KOZUSKO HARRIS DUNCAN

Washington, DC
New York, NY
New Haven, CT
Chicago, IL

U.S. TAX AND ESTATE PLANNING STRATEGIES FOR THE INTERNATIONAL FAMILY

Stanley A. Barg
Email: sbarg@kozlaw.com
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Kozusko Harris Duncan
575 Madison Ave.
New York, NY 10022

Importance of Estate and Tax Planning

- Persons subject to U.S. taxation can realize substantial savings through estate and asset planning.
- U.S. recognizes broad range of trusts and trusts play an important role in many structures.
- Particularly effective for non-U.S. persons who take professional advice before coming to or investing in the U.S.
- Also important for U.S. persons who acquire assets outside the U.S. or who have family members who reside outside the U.S. and may not be U.S. persons.

Citizens and Residents of the U.S.

- Must pay U.S. income taxes on their worldwide income.
  - Includes, *inter alia*, all interest income and capital gains derived from anywhere in the world. (Please note that, for this purpose, gain is determined by reference to historic cost basis even if the asset was acquired many years before becoming a U.S. resident.)
  - Shares owned in a foreign corporation may be subject to current U.S. tax on the pro-rata share of the corporation's undistributed earnings if the company is a controlled foreign corporation (CFC) or a passive foreign investment company (PFIC).
- Citizens – There are said to be 6 million American citizens who live outside the U.S.
- Residents for Income Tax Purposes.
  - Green Card Holders
  - Substantial Presence Test
- Treaty Tie-Breakers: An individual who is a resident of the U.S. and a country with which the U.S. has an income tax treaty that contains the necessary relief provisions, may apply these rules to determine which country can claim the individual as a resident for tax purposes.
  - Does not apply to citizens
  - Problems for Green Card Holders

Who Is A U.S. Citizen?

- Persons born in the U.S.
- Naturalized persons.
- Persons born outside the U.S. with a U.S parent in certain circumstances. Depends on:
  - Year of child's birth
  - U.S. physical presence of U.S. parent
  - Examples
    - Children born to two U.S. citizen parents are U.S. citizens
    - Children born after 12/23/52 and before 11/14/86
      - One parent is a U.S. citizen; and
      - Was physically present in the U.S. for at least 10 years prior to the child's birth (at least 5 of which were after the age of 14).
    - Children born on or after 11/14/86
      - One parent is a U.S. citizen; and
      - Was physically present in the U.S. for at least 5 years prior to child's birth (at least 2 of which were after age 14).

Immigration Status: Permanent Residence

- A foreign national who is a "lawful permanent resident" of the U.S. during a calendar year is a resident of the U.S. in that year.
- A lawful permanent resident is generally referred to as a "green card holder".
- A lawful permanent resident is one who has been granted the privilege of residing permanently in the U.S. as an immigrant. Application for a green card is not sufficient to establish residence for income tax purposes. (Compare with transfer tax.)
- Taxation applies irrespective of whether the individual has any real intention of residing in the U.S. on a permanent basis.
- Resident status is deemed to continue unless it is rescinded or administratively or judicially determined to have been abandoned.
  - Please note that one cannot merely put the card aside even if it has expired.
  - The time at which the loss of lawful permanent resident status is effective for tax purposes depends on whether the loss occurs at the initiative of the taxpayer or of the government. If initiated by the individual, the loss is effective when the application is filed with the Immigration and Naturalization Service or with a consular office. If initiated by the government, residence ends upon issuance of a final administrative or judicial order.

Substantial Presence Test

- An individual is considered a resident alien under the substantial presence test if he or she was in the U.S. 183 days or more during any calendar year.
- Resident alien status can also be established under a three-year test which counts 183 days to include:
  - each day in the current year; plus
  - during the first preceding year, 1/3 days in the U.S.; plus
  - during the second preceding year, 1/6 days in the U.S.
- General rule: to avoid resident alien status, average annual days lived in the U.S. should not exceed approximately 120 days.
- Test is based on a strict counting of the days.

Substantial Presence Test - Exemptions

- Certain individuals such as students who enter the U.S. on an F-1 visa, or other student visa are exempt from the substantial presence test for a period of time, usually five years.
- Closer connection test: One who meets the substantial presence test but who is physically present in the U.S. for fewer than 183 days in one calendar year and who has a "tax home" outside the U.S. for the entire year can avoid U.S. residence by establishing a closer connection with another country.
  - No individual who has taken steps toward applying for a green card can maintain a "closer connection" with a foreign country.
  - Both the closer connection to the foreign country and the foreign tax home must be maintained during the entire year.
  - The Regulations permit a foreign individual to have a closer connection to 2 foreign countries (but not more) if a tax home is maintained in one of the 2 countries at all times during the year, and if the individual changes the tax home only once during the year, has at all times a closer connection to the country of each tax home than to the U.S., and is subject to tax as a resident in each of the 2 foreign countries at least during the time the tax home is maintained there.
- Use of treaties.

Liability for Estate and Gift Taxes

- U.S. Citizens and those deemed "resident" in the U.S. for Estate and Gift Tax Purposes are subject to a complex tax regime on worldwide assets.
- Residency for Estate and Gift Tax purposes is based upon domicile.
  - Distinct from "substantial presence" and Green Card analysis for Income Tax purposes. Domicile: where one lives with the intent to remain.
  - Green Card holders are generally presumed to be residents, but can, under limited circumstances, rebut the presumption based upon "intention."
  - Similarly, although one with a temporary visa is generally not considered a U.S. domiciliary, under certain circumstances, courts have held that temporary visa holders demonstrating intent to remain might be domiciliaries for Estate and Gift Tax purposes.

