

# Life in Another World:

Inbound Foreigners and Outbound Americans

LOMA / LIMRA

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### **OVERVIEW**

- I. Case Study
- II. U.S. Income and Transfer Taxes: Citizens and Residents
- III. Income Taxation of U.S. Persons and Nonresident Aliens
- IV. Transfer Taxation of U.S. Citizens / Domiciliaries and Noncitizen Nondomiciliaries
- V. Situs Rules for Transfer Taxes (and General Income Tax Rules)
- VI. Life Insurance
- VII. Reporting Obligations
- VIII. Expatriation



CASE STUDY

# Case Study

Pam

Wife – Australian Citizen U.S. Green Card Holder

<u>Bob</u>

Husband – Australian Citizen

#### 1 Child

Australian Citizen (Previous Marriage)

### 3 Children

Dual U.S./Australian Citizens

#### Facts

- Live in Australia majority of year.
- Spend between 100 and 150 days per year in U.S.

### Joint Assets

- U.S. and Australian Real Estate (U.S. Vacation Home)
- U.S. and Australian Brokerage Accounts
  - Australian Accounts hold some U.S. Securities
- Australian Bank Accounts

### Pam's Assets

- Australian superannuation fund
- Australian Bank Account

#### Bob's Assets

- Shares of Australian Company
- Australian Bank Account



### Scope of U.S. Taxes

- U.S. citizens and U.S. residents are subject to income tax on their worldwide income.
- U.S. citizens and U.S. residents are subject to transfer (i.e., gift, estate, and generation-skipping transfer) tax on their worldwide assets.
- However, the definition of a U.S. resident is very different for income tax purposes than for estate and gift tax purposes.
  - For example, it is possible for a person at his death to be a U.S. resident for income tax purposes but not a U.S. resident for estate tax purposes.

# Tax Residency Definition (U.S. Income Tax)

### Residency for *Income* Tax Purposes: General Rules

- Green card holder (lawful permanent resident)
- "Substantial presence test" Section 7701(b)(3)
  - Basic Test: 183 days in U.S. in current year, OR
  - Lookback Test:
    - Present in U.S. more than 30 days during the calendar year, and
    - Total of 183 "weighted" days in the U.S. over three calendar years, calculated as follows:

      Days in current year (if at least 31) + 1/3 of days in the first preceding year + 1/6 of the days in the second preceding year
  - **Practice Tip:** Stay below 122 days per year!
- First year election
  - Individuals must wait until July 3 (after the 183rd day) in the year following their first year in the U.S. to opt in to being a resident for that year if they otherwise would not qualify. Therefore, individuals should file an extension or an amended return electing residency on or after July 3.

# Tax Residency Definition (U.S. Income Tax)

# Residency for *Income* Tax Purposes: Exceptions to the Substantial Presence Test

- Exempt individuals
  - Foreign government-related individuals (A or G visas, other than A-3 or G-5)
  - Teachers or trainees (J or Q visas)
  - Students (F, J, M, or Q visas)
  - Professional athletes in the U.S. for a charitable event
- Medical exception for counting days
- "Closer Connection" Exception
  - Present in U.S. for less than 183 days in a given year AND can establish a tax home (i.e., a closer connection) in another country
  - Some treaties make the exception available to individuals that spend more than 183 days in the U.S. in a year
    - The exception is generally contained in the Residency article of treaties. These provisions generally look first to the location of the individual's permanent home or center of vital interests, and then to the place where the individual maintains a habitual abode, and finally to citizenship.

## Tax Residency Definition (U.S. Income Tax)

### Residency for *Income* Tax Purposes: Additional Considerations

- If "closer connection" is not available, may consider being a "treaty nonresident" under "tie-breaker" rules
  - May still have reporting obligations on all income, except Forms 8938 (Statement of Specified Foreign Financial Assets) & 8621 (Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund)
  - Could trigger expatriation with potential exit tax
- Review state and local rules to determine residency in those jurisdictions.

# Tax Residency Definition (U.S. Transfer Tax)

### Residency for *Transfer* Tax Purposes

- Any noncitizen whose "domicile" is in the U.S.
  - There is no bright-line rule akin to the substantial presence test for determining domicile.
  - Rather, an individual is a U.S. domiciliary if she maintains her home there, always returns to that home, and intends to remain in the U.S. indefinitely.
- To determine whether someone is a U.S. domiciliary, look at all the facts and circumstances that speak to those determinations, including the individual's:
  - Visa status obtaining a green card is a strong factor suggesting intent to remain indefinitely, but visa status (immigrant versus non-immigrant) is *only one factor* in domicile determination;
  - Time spent in the U.S. compared with time spent in other possible domicile;
  - Location of family, friends, business activities, doctors, accountants, etc.;
  - Characteristics of residences (e.g., relative size, whether maintained for year-round living, whether items "near and dear" are kept there);
  - Location of social, professional, religious affiliations, and other community connections (e.g., where does the person vote); and
  - Declarations of intent in legal documents

# Tax Residency Definition (U.S. Transfer Tax)

### Residency for *Transfer* Tax Purposes

- Once an individual establishes a domicile, the individual remains a domiciliary of that jurisdiction until a new domicile is established.
- An individual can have only one domicile, though different countries may define domicile differently.
- Review state rules to determine whether an individual is domiciled in a particular state.

