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Panel 18: Asian/North American Estate Planning for the Coming Decade

***US Perspective***

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# Background On US Wealth Transfer Laws

# US Wealth Transfer Laws

- The manner in which property is transferred by gift during life and upon death is determined by the laws of each state. Therefore, in essence there are 51 different legal systems for the transfer of wealth (since there are 50 states and the District of Columbia).
- All 50 states, with the exception of Louisiana, base their systems of wealth transfer on the common law handed down through English law.
- Under the laws of all states, during one's lifetime a person is generally free to give away any or all of his or her property without any restrictions.

# US Wealth Transfer Laws (Cont'd.)

- Likewise, upon death a person is free to bequeath any or all of his or her property to anyone he or she desires, with one exception.
- The exception is that a spouse is entitled to elect to receive up to 1/3 of the deceased spouse's estate in most states (other than Georgia) if the spouse has been bequeathed less than 1/3.
- Children are not entitled to any inheritance.
- Therefore, with a Will a person can disinherit his children and his spouse (other the spouse's 1/3 right of election).

# US Wealth Transfer Laws (Cont'd.)

- If a person dies without a Will, state intestacy law will determine how property passes upon death (usually in some combination to spouse and children).
- All of the US states, including Louisiana, permit the transfer of assets to lifetime trusts or testamentary trusts (trusts created upon death under a Will) for the benefit of the creator of the trust or anyone else.
- Whether or not a decedent has a Will, prior to his or her assets passing to the beneficiaries or heirs, a separate "estate" will exist that is managed by a personal representative called an "administrator" (for intestate estates) or an "executor" (when there is a Will).
- Once the personal representative has paid all debts and marshalled all assets, he or she distributes the estate to the beneficiaries pursuant to intestacy law or the Will.
- Trusts can be revocable or irrevocable, can be created by agreement or under a Will, and are used for legitimate tax planning in the US pursuant to state and federal tax law.

# US Wealth Transfer Laws (Cont'd.)

- Depending upon how property is titled under state law, it may avoid probate (i.e., it may avoid the need to pass under a Will upon death). Examples are:
- Jointly held real property or personal property (e.g., joint tenants with rights of survivorship).
- Property that passes by beneficiary designation (e.g., life insurance, retirement accounts, "in trust for" accounts, etc.).
- Property held in trust.

# Conflict of Law Rules

- Personal property (both tangible and intangible) passes according to the law of one's domicile upon death.
- Real property passes according to the law of the jurisdiction where the property is located.
- Most states permit a testator to elect in his or her will that the jurisdiction where the personal property is located will govern the disposition on death. See NY EPTL 3-5.1(h) and *Estate of Renard* (may need multiple wills, which is not ideal, so consider trusts).
- Due to the above state laws, a testator domiciled in a forced heirship jurisdiction where issue cannot be disinherited (i.e., a civil law law jurisdiction like France) can cut off such rights by keeping assets in NY (for example) and electing for NY law to apply in his NY will.

# Background On US Income Tax

# Income Subject to Income Tax

- US citizens, US permanent residents and non-US citizens who reside or spend a requisite number of days in the US are subject to US income tax on worldwide income.
- Non-US Resident/Non-US citizen (“NRNC”) subject to US income tax only on certain types of income from US sources and, to a limited extent, foreign source income connected with a U.S. trade or business.

# Examples of US Source Income (non-ECI) Subject to US Income Tax for NRNC

- Interest, dividends, rents, salaries, wages, premiums, annuities, compensation, remuneration, emolument, and other fixed or determinable annual or periodic gains, profits, and income
- Certain gains from the sale or exchange of patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, and other like property.
- Exceptions are bank deposits in the US and capital gains from US sources assets, which are not subject to income tax.

