

Meritas Capability Webinar – U.S. Tax and Estate Planning for Foreign Persons

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Speaker – Matthew R. Hillery

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- Concentrates on estate planning, estate administration and trust administration for high net worth individuals and families.
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Introduction

- Your immigration status.
- Wills, trusts and other estate planning documents.
- Who pays U.S. tax?
- Non-citizen spouses.
- Purchasing a home in the U.S.
- Challenging assets.
- Expatriation.

Your Immigration Status

- Three general categories for tax purposes.
 - U.S. citizen.
 - Non-citizen resident: permanent or “green card” status.
 - Non-resident alien: neither a citizen nor a resident.
- Each has different burdens and benefits relating to employment, voting rights, border crossings, taxation and government benefits.
- Tax burdens generally increase as the connections with the U.S. become more permanent.
- Carefully consider long-term tax implications before “going to the next level.”

Wills, Trusts and Other Estate Planning Documents

- Local will.
 - Important for guardianship of minors.
 - Avoid state intestacy laws for U.S. assets.
 - Consider whether it should apply to worldwide assets or just U.S. assets.
- Trusts.
 - May be important for U.S. tax minimization.
 - Management of assets for children.
 - Privacy.
 - But, be cognizant of tax considerations in home jurisdiction.
 - Trustee selection can have income tax consequences in the U.S.
- Durable powers of attorney and health care documents.
 - Name people to act for you in the case of incapacity.
 - Foreign/home jurisdiction documents may not be enforceable or accepted in the U.S. and vice versa.

Who Pays U.S. Tax?

U.S. Citizens

- Taxed on worldwide income.
 - Earnings in U.S. (job here).
 - Earnings abroad (job in Japan).
 - Gains on U.S. assets (stock in U.S. companies).
 - Gains on overseas assets (house in Paris).
- Subject to estate, gift and generation-skipping transfer tax on worldwide assets.
- Treaty relief to prevent double taxation, depending on other jurisdictions and citizenship/residency.

Who Pays U.S. Tax?

Non-Citizen Residents

- Taxed on worldwide income.
 - Permanent resident: green card.
 - “Substantial presence test.”
 - Present in U.S. at least 31 days in current calendar year.
 - Substantially present at least 183 days during current calendar year and prior two calendar years. Count 1/3 of days in preceding year and 1/6 of days in second preceding year.
 - Any presence on a single day is counted as a full day.
 - Exceptions for students or other aliens with “closer connection” to another country
 - Separate rule for capital gains – must be in U.S. for 183 days in year of gain recognition to be taxed.
- Subject to estate, gift and generation-skipping transfer tax on worldwide assets, if domiciled in U.S.

Who Pays U.S. Tax?

Substantial Presence Examples for Non-Citizen Residents

Example 1:

- Jack is present in the U.S. 90 days in 2016, 210 days in 2015 and 180 days in 2014.
- He is substantially present for 190 days in 2016:
 - $2016 (90 \text{ days}) + 2015 (210/3 = 70 \text{ days}) + 2014 (180/6 = 30 \text{ days}) = 190 \text{ days}.$

Example 2:

- Jill is present in the U.S. 60 days in 2016, 240 days in 2015 and 210 days in 2014.
- She is substantially present for only 175 days in 2016:
 - $2016 (60 \text{ days}) + 2015 (240/3 = 80 \text{ days}) + 2014 (210/6 = 35 \text{ days}) = 175 \text{ days}.$

Who Pays U.S. Tax? *Non-Resident Aliens and Transfer Tax*

Estate Tax

- Subject to U.S. estate tax on U.S. situs assets only.
 - Real estate.
 - Tangibles.
 - Stock in U.S. domestic corporations.
- Not subject to estate tax on certain favored investments.
 - Portfolio debt.
 - Life insurance (on the life of an NRA).
 - Bank deposits (but be careful about money market funds).
 - Foreign stocks.
- Step-up in basis at death applies whether or not a particular asset was taxed for U.S. estate tax purposes.

