas generally every year.

Residence From a Tax Perspective. A person who is a U.S. tax resident is generally subject to U.S. income tax on their worldwide income and often also subject to U.S. gift and estate tax on transfers of their worldwide assets wherever situated. Different tests apply to determine whether a non-U.S. citizen is considered resident for U.S. income tax and information reporting purposes and whether a non-U.S. citizen is considered resident for U.S. estate and gift tax purposes.

U.S. income tax residents, aside from U.S. citizens, include (1) lawful permanent residents (i.e., holders of U.S. green cards) and (2) people who meet the “substantial presence” test under Internal Revenue Code (IRC) §7701(b)(1)(A)(ii). Under the “lawful permanent residence” test, a foreign national is generally considered resident in the United States from the day he/she first enters the United States with a U.S. green card until the day that resident status is revoked by the immigration authorities or judicially determined to have lapsed. During the period that a foreign national maintains permanent resident status, he/she is considered to be a U.S. tax resident for income tax purposes (and subject to worldwide U.S. income taxation) even if living outside the United States.

Under the “substantial presence” test, a foreign national is generally considered resident in the United States for U.S. income tax purposes if (1) present in the United States for at least 31 days during the current calendar year, and (2) present in the United States for a weighted average of at least 183 days over a three-year period covering the current calendar year and the two preceding calendar years, with all days present...
in the United States during the current calendar year being multiplied by one, all days present last year being multiplied by one-third and all days present in the year before last being multiplied by one-sixth.¹

Residency for U.S. estate and gift tax purposes is determined by one’s “domicile.” The key is whether a foreign national is residing currently in the United States and has no “definite present intention of later removing therefrom.”²

The immigration concept of “permanent residence” and the tax concept of domicile clearly overlap but are not perfectly coincident, leaving open the possibility that at least a small minority of green card holders who may not be living all the time in the United States may not be subject to U.S. estate and gift tax on a worldwide basis.

As discussed below, U.S. permanent residents should generally be careful to maintain consistency between their immigration and tax resident statuses, while legal non-immigrants have a choice in whether to become U.S. tax residents or maintain non-U.S. tax status.

**Importance of Maintaining Consistency Between U.S. Resident Status for Tax and Immigration Purposes.**

A U.S. permanent resident who is also considered by another country with which the United States has an income tax treaty to be a resident of that other country may be able to take the position under “tie-breaker” provisions of such treaty that he/she is a nonresident for U.S. income tax purposes and avoid U.S. taxation on his/her worldwide income. However, there may be both immigration and tax dangers for adopting such a position.

The immigration danger is that U.S. immigration authorities may consider filing as a nonresident for U.S. income tax purposes based on a treaty to be inconsistent with an intent to be a permanent resident, leading to a determination that such individual has abandoned permanent resident status.³ In addition, as to any permanent resident who is contemplating applying for U.S. citizenship, filing as a U.S. nonresident pursuant to an income tax treaty creates a rebuttable presumption that the applicant for naturalization “has relinquished the privileges of permanent resident status in the United States” and therefore is ineligible for naturalization.⁴

U.S. permanent residents should generally be careful to maintain consistency between their immigration and tax resident statuses, while legal non-immigrants have a choice in whether to become U.S. tax residents or maintain non-U.S. tax status.

The tax danger is that a U.S. permanent resident taking a treaty position who has had a green card in eight of 15 years (including the current year) and has substantial amounts of assets or income (a so-called “covered expatriate”) may be subject to the same “exit tax” on certain deferred income and on the unrealized appreciation of his/her worldwide assets to which a U.S. citizen or a long-term U.S. permanent resident with substantial assets or income would be subject upon renunciation of U.S. citizenship or abandonment of U.S. permanent residence.⁵

Ironically, a U.S. permanent resident who becomes subject to the “exit tax” by virtue of asserting a treaty position still remains obligated to comply with many U.S. reporting requirements including, but not limited to, the Report of Foreign Bank and Financial Accounts (commonly known as the FBAR form), Form 8938 (Specified Foreign Financial Assets), Form 5471 (U.S. Persons With Respect to Certain Foreign Corporations), and Form 3520 (Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts) as long as he/she continues to hold the “green card.”⁶

**Relation Between U.S. Legal Non-Immigrant Status and Non-Resident Tax Status.** The fact that an individual is a legal non-immigrant of the United States does not mean that that person cannot become a U.S. income tax resident or even a U.S. resident for U.S. estate and gift tax purposes. Even though such an individual will not become U.S. tax resident simply by virtue of being a legal non-immigrant, he/she can become a U.S. income tax resident under the “substantial presence” test and can become a U.S. gift and estate tax resident under the domicile test. Thus, in many cases, holders of H-1B and L-1 category visas will work in the United States and become U.S. income tax residents by virtue of the “substantial presence” test, but they stand a relatively small risk of becoming U.S. residents for estate and gift tax purposes because of the time bar on how long they can remain in the United States under those visas.

However, the repeal in 1990 of the immigration law doctrine of “dual intent” for H-1B and L-1 visas,⁷ which had barred a holder of a non-immigrant visa who formed an intent to stay in the United States permanently from eligibility for non-immigrant status, now means that H-1B and L-1 visa holders can plan for obtaining permanent resident status in the United States and still maintain valid non-immigrant status. Subsequently, Congress enacted “portability” legislation allowing H-1B visa holders (ordinarily subject to a six-year limitation of stay), whose employers filed applications for U.S. permanent resident status on their behalf, to renew H-1B status annually, pending the outcome of those applications. Such an H-1B person clearly could in that time acquire a U.S. domicile and become subject to worldwide U.S. estate and gift tax.

Legal non-immigrants in E and O-1 visa status are more vulnerable to becoming not only U.S. income tax residents but also U.S. residents for U.S. estate and gift tax purposes because there is no absolute limitation on the time they can spend in the United States. Following the statutory repeal of the “dual intent” doctrine for H-1B and L-1 visas, the doctrine was administratively repealed for E and O-1 visas.⁸ As such, the estates
of E and O-1 visa holders may not be able to argue convincingly that, solely due to their decedent’s non-immigrant status, such decedent could not have intended to make the United States his/her domicile and subject his/her worldwide estate to U.S. estate taxation.9

On the other hand, for individuals who wish to avoid U.S. tax residency, maintaining H-1B, L-1, E or O-1 visa status allows them to enter the United States whenever they want, to be employed by a U.S. employer, and to receive employment-related remuneration from U.S. sources without becoming U.S. tax resident. None of the criteria for eligibility for any of these visas necessarily requires the holder to stay in the United States an amount of time that would make him/her a U.S. tax resident for U.S. income tax purposes under the “substantial presence” test. For example, an individual who is an officer of a foreign parent could also serve as an officer of its U.S. subsidiary, receive remuneration from such subsidiary, and spend up to 121 days per year in the United States without triggering resident status under the U.S. income tax laws. Moreover, it is important to note that the five, six and seven-year limitations for L-1B, H-1B and L-1A statuses, respectively, apply to days actually spent in the United States. Therefore, persons in these visa categories who spend less than 365 days in the United States of any authorized year of stay may essentially recoup all the days not spent in the United States in any such year until they have exhausted the limitation period.10 Thus, for example, an L-1A executive who carefully tracks and documents the days he/she spends inside and outside the United States and only spends 91 days a year in the United States (i.e., the equivalent of one-quarter of a year) in any year after commencing L-1A status could theoretically extend L-1A status for as long as 28 years and still not trigger U.S. resident tax status.

Even if a person holding a non-immigrant visa should stay long enough in the United States to become a U.S. income tax resident under the “substantial presence test,” but continues to maintain a home or close economic ties to another country with which the United States has an income tax treaty, he/she may be able to take a treaty position that he/she is a resident of that other country and file his/her U.S. income tax return on a non-resident basis without the adverse consequences that may follow when a long-term U.S. permanent resident attempts to do the same. Taking a treaty position, however, as mentioned above, does not exonerate the U.S. income tax resident from having to comply with U.S. reporting requirements related to foreign accounts and assets.

The fact that an individual is a legal non-immigrant of the United States does not mean that that person cannot become a U.S. income tax resident or even a U.S. resident for U.S. estate and gift tax purposes.

A New Immigration Era? Currently, there is much public discourse as Congress considers historic legislation that would not only legalize the immigration status of millions of people presently living in the United States without legal status but may also widen eligibility for obtaining immigrant or legal non-immigrant status based on skills, education, and other related criteria.