# Individual Income Tax Rates

- 37% rate on ordinary income over $600,000 for married US citizen or resident filing jointly, over $500,000 for single US citizen or resident, and over $300,000 for married US citizen or resident filing separately (10% to 35% for lower brackets) – *Note that these rates revert to higher pre-2018 rates as of 1 January 2026.*
- 15% rate on capital gains of US citizen or resident if income is otherwise taxed at lower ordinary income rates.
- 20% rate on capital gains of US citizen or resident if income is otherwise taxed at 37% rate.
- Additional 3.8% tax on net investment income.
- Income Tax Rate for NRNC – 30%

# Residency for U.S. Income Tax Purposes

- Non-US citizen treated as a resident for U.S. income tax purposes, if individual:
  - Is lawfully admitted for permanent residence (receives green card);
  - Qualifies under the substantial presence test; or
  - Makes an election to be treated as a U.S. tax resident.

# Substantial Presence Test

Substantial presence test satisfied if:

- Non-US citizen present in the U.S. on at least 31 days during the calendar year; and
- Sum of the number of days on which such individual was present in the U.S. during the current year and the 2 preceding calendar years equals or exceeds 183 days.
    - For purposes of 183 day test, each day in the 2nd preceding calendar year counts as 1/6 of a day, each day in the 1st preceding year counts as 1/3 of a day, and each day in the current year counts as a whole day.
    - Cannot satisfy test if not present more than 121 days in any year.

# Background On US Estate Tax & Gift Tax

# Assets Subject to U.S. Estate and Gift Tax

- Persons who are U.S. citizens at the time of their death, or who are domiciled in the U.S. at the time of their death, are subject to U.S. estate tax on all of their worldwide property and receive a foreign death tax credit for any foreign death taxes.
- Persons who are U.S. citizens or who are domiciled in the U.S. are also subject to U.S. gift tax on lifetime gifts they make. There is no U.S. gift tax credit for foreign gift taxes paid unless allowed by treaty.
- Persons who are neither U.S. citizens nor domiciled in the U.S. at the time of their death ("NRNCs") are subject to U.S. estate tax only on "U.S.-situs" property, with no credit for foreign death taxes paid. (foreign country will usually allow a credit against its death taxes for U.S. estate tax paid).

# US Situs Property for NRNC Estate Tax

- Real property and tangible personal property (including cash, cars, furniture, jewelry, artwork, etc.) situated in the U.S.
- Shares of stock issued by a U.S. corporation.
- Subject to significant exceptions (set forth below), any debt obligation, the primary obligor of which is a U.S. person or the U.S., a state or any political subdivision of the U.S., or the District of Columbia, or any agency or instrumentality of any such government.

# US Situs Property for NRNC Estate Tax (Cont’d.)

- Property gratuitously transferred by an NRNC decedent during life if
  - (i) the NRNC decedent retained for life some type of possession, control, or enjoyment of said property or its income,
  - (ii) said property was, on the date of the NRNC decedent’s death, subject to his or her right to revoke the transfer (or if such a power was relinquished by the NRNC decedent within three years of the date of his or her death), or
  - (iii) the transferee must survive the NRNC decedent in order to possess the property and the decedent retained a right of reversion in the property, and the property so transferred was situated in the U.S. at the time of the transfer or at the time of the decedent’s death.

# US Situs Property for NRNC Estate Tax (Cont'd.)

An interest in a partnership, if the partnership does not qualify as a separate legal entity under the law of the jurisdiction where it was established or is dissolved on the death of one partner, and the underlying assets of the partnership are situated in the U.S., or if the partnership is a separate legal entity under the laws of the jurisdiction where it was established and it survives the death of a partner and the partnership carries out its business in the U.S. (However, this conclusion as to US situs property is subject to debate, as noted below).

# Non-US Situs Property for NRNC Estate Tax

- Shares of stock issued by a foreign corporation.
- Deposits with persons carrying on the banking business, deposits or withdrawable accounts with a federal or state chartered savings institution (if the interest on such accounts is withdrawable on demand subject only to customary notice requirements), and amounts held by an insurance company under an agreement to pay interest thereon, as long as, in each case, the interest on such deposits or amounts is not effectively connected with the conduct of a trade or business in the U.S. by the recipient thereof.
- Deposits with a foreign branch of a domestic corporation or partnership engaged in the commercial banking business.

