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UPDATES AND COMMENTARY ON BUSINESS AND INDIVIDUAL TAX AND ESTATE PLANNING

PUBLISHED BY



## Case Study: When a Nonresident Alien Dies Owning US Situs Real Estate

Posted at 9:20 AM on February 24, 2010 by Steven M. Saraisky

It is fairly common for foreigners to invest in US real estate. Before doing so, however, they should consider the income, gift and estate tax implications of such investments and possible tax structuring (entities, trusts, etc.) to minimize exposure.

A foreigner may purchase US situs real estate directly and own the property or properties in his or her individual name, though this creates income tax reporting and withholding issues. In addition, if the foreign owner then dies, his or her US situs real estate is subject to US estate tax, often an unpleasant surprise for the surviving family members. This tax result is exacerbated because, generally speaking, foreigners do not get the benefit of a unified credit.

Example: Charles, a Japanese citizen, buys a New York City rental apartment valued at \$2 million. He dies 10 years later when the property is worth \$4 million. Absent other circumstances, Charles' US situs property is subject to US estate tax. Assuming a 45% tax rate and no exemption, federal estate tax of \$1.8 million will be due nine months from Charles' date of death. New York estate tax would be additional. (Note that the federal estate tax is currently repealed, so these figures in this example apply only if/when the federal estate tax is re-enacted).

There are a number of steps that foreigners and their families should consider if faced with the situation of a foreign decedent owning US property, including:

**Treaty relief.** If the US has an estate tax treaty with the decedent's home country, the decedent may be entitled to a greater unified credit. A common treaty provision gives a nonresident alien decedent a unified credit equal to a fraction of the unified credit available to US persons. The fraction is equal to the percentage of the decedent's US situs property over the decedent's worldwide property. The greater unified credit permitted under a treaty can mitigate the estate tax exposure.

**Post mortem QDOT.** A surviving spouse (often a nonresident alien too) can create a qualified domestic trust ("QDOT") and transfer to it inherited US situs real estate. With a proper structure and a QDOT election in place, property passing to a nonresident alien spouse will qualify for the estate tax marital deduction. The effect of this is to defer the estate tax until the death of the surviving spouse, though it does not avoid the estate tax altogether.

**Pre-death planning.** There are any number of steps that could be taken prior to death to avoid US estate tax. Some common considerations include (1) annual exclusion gifts of interests in the property which will qualify for the gift tax annual exclusion, (2) transferring the real estate to a US corporation, since the shares of a US corporation – considered intangible assets whose situs is the domicile of the owner – are not subject to estate tax in a nonresident alien's estate, or (3) transferring the real estate to another entity, the ownership of which will not be subject to US estate tax. Before taking any of these steps, the property owner should look into the income tax considerations (including FIRPTA), gift tax considerations, and reporting requirements that can be quite onerous. These approaches also should be considered for a surviving spouse's portion of jointly owned property.

**Conclusion.** When a foreigner dies owning US situs real estate, the executor or surviving family members can consider a number of steps to reduce the US estate tax exposure.

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