Who Pays U.S. Tax? *Non-Resident Aliens and Transfer Tax*

Gift Tax

- No U.S. gift tax on NRAs for gifts of intangible assets (except from certain expatriates).
- Gifts of U.S. situs tangibles and real estate are taxable – annual exclusion is available.

Generation-Skipping Transfer Tax

- No skips at all, unless the transfer when made was subject to gift or estate tax.

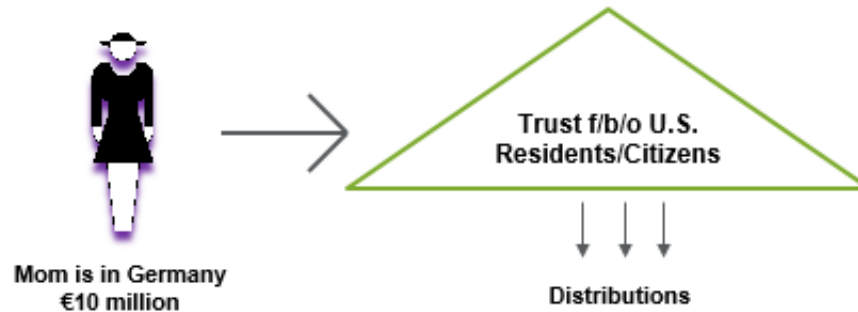
Who Pays U.S. Tax? *Non-Resident Aliens and Transfer Tax*

Inbound Estate Planning

- Important while living in the U.S. to avoid exposure to U.S. tax.
- Must be done before inheritance is received.
- Excellent planning opportunities whether or not one plans to remain in the U.S. permanently.
- Offshore trusts or companies may make sense (but watch out for reporting requirements and tax treatment of income).

Who Pays U.S. Tax?

Inbound Gifts and Inheritances



- Can avoid all U.S. income and capital gains tax during mom's lifetime.
- Choices about U.S. income taxation after mom's death.
- Can avoid U.S. estate, gift and inheritance taxes on undistributed trust funds for multiple generations of beneficiaries.

Non-Citizen Spouses

For estate and gift tax purposes, marital deduction only is available if the recipient spouse is a United States citizen.

- Policy considerations – concern assets may otherwise disappear from the U.S. tax regime.
- Special gift tax annual exclusion for non-citizen spouses – (\$148,000 for 2016).
- Transfers in excess of annual exclusion are taxable (subject to unified credit).
 - Includes transfers of offshore assets for U.S. resident taxpayers.
- Estate tax – QDOT.
 - U.S. trustee.
 - Recapture tax on principal distributions (including at death).
 - Income distributions subject to normal fiduciary income tax rules.
- Consider special rules for jointly owned property (e.g., joint accounts and real estate).

Purchasing a Home in the U.S.

Citizens and Non-Citizen Residents

- Liable for capital gain (or loss) upon sale of house.
- Home subject to federal and state estate taxes at owner's death.

Non-Resident Aliens

- Income tax considerations and strategies.
 - Foreign sellers subject to withholding tax on amount realized.
 - Buyer required to withhold up to 15% of sales prices under Foreign Investment in Real Property Tax Act (FIRPTA).
 - Sale of shares in foreign corporation owning U.S. real estate not subject to withholding, but new owner takes basis in real estate.
 - Capital gains exclusion for primary residence available to non-resident aliens.
- Estate tax considerations and strategies.
 - Consider steps to avoid direct ownership.
 - Consider owning house through foreign corporation or through two entity structure.

Purchasing a Home in the U.S.

Plan now for status which may change later

- Don't necessarily “throw in the towel” and accept direct ownership if next year you may no longer be U.S. resident.

Challenging Assets, Pt. 1

- U.S. citizens and non-citizen residents may hold interests in foreign trusts, foreign accounts and foreign companies.
- Bottom line: worldwide income is subject to U.S. tax.
- U.S. enforces taxation through reporting by taxpayers. When in doubt, report.
- Increased reporting requirements generally applicable to offshore assets.
 - Reporting usually for information purposes, but special tax regimes can apply to certain types of offshore assets.
 - Creates traps for unwary.