# Non-US Situs Property for NRNC Estate Tax (Cont'd.)

- "Portfolio Debt Obligations", as long as the decedent was an NRNC for income tax purposes. Portfolio Debt Obligations are bonds, debentures, notes or other forms of debt which meet specific requirements, such as non-registered obligations available only to non U.S. persons or registered obligations if the payor is advised that the owner is not a U.S. person.
- Proceeds from a life insurance policy on the NRA decedent's life.

# Property of NRNC Subject to Gift Tax

- Persons who are neither U.S. citizens nor domiciled in the U.S. are also subject to U.S. gift tax on lifetime gifts of U.S.-situs property, but not gifts of intangible property (unless person is a US expatriate).
- Property which is not considered intangible property and is therefore subject to U.S. gift tax for NRNC includes:
  - Real property situated within the U.S.
  - Tangible personal property situated within the U.S. at the time of the gift.
  - U.S. or foreign currency or cash situated within the U.S. at the time of the gift.

# Property of NRNC Subject to Gift Tax (Cont'd.)

- Property which is considered intangible personal property and is therefore not subject to U.S. gift tax for an NRNC:
  - Shares of stock issued by a U.S. or foreign corporation.
  - Debt obligations, including a bank deposit, the primary obligor of which is  a U.S. person, the U.S., a State, or any political subdivision thereof, the District of Columbia, or any agency or instrumentality of any such government.
  - Interests in U.S. or foreign partnerships (although there is some debate on whether such interests are intangible personal property).

# Estate and Gift Tax Exemptions

US citizens and residents:

- Gift tax exemption exempts up to $11.4 million (indexed for inflation) of US person's collective lifetime gifts from gift tax.
- Estate tax exemption exempts up to $11.4 million (indexed for inflation) of US person's bequests at death from estate tax (if a portion of the gift tax exemption is used, the estate tax exemption is reduced by an equal amount).
- Portability - any portion of the exemption unused as of the death of a spouse is available for use by the surviving spouse during life or upon death as an addition to his or her exemption, if the estate of the deceased spouse makes an election.
- Note – Above exemption amounts revert to $5.6 million as of 1 January 2026.

# Estate and Gift Tax Exemptions (Cont'd.)

NRNCs

The estate tax exemption for bequests at death for persons who are neither U.S. citizens nor domiciled in the U.S. is $60,000 (such persons do not receive a lifetime gift tax exemption).

Portability provisions do not apply to NRNCs, even if their spouse was a US citizen.

- Gift Tax Annual Exclusion - In addition to the estate and gift tax exemption, each taxpayer, whether or not he or she is a U.S. citizen or resident, can give up to $15,000 (indexed for inflation) a year ($30,000 for a married couple together) to anyone in the world without paying US gift tax or using up any part of his or her exemption.

# Estate and Gift Tax Marital Deduction

- Property passing to a spouse, outright or in certain types of trusts, is generally not subject to U.S. estate or gift tax because of the U.S. estate and gift tax “marital deduction.”
- Estate tax marital deduction is generally not allowed for property passing to a spouse who is not a U.S. citizen unless the spouse becomes a U.S. citizen before the estate tax return is filed or the property passes, instead, to a "qualified domestic trust” ("QDOT").
- In addition, the gift tax marital deduction is generally not allowed for property passing to a spouse who is not a U.S. citizen, except that a donor can give his or her non-U.S. citizen spouse up to $155,000 per year (in 2019, the number is indexed for inflation) without the imposition of any gift tax.

# Domicile of Non-Citizen of US for Estate and Gift Taxes

- For purposes of the US estate and gift taxes, an non-citizen is considered a US resident for if he or she is domiciled in the US at the time of his or her death or at the time of a gift.
- If a non-citizen enters the US for even a brief period of time, with no definite present intention of later leaving the US, he or she is deemed to be domiciled in the US and, therefore, is considered a US resident for estate and gift tax purposes.
- Thus, an alien may be considered an NRNC for estate tax purposes and a US resident for income tax purposes, or vice versa, since the estate tax residency test is the more subjective domicile test just described, while the income tax residency test is met if the alien satisfies the objective day count test of the "substantial presence test" or holds a green card (discussed above).