Any person, while residing in the United States illegally, could become a U.S. income tax resident (and thereby subject his/her worldwide income to U.S. income taxation) by virtue of meeting the “substantial presence” test described above. Additionally, any such person can assume a U.S. domicile and therefore be treated as a U.S. resident for U.S. estate and gift tax purposes. It is precisely for this reason that many of these illegal immigrants will likely need to regularize their U.S. tax compliance in order to rectify their immigration status. Under an expanded basis for immigration based on skills and education, it is more likely that future candidates for U.S. legal immigrant or non-immigrant status will come to the United States already holding non-U.S. assets and financial interests. Such individuals must be aware that U.S. income tax compliance not only entails the filing of income tax returns, but also the filing of various types of disclosure about non-U.S. assets including, but not limited to, the FBAR form, Form 8938, Form 5471 and Form 3520, starting with the first year they qualify as U.S. income tax residents. Such individuals, therefore, will need to be well-advised about these requirements because failure to comply not only could carry substantial penalties, but under certain circumstances, depending on the final terms of any enacted legislation, could actually jeopardize their long-run eligibility to obtain valid U.S. immigration status.

1. Exceptions exist that allow some foreign nationals to avoid being treated as resident aliens even though their U.S. presence would satisfy the three-year “look-back” rule (for example, foreign government employees, certain foreign students and exchange visitors).
2. Treasury Regulations §20.1(b). While there is no bright-line test, U.S. courts look to several factors in gauging which location an individual has intended to be his/her domicile. Court rulings can be surprising at times. (See, e.g., Estate of Khan v. Comm., TC Memo 1998-22 (1998) (still finding U.S. green card holder living abroad for final four years of his life to be U.S. domiciliary for U.S. estate tax purposes)).
4. 8 C.F.R. §110.3(c)(2).
5. See IRC §877A(g)(3)(B) and §7701(b)(6).
6. See generally Treasury Regulations §301.7701(b)-7(a)(3) (IRS forms); 76 Fed. Reg. 10234, 10238 (2/24/11) (FBAR form). While a dual-resident alien claiming the benefit of a treaty will be treated as nonresident for purposes of computing his/her U.S. income tax liability, Treasury Regulations §301.7701(b)-7(a)(3) treats him/her as a U.S. income tax resident for all other purposes of the IRC which arguably suggests that he/she would still be obligated to file most, if not all, U.S. foreign disclosure forms (such as Forms 8938, 5471, 8621, 926, 3520, 8865, etc.) when applicable.
7. INA §214(h) (8 U.S.C. 1184(h)).
8. See Kurzban, Immigration Law Sourcebook, 759-60 (2012) and INS documentation cited therein (E status) and 8 C.F.R. §214.2(o)(13) (O-1 status).
9. See, e.g., Estate of Jack v. United States, 54 Fed. Cl. 509 (2002) (decedent who held TN status, for which “dual intent” doctrine had not been repealed, could be found to be U.S. domiciliary).

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Estate and Tax Planning: *The US – Ireland Connection*

New York State Bar Association – Spring Meeting 2017

1. **Introduction**

   The US-Irish connection remains as strong as ever and thus understanding the legal and tax implications of greater connectivity between the US and Ireland is important. The purpose of this note is to give a high level overview of the legal and tax principles relevant to a US individual moving to Ireland (either in the short or long-term) or of acquiring property in Ireland, or where there might be other issues providing connectivity.

2. **Domicile and Residence**

   Liability to Irish income tax depends on residence, ordinary residence and domicile.

   **Tax Residence**

   The test for tax residence is a day count test. Pursuant to the Irish Taxes Consolidation Act 1997 (“TCA 1997”), an individual shall be considered tax resident in Ireland in a tax year, where the individual is:

   - Present in Ireland for 183 days / more in the current tax year (the “Current Year Rule”). In this regard, an individual will be treated as being present for a day, where the individual spends any part of that day in Ireland; or
   - Present in Ireland for 280 days / more in the current tax year and the previous tax year (the “Look-Back Rule”), subject to the provision that where an individual is present in Ireland for thirty days or less in the current tax year, he / she will not be regarded as resident in that tax year.

   The Irish tax year is the calendar year.

   **Ordinary residence**

   A person is ordinarily resident for tax purposes if that person is resident for three consecutive tax years. An individual ceases to be ordinarily resident if he / she is non-resident for three consecutive tax years.
Domicile

The concept of domicile is a common law concept which seeks to determine the country, with which an individual has the closest links. The concept of domicile is usually linked with the notion of a person’s “permanent home”, and is distinct from nationality and/or residence. In common law systems, the concept is used to determine the country whose laws a particular person should be subject to in relation to certain personal matters, such as taxation, wills, divorce.

There are four fundamental rules pertaining to domicile:

- A person cannot be without a domicile at any point in time;
- A person cannot have two domiciles at any point in time;
- The domicile of an individual must be that of a territory, which is subject to a single system of law; and
- A change in a person’s domicile cannot be presumed, i.e. a definite intention must be present.

Domicile under Irish law - there are three types of domicile:

- Domicile of origin;
- Domicile of dependence; and
- Domicile of choice.

Every individual is born with a domicile of origin, normally that of their father, and will maintain this domicile of origin until they reach the age of majority.

There are two elements to the acquisition of a domicile of choice, both of which must be present:

- Residence in a new country; and
- An intention to reside in the new country indefinitely.

Therefore, in order to acquire a domicile of choice, an individual must essentially sever all ties with their country of origin, move to a new country, show an intention to establish a permanent home in that country, and physically reside there.

A mere intention to return to the country of origin does not revive the domicile of origin unless there is also a change of residence back to that country. Also an intention to stay in a country for an uncertain or contingent period is not sufficient to establish the required degree of permanence, in order to establish a domicile of choice.

Where an individual has acquired a domicile of choice, but then leaves the country of that domicile of choice, her domicile of origin will automatically be revived, unless they acquire a new domicile of choice, or, they have a definite intention to return to the original domicile of choice.
Citizenship or nationality does not decide a person’s domicile, although in certain situations it may be taken into account. It is possible for an individual to retain a foreign citizenship or nationality, but to still be considered domiciled in Ireland where they make a permanent home in Ireland.

**Summary of tax implication:**

(a) Individuals who are resident, ordinary resident and domiciled in Ireland must pay Irish income tax on worldwide income and gains earned or arising in a tax year.

(b) Individuals who are resident but are non-ordinarily resident and not Irish-domiciled are liable to tax only on: (i) Irish-source income and gains; (ii) certain foreign income and gains remitted to Ireland; and/or (iii) potentially income and gains from an offshore structure.

(c) Individuals who are resident, ordinarily resident and not Irish-domiciled are liable to tax only on: (i) Irish-source income and gains; (ii) foreign income and gains remitted to Ireland; and/or (iii) potentially income and gains from an offshore structure.

(d) Individuals who are resident, non-ordinarily resident and Irish-domiciled are liable to tax on worldwide income and gains.

(e) Individuals that are non-resident, but are ordinarily resident and Irish-domiciled are taxed on their worldwide income and gains, except for: (i) income from a trade, profession or employment exercised outside Ireland; (ii) foreign investment income of under EUR3,810; (iii) income from an offshore structure.

(f) Individuals that are neither resident nor ordinarily resident are taxed only on Irish-source income and gains.

3. **Income Tax**

An individual who is resident and domiciled is taxable on their worldwide income wherever located. A non-domiciled Irish resident or ordinarily resident person is taxed on the remittance basis of taxation (discussed further below).

Income tax is deducted at source for employees under the pay as you earn (PAYE) system. Self-assessment applies to all self-employed persons and persons who are receiving income that is not chargeable to tax under the PAYE system.

For the 2016 tax year, the taxpayer must, by 31 October 2017: (i) pay preliminary income tax for the current tax year; and (ii) file a tax return for the previous year and pay the balance of the previous year’s income tax liability.

Preliminary income tax is payable by self-assessed taxpayers and is operated through the self-assessment system. To avoid interest charges, the amount of preliminary income tax paid for a tax year must be equal to or exceed the lower of: (i) 90% of the final liability for the tax year; (ii) 100% of the final liability for the previous tax year; or (iii) 105% of the final liability for the pre-preceding tax year.

This option is only available where preliminary income tax is paid by direct debit and does not apply where the tax payable for the pre-preceding year was zero.
4. **Capital Gains Tax**

An individual who is resident and domiciled is taxable on their worldwide gains wherever located. A non-domiciled Irish resident or ordinarily resident person is taxed on the remittance basis of taxation (discussed further below).