Challenging Assets, Pt. 2

Foreign Trusts

- Trust is foreign if it does not pass both the “court test” and the “control test.”
- Tax issues:
 - (1) grantor trust if U.S. donor and U.S. beneficiary;
 - (2) transfer to foreign non-grantor trust leads to recognition of gain;
 - (3) Conversion from foreign grantor trust to foreign non-grantor trust can lead to gain recognition;
 - (4) distributions from foreign non-grantor trust to U.S. beneficiaries of accumulated income or gains leads to throwback tax.
- Special reporting when funding foreign trusts or receiving distributions from them.

Challenging Assets, Pt. 3

Foreign Accounts

- Report on Foreign Bank and Financial Accounts (a/k/a “FBAR”) must be filed annually by persons with (1) financial interest in or (2) signature authority over foreign account if aggregate value of assets in all foreign accounts exceeds \$10,000.
 - Form now called FinCEN Report 114. Filed electronically.
 - Foreign accounts include bank or brokerage accounts, life insurance with cash value, option/futures accounts and mutual funds.
- Similar disclosures are required on Form 1040 and Form 8938 – Statements of Specified Foreign Financial Assets.
- FATCA
 - 30% withholding tax on payment of U.S. source passive income to foreign financial institutions unless foreign institution meets reporting requirements.
 - Foreign financial institution must disclose identities of U.S. persons with accounts or certify that it has none.

Challenging Assets, Pt. 4

Controlled Foreign Corporations (CFCs)

- Definition: Foreign corporation controlled by U.S. shareholders with non-operating assets.
- Must treat as pass-through.
- Shareholder must file Form 5471: Information Return of U.S. Persons With Respect to Certain Foreign Corporations.
- \$10,000 per shareholder per year penalty.
- Form 926 for capital contributions – 10% penalty for failure to file
 - If a transfer is made by a partnership, the domestic partners – not the partnership itself – must file. Problem for investors.

Challenging Assets, Pt. 5

Foreign Partnerships

- Foreign partnerships controlled by U.S. partners.
- Information return required for partners who make large capital contributions (partners who contribute more than \$100,000 or own more than 10% of partnership after contribution).
- Form 8865 must be filed. Penalty for failure to file depends on type of partner.
- \$10,000 for failure to file. Additional \$10,000 for every 30 days after notice from IRS (up to \$50,000).
- For failure to report transfer of property, transferor subject to 10% of FMV of property, up to \$100,000.

Challenging Assets, Pt. 6

Passive Foreign Investment Companies (PFICs)

- Issue for foreign mutual funds.
- A foreign corporation is a PFIC if it meets either the income or asset test.
 - Income Test: 75% or more of the corporation's gross income for its taxable year is passive income.
 - Asset Test: At least 50% of the average percentage of assets held by the foreign corporation during the taxable year are assets that produce passive income or that are held for the production of passive income.
- Special allocation of income and gain to U.S. taxpayers – generally ordinary income treatment for items otherwise classified as gain.
- Qualified Electing Fund (QEF) Election – PFIC can be treated the same as a U.S. based mutual fund.
- Section 1291 Fund.
- Market to Market Election.

Expatriation

- Concern for citizens who renounce citizenship and long term green card holders (8 out of 15 years) who renounce or lose residency.
- Current law applies to a “Covered Expatriate” – U.S. citizen or resident seeking to expatriate on or after June 17, 2008 who:
 1. Has an average annual income tax for prior five years greater than \$161,000 (for 2016), or
 2. Has a net worth of at least \$2 million, or
 3. Fails to certify that he complied with U.S. tax laws for preceding 5 years.
- Covered Expatriate subject to mark-to-market exit tax. Property deemed to be sold on day before expatriation date. Exclusion of \$693,000 (for 2016) applies.
- Interests in deferred compensation plans and non-grantor trusts exempt from exit tax, but distribution to Covered Expatriates subject to 30% withholding.
- US citizen or resident who receives a gift or bequest from a Covered Expatriate must pay gift or estate tax at top rate then in effect (40% in 2016). Charitable and marital deductions available.
 - This is a big issue when children remain citizens/residents after expatriation
 - No gift or estate tax exclusion applies except for annual exclusion

Questions?

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