# Domicile of Non-Citizen of US for Estate and Gift Taxes (Cont'd.)

- The determination of domicile for estate and gift tax purposes is a factual issue that focuses on the following factors. (No one factor is determinative of whether non-citizen is domiciled in the US. In each case all of the facts and circumstances are examined.):
- The length of time spent in the US and abroad and the amount of travel to and from the US and between other countries.
- The value and size of the donor's or decedent's homes and whether he or she owned or rented them.
- The locations of houses and other residences, since a house in a vacation area is less of an indication to remain indefinitely than in other areas.

# Domicile of Non-Citizen of US for Estate and Gift Taxes (Cont'd.)

- The situs of valuable or meaningful tangible personal property.
- Where the non-citizen's close friends and family are situated.
- The locales in which the non-citizen has religious and social affiliations or in which he or she partakes in civic affairs
- The locales in which the non-citizen's business interests are situated
- Visa Status.
- The places where the non-citizen states he or she resides in legal documents.
- Whether the non-citizen spends time in a locale due to poor health, for pleasure, to avoid political problems, etc.

# Domicile of Non-Citizen of US for Estate and Gift Taxes (Cont'd.)

- The jurisdiction where the alien is registered to vote.
- The jurisdiction that issued the alien's driver's license.
- Income tax filing status.

# US Planning Considerations for NRNC

# Intangibles Exception to Gift Tax

- An NRNC who owns intangible assets that will be subject to U.S. estate tax because the assets are situated in the U.S., such as shares of stock in U.S. corporations or interests in partnerships that carry on businesses in the U.S., should consider giving the assets away prior to his or her death, since the gift will not be subject to gift tax or estate tax due to the intangibles exception.
- This can be a particularly powerful tool for an NRNC who has a spouse or child who is a U.S. citizen.
- For trusts over which the spouse or child does not have a general power of appointment, the assets in the trust should not be subject to gift tax with respect to the spouse and child.

# NRNC's Investing in US Business or Real Property through Foreign Corporation

- Shares of stock that are given away or bequeathed at death will avoid US estate tax and gift tax.
- Prior to 2017 tax reform, the downside of this form of business ownership was that the income at the corporate level was subject to a 35% tax rate and then dividends were subject to a 30% rate when distributed (unless a lower treaty rate applies) so the double tax was quite cost prohibitive.
- Subsquent to 2017 tax reform, the income at the corporate level is subject to a 21% tax rate. Dividends are still subject to a 30% tax rate, but the lower corporate rate makes a corporate structure more attractive.
- In addition to US corporate income tax, a foreign corporation engaged (or treated as engaged) in a U.S. trade or business is subject to a 30% branch profits tax on earnings of the U.S. business that are deemed repatriated offshore.
- If a foreign corporation owns U.S. real property and sells that property it is subject to FIRPTA withholding and generally subject to branch profits tax.
- A foreign corporation is more attractive due to tax reform, but the double tax is still not always ideal.

# NRNC Investing in US Business or Real Property through US Sub Corp of Foreign Corp

- Avoids gift and estate tax and the branch profits tax
- Lower 21% rate after tax reform makes the corporation more attractive, but there is still double tax when dividends are distributed.
- In addition, the entity may be considered a “personal holding company” (“PHC”). PHC rules are generally intended to prevent the avoidance of shareholder level taxes by the accumulation of certain types of earnings by certain closely-held corporations (this is beyond the scope of this outline).
- The downside of double taxation must be weighed against the possible estate tax if the underlying assets were owned through a partnership or limited liability company (although as discussed below there is a credible argument that a dual partnership  structure will avoid estate tax).