The standard rate of capital gains tax (CGT) for disposals in Ireland since 6 December 2012 is 33%.

In respect of the disposal of foreign property, CGT is charged on disposals of property or assets for the year of assessment where the individual is resident or ordinarily resident in Ireland subject to double taxation agreement relief.

A foreign national who is non-resident must pay tax on gains made on the disposal of Irish specified assets, which include: (i) immovable property situated in Ireland; (ii) minerals or mineral rights in Ireland (including the Irish area of the continental shelf); (iii) shares in a company that derive more than 50% of their value from Irish property or mineral rights; and (iv) assets used for the purposes of a trade carried on in Ireland through a branch or agency.

A disposal on death is not a chargeable disposal for CGT. The beneficiary is treated as having acquired the asset on the date of death, and its market value is assigned on this date. A gift of an asset is a chargeable disposal for CGT purposes unless the disposal falls into any of the available exemptions or reliefs.

Payment of any CGT liability arising between 1 January and 30 November will be due on or before 15 December of that year; and payment of any CGT liability arising between 1 December and 31 December will be due on or before 31 January the following year.

5. **Transaction based cost**

A stamp duty rate of 1% applies to residential properties valued at up to EUR1 million, with a 2% rate applying to amounts over EUR1 million. From 7 December 2011, there is a single rate of stamp duty of 2% on all non-residential property.

6. **Property Tax**

A local property tax was introduced in 2013 as a charge on the market value of residential properties.

7. **Real estate held through a structure by non-resident investors**

Property can be held either personally, or through a trust or legal entity (including a company). A non-resident company is chargeable to income tax at 20% as opposed to the 25% corporation tax rate on investment income.

The value of using a regulated vehicle to acquire residential property has been dampened by recent amendments to the Irish tax code.
8. Remittance

Non-domiciled but Irish tax resident individuals can avail of the remittance basis of taxation.

Remittances from foreign capital sources, which would include income or capital gains accumulated prior to them becoming Irish tax resident, would not be within the charge to Irish tax. There are certain pre-residence planning techniques that can be availed of in order to maximise the remittance basis of taxation and mitigate an individual's exposure to Irish tax.

Furthermore, foreign income and gains (save for certain exceptions) earned while Irish tax resident but not Irish domiciled will be subject to Irish tax only to the extent it is remitted into Ireland.

The non-domiciled individual will however be subject to Irish tax on Irish source income and gains.

9. Capital Acquisitions Tax (CAT)

CAT applies to both gifts and inheritances in this jurisdiction and will arise where either the disposer or the beneficiary is Irish resident, or the benefit is Irish situate.

The tax basis depends on the:

(a) tax residence status of the disposer (that is, a donor, testator or intestate person) or the beneficiary, save in the case of trusts settled before 1 December 1999 where domicile of the disposer is still relevant;

(b) monetary value of the gift or inheritance a beneficiary receives;

(c) relationship between the disposer and the beneficiary; and

(d) prior benefits (that is, since 5 December 1991) that the beneficiary has received from any person to whom the beneficiary bears the same relationship as he / she does to the current disposer.

These classes of relationships are called groups (see below).

There are three groups with different thresholds or tax-free allowances:

(e) Group A. This group includes a child, foster child, or minor child of a deceased child. This group has a tax-free allowance of EUR310,000 (in 2017).

(f) Group B. This group includes a lineal ancestor (for example, parent or grandparent), lineal descendant (for example, a grandchild), brother, sister, or child of a brother or sister. This group has a tax-free allowance of EUR32,500 (in 2017).

(g) Group C. This group includes all other persons. This group has a tax-free allowance of EUR16,250 (in 2017).

Prior taxable gifts or inheritances taken since 5 December 1991 must be aggregated with benefits taken since 5 December 2001 from persons within the same group threshold to calculate the tax on the benefit.
To calculate a person's taxable excess, the unused group threshold is deducted from the taxable value of the current benefit (that is, the market value of the benefit less relevant reliefs, liabilities, costs and expenses).

CAT is charged at a flat rate of 33%. The payment date for CAT depends on when the valuation date arises. Where the valuation date for a gift / inheritance arises in the 12-month period up to and including 31 August in a tax year, a pay and file return must be made by 31 October of that year. Where the valuation date arises between 1 September and 31 December the pay and file obligation is due by 31 October in the following year.

The valuation date for a gift is normally the date of the gift itself. However, the valuation date for an inheritance is often not the date of death and further analysis is required.

**Exemptions from CAT**

The “Convention between Ireland and the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on the estates of deceased persons (the “US-Ireland DTA”) provides relief from double taxation of Irish inheritance tax and US Federal Estate Tax. Where a person dies domiciled in Ireland or in a State in the US, the US-Ireland DTA should be consulted to determine which country has primary, or sole, taxing rights over assets comprising the deceased’s estate. The US-Ireland DTA is discussed further below.

A number of reliefs or exemptions can be used, including business relief, agricultural relief, dwelling house relief (dwelling house relief has been significantly limited by the Finance Bill 2016 and no longer applies to gifts of property) and a credit mechanism to offset CGT against CAT.

The first EUR3,000 taken as a gift by a beneficiary from a disponer in any one year is exempt from tax.

There is no CAT on gifts or inheritances between a married couple or civil partners. An inheritance or gift taken by a qualifying cohabitant by court order is exempt from CAT. A benefit taken for public or charitable purposes is generally exempt from tax.

Planning to reduce liabilities involves the use of the various reliefs and exemptions. However, certain wealth management structures can be put in place during the lifetime of the testator that can reduce CAT (for example, family partnership arrangements or selling assets and retaining a lifetime interest). These arrangements are designed to ensure further value does not accrue in the donor’s name,

Qualifying insurance policies are exempt from CAT, to the extent that they are used in the payment of certain gift or inheritance taxes.

**Charge to CAT for non-domiciled individuals**

A foreign domiciled person is not considered resident or ordinarily resident for CAT purposes in Ireland unless he: (i) was resident for the five consecutive years of assessment preceding the date of the benefit; and (ii) on that date of the benefit, is either resident or ordinarily resident in Ireland.
Gifts or inheritances of property situated in Ireland are taxable regardless of the domicile, residence or ordinary residence of the disponer or beneficiary.

However, it is possible, with appropriate structuring, for non-domiciled individuals to overcome the *situs*-based charge to CAT, which would otherwise arise if an individual acquired Irish property directly.

However, in the case of a US domiciled deceased person whose estate comes within the charging provisions for CAT, the provisions of the US-Ireland DTA should be considered. Under Article IV(2) of the US-Ireland DTA, where a deceased person dies domiciled in a US State, Ireland will not tax assets with a non-Irish situs. The situs of the asset shall be determined in accordance with Article III, unless this creates a scenario where assets situate in the territory of Ireland that would, but for Article III, be taxed in Ireland, are not taxed in the US (other than due to a specific exemption), if for example, the estate does not exceed the US Federal Estate Tax threshold, then, in such a case, Ireland can tax the assets situated in its territory.

10. **Trusts**

**Types of trust**

Trusts are recognised in Ireland and the following types of trusts are frequently used:

(a) **Bare trusts.** A simple or bare trust consists of trustees holding property on trust for a person absolutely beneficially entitled to the assets of the trust. The trustees have no active duties and simply hold the legal title to the property for the beneficiary.

(b) **Fixed (interest in possession) trusts.** The beneficiaries of the income or capital is fixed by the settlor.

(c) **Discretionary trusts.** The trustees hold the trust fund for the benefit of a class of beneficiaries. The trustees have discretion as to when and to which beneficiaries distributions of income and/or capital are made out of the trust fund.

**Revocable living trusts**

The tax treatment of a US revocable living trust will depend on the terms of the deed of trust, and, whether the trust is viewed as a settlement for Irish tax purposes or rather a bare trust.

A settlor of a US revocable living trust (considered to be a non-resident settlement for Irish tax purposes) could be deemed to be subject to Irish tax on the income and gains of the trust on an arising basis, under certain anti-avoidance provisions of Irish tax law that operate to impute income and gains of offshore structures to Irish resident persons. In other words, such settlor would not be able to avail of the remittance basis of taxation in respect of any income and gains accruing to the trust.

Separately, if the settlor is the sole trustee and is Irish resident, there is a risk that Revenue may view the trust / settlement as an Irish tax resident trust. Careful review of existing US planning structures is required before taking up Irish tax residence.