# Case Study

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U.S. Green Card Holder

<u>Bob</u>

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3 Children

Australian Citizen Dual U.S./Australian Citizens

(Previous Marriage)

#### **Facts**

- Live in Australia majority of year.
- Spend between 100 and 150 days per year in U.S.

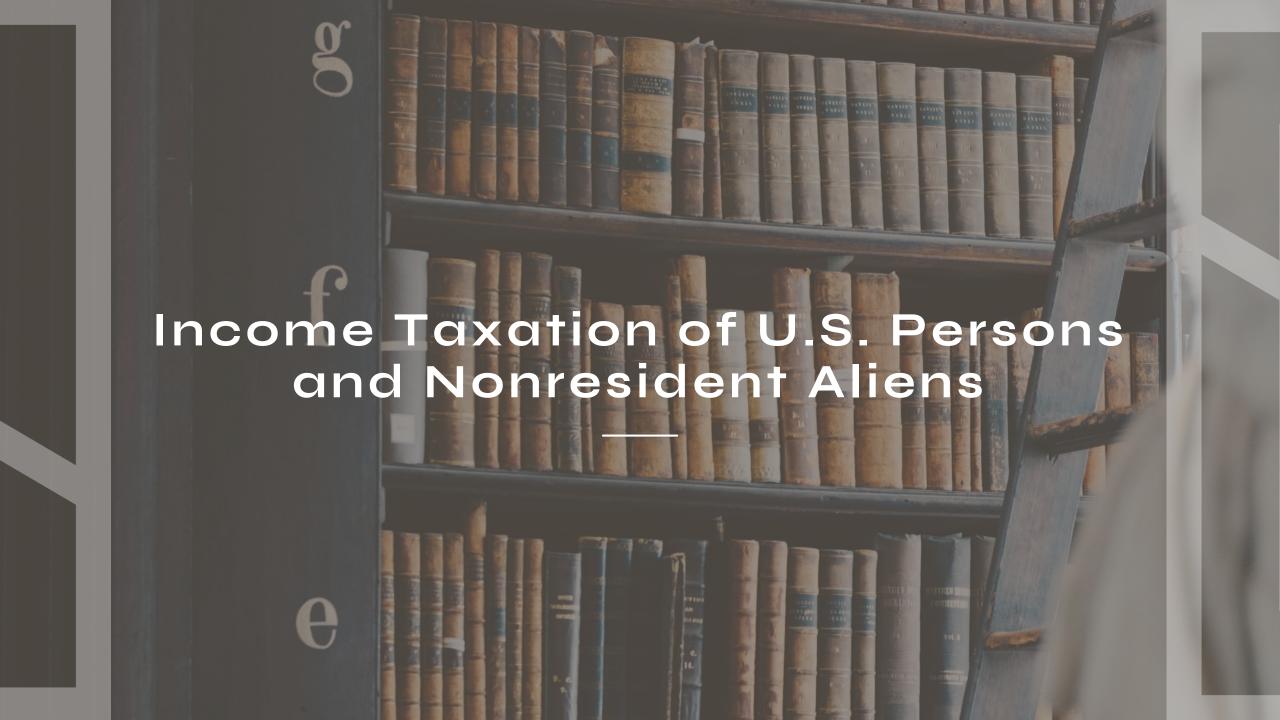
### **U.S. Tax Status**

### **Pam**

- Income Tax
  - U.S. Green card holder, so taxable on worldwide income, absent taking any other action. Would receive foreign tax credits for any tax paid while living in Australia.
  - Consider giving up green card, BUT beware U.S. exit tax rules.
  - Similarly, taking treaty nonresident position could risk imposition of U.S. exit tax rules.
  - We will assume U.S. resident.
- Estate Tax
  - U.S. may presume domiciled in U.S. given green card, but other subjective factors may support Australian domicile.
     Must examine all factors.
  - We will assume U.S. domicile.

#### Bob

- Income Tax
  - Exact number of days in U.S. matter if Bob was in the U.S. fewer than 183 days and kept his tax home in Australia, he could "closer connect."
  - Otherwise, can try to take advantage of the treaty provision that allows for "closer connect" even if in U.S. more than 183 days.
    - Article 4(2) of the Australia/U.S. treaty and looks first to permanent home, then habitual abode, and then to personal and economic relations if the individual has a habitual abode in both States and is a citizen of one State.
  - We will assume he is not a U.S. resident.
- Estate Tax
  - Must examine all factors. We will assume not U.S.



### Income Taxation of U.S. Persons

### Reminder

- U.S. Persons for income tax purposes are:
  - U.S. citizens;
  - Green Card holders;
  - Residents under Substantial Presence Test; and
  - Individuals making First Year Election.
- Also, always consider applicable exceptions and applicable treaties.