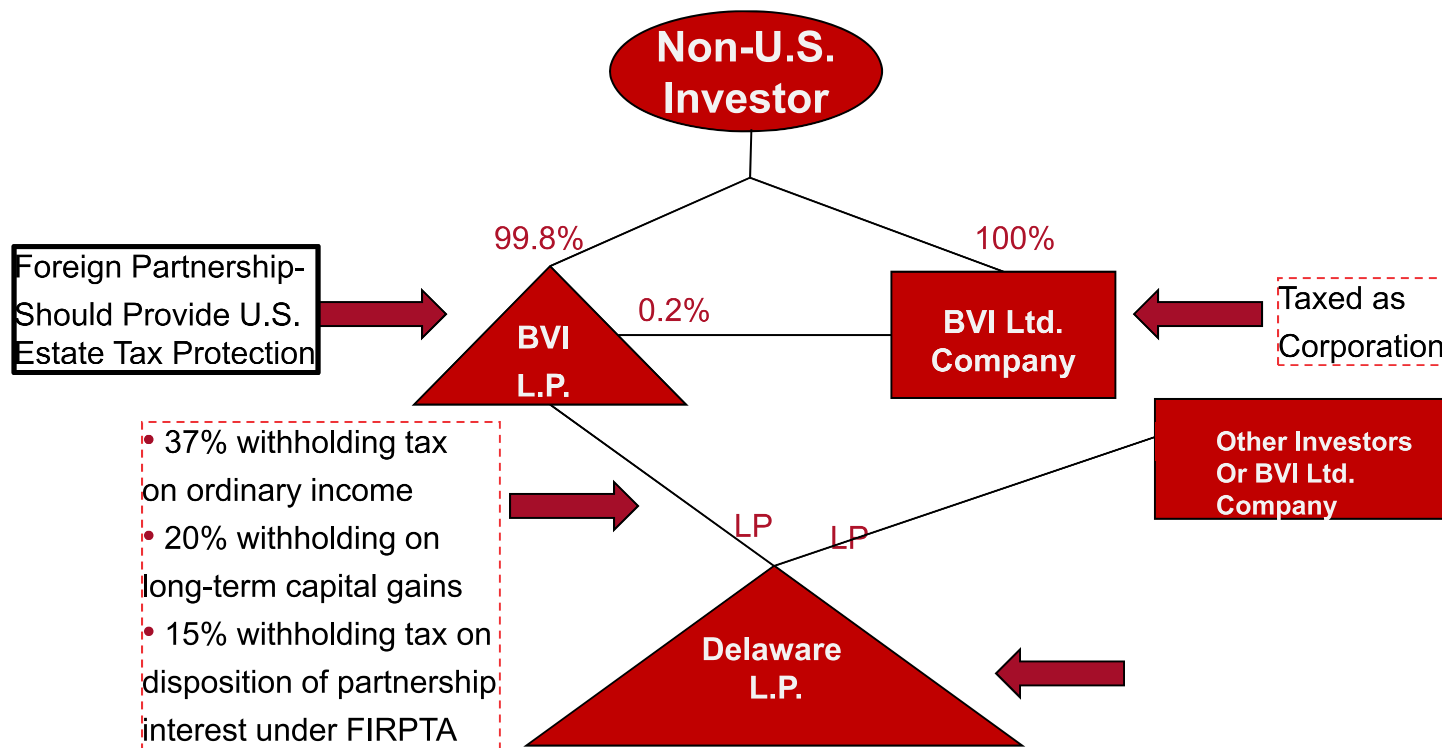
# NRNCs Owning US Residential Real Estate

- Individual ownership – Will result in U.S. estate tax. However, this can be mitigated if the NRNC acquires a life insurance policy that has a face value that will cover the estate tax. Life insurance policy is not included in the decedent NRNC's estate. Another possibility is to obtain a mortgage on the property for which the NRNC is not personally responsible, since, in such a case the entire mortgage is in effect deductible.
- Ownership through a corporation – See above.
- Ownership through a dual partnership structure – See below.

