Estate Planning for Non-U.S. Citizens

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GE-96150 07/14 (Exp. 07/16)

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Agenda

- Basic Rules
  - Determination of Residency for Estate Tax purposes
  - Tax Rules
  - Estate and Gift Tax Treaties
  - Asset Situs Rules
  - Taxation of Life Insurance and Annuities held by Non-US citizen
- Planning Strategies
  - Gifting
  - Joint Tenant Property Rules
  - Foreign Death Tax Credit
- Using Qualified Domestic Trusts (QDOTs)
  - QDOTs
  - Alternative to QDOT

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Basic Rules

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Determining Residency

- Resident Alien Status
  - U.S. income tax imposed on worldwide income
  - US estate tax imposed on worldwide assets
- Nonresident Alien Status
  - US income tax imposed only on income from the US
  - US estate tax imposed on assets domiciled in the US or tangible property in the US
- **Country of Domicile**—a “facts and circumstances” test
- One can be a nonresident alien for income tax purposes, but not for estate tax purposes. Reverse could be true as well.

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Who is a Resident?

- Income Tax rules
  - Residency Test
    - Green card test
    - Substantial presence test
- Estate Tax rules
  - Common law test of domicile
    - At time of death, domicile is the United States
    - No definite present intention from moving

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Basic Gift and Estate Transfer Tax Rules

Decedent/ Surviving Spouse	Unified Credit	Est. Tax Marital Deduction	Gift Tax Marital Deduction	Gift Tax Exclusion ($14,000)	Gift Splitting
US Citizen/ US Citizen	$5,340,000 (2014)	Unlimited	Unlimited	Yes	Yes
US Citizen/ Resident Alien	$5,340,000 (2014)	Yes, with QDOT	$145,000 (2014)	Yes	Yes
US Citizen/ Nonresident Alien	$5,340,000 (2014)	Yes, with QDOT	$145,000 (2014)	Yes	No
Resident Alien/ US Citizen	$5,340,000 (2014)	Unlimited	Unlimited	Yes	Yes
Resident Alien/ Resident Alien	$5,340,000 (2014)	Yes, with QDOT	$145,000 (2014)	Yes	Yes
Resident Alien/ Nonresident Alien	$5,340,000 (2014)	Yes, with QDOT	$145,000 (2014)	Yes	No
Nonresident Alien/ US Citizen	$60,000	Unlimited	Unlimited	Yes	No
Nonresident/Alien/ Resident Alien	$60,000	Yes with QDOT	$145,000 (2014)	Yes	No
Nonresident Alien/ Nonresident Alien	$60,000	Yes with QDOT	$145,000 (2014)	Yes	No

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U.S. Estate and Gift Tax Treaties

- Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, The Netherlands, Norway, South Africa, Switzerland and the United Kingdom
- For non-U.S. citizens, a treaty may change the rules regarding domicile, residency and the location of assets in an effort to limit double taxation of assets
- Client should engage legal counsel that has experience in advising clients as to the applicability of treaty rules in estate planning for non-U.S. citizens plus has experience with estate, gift and inheritance tax issues in the client's other country of residency

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Non Resident Aliens

- The situs rules for Estate Tax and Gift Tax are *not* the same for purposes of determining a non resident alien (NRA) tax liability
  - This disjunction provides for both confusion and planning leverage

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Gift tax vs Estate Tax for NRAs

	Gift Taxable	Estate Taxable
US Stocks	No	Yes
Cash	Yes, but cash contributed to an irrev trust - No	Yes
Bank Deposits (US Bank)	Yes	No
Life Insurance	Probably	No
Bonds	No	Generally, No
US Real Estate	Yes	Yes

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Example

Korean client, who is a nonresident for transfer tax purposes, inquires about making gifts to his daughter, a US resident. What are the tax issues involved in making gifts?

- Father buys a $50,000 sapphire necklace in Korea, and then gives it to his daughter at dinner in LA. Subject to gift tax?
- Father withdraws $20,000 in cash in Santa Barbara, and gives it to daughter at the beach. Subject to gift tax?
- Father withdraws $20,000 in cash from an ATM on the way to LAX, flies back to Korea with daughter and then gives it to daughter. Subject to gift tax?