**Taxation of Trusts**
(a) Income tax. If all the trustees are resident in Ireland, the settlement is liable to income tax on the worldwide trust income. The income of a trust (including corporate trusts) is subject to income tax at a standard rate of 20% only, although there is a surcharge of 20% if income is accumulated and not distributed within a certain timeframe. The ultimate beneficiary is given a credit for the income tax paid by the trustees against his income tax liability. A beneficiary can be taxed directly where he / she has the right to be paid the income as it arises.

(b) Capital acquisition tax (CAT). CAT is a beneficiary-based charge to tax on gifts and inheritances appointed from the trust, currently charged at the rate of 33%.

(c) Discretionary trust tax. A one-off 6% charge arises to the trustees of a discretionary trust on the latest of the following happening:

(i) the death of the settlor; or

(ii) the date on which all the principal objects of the trust have reached the age of 21 years.

The term "principal objects" includes the spouse of the disponer, the children of the disponer or children of a pre-deceased child of the disponer.

One Half (ie. 3%) of the initial charge is refunded if all the trust fund is wound up within five years of the one-off charge.

There is an annual charge of 1% of the value of the assets held on trust but this does not apply in the year of the one-off charge.

(d) Capital gains tax (CGT). Trustees are liable to CGT in respect of any gains they make on disposals of assets in the course of administration of a trust. If a trust is Irish resident, the trustees are liable to CGT on the worldwide gains of the trust.

If a trust is resident in Ireland it will be liable to income tax on its worldwide income and CGT on the worldwide gains of the trust, subject to a professional trustee exemption. Where a trust is non-resident, only Irish-source income is chargeable to income tax and CGT is only due on Irish specified assets.

Aside from the general rules set out above, where trustees cease to be resident in Ireland, the trustees are deemed to have sold the assets of the trust for the market value at the date on which the trust becomes non-resident and to have reacquired them on that date for their market value.

Anti-Avoidance rules in respect of offshore structures

There are specific anti-avoidance rules that can attribute the income and gains of offshore structures to Irish resident individuals (income: sections 806 and 807A Taxes Consolidation Act 1997 ("TCA"); gains: sections 579, 579A and 590 TCA). These provisions target the transfer of assets to a non-resident entity for the purpose of avoiding tax, which results in an attribution of income to an Irish resident transferor or their spouse or on receipt by an Irish resident beneficiary. One should review their structures in advance of becoming Irish resident.

May 1st deadline for disclosure
Ireland is an early adopter of the OECD Common Reporting Standard between tax authorities. There is an important incentive for taxpayers with undisclosed income and gains from such structures to make a disclosure to Revenue ahead of 1 May 2017.

Whilst Ireland does not have a formal disclosure programme operating at present and therefore the disclosures are made in the context of the Audit Code, it is important to highlight taxpayers will be denied the opportunity to make a qualifying disclosure under the Audit Code for offshore tax liabilities from 1 May 2017. Making a qualifying disclosure results in lower interest and penalties and the taxpayer avoids publication.

Ireland as a trust jurisdiction

Ireland presents a viable alternative as a wealth-holding jurisdiction, offering trust structures for non-resident and domiciled families.

There is a professional trustee exemption from CGT and subject to managing the income tax exposure, which can be achieved by mandating income, it provides a robust jurisdiction with clear trust principles deriving from English law.

We enclose our note “Ireland as a Trust Location for International Wealth Structuring” at Appendix 2.

11. Double Taxation Agreement between Ireland and the USA with respect to taxes on the estates of deceased persons, 5 July 1950 (the “US – Ireland DTA”)

The US – Ireland DTA applies to CAT in Ireland and Federal Estate Tax in the US, thus relieving the possibility of double taxation in respect of a deceased’s estate. It does not apply to gift tax or death duties which may be imposed by individual States in the US.

Pursuant to Article III of the US – Ireland DTA, where a person is domiciled in either the US or Ireland at his / her date of death, the situs of the assets comprised in that person’s estate will determine which jurisdiction has sole or primary taxing rights in respect of the assets of the estate, and, the situs of certain assets must be determined exclusively in accordance with rules laid out at Article III, paragraph 2 of the US – Ireland DTA. The situs of assets not expressly dealt with under Article III(2) should be determined in accordance with the laws of the territory in which the deceased is not domiciled.

In summary, Article III of the US – Ireland DTA states the following:

(i) The situs of immoveable property (eg, land or buildings) is the place where the property is located;

(ii) The situs of most tangible property, currency and legal tender is the place where the property is located at the time of death;

(iii) The situs of the majority of unsecured and secured debts is the place of domicile of the deceased at his / her time of death. However, the situs of a judgment debt is the place where the judgment is recorded (notably, the reference to debts includes bank accounts);

(iv) The situs of shares / stock in a non-municipal or non-governmental company is the place of incorporation (or organisation) of the company (this treatment varies in relation to certain UK
or Northern Irish companies if the branch register of those companies is kept in Ireland, in which case the shares of those companies would be deemed to be situated in Ireland);

(v) The *situs* of monies payable under policies of assurance / insurance is the place where the deceased was domiciled at his / her time of death;

(vi) The *situs* of a ship / aircraft or shares in a ship / aircraft is the place of registration of the ship / aircraft;

(vii) The *situs* of the goodwill of a trade, profession or business is the place where the trade, profession or business is carried on;

(viii) The *situs* of patents, trademarks and designs is the place where these assets are registered. However, the *situs* of a copyright, franchise or licences is the place where these rights are exercisable;

(ix) The *situs* of a right or cause of action of the benefit of the estate of a deceased person is the place where the right or cause of action arose.

However, if on application of these rules, tax is not imposed in the jurisdiction in which the asset is deemed to be situated (unless this is due to a specific exemption), then, the other jurisdiction may be entitled to tax the asset provided the asset is situated in its territory and it would ordinarily be able to tax the asset if Article III did not apply. It is our understanding that the Federal Estate Tax threshold is not considered a specific exemption for the purposes of Article III and thus where an asset situate in the territory of Ireland is not taxed in the US because the US Federal Estate Tax threshold has not been exceeded, and would, but for Article III, be taxable in Ireland, then Ireland can tax that asset.

Article IV(2) provides that where the deceased dies domiciled in the US, Ireland will not seek to tax assets that do not have an Irish situs and situs is determined in accordance with Article III, thereby providing exemption relief.

Therefore, irrespective of the CAT charging provisions and the definition of what constitutes a “taxable inheritance” for CAT purposes, Ireland does not have taxing rights in respect of non-Irish situs assets in circumstances where the deceased died domiciled in a State of the US, even where those assets remain outside of the charge due to the asset value being under the US Federal Estate Tax threshold.

As Ireland no longer seeks to tax persons by virtue of their domicile, one could argue that Ireland cannot provide a credit under Article V(1) of the Treaty and that Article V(2) should no longer apply. However, as illustrated in the examples provided at Appendix 2, the Irish Revenue Commissioners do still allow for a credit. A unilateral credit relief is also available under s.107 of the CAT legislation on tax paid on assets situate in a different jurisdiction.

Where the deceased dies Irish domiciled but a US citizen, Ireland should provide a credit for US Federal Estate Tax attributable to the US situs assets. The US should give a credit for the CAT attributable to the Irish situs assets against the US Federal Estate Tax.

An extract from the Irish Revenue Commissioners website ([www.revenue.ie](http://www.revenue.ie)) is included at Appendix 2, which provides worked examples of how the US-Ireland DTA applies.

The Double Taxation Treaty between Ireland and the US regarding income and gains, 1997 (the “1997 DTA”) aims to assign primary taxing rights to one country and to facilitate relief against double taxation. The purpose of the 1997 DTA is to avoid double taxation as opposed to tax mitigation. The Treaty applies to Federal income tax, Federal excise tax, Irish income tax, Irish capital gains tax and Irish corporation tax.

Under the terms of the 1997 DTA, a US domiciled Irish resident individual should be able to avail of a credit in Ireland for any tax suffered (either income tax or capital gains tax) in the US. However, to the extent that the effective rate of tax payable in Ireland is greater than that applicable in the US, the individual would still be accountable to the Irish Revenue Commissioners for the excess tax due.

However, the 1997 DTA includes a specific provision, widely referred to as the “Savings Clause”, which permits the US to tax any citizen of the US as if the 1997 DTA does not have any effect. It would appear therefore, that the “Savings Clause” effectively makes the 1997 DTA redundant in so far as it grants primary taxing rights in respect of any source of income to Ireland.