### Income Taxation of U.S. Persons

### U.S. persons are taxed on worldwide income

- Ordinary income is now taxed at graduated rates up to 37%
  - The non-wage portion of "pass-through" income earned by an eligible taxpayer from a qualified trade or business may qualify for a 20% deduction.
- Long-term capital gains and qualified dividends generally taxed at 20% rate
- Net investment income of individuals with modified adjusted gross income over \$200,000 subject to 3.8% Medicare tax
- State and local taxes may also be imposed on worldwide income

## Income Taxation of Nonresident Aliens ("NRAs")

NRAs are subject to U.S. federal tax only on the following types of income:

- Fixed, Determinable, Annual, or Periodical ("FDAP") income
  - Generally U.S.-source dividends, interest, rents, royalties and other portfolio income, as well as certain types of services income).
- Income that is effectively connected with the conduct of a U.S. trade or business ("effectively connected income" or "ECI")
  - Engaged in a U.S. trade or business if economic activity is considerable, continuous, and regular.
  - Personal services can constitute a U.S. trade or business if NRA is in U.S. more than 90 days and receives over \$3,000
  - ECI from a qualified trade or business potentially may be eligible for the 20% pass-through deduction.
- FDAP income is subject to 30% withholding at the source on a gross basis with no offsetting deductions.
- ECI income is taxed at graduated rates of up to 37%.
- Review state and local taxes to determine their applicability.

# Income Taxation of Nonresident Aliens ("NRAs")

### Additional Points of Note for U.S. Income Tax Treatment of NRAs

- Not subject to 3.8 percent Medicare tax on net investment income.
- Some categories of income are exempt from U.S. income tax.
  - "Portfolio Interest" corporate and government bonds, interest on bank deposits. Section 871(h)
  - ECI not attributable to a permanent establishment in the U.S.
  - Capital gains generally, except:
    - 183 Day Rule any NRA present in U.S. for 183 days (including those otherwise exempt) is taxable on gains from sale of personal property (unless one of the residency exceptions is available); an exception may be available if the person can claim a "tax home" outside the U.S. during the tax year.
    - U.S. Real Property
      - Gains are taxable as ECI under the Foreign Investment in Real Property Act ("FIRPTA"), and FIRPTA triggers withholding unless an exception applies or a transfer certificate is received.
      - All or a portion of the gains may be excludable if the property is the NRA's principal residence. Under Section 121, NRA can elect or otherwise qualify to apply the home sale exclusion of \$250,000 (per person, up to \$500,000 for married couples).
      - Reduced long term capital gains rate of 20% may be available.
- Interest, dividends, royalties may qualify for reduced rates under tax treaties

### Income Taxation of U.S. Persons

### U.S. Persons' Foreign Pensions

Grantor trust vs nonexempt employee trust under Section 402(b)(3) & Treas. Reg. 1.402(b)-1(b)(6)

- Nonexempt employee trust where employer makes more than 50% of contributions
- Employee's contributions cannot be "incidental" compared to employer's
- Pre-tax contributions by employee count as employer contributions
  - **Practice Tip**: Employer contributions and pre-tax employee contributions are includable in income each year for the individual.
- Discriminatory plan: must meet requirements of Section 401(a)(26) or Section 410(b)
  - Generally, in order to not be considered discriminatory, the plan must include enough U.S. citizens or non-resident aliens with U.S. source income.
- Highly-compensated employee: if highly compensated i.e. salary >\$125,000 for 2019 then taxed on vested accrued benefit annually

### **Grantor Trust**

• Beware potential passive foreign investment company (PFIC) issues for underlying investments (e.g., foreign mutual funds)

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Husband – Australian Citizen

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Australian Citizen (Previous Marriage)

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#### **U.S. Income Tax**

#### Pam (U.S. resident for income tax purposes)

- Worldwide income.
- Taxation of superannuation fund?

### Bob (Nonresident alien for income tax purposes)

- Not subject to U.S. tax unless earns income in the U.S.
- What about income from U.S. real estate jointly owned with his wife? Withholding?
- Dividends from U.S. equities withholding reduced to 15% by U.S.-Australia Tax Treaty.