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Life Insurance and Annuities Estate Taxation

- Life Insurance
  - Resident alien—death benefit included in estate
  - Nonresident alien Insured
    - Estate tax free death benefit
    - Requirement--insured owns the policy
  - If owned by another…
    - Not covered by the exception
  - Planning opportunity—could provide estate liquidity for NRA holding U.S. situs assets at death

- Annuities
  - Resident alien—cash value included in estate
  - Owned by a nonresident annuitant
    - If it is an annuity issued by a US based company—included for estate tax purposes

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Estate Planning Strategies

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Gifting During Lifetime

- Annual Exclusion Gifts
- Gift splitting under certain circumstances
  - Nonresident aliens do not qualify for gift splitting
  - Community property state—gift of one-half interest, no need to gift split
- Inter-Spousal Annual Gift Tax Exclusion
  - $145,000 for 2014
- Gift Tax Applicable Exemption Amount
  - Resident Alien---$5.34 million
  - Nonresident Alien---$60,000
- Minority Interest Gifts
  - FLLC or FLP shares
  - Minority interest valuation discount

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Joint Tenant Property

- Not a U.S. citizen
  - the entire value of the joint tenant property is included in the deceased spouse's estate unless the surviving spouse can establish contributions toward the purchase of the property
  - In a community property state—only one-half of the property value is included in accordance with state property law

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Foreign Death Tax Credit

- Resident Alien—available
- Nonresident alien--unavailable

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USING QUALIFIED DOMESTIC TRUSTS TO TRANSFER ASSETS TO THE SURVIVING SPOUSE

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Married to a Nonresident/Resident Alien

- Gross Estate
  - Surviving spouse must be a U.S. Citizen at date of death
    - If not, no marital deduction
      - **Must pay taxes due**
    - Unless Qualified Domestic Trust (QDOT)
      - **If surviving spouse becomes a US citizen prior to the federal estate tax return and remains a US resident, then do not need a QDOT**

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QDOT requirements

- Who can create?
  - Executor
  - Surviving spouse
  - Decedent
- Must elect
  - AND meet tests for marital deduction
- Trust must be maintained under the laws of a state of the US or D.C.
- Control Test
  - U.S. person have authority to control all substantial decisions of the trust
  - At least one trustee must be a U.S. person
- Security Requirements
  - Large QDOT (over $2 million)
  - Small QDOT ($2 million or less)

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QDOT

- What if no QDOT exists in the estate plan?
  - Trust can be reformed to meet requirements of QDOT
    - May require local court approval
  - Surviving spouse takes property that is not in trust and transfers or irrevocably assigns property to QDOT
  - Plan would have otherwise qualified for marital deduction

AND

  - Executor makes a timely QDOT election

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QDOT Example

Mexican citizen client holds a green card. He has a ranch in Texas. It is in his own name. His wife is also a legal permanent resident, as are his children.

The ranch is valued at $15 million. He wants the property to pass to his wife and his children. How to solve?

A QDOT. Without a QDOT, there is an estate tax due

What happens at the death of the surviving spouse?

Estate tax will be due.

How do you cover the estate tax bill?

Insurance can be used as a wealth replacement tool, but note that this client holds a green card, it may be includible in his estate, unless an ILIT is used.

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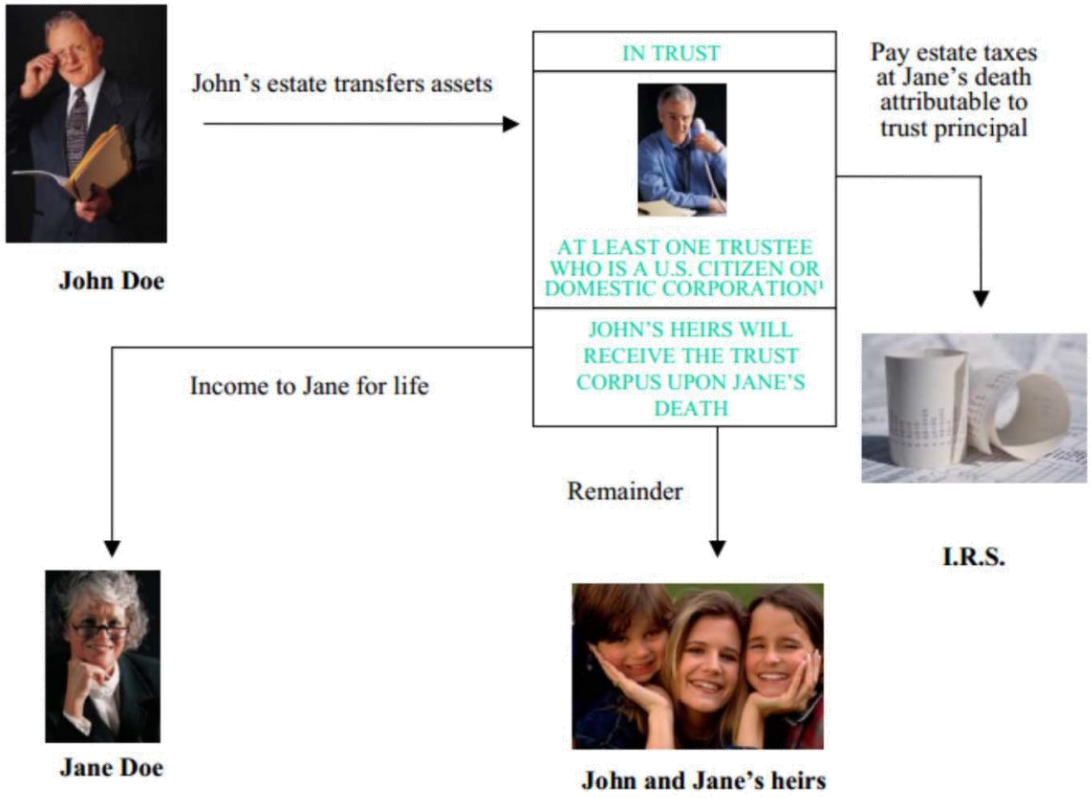
QDOT Illustrated