It is likely that the US will seek to rely on the Savings Clause to tax US income which is subject to the remittance basis of taxation in Ireland, as otherwise, the individual could potentially avoid paying any tax in any jurisdiction on this income until such time as it is remitted into Ireland.

However, where the Savings Clause is invoked, the individual should obtain a credit in either the US or Ireland (depending on the source of the income) so as to avoid double taxation.

Who has taxing rights under the DTA?

*Rental income / capital gains from real immovable property (land, buildings etc)*

- If the property is situated in the US, any rental income from the property or capital gains arising in respect of the property may be taxed in the US, and then, to the extent that this income or capital gain is remitted into Ireland it may also be subject to tax in Ireland. However, Ireland should give a credit for tax suffered in the US.

- If the property is situate in Ireland, any rental income from the property or capital gain arising in respect of the property should be taxable in Ireland. Potentially, under the Savings Clause (referred to at above), the US may also try to tax this income or capital gain where the individual is a citizen of America, and, to the extent that it does, the individual should be able to obtain a credit in the US for any Irish tax suffered.

*Dividends (which by definition includes income derived from owning shares in a company, eg a distribution)*

- Dividends paid by a US company may be subject to tax in Ireland, but again credit may be given for tax suffered in the US. In this regard, the DTA states that only 15 percent tax should be payable in the US, but it would be necessary to confirm whether the Savings Clause would apply. Where the Savings Clause is invoked, the individual should be able to obtain a credit in Ireland for any tax suffered in the US.
Interest

- Under the terms of the treaty, any interest income should only be taxed in Ireland as the individual’s country of residence. However, it should be confirmed whether the Savings Clause applies. If the US seeks to tax this income under the Saving Clause, the individual should obtain a credit in Ireland for any US tax suffered.

Pension income / alimony

- Pursuant to the terms of the DTA, pension income and alimony should only be taxed in Ireland. However, it should be confirmed whether the Savings Clause applies. If the US seeks to tax this income under the Saving Clause, the individual should obtain a credit in Ireland for any US tax suffered.

13. Wills and estate administration and succession law

An Irish Will

It is not essential for an owner of assets in Ireland to make a will in this jurisdiction as there are eight alternative systems of law under which a will or other testamentary disposition is formally valid in Ireland (section 102 Succession Act 1965; implementing Articles I and II Hague Convention of 5 October 1961 on the Conflicts of Laws Relating to the Form of Testamentary Dispositions, adopted by the Hague Conference on Private International Law (HCCH)) (see section 18). However, it does make the process of extracting the Irish grant of representation more straightforward and the process of extracting the grant in Ireland can be undertaken at the same time that the foreign Will is being proved abroad and thus avoids delay. Furthermore, it avoids the need for a foreign translation of a Will written in another language.

Validity of foreign grants of probate

A foreign grant of probate is not recognised in Ireland, nor do the Irish courts recognise a resealing of the grant process. The Probate Office requires a sealed and certificated copy of the foreign will and grant to accompany a substantive application for an Irish grant of probate.

Where no foreign grant is issued and a foreign will is used to seek a grant of probate in Ireland, an affidavit setting out the internal law of one of the eight systems in the Succession Act 1965 is required. An affidavit is not required for wills executed in England, Wales and Northern Ireland.

The Probate Office can also issue a limited grant of probate if the deceased's estate comprises only movable or immovable property situated in Ireland.

Entitlement to extract the grant of representation

Establishing title and gathering in assets depends on whether the deceased left a will or died intestate:

(a) Died testate. The will can appoint an executor, who will have the first right to prove the will (that is, present the will to the Probate Office to obtain a grant of probate).

(b) Died intestate. The nearest next-of-kin alive at the date of death are entitled to apply. For example, on the death of a widower, the next-of-kin entitled to apply to become an
administrator is the widower’s child, or the issue of a predeceased child. The order of priority of entitlement to extract a grant of administration is linked to the entitlement under a deceased intestate’s estate.

If the Irish estate comprises real and personal property and the parties entitled to extract the grant are different, it may be beneficial to make a section 27(4) Succession Act 1965 application to provide that one person has the authority to extract the grant to both legal and personal estate, rather than seeking two limited grants.

**Succession regimes**

Ireland operates a schismatic system of succession law. The principal legislation governing the area of succession law in Ireland is the Succession Act 1965.

Movable property passes in accordance with the succession laws of the country in which the deceased was domiciled at the time of his death. Immovable property passes in accordance with the laws of the country in which it is actually situated. Where an individual dies leaving both real and personal property in Ireland but non Irish domiciled, Irish law applies to determine the succession to the Irish real property and foreign law to determine the succession to the Irish movable property.

Ireland is not a party to the Regulation (EU) 650/2012 on jurisdiction, applicable law, recognition and enforcement of decisions and acceptance and enforcement of authentic instruments in matters of succession and on the creation of a European Certificate of Succession (Succession Regulation).

**Forced Heirship**

Ireland has a form of forced heirship in that a surviving spouse has a legal right to a share in the deceased's estate (section 111 Succession Act 1965). It will apply where the deceased died domiciled but also where the deceased died non-domiciled but holding Irish immovable property. Therefore, Irish real property held by a non-domiciled and/or non-resident person will be subject to Irish succession law and thus Irish forced heirship provisions.

If the testator has left surviving children, the surviving spouse is entitled to a one-third share of the estate. If there are no children, then the surviving spouse is entitled to one-half. The spouse can renounce the legal right to a share either before or after marriage.

Where the deceased has died intestate leaving surviving children, the surviving spouse is entitled to a one-half share of the estate. If there are no children, then the surviving spouse is entitled to all of the estate. The spouse can renounce the legal right to a share either before or after marriage.

The courts have a discretionary power to make provision for a child (including a child born outside marriage) where satisfied that the testator has failed in his / her moral duty to make proper provision for the child. An order will not affect the legal right to a share of a surviving spouse or any bequest to that spouse if that spouse is also the child's parent. There are strict time limits on bringing an application.

**Immigration and Visas**
Subject to being granted permission to enter, all non-EEA citizens will be permitted to stay in Ireland for a maximum of three months. If a citizen of a non-EEA country wants to remain for longer than three months, they must apply for permission to remain.

A person of independent means who meets the financial thresholds for income / savings will be able to apply for permission to remain which will take the form of a passport endorsement with a Stamp 0 in conjunction with a certificate of registration. Stamp 0 is a low level form of immigration. It does not permit the applicant to work nor indeed does any period of residence under a Stamp 0 count as reckonable residence for long-term residence status or indeed citizenship.

These limitations mean that wealthy private clients and their families seeking to relocate to Ireland for the long term or have a qualified right of residence for up to five years will need to look to an alternative route. The Immigrant Investor Programme ("IIP") provides an alternative proposition.

The IIP provides for different types of qualifying investments that can be made including: an enterprise investment of €1m in a single enterprise or spread across a number of separate enterprises; an investment of €1m in an approved investment fund; or an investment of €3m in a REIT.

Successful candidates will receive a Stamp IV visa. Certain investments must be made for a period of three years in order for the investment to be complete for immigration purposes.

The IIP grants the successful candidate long term residence in Ireland, it does not provide citizenship. However, it is feasible that candidates may apply separately for citizenship once they have established five years of reckonable residence.
15. **Contacts**

For further information, please refer to your usual Matheson contact or one of the following members in our Private Client Group:

- **Paraic Madigan**  
  E: paraic.madigan@matheson.com  
  Partner, Dublin

- **John Gill**  
  E: john.gill@matheson.com  
  Partner, Dublin

- **Lydia McCormack**  
  E: lydia.mccormack@matheson.com  
  Senior Associate, Dublin

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Appendix 1

Extract taken from the website of the Irish Revenue Commissioners regarding the

Double Taxation Agreement between Ireland and the USA

with respect to taxes on the estates of deceased persons

The information in this document is an extract from the Irish Revenue Commissioners’ website and does not constitute legal or any other advice on any particular matter from Matheson, and is provided for general information purposes only.
Convention with the US

The Ireland - US Treaty, which was concluded in 1951, is treated now as applying to inheritance tax in Ireland and federal estate tax in the USA. It does not apply to gift tax or to any taxes in the nature of death duties which may be imposed by individual U.S. States, e.g. Californian inheritance tax, however in such cases unilateral relief may apply.