#### Joint Assets

- U.S. and Australian Real Estate (U.S. Vacation Home)
- U.S. and Australian Brokerage Accounts
  - Australian Accounts hold some U.S. Securities
- Australian Bank Accounts

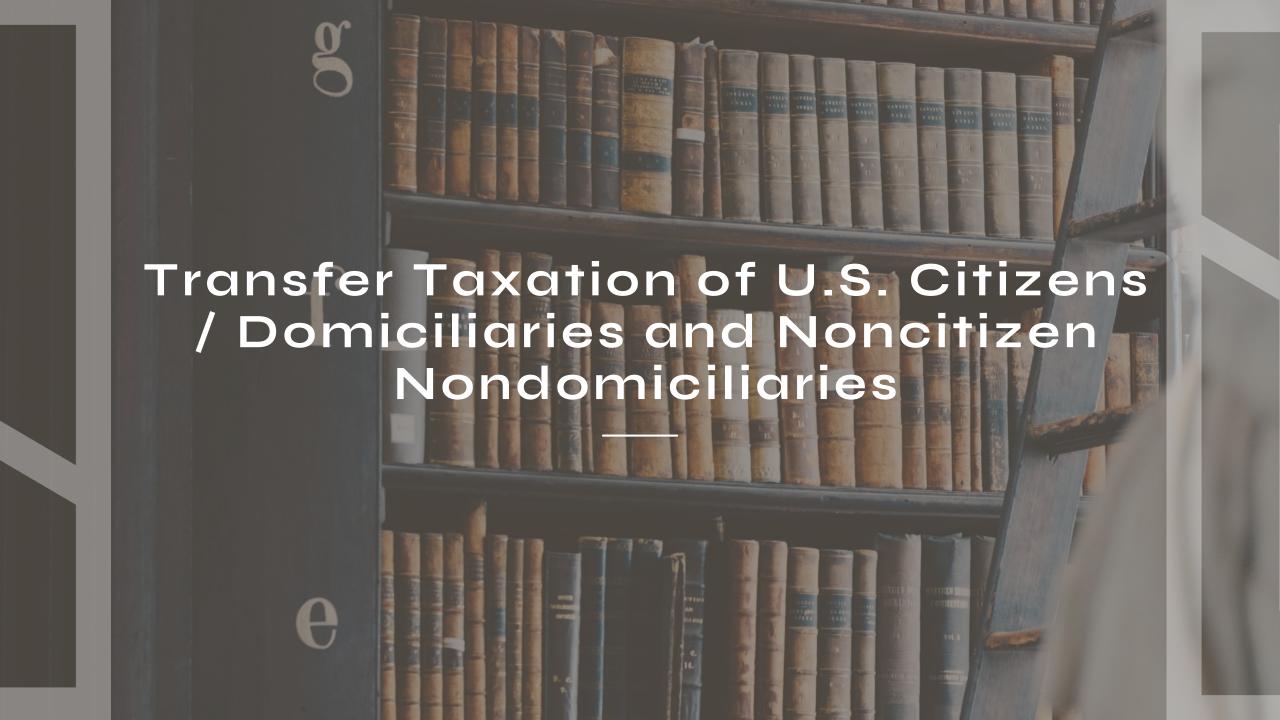
#### Pam's Assets

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#### Bob's Assets

- Shares of Australian Company P. 19
- Australian Bank Account

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## Assets Subject to U.S. Transfer Taxes

	For Citizens / Domiciliaries,	For Noncitizen Nondomiciliaries,
gift tax is imposed on	worldwide assets.	tangible U.S. situs property (real and personal).
estate tax is imposed on	worldwide assets.	U.S. situs property (including tangible and intangible U.S. situs property (e.g., stock in a U.S. corporation)).

Generation-skipping transfer taxes are imposed consistent with the type of transfer (i.e., gift or bequest).

### Gift Taxation

### Gift Taxation of U.S. Citizens / Domiciliaries:

- Each individual can annually give \$17,000 (in 2023) to any other individual, no matter whether that individual is a U.S. citizen or U.S. resident under any definition.
- On top of that, each individual has a single lifetime credit against the gift and estate taxes that is equivalent to a lifetime exemption of \$12.92 million in 2023 (up from ~\$5.6 million in 2017)
  - To the extent this credit is used on lifetime gifts, it is not available at death.
  - Under present law, the credit amount reverts to closer to \$5/6 million in 2026.
- An unlimited marital deduction, only if spouse is a U.S. <u>citizen</u>; if spouse is only a U.S. domiciliary, it is not available.
- Otherwise, there is a \$175,000 (in 2023) annual exclusion (total not additive to the \$17,000)
- Most states and local governments do not impose gift tax.

### Gift Taxation

### Gift Taxation of Noncitizen Nondomiciliaries (NCNDs):

- NCNDs are subject to gift tax of up to 40% on gifts of real and tangible personal property situated in the U.S.
- Gifts of intangible property are not subject to gift tax.
  - **Practice Tip** Gifts of disregarded entity LLC interests are likely considered a gift of the underlying property owned by the LLC. *But see Pierre v. Commissioner, T.C. Memo. 2010-106*.
- Therefore, the primary strategy for NCNDs to avoid U.S. gift tax is to gift intangible property.
- **Practice Tip** Gifts of cash from non-U.S. person to U.S. persons should be made from non-U.S. account of donor or via a similar non-U.S. situs cash equivalent asset (e.g., T-Bills).
  - Because cash is tangible, gifts of cash may be subject to gift tax if transferred from U.S. account, as that cash is situated in the U.S.
- **Practice Tip** Reporting is required by U.S. recipient of gifts exceeding the applicable filing threshold (even if the gift is of non-U.S. situs property).
- Most states and local governments do not impose gift tax.