This graphic overview of a Qualified Domestic Trust (QDOT) is based on our general understanding of the subject matter is for informational purposes only. The subject matter can be complex and you should consult with your own legal and tax advisors regarding your individual circumstances.

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QDOT Alternative

- Spousal Lifetime Access Trust
  - Funded with a single life policy on the grantor's life
  - Trustee should probably not be the noncitizen spouse
  - Can use present interest gifts for non-spousal beneficiaries
  - Can use annual marital gift for spouse—currently at $145,000 per year
  - Spouse and other beneficiaries can receive income and principal under the trust terms
  - Can also use a "plain vanilla" irrevocable life insurance trust

Avoids QDOT restrictions

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Questions

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Presenters Matt O'Kane, Esquire

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Date: May 19, 2015

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2015 Gift and Estate Transfer Tax Rules

Decedent/ Surviving Spouse	Unified Credit	Est. Tax Marital Deduction	Gift Tax Marital Deduction	Gift Tax Exclusion ($14,000)	Gift Splitting
US Citizen/ US Citizen	$5,430,000 (2015)	Unlimited	Unlimited	Yes	Yes
US Citizen/ Resident Alien	$5,430,000 (2015)	Yes, with QDOT	$147,000 (2015)	Yes	Yes
US Citizen/ Nonresident Alien	$5,430,000 (2015)	Yes, with QDOT	$147,000 (2015)	Yes	No
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Resident Alien/ Nonresident Alien	$5,430,000 (2015)	Yes, with QDOT	$147,000 (2015)	Yes	No
Nonresident Alien/ US Citizen	$60,000	Unlimited	Unlimited	Yes	No

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Alternative Investment Structures for Nonresidents

1. Nonresident Individual Direct Ownership
   a. Liability Exposure
   b. Disclosure/filing individual tax returns
   c. Gift and Estate Tax
   d. Income Tax
   e. FIRPTA

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Alternative Investment Structures for Nonresidents

2. Nonresident Individual Investment through Disregarded Entity – Single Member LLC/Revocable Trust
   a. Liability Exposure
   b. Disclosure/filing individual tax returns
   c. Gift and Estate Tax
   d. Income Tax
   e. FIRPTA

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Alternative Investment Structures for Nonresidents

3. Nonresident Individual Investment through Foreign Corporation Ownership
   a. Liability Exposure
   b. Disclosure/filing individual tax returns
   c. Gift and Estate Tax
   d. Income Tax
   e. FIRPTA

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Alternative Investment Structures for Nonresidents

4. Nonresident Individual Investment through U.S. Corporation Ownership
   a. Liability Exposure
   b. Disclosure/filing individual tax returns
   c. Gift and Estate Tax
   d. Income Tax
   e. FIRPTA

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Alternative Investment Structures for Nonresidents

5. Nonresident Individual Investment through Foreign Corporation with U.S. Subsidiary
   a. Liability Exposure
   b. Disclosure/filing individual tax returns
   c. Gift and Estate Tax
   d. Income Tax
   e. FIRPTA

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Alternative Investment Structures for Nonresidents

6. Nonresident Individual Investment through Foreign Partnership
   a. Liability Exposure
   b. Disclosure/filing individual tax returns
   c. Gift and Estate Tax
   d. Income Tax
   e. FIRPTA

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Alternative Investment Structures for Nonresidents

7. Nonresident Individual Investment through U.S. Partnership
   a. Liability Exposure
   b. Disclosure/filing individual tax returns
   c. Gift and Estate Tax
   d. Income Tax
   e. FIRPTA

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Alternative Investment Structures for Nonresidents

8. Nonresident Individual Investment through Trust
   a. Liability Exposure
   b. Disclosure/filing individual tax returns
   c. Gift and Estate Tax
   d. Income Tax
   e. FIRPTA

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