Scope of Irish and US Inheritance Tax

Ireland imposes inheritance tax on worldwide assets where the disposer or beneficiary is resident/ordinarily resident in Ireland, otherwise only assets situated in Ireland are liable to inheritance tax. The U.S. imposes federal estate tax on worldwide assets if the disposer was a US citizen or was domiciled in one of the States of the U.S., otherwise only property situated in the U.S. is liable to federal estate tax (subject to certain exceptions).

However the Convention provides that Ireland cannot tax property outside its territory unless the disposer died domiciled in the State (or the disposition in question was governed by the law of the State) or else died not domiciled (i.e. not resident) in the U.S and this will continue to be the position irrespective of the residency rules. This means that a benefit taken by an Irish resident beneficiary of U.S. situate property from a disposer who is domiciled in the U.S. might appear to be subject to C.A.T. but is in fact not liable under the terms of the Convention. Where either country imposes tax on property situated solely in the other country then the country where the property is not situated gives credit for the tax paid in the other country. Like both unilateral relief, and relief under the UK Double Taxation Treaty, the amount of the credit cannot exceed the amount of inheritance tax on the property which is doubly taxed. In circumstances where the convention does not provide relief, the unilateral provisions of section 107 of the Act may apply.

As the U.S. claims to tax assets wherever situated if the deceased is a U.S citizen at the time of his death, irrespective of the domicile, it often results in both Ireland and the U.S. claiming tax on worldwide assets. In such a case the Convention, if the deceased died domiciled and resident or ordinarily resident in Ireland but a citizen of the U.S. at the date of death, provides that Ireland will allow against its tax on property situated in the U.S. a credit for the U.S. tax payable on that property. The credit given is the lesser of the Irish or U.S. tax on that property. The U.S. on the other hand will allow against its tax on property situated in Ireland a credit - again equal to the lesser of the Ireland or U.S. taxes (see example 8).
Location of property

The location of property is central to the whole question of the relief and it is here that the convention with the U.S. differs significantly from the convention with the U.K. It contains a code in Article III called the "Situs Code" which is to be applied where the deceased died domiciled in either Ireland or the U.S. (or in both). The code in Article III sets out eleven rules for determining the situs (location) of different classes of property. While it conforms substantially to general law with regard to most classes of property, it differs significantly with regard to the following classes:

- Debts due to the deceased (unless otherwise provided for). It is important to note that debts include bank accounts.
- Moneys payable under an assurance policy or an insurance policy on the life of the disponer.
- Government securities and shares or stock in municipal or government corporations.

These categories of property are deemed to be situated where the disponer was domiciled.

This can result, exceptionally, in property being treated as located in both countries as both countries may claim domicile. When this happens, the credit is split. The credit to be given is based upon the lower of the taxes charged in both jurisdictions and each gives a proportion of that sum as a credit so that the amount of tax payable between the two countries is equal to the greater amount payable in the two countries separately (see example 9).

Note that the situs code is governed by the domicile of the disponer and not by his/her citizenship

Under the provisions of Article VI any claim for credit (or for a related refund of tax) must be made within six years from the date of the disponer’s death.

### Ireland - U.S. Convention: Situs Code: Article III (2)

<table>
<thead>
<tr>
<th>Class of Property</th>
<th>Situs for purposes of the Convention</th>
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<tbody>
<tr>
<td>Immovable Property</td>
<td>Place it is located</td>
</tr>
<tr>
<td>Tangible moveable property including currency, negotiable bill of exchange promissory notes.</td>
<td>Place where located or if in transit, at the place of destination</td>
</tr>
<tr>
<td>Debts due to the deceased, secured or unsecured - includes bank accounts, mortgages, dividends, shares in Government or municipal corporations</td>
<td>Place of domicile</td>
</tr>
<tr>
<td>Shares or stock in a corporation except government or municipal</td>
<td>Place where or under the law of which the corporation was created</td>
</tr>
</tbody>
</table>
Class of Property | Situs for purposes of the Conversion
--- | ---
Policies of insurance and assurance | Place of domicile
Goodwill of business | Place where business carried on
Ships and aircraft and shares thereof | Place of registration
Patents, trademarks and designs | Place of registration
Copy right, franchises and rights of licences to use any copyrighted material, patent, trademark or design | Place where the rights are exercisable
Rights or causes of action ex delicto surviving for the benefit of an estate of a decedent | Place where such rights or causes of action arose
Judgment debt | Place where judgment is recorded

Example 6

**Michael dies domiciled in New York and leaves the following assets:**

<table>
<thead>
<tr>
<th>Asset</th>
<th>Situs</th>
<th>Country/State</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lands in Ireland</td>
<td>Place Located</td>
<td>Ireland</td>
</tr>
<tr>
<td>House in New York</td>
<td>Place Located</td>
<td>Place Located</td>
</tr>
<tr>
<td>Irish Bank Account</td>
<td>Place of Domicile</td>
<td>New York</td>
</tr>
<tr>
<td>Irish Government Stock</td>
<td>Place of Domicile</td>
<td>New York</td>
</tr>
<tr>
<td>U.S. Corporation Shares</td>
<td>Place Corporation created</td>
<td>New York</td>
</tr>
<tr>
<td>Insurance Policy</td>
<td>Place of Domicile</td>
<td>New York</td>
</tr>
</tbody>
</table>

Where the code does not specifically provide for the situs of any particular property in an estate the Convention provides that the situs is to be determined according to the law of the territory in which the deceased was not domiciled. The operation of the situs code could result in property escaping taxation in both jurisdictions. The code contains a proviso to prevent this happening (see example 7).

Example 7

John dies domiciled in the State of New York leaving lands in Ireland and an Irish bank account to Tom who is resident in Ireland.

Under the situs code Ireland can only tax the lands as the bank account is deemed to be located in New York. If the bank account is not large enough to attract tax in the U.S. it would therefore escape tax in both jurisdictions. However a proviso in Article III of the Convention provides that in that scenario, Ireland may impose tax.

Example 8
Patrick Jones dies domiciled in Ireland. He is a U.S. citizen at the time of his death. He leaves all his
property to his two children. At his death his estate is as follows:

A house in Ireland - €120,000
Irish Bank Accounts - €90,000
Furniture and personal effects - €60,000
Shares in U.S. Corporations - €300,000
Irish Government Stock - €24,000
U.S. Government Stock - €6,000
Insurance policies in Ireland and the U.S. - €600,000

Total Estate €1,200,000

Total Federal Estate Tax paid €150,000 (Converted as on the date of payment)

Rate of Federal Estate Tax 12.5% i.e. €150,000/€1,200,000 x 100

Each beneficiary takes a benefit of €600,000

Capital Acquisition Tax payable by each €35,570

Rate of Capital Acquisitions Tax 5.9% i.e. €35,570/€600,000 x 100 Situs Article III (2) of Convention

<table>
<thead>
<tr>
<th>Asset</th>
<th>Situs</th>
<th>Country/State</th>
</tr>
</thead>
<tbody>
<tr>
<td>House</td>
<td>Place Located</td>
<td>Ireland</td>
</tr>
<tr>
<td>Bank Accounts</td>
<td>Place of domicile</td>
<td>Ireland</td>
</tr>
<tr>
<td>Furniture and effects</td>
<td>Place located</td>
<td>Ireland</td>
</tr>
<tr>
<td>U.S. Corporation Shares</td>
<td>Place Corporation created</td>
<td>U.S.</td>
</tr>
<tr>
<td>Irish Government Stock</td>
<td>Place of domicile</td>
<td>Ireland</td>
</tr>
<tr>
<td>U.S. Government Stock</td>
<td>Place of domicile</td>
<td>Ireland</td>
</tr>
<tr>
<td>Insurance Policies</td>
<td>Place of domicile</td>
<td>Ireland</td>
</tr>
</tbody>
</table>

A credit is given against Capital Acquisitions Tax payable on property situated in the U.S. for Federal
Estate Tax, (F.E.T.) payable on the same property, at the lower effective rate.

Ireland gives credit for F.E.T. payable on the U.S. Corporation shares as the only property situated in
the U.S.A.

U.S. tax referable to U.S. Corporation shares €300,000/€1,200,000 x €150,000 = €37,500 = 12.5%

Extract from the Irish Revenue Commissioners’ Website
(www.revenue.ie) (March 2017)

40040262.1
Irish Tax referable to U.S. Corporation shares *€150,000/*€600,000 x €35,570 = €8,892.50 = 5.9%

*1/2 share of U.S. Corporation shares and benefit taken by each beneficiary.