### Gift Taxation of Gifts to Spouse

#### Amount can gift without triggering U.S. gift tax

	To spouse who is		
		U.S. citizen	Noncitizen
From spouse who is	U.S. citizen / domiciliary	Unlimited	\$175,000 annually (of any assets)
	NCND	Unlimited (but check local country gift tax rules)	Unlimited non-U.S. situs assets and \$175,000 annually of U.S. situs assets

### **Practice Tip** – Beware Transfer to Spouse Recast as Gift

- Section 1041 Non-recognition Treatment
  - Section 1041 provides non-recognition treatment for transfers between spouses. It covers transfers of property intended as gifts, and sales or exchanges of property between spouses acting at arm's length (Temp. Reg. §1.1041-1T(a) Q&A 2).
  - Transfers of property to a spouse who is a nonresident alien (an "NRA") are not subject to the non-recognition rule of Section 1041. However, Section 1041 does apply to transfers from an NRA to the spouse of the NRA who is a United States person. Section 1041 applies when an NRA spouse transfers property to a spouse that is a U.S. person, and the U.S. spouse would then take a carry-over basis in the transferred property.
- Avoiding 1041
  - Section 1041 can be avoided if the transfer is made by a third party. Section 1041 does not apply to transfers to a spouse from an entity, even if it is wholly-owned or controlled by the other spouse. As a result, a sale of property by a corporation that is owned by one individual to that individual's spouse is not subject to non-recognition under Section 1041 (Temp. Reg. §1.1041-1T(a) Q&A 2, Example (3)).
  - It is important to note that the temporary regulation emphasizes that while a sale between one spouse and a corporation owned by the other spouse will be respected for purposes of Section 1041, the step transaction doctrine could apply if the transfer is not a bona fide sale.

# Case Study

Wife – Australian Citizen
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Husband – Australian Citizen

1 Child
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Dual U.S./Australian Citizens
(Previous Marriage)

### **U.S. Gift Tax Implications**

- Transfers from Pam (U.S. domiciliary) to Bob (NCND)
  - Annual exclusion of \$175,000.
  - Transfers in excess of \$175,000 will use lifetime exemption amount.
- Transfers from Bob (NCND) to Pam (U.S. domiciliary)
  - No U.S. gift tax consequences, unless transfer is of U.S. real property or U.S. tangible property.
  - If impossible to avoid such a transfer, note that unlimited marital deduction not available.
  - Will want to check treaty to evaluate whether afforded any benefits.
- Consider: transfers into and out of joint bank accounts?

### Estate Taxation of U.S. Citizens and Domiciliaries

- US citizens and domiciliaries are subject to estate tax on 40% of their worldwide assets, wherever situated.
  - Credits may be available if property subject to tax by other jurisdictions.
- Exemption available is portion of \$12.92 million (2023) leftover after lifetime gifts.
- Unlimited deductions for bequests to
  - U.S. citizen spouse
  - Charities
- May also be subject to state estate tax, and beneficiaries may be subject to state inheritance tax.
  - Maryland imposes inheritance tax on bequests to nieces and nephews, among others.

### Estate Taxation of Noncitizen Nondomiciliaries

- NCNDs are subject to the U.S. estate tax on U.S. situs assets
  - Situs rules may be modified by treaty
  - Remember situs rules are different for gift and estate tax
- Exemption
  - NCNDs are only allowed a unified credit of \$13,000, amounting to an exemption of \$60,000.
  - May qualify for increased credit/exemption under applicable estate tax treaty.
- Unlimited deductions for bequests to
  - U.S. citizen spouse
  - <u>U.S</u>. charities only
- May be subject to state estate tax
- U.S. beneficiaries must report bequests from NCND decedents (including of non-U.S. property) if above applicable reporting threshold

## Estate Taxation for Spousal Bequests

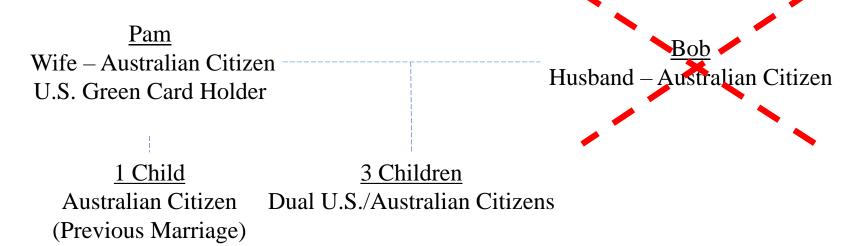
	To spouse who is		
		U.S. citizen	Noncitizen
From spouse who is	U.S. citizen / domiciliary	Unlimited deduction*	Can apply lifetime exemption amount; can also use qualified domestic trust (QDOT)**
	NCND	Unlimited deduction (but check local country tax rules)	Can apply lifetime exemption amount (though small); can also use QDOT for U.S. situs property