Liability for U.S. Estate and Gift Tax Non-U.S. Situs Property

- Non-U.S. situs property includes:
  - Non-U.S. real estate
  - Non-U.S. corporate shares
  - Tangible Property located outside of U.S. (including certain works of art located within the U.S. at death)
  - Bank deposits (including those located in U.S.)
  - Debt obligations issued by non-U.S. persons
  - "Intangible personal property the written evidence of which is not treated as being the property itself, if it is not issued by or enforceable against a resident of the United States or a domestic corporation or governmental unit"
  - Life insurance proceeds on life of Non-U.S. person

Liability for U.S. Estate and Gift Tax U.S. Situs Property

- U.S. situs" property includes:
  - Real property located in the U.S. and tangible property located in the U.S. (except certain works of art on loan for exhibition)
  - Shares of stock issued by a U.S. corporation, regardless of where the certificates are physically located
    - ***NOTE*** that gifts of shares of stock of U.S. corporations are free from gift tax (but not estate tax)
  - Debt obligations issued by U.S. persons (including U.S. governmental agencies), except for: (a) "Portfolio Debt" Obligations; & (b) Certain short-term debt obligations
  - Deposits in U.S. banks that generate interest income *effectively connected with a U.S. trade or business*
  - Assets owned in trust where (a) trust is considered includible in taxpayer's gross estate for U.S. estate tax purposes (e.g., revocable trusts) and (b) assets contributed to trust were originally U.S. situs – i.e., assets tainted by "tracing"

Foreign Investment in U.S. Real Estate

- Over the past several years, exponential increase of foreign investment in US real estate market.
- Haven from more volatile share prices.
- Important domestic US effect in the moderation of long term interest rates (National Association of Realtors).
- On January 13, 2016 the Financial Crimes Enforcement Network (FinCEN) issued a Geographic Targeting Order (GTO) directed at US title insurance companies requiring them, for a temporary period (from March 1, 2016 until August 27, 2016), to identify the "beneficial owners" behind any legal entity that is used to purchase high-end residential real estate in Manhattan and Miami-Dade County on an "all cash" basis.
  - Applies if the purchase price is $1million or more in Miami-Dade County and $3 million or more in Manhattan.

Tax Entity Alternatives

- Individual Ownership
- Partnerships
- Corporations
- Trusts
- Debt

The Use of Trusts

- Important part of estate plan for virtually every person of means
  - Control
  - Privacy
  - Asset protection
  - Tax efficiency

Grantor Trusts

- Trust assets treated as owned by the foreign grantor and not subject to U.S. tax unless U.S. source.
- The Internal Revenue Service Office of Chief Counsel in a chief counsel advice memorandum said that grantor trusts are disregarded as entities separate from their owners for all federal income tax purposes. CCA 201343021 released November 1, 2013
  - "The Service position of treating the owner of an entire trust as the owner of the trust's assets is consistent with and supported by the rationale for attributing items of income, deduction, and credit to the owner. Accordingly, we conclude that a trust that is treated as a grantor trust is ignored as a separate entity apart from the owner for all federal income tax purposes…"
- Need to identify the "Grantor"
  - Distinguished from the Settlor
  - Multiple contributors to the trust
  - Trusts that fund other trusts

Grantor Trusts with Foreign Grantors

- General rule: A trust (foreign or domestic) is treated as a grantor trust only if the person deemed to own the trust is a US citizen or resident or a domestic corporation.
- Designed to preclude the use of the grantor trust rules to eliminate all US income taxation on foreign-source income of a foreign grantor trust distributed to US beneficiaries
- Exceptions:
  - Revocable Trusts
    - Problems for trusts which were once non-grantor trusts
  - Irrevocable Trusts Benefiting Only the Grantor and/or the Grantor's Spouse
  - Grandfather rule

Tax Implications of Non-grantor Trusts

- Trust treated as owner of trust assets and not subject to US tax unless U.S. source
- Distributions to U.S. beneficiaries will carry out income:
  - To the extent distributions from DNI the retain the character of income (DNI is current year income)
  - To the extent distributions exceed DNI, FAI and trust has UNI, income is deemed ordinary and subject to interest charge ("Throwback rules")
    - UNI is income from prior years that has not been distributed
    - FAI is fiduciary accounting income

Mitigation of Throwback Tax

- Isolate Tainted Income with Cleansing Distribution
  - A wholly discretionary trust that makes a distribution to a foreign person carries out income of the distributing trust. The distribution could be to a foreign trust.
  - A distribution to a U.S. beneficiary in a subsequent year will not carry out income of the trust if all income has been "stripped" by the distributions to foreign persons in prior years.
- Distribution of no more than current income in any year
- Use of Default Method
- Life Insurance Products
- Sale of a beneficial interest in the trust
- Domestication
- Fiduciary Accounting Income Limitations: No accumulation distribution is deemed to have occurred if the total trust distributions do not exceed the year's fiduciary accounting income. Code § 665(b)
- Resettlement to a new (grantor) trust using a general power of appointment
  - Distinguish from use of a distribution or pour-over. The powerholder is the grantor of a trust funded by using general power of appointment. Reg. §1.671-2(e)(5).

Expatriations

- According to U.S. Treasury reports, 4,279 individuals, a record number, expatriated in 2015. The compares to 3415 in 2014 and 2,999 in 2013 which were also both records.
- According to a July 14, 2014 survey released by the deVere Group, the increased desire to expatriate has been as a result of FATCA making it difficult to bank overseas and a belief that they are under suspicion by the IRS.

Expatriation

- Applies a mark-to-market rule (i.e., exit tax) under which covered expatriates are treated as having sold all property for fair market value.
- Trustees of nongrantor trusts must withhold 30% on any distribution made to a covered expatriate.
- Estate or gift tax is imposed on the receipt of bequests and gifts from a covered expatriate. Also applies to transfers in trust.

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