As the Irish rate of tax is the lowest effective rate, credit is given against the tax liability of each beneficiary amounting to €150,000 x 5.9% = €8,850.

Total Capital Acquisitions Tax payable by each beneficiary is €35,570 less €8,850 = €26,720

Example 9

1. John Burke dies domiciled in both Ireland and New York and leaves a bank account in Ireland.

2. Under the situs code, the situs of the bank account is the place of domicile and therefore it is situated in both Ireland and New York as both jurisdictions are claiming domicile under their law.

3. Each country assesses tax on the bank account.
   
   U.S. tax = €600
   
   Irish tax = €400
   
   Total tax = €1,000

4. The credit given is the lesser of the two taxes i.e. €400 Irish tax

5. Ireland gives a proportion of the credit according to the formula:
   
   Irish Tax/Irish & U.S. Tax x Total Credit = €400/€1,000 x €400 = €160

6. Net Irish Tax = €400 less €160 (credit) = €240

7. U.S. gives a proportion of the credit according to the formula:
   
   U.S. Tax/U.S.& Irish Tax x Total Credit = €600/€1,000 x €400 = €240

8. Net U.S. Tax = €600 less €240 (credit) = €360

9. Total tax payable in both jurisdictions after credits is €600 i.e. the greater of the two amounts chargeable in either jurisdiction.

In the event that there is property in a third country, the credit for the tax on such property should be apportioned in the same way.
Appendix 2

Ireland as a Trust Location for International Wealth Structuring
Ireland as a Trust Location for International Wealth Structuring  
(March 2016)  

Introduction  

The world as we know it is changing. As wealth generation is becoming increasingly more sophisticated and globalised, there has been an increased focus on tax transparency both at domestic government level and on a supranational institutional level, from the OECD to G8 and G20.  

Whilst the trust continues to serve as a flexible device for the structuring of wealth for sophisticated international families, perhaps the more important considerations now are the jurisdiction in which those trusts should be tax resident and the proper law to govern such trusts.  

This note highlights Ireland as a viable alternative for such trusts. In summary, the advantages of Ireland include:  

1. A deep rooted tradition of trusts;  
2. A sophisticated professional environment with a developed market outlook;  
3. An “onshore environment” which avoids blacklisting by the local laws of many jurisdictions, in particular Latin American countries;  
4. Long established “onshore taxing principles”.  

The Tradition of Trusts  

Ireland is a constitutional democracy with a common law jurisdiction. Trust law in Ireland originated from and developed following the principles of English law.  

On statutory terms, the principal legislation is the Trustee Act of 1893. This continues to be the substantive statutory form of Irish trust law and broadly places Irish law on the same terms as English trust law, prior to the enactment of the English Trustee Act 1925. The Land and Conveyancing Law Reform Act 2009 also introduced a regime to allow for the variation of trusts in prescribed circumstances and also abolished the perpetuity period for trusts.  

Following a number of reports by the Law Reform Commission, the present programme for government includes the introduction of a new trust bill to “reform and consolidate the general law relating to trustees so as to deal better with and protect trust assets”. The heads of the proposed bill are however yet to be agreed. The limits on statutory authority should, however, not be seen as a disadvantage as its practical impact is reduced by effective drafting of the trust deed. With appropriate drafting, we believe that Irish trust law is a suitable proper law for settlements to hold assets on behalf of sophisticated international families.
Irish trust law recognises bare trusts, discretionary trusts and interest in possession trusts. The key advantages provided by trusts established outside of Ireland, apply equally to Irish proper law trusts and include succession planning and also to provide for wider estate planning for the preservation of wealth and to preserve the continuity of the ownership of particular assets, such as a business or property within a family over the long term.

**A Developed Market Outlook**

Ireland and its advisors are already accustomed to dealing with complex international issues. One third of the world’s investment funds are domiciled in Ireland and one-half of the world’s commercial aircraft leasing special purpose vehicles are domiciled in Ireland. This brings with it a developed intellectual capital infrastructure, with highly qualified legal, tax and accountancy professionals.

Quite apart from the requirement for a well-organised trust law model and a developed market outlook in terms of professional expertise, sophisticated families should ensure that the structures through which they hold wealth do not create unnecessary and cumbersome tax consequences. The “blacklisting” of many traditional offshore jurisdictions enhances the Irish proposition.

**Blacklisting**

When the OECD published its report in 2000 identifying which jurisdictions it considered to be tax havens, they did so according to criteria of low tax rates and a lack of transparency. Since then, a number of jurisdictions initially considered “out of favour”, addressed those OECD concerns by signing a requisite number of tax information exchange agreements.

The introduction of Foreign Account Tax Compliance Act (“FATCA”) by the US has prompted the signing by multiple jurisdictions of Intergovernmental Agreements (“IGAs”) with the US so as to facilitate financial institutions and investment advisors in their jurisdictions to meet compliance obligations under FATCA who would otherwise have a direct reporting requirement to the IRS. Notably, the G20 recently reported that the FATCA model should be adopted by all of its members as a means to ensure the exchange of information and minimise tax evasion.

Quite apart from the intense activity at a supranational level, very often it is the domestic legislation of certain jurisdictions which has caused a significant problem for those engaging in wealth planning structuring through some of the traditional offshore centres. Indeed, for some time, many Latin American families have been looking to restructure their affairs, to move away from some of the traditional offshore financial centres, on account of the fact that the domestic laws of those jurisdictions operate a black list of foreign countries. The effect of their blacklists include punitive withholding tax implications on payments to structures in traditional offshore financial centre jurisdictions.

**Taxation of Irish Trusts**

Bearing the above commentary in mind, ironically, the presence of a taxing regime may be an attractive consideration for family offices considering a suitable structure to locate trusts holding the
wealth of high net worth families. There are three principal taxes which may affect the Irish Trust on an ongoing basis – Income Tax, Capital Gains Tax (“CGT”) and Capital Acquisitions Tax (“CAT”).

Unlike the position as applies in other jurisdictions, there is no separate tax regime for non-resident / foreign trusts. Instead, Irish tax law for trusts operate on long established statutory and case law principles.

**Income Tax**

For income tax purposes, it is the residence of the trustees of the trust which determines a liability to Irish income tax. Any trustee who receives income is chargeable to income tax on that income at the standard rate (20% at present) only. Even if the trustee is a corporate trustee, the income accruing to the corporation in that capacity is still subject to income tax at the standard rate, rather than to corporation tax.

It may however, be possible to overcome this Irish trustee charge to income tax, by mandating the income of an Irish resident trust to non-resident and non-ordinarily resident beneficiaries as that income arises.

Alternatively, with suitable structuring, include the interposing of a corporate in receipt of loan funding, it may be possible to overcome this income tax charge.

**CGT**

Unlike the position with the income tax code, there are specific provisions dealing with the taxation of a trust for CGT purposes.

For Irish CGT purposes, where the settlor and the beneficiaries are non-resident, not ordinarily resident and not domiciled in the State, there should be no Irish CGT issues for such settlers and beneficiaries, in relation to foreign assets and non-specified Irish assets. Specified Irish assets include land and buildings in the State and shares that derive their value from such assets.

Our tax code provides that the trustees of settlement shall for the purposes of CGT be treated as being a single and continuing body of persons, which as a general rule is treated as being resident and ordinarily resident in Ireland unless:

(a) The general administration of the trust is administered outside of Ireland; and

(b) The trustees or the majority of them are not resident or ordinarily resident in Ireland.

It is also possible for an Irish resident professional trustee to be treated by statute as non-resident where a settlor is non-domiciled, non-resident and non-ordinarily resident. In such a case the trustee should only be subject to Irish CGT on gains arising from disposals of specified Irish assets.
CAT

CAT is a beneficiary based charge to tax on gifts and inheritances currently charged at the rate of 33%.

An individual who takes a gift or an inheritance on or after 1 December 1991, is within the charge to Irish CAT if either the disponer or the beneficiary is resident or ordinarily resident in Ireland at the date of the gift or inheritance, or the assets are subject to the gift or inheritance are Irish situate assets.

Based on the above, provided the following conditions are satisfied;

(a) the settlor of the trust is not resident and not ordinarily resident in Ireland at the date of the establishment of the trust and at the date of any appointment from the trust;
(b) the beneficiaries are not Irish resident and not resident or ordinarily resident in Ireland at the date of any benefit received; and
(c) the assets in the trust are not Irish situate assets;

then the trust or any appointment out of the trust should not be subject to CAT.