<sup>\*</sup> Spouse can "port" deceased spouse's unused estate tax exemption (DSUE amount)

- Qualified Domestic Trust (QDOT):
  - Designed to ensure property stays within U.S. jurisdiction
  - Property passing to it by irrevocable assignment by a noncitizen spouse before the decedent's estate tax return is filed can qualify for the marital deduction.
  - Results in deferral of estate tax on first spouse's estate on certain taxable events, principal distributions from QDOT are subject to the Sec. 2056A estate tax.
  - QDOT property is also potentially includible in the surviving spouse's gross estate under other Code provisions (such as Sec. 2044, if the QDOT is also a qualified terminable interest property (QTIP) trust), although a credit is allowed so that (mostly) a single estate tax is imposed on the couple's assets (as would be the case if they were both U.S. citizens).
- Check treaty provisions for alternative treatment of spousal bequests (e.g., France)

<sup>\*\*</sup> Generally no porting is allowed

# Case Study



### Bob (NCND) dies first – U.S. estate tax

- Will need to check treaty
- U.S. Situs Assets
- How to divide the assets?

### **Joint Assets**

- U.S. and Australian Real Estate (U.S. Vacation Home)
- U.S. and Australian Brokerage Accounts
- Australian Accounts with U.S. Securities
- Australian Bank Accounts

### Bob's Assets

- Shares of Australian Company
- Australian Bank Accounts



- Because NCNDs are subject to gift tax on gifts of U.S. situs tangible property and are subject to estate tax on bequests of U.S. property, the situs rules are important to understand in cross-border estate planning.
- **Practice Tip** treaties may modify situs rules for certain assets. They may also alter the tax treatment of certain income items, as discussed earlier.

### **Tangible Personal Property**

### Transfer Taxes

- Tangible property *located in the U.S.* is a U.S. situs asset subject to gift tax.
- Tangible property *located in the U.S.* is a U.S. situs asset subject to estate tax.
  - Exception: art on loan to public gallery or museum (Treas. Reg. Section 20.2105-1(b))
- Treaties may provide exceptions to situs rules for tangible property

### • *Income tax*

- Gains not generally taxable unless property held as inventory or used in a U.S. trade or business.
- *If income is ECI, may be exempt under applicable treaty (business profits).*

### Cash

### Transfer Taxes

- Cash (in bills) is tangible personal property and therefore a U.S. situs asset subject to U.S. gift tax; gifts of cash from U.S. bank account may be treated the same. See earlier **Practice Tip**.
- By contrast, bank accounts maintained with U.S. banks are not U.S. situs property and not subject to U.S. estate tax unless the decedent was an income tax resident at death, BUT cash deposits with U.S. brokers, money market accounts with U.S. mutual funds, and cash in U.S. safe deposit boxes are U.S. situs property subject to U.S. estate tax.

#### • *Income tax*

• Interest paid on a bank account is excludable from income by nonresident aliens under Section 871(i).

### Stock in U.S. Corporations

### Transfer Taxes

- As intangible assets, not U.S. situs for gift tax purposes.
- Are generally U.S. situs and subject to U.S. estate tax, although this treatment can be modified by treaty.

### • *Income tax*

- Withholding on dividends dividends paid to a NRA individual are subject to 30% withholding (may be reduced by treaty).
- Capital gains gains from the sale of stock in a U.S. corporation by a non-U.S. person are generally not taxable unless the corporation is a U.S. real property holding company.

### Life Insurance

### Transfer Taxes

- As intangible assets, not U.S. situs for gift tax purposes.
- U.S. issued policy owned by NCND on life of self not U.S. situs and not subject to U.S. estate tax.
- U.S. issued policy owned by NCND on the life of another person is U.S. situs and included in NCND's taxable U.S. estate at FMV based on value of policy.

### • *Income tax*

- Generally no current tax on appreciation of funds or distribution of death benefits if policy on life of alien decedent.
- Distributions during insured's life may be taxable.

### U.S. Real Property

- Transfer Taxes
  - U.S. situs and subject to U.S. gift tax. Gift is a FIRPTA disposition, but if basis is more than debt relief on transfer then no FIRPTA tax owed. *See* Treas. Reg. 1.897-1(h), Ex. 1
  - U.S. situs and subject to U.S. estate tax.
  - U.S. real property holding corporations
    - As intangible asset, not U.S. situs for U.S. gift tax purposes.
    - U.S. corporate stock is U.S. situs for U.S. estate tax purposes.
  - Treaty Provisions
    - Generally, treaties do not provide significant, if any, relief.
    - At least one treaty tries to look through companies holding real property to determine situs.