# Owning U.S. Real Estate by NRNC Through Dual Partnership Structure

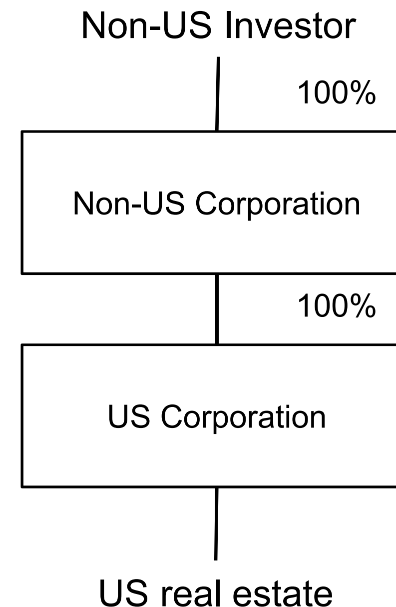
- Properly structured dual foreign/US partnership (see next slide) may qualify as exempt from US estate tax, although there is some debate on this (owning through a foreign corporation is more certain to shield form estate tax).
- Partnership structure results in one level of income tax, and tax on sale is at capital gains tax rate of 20%.
- Sale subject to U.S. income tax under FIRPTA.
- If taxpayer is willing to take some risk that partnership structure may attract estate tax, understanding that there is a credible argument that no estate tax will apply, this could be an ideal structure.

# Owning U.S. Real Estate by NRNC – Foreign Partnership Option



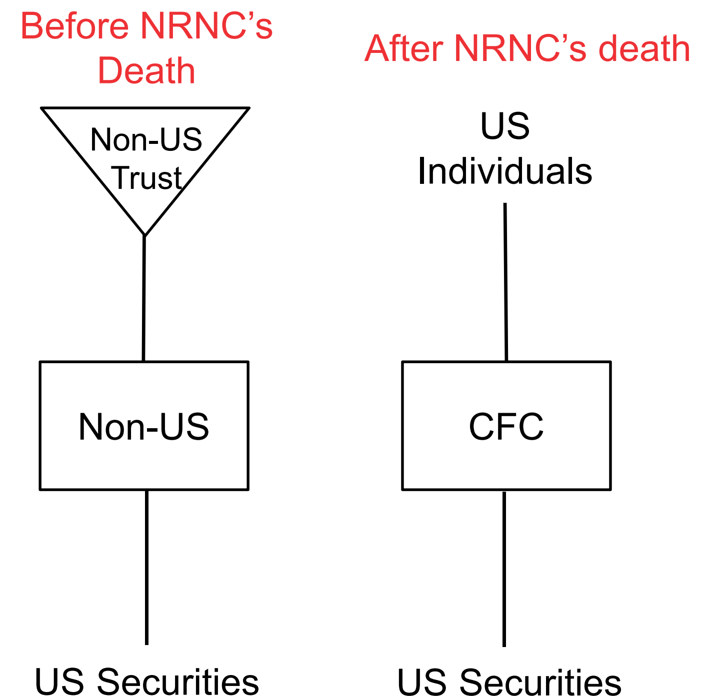
# Owning U.S. Real Estate by NRNC – Foreign Corporation Option

- Income tax
  - Corporate rate now 21%
  - Could rate go up if Congress changes hands?
- Highest individual rate 37%
  - With pass-through deduction rate could be 29.6%
- Estate tax
  - Statutory certainty on situs for corporate blocker
- Not ideal structure after US tax reform if shares will pass to US beneficiaries (see next two slides)



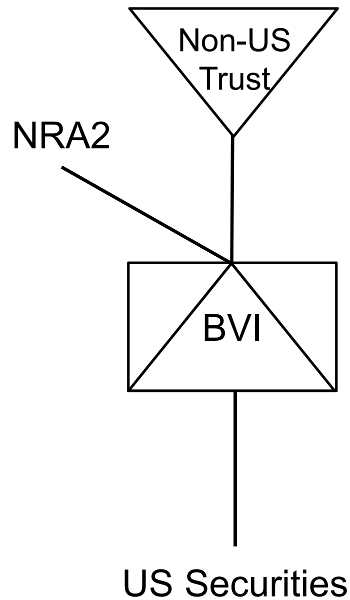
# Owning U.S. Marketable Securities by NRNC with US Beneficiary – Foreign Corporation Option Before Tax Reform