Summary

An Irish proper law trust provides a viable solution as a wealth structuring vehicle for international families. The limits on statutory authority do make the quality of the drafting of settlements significantly more important. However, the fact that many of the principles in English trust law are considered to be persuasive in this jurisdiction with such cases being regularly cited, should provide significant comfort to the advisors of families looking to alternative jurisdictions.

In addition, provided a settlor is non-domiciled and non-resident and the beneficiaries are non-domiciled and non-resident with no Irish assets in the structure, the only significant tax issue to be managed is the income tax position of the trustees. In some respects, particularly to overcome the concerns of certain domestic jurisdictions which operates their own black list (based on a tax free status of certain jurisdictions) the existence of a flat income tax charge may in fact be welcomed. Alternatively, the mandating of such income to a non-resident beneficiary should address the concern.

Contacts

For further information, please refer to your usual Matheson contact or one of the following members in our Private Client Group:

Paraic Madigan
E: paraic.madigan@matheson.com
Partner, Dublin

John Gill
E: john.gill@matheson.com
Partner, Dublin

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The US – Ireland Connection
John Gill and Lydia McCormack

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The charge to Irish tax

- Liability to Irish tax depends on:
  - Residence
  - Ordinary Residence
  - Domicile
  - Situs of the Property
Tax Residence – Statutory Day Count Test

- 183 days in one year = tax resident
- 280 days over two years = tax resident
- 3 years tax resident = ordinary resident in fourth year
- 3 year non-tax resident = non-ordinarily resident in fourth year
Domicile

- Common law concept similar to the English concept of domicile
- Domicile of origin
- Domicile of choice
- Domicile of dependence
Impact of tax residence and domicile for income and gains

- Irish resident and domiciled = Worldwide income and gains
- Non-resident, Irish domiciled and ordinary resident = Worldwide income (save income from duties outside of the State) and gains
- Non-resident, non-domiciled and ordinary resident = Irish source income / gains and foreign remittances
- Neither resident nor ordinarily resident = Irish source income / gains on Irish specified assets
Impact of tax residence and domicile for income and gains

- Irish resident and non-domiciled = Irish source income and gains / foreign income and gains remitted (some exceptions) / income from an offshore structure (unless can argue the motive defence)
Attractive tax regime for non-Irish domiciled residents

- Effective estate planning prior to becoming Irish resident
- Income / gains earned prior to becoming Irish resident – can be remitted into Ireland free of Irish tax
- Remittance basis of taxation
  - Only taxed on:
    - Irish source income and gains; and
    - Income / gains (earned after becoming Irish resident and remitted)
  - Broadly not taxed on foreign income and gains not remitted into Ireland (subject to some exceptions)
Income tax and Capital Gains Tax ("CGT") anti-avoidance legislation for Irish residents

- Tax on settlor with ‘power to enjoy’ the income as it arises (section 806 of the Taxes Consolidation Act 1997 ("TCA 1997"))
- Tax on the beneficiary on receipt of income (section 807A TCA 1997)
- Tax on gains as they arise on the settlor interested structures (section 579 TCA 1997)
- Tax on beneficiaries on receipt of gains (section 579A TCA 1997) – must be resident and domiciled
- Motive Defence
Capital Acquisitions Tax ("CAT")

- Gift and inheritance tax - a tax on the beneficiary
- Charge to CAT arises:
  - If donor is resident / ordinary resident at date of gift / inheritance
  - If beneficiary is resident / ordinary resident at date of gift / inheritance
  - Gift / inheritance comprises Irish situs assets
- 5 year window for non-Irish domiciled persons (exception for US-Ireland Double Taxation Agreement 1950 ("US-Ireland DTA") on inheritances)
- Pre ’99 Trusts – Charge to CAT if settlor Irish domiciled
US-Ireland DTA: Taxes on the Estate’s of the Deceased

- US-Ireland DTA: Estate Taxes
  - Domicile of the deceased determines situs
  - Situs of asset determines which jurisdiction has taxing rights
  - Ireland does not have taxing rights in respect of non-Irish situs assets where deceased died domiciled in a US State
  - Clawback: Ireland will tax assets “situated in its territory” if the asset is not taxed in the US (other than by reason of a specific exemption) and would have otherwise taxed it, but for Article III(2)
  - Credit for CAT on Irish situs assets should be available for Federal Estate Tax
Irish Succession Law

- Succession Act 1965
- Lex domicilii / Lex situs principles
- Legal right share of the spouse
- Application for provision for children of the deceased
- EU Succession Regulation
Immigration Options

- 90 Day Stay
- Stamp 0
- Immigrant Investor Programme
- Start Up Entrepreneur Programme
- Citizenship
Case Study 1: Returning home from the US to Ireland

- George was born in Ireland and moved to the State of New Jersey as a young man.
- He first obtained a green card and then ultimately became a US citizen, living in the US most of his life.
- He has recently retired and he and his wife, who is a US citizen and domiciled in the State of New Jersey, have decided to move to Ireland for good.
- They return on 1 January 2017.
Case Study 1: Irish implications for George of returning to Ireland:

- Domicile of origin revives
- Tax resident in 2017
- Implications of George becoming Irish tax resident and Irish domiciled:
  - Worldwide income and gains
  - Gifts
  - On death
Case Study 1: New Jersey Implications for George of returning to Ireland (Phillips Nizer LLP):

- George remains subject to Worldwide US income (including capital gains), gift and GST tax
- Option to take non-resident Treaty position under US-Ireland Income Tax Treaty is not available
- George is subject to US disclosure requirements for Irish and other non-US financial accounts and investments
- George will generally be subject to US PFIC regime with regard to any investments in Irish or other non-US mutual funds or other “passive” investment entities (other than stock of most non-US publicly-traded companies)
- Same issues apply to spouse, assuming she is a US citizen
Case Study 2: US citizen moving to Ireland

- Jessica (45) is a resident of and is domiciled in the State of New York
- She has recently gone through a difficult divorce and has decided to relocate to the West of Ireland in the short term to see how she likes it
- She is financially independent and of high net worth
- Some 20 years prior, Jessica had settled a discretionary trust in the Bahamas, of which she is a beneficiary
Case Study 2: Irish implications of a US citizen moving to Ireland:

- Pre-entry planning before becoming Irish tax resident
- Remittance basis of taxation
- Immigration issues for Jessica
- Acquisition of real property
- Taxation of gifts
- Implications of her Bahamian discretionary trust: anti-avoidance provisions
Case Study 2: New York implications of a US citizen moving to Ireland (Phillips Nizer LLP):

- Generally, same points as Case Study 1 apply
- Jessica’s trust will continue to be a grantor trust for US income tax purposes
- Jessica’s trust is at substantial risk of being fully subject to US estate tax using values of trust assets on her date of death
Case Study 3: A person, domiciled in the State of New York, dies tax resident in Ireland, but not Irish domiciled

- Brad is domiciled in the State of New York and is a US citizen with a revocable lifetime trust comprising only US situs assets
- Brad dies some 7 years after becoming Irish tax resident but non-Irish domiciled
- In his personal name, Brad holds an Irish bank account, a house in Dublin (with furniture and effects) and some US shares
- Brad’s estate is below the threshold for Federal Estate Tax
Case Study 3: Irish implications of a person, domiciled in the State of New York, dying tax resident in Ireland, but not Irish domiciled

- Treatment of a revocable trust under Irish law
- Application of the US – Ireland Double Taxation with respect to taxes on the estates of deceased persons:
  - Article III(2) – Situs of Assets
  - Article IV – Exemption Relief
  - Article V – Credit Relief
  - Article III - Clawback
Case Study 3: New York implications of a person, domiciled in the State of New York, dying tax resident in Ireland, but not Irish domiciled (Phillips Nizer LLP):

- Brad’s executor must file his final US income tax return and complete US disclosure of Irish and other non-US financial accounts and investments.
- Brad is subject to US income tax on all income of revocable trust.
- If Brad did not correctly file US income tax returns and disclosure, Brad’s executor may have to consider applying for some form of US disclosure relief.
Case Study 4: Son moves to Ireland to study / work

- Richard is domiciled and resident in the State of New York. His son Robert intends to study in Trinity College, Dublin for his undergraduate degree and perhaps take up employment in Ireland thereafter.
- Richard intends to purchase a property for Robert to live in during the course of his studies.
- Richard shall open an Irish bank account to deposit funds to use to maintain the property.