# Situs Rules for Transfer Taxes (and General Income Tax Rules)

### U.S. Real Property

- *Income tax* 
  - Gains from sale of U.S. real property (USRP) are taxed as ECI under FIRPTA
    - If holding period greater than 1 year, may qualify for long-term capital gain rates
  - FIRPTA Withholding
    - When purchasing USRP from non-U.S. persons, the purchaser must generally withhold 15% of the gross proceeds under Section 1445
    - Can apply for withholding certificate to reduce withholding seller can apply for refund on return
  - Rental income is taxed as FDAP subject to 30% withholding
    - *Net election* − *Section 871(d)* − *income taxed as ECI but deductions allowed*
  - If an alien has rental income from U.S. real property (i.e., rental income), then the alien may want to make a Section 871(d) "net election". This election allows the alien to claim deductions attributable to the real property income and only have the net income from the real property taxed.
  - If rental activity is "passive", then alien technically would owe 30% gross tax on the rent paid.
  - If the alien becomes U.S. resident then the alien can deduct real estate taxes and mortgage interest.

# Situs Rules for Transfer Taxes (and General Income Tax Rules)

### U.S. Real Property – FIRPTA

- *Income tax cont'd.* 
  - U.S. Real Property Holding Corporation
    - If more than 50% of interests in U.S. real property then presumed USRP under FIRPTA
    - If a US corporation cannot establish that it was not a USRPHC at any time during the previous five years, it is presumed to be a US real property interest under FIRPTA
    - 15% withholding on any sale by a non-U.S. person
  - Sale of partnership interest with underlying USRP investments
    - Taxable under FIPRTA to extent of USRP holdings
    - 15% FIRPTA withholding applies under Section 1445 if 50% or more of the value of the gross assets consists of US real property interests and 90% or more of the value of the gross assets consists of US real property interests plus cash or cash equivalents

# Situs Rules for Transfer Taxes (and General Income Tax Rules)

### Property with Unclear Situs Rules for Transfer Taxes

- Interests in Partnerships
  - As intangible assets, not subject to U.S. gift tax.
  - It is unclear whether an interest in a partnership is considered U.S. situs or non U.S. situs for U.S. estate tax purposes.
  - IRS could take an aggregate approach.
    - If the IRS takes an aggregate view, it is not clear what situs determination would hinge on.
    - If the IRS takes a look-through approach, the situs of the underlying assets would control
      - Congress took the look-through approach in the income tax context with respect to Section 864 and the treatment of sales of partnership interests, effectively overruling *Grecian Magnesite Mining, Industrial & Shipping Co., SA v. Comm'r, 149 T.C. 3 (2017)*
- Retirement Accounts
  - Must be evaluated based on the specific assets held.



# Life Insurance in Estate Planning

### Primary Estate Uses

- Liquidity at Death
- Estate Preservation
- Equalization of Inheritance
- Wealth Replacement
- Irrevocable Life Insurance Trust (ILIT)
- Estate Tax Rate Mitigation
- Provision for Heirs with Special Needs
- Generation Skipping Transfer Tax Planning
- Leverage

### Other Uses

- Funding Retirement
- Covering Debts
- Key Person Insurance
- Buy-Sell Agreements
- Investment Diversification
- Asset Protection

# Life Insurance Considerations for Foreigners

U.S. estate tax for Non-Citizens who are also Non-Domiciliaries:

- Applies to <u>U.S. situs assets</u>
  - Tangible and Intangible
  - Real estate in the U.S.
  - Tangible Property in the U.S.
    - Art work or other physical types of property inside the U.S.
  - Intangible Property connected to the U.S.
    - Direct ownership of U.S companies (directly or through investment account)
    - U.S. based investment accounts

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  - Tangible Property in the U.S.
    - Art work or other physical types of property inside the U.S.
  - Intangible Property connected to the U.S.
    - Direct ownership of U.S companies (directly or through investment account)
    - U.S. based investment accounts
    - Life insurance policies (depending on owner/person's life/insurer)

# Life Insurance Considerations for Foreigners

Life Insurance Death Benefit or Cash Surrender Value (Possible U.S. Taxable Estate Inclusion of Foreign Person ("FP"):

- FP owns U.S. policy on own life or life of another (possible CSV at risk)
- FP owns U.S. or Foreign policy that is connected to a U.S. trade or business (possible CSV at risk)

■ Possible Solutions? – Own policy through foreign corporation, or some type of trust; or have no CSV

# ILIT – Irrevocable Life Insurance Trust

#### Estate Tax N/A

### **Typical Situation: Various**

- Usually ILIT is owner and benevidiary of insurance policy
- Removes insurance proceeds from taxable estate
- Provides liquidity
- May purchase non-liquid assets from estate
- May loan estate funds to satisfy estate tax where assets primarily non-liquid
- Essentially permits unlimited marriage deduction that's otherwise n/a
- ILTI exempt from estate tax
- Distributions of income or principal permitted without estate tax



# Reporting Obligations

## Foreign Bank Account Reports (FBAR)

- U.S. taxpayer with financial interest in or signature authority over foreign financial account if the value exceeds \$10,000 must file the FBAR.
- A trust beneficiary can have an FBAR filing obligation if the beneficiary has a "present" beneficial interest in more than 50% of the trust assets or receives more than 50% of trust income.

### Form 3520

• Used to report transactions with foreign trusts and the receipt by a U.S. person of gifts from NRAs or bequests from foreign estates over \$100,000.

# Reporting Obligations

## Form 8938 - Statement of Specified Foreign Financial Assets

- Specified foreign financial assets include:
  - Foreign accounts at financial institutions;
  - Foreign stock;
  - Certain foreign financial instruments; and
  - Interest in other foreign entities.
- Must report an interest in a foreign trust or estate.

# Reporting Obligations

### Forms to Consider:

- Form 56, *Notice Concerning Fiduciary Relationship*
- Schedule B (Form 1040) Part III, Foreign Accounts and Trusts
- Form 1040NR, U.S. Nonresident Alien Income Tax Return (Foreign Non-Grantor Trusts)
- Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
- Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner
- Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)
- Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

- Form 673, Statement for Claiming Exemption from Withholding on Foreign Earned Income Eligible for the Exclusion(s) Provided by Section 911
- Form 8233, Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual
- Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for U.S. Tax Withholding and Reporting (Individuals)
- Form W-8IMY, Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding and Reporting
- Form W-8BEN-E, Certificate of Status of Beneficial Owner for U.S. Tax Withholding and Reporting (Entities)
- Form 8833, Treaty Based Return Position Disclosure under Section 6114 or 7701(b)



Section 877A – The "Exit Tax"

- Applicable to expatriations after June 17, 2008.
- Applies a "mark-to-market" tax.

Section 877A Exit Tax – Who does it apply to?

- "Expatriates"
  - Citizen who relinquishes citizenship.
  - Long-term green card holder (8 of past 15 years, or 7 years and one day) who formally relinquishes green card.
  - Can break long-term green card holder status by:
    - Administrative revocation;
    - Treaty tie-break; and
    - Applying for sailing or departure permit.

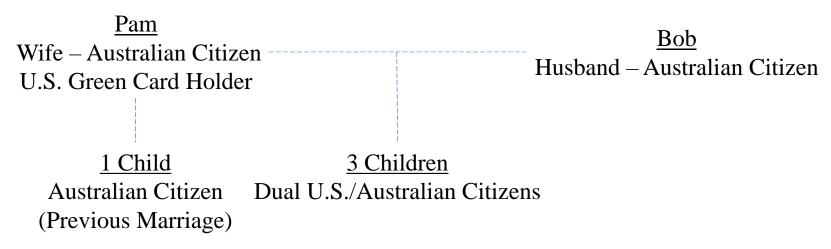
Section 877A Exit Tax – Who does it apply to?

- "Covered Expatriates" Expatriates that meet one of the below tests
  - Income Test Average annual net income tax liability greater than \$190,000 (2023 amount) for five tax years preceding expatriation.
  - Net Worth Test Net worth of \$2 million or more on expatriation date.
  - Compliance Test 5-years tax compliant (focus on income tax compliance).
  - Exceptions for dual citizens at birth and minors who give up citizenship prior to 18<sup>th</sup> birthday.

### Section 877A Exit Tax – What is it?

- Deemed sale of worldwide assets recognize gain to extent it exceeds \$821,000 (in 2023).
- Various types of retirement accounts deemed distributed.
- Section 2801 Tax on Gifts and Bequests from Covered Expatriates to U.S. Persons
  - The law also imposes a tax on U.S. citizens or residents who receive certain gifts or bequests from Covered Expatriates.
  - The tax, which is assessed at the highest marginal estate or gift tax rate (currently 40%) at the time of such gift or bequest, applies to the extent that the value of the gift/bequest exceeds \$17,000 during the calendar year. Section 2801
  - Proposed regulations have been issued, but the tax is suspended until the regulations are finalized by the IRS.

# Case Study – Expatriation



Facts: Pam gives up green card.

- Assets in excess of \$2 million?Can Pam avoid this?
- Consider gifting assets to family members to decrease Pam's net worth below \$2 million.

#### **Joint Assets**

- U.S. and Australian Real Estate (U.S. Vacation Home)
- U.S. and Australian Brokerage Accounts
- Australian Accounts with U.S. Securities
- Australian Bank Accounts

#### Pam's Assets

- Australian superannuation fund
- Australian Bank Account

#### Bob's Assets

- Shares of Australian Company
- Australian Bank Account.

MNF LEGAL

## SEVERIANO E. ORTIZ



### Managing Member, MNF Legal

Severiano practices in the area of tax law, advising institutional and private clients, both domestic and international, in individual and business tax planning matters. He focuses on cross-border transactions and tax efficient restructurings. He advises clients regarding tax developments affecting their business, both globally and domestically. He also advises clients regarding their individual and family cross-border tax planning and restructuring needs with respect to pre-immigration, expatriation, cross-border income, gift, and estate tax, and offshore tax compliance.

Before founding MNF Legal, Severiano worked for global law and accounting firms. First, he worked as an international private client and tax controversy attorney, and then for international accounting firms advising billion-dollar multinational businesses with their global restructurings, later returning to private clients with their cross-border income, gift, and estate tax planning.

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