- Before repeal of 30-day rule
  - Check-the-box (CTB) election on foreign corporation within 30 days of NRNC's death
  - No income inclusion
  - Preserved estate tax protection on settlor's death
  - US beneficiaries do not have interest in CFC
- After repeal of 30-day rule
  - CTB election results in income inclusion for US beneficiaries
- Now what?
  - CTB on non-US corporation pre-death? Lose corporation protection
  - Manage estate tax exposure
  - What if two shareholders at time of CTB election?

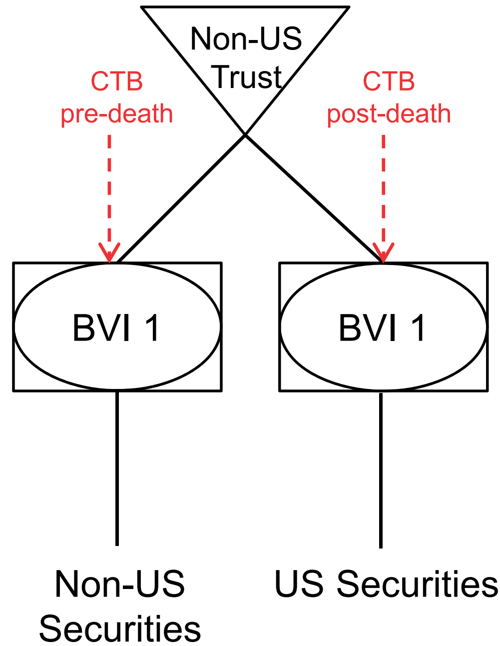


# Owning U.S. Marketable Securities by NRNC with US Beneficiary – Options After Tax Reform

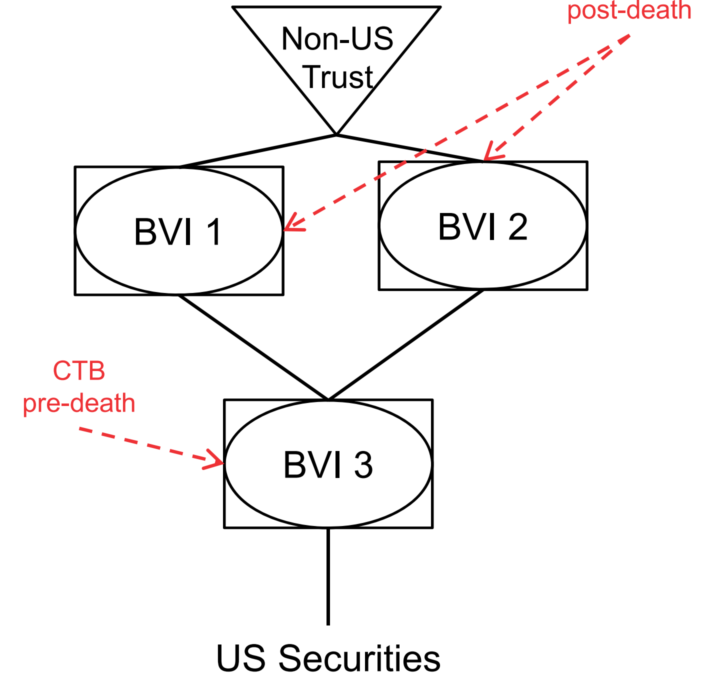
## Option 1 – Partnership Structure




## Option 2 – Foreign Corporation Option




## Option 3 – Corporation/Partnership Combo



# Pre-immigration Planning Considerations

- Type of Visa – Green Card vs. Other
- Accelerate sale of appreciated assets/defer losses
- Step up basis of assets pre-immigration
- Avoid Anti-Deferral Regimes
- Pre-Immigration Trusts
- Put assets in Life Insurance / Deferred Variable Annuity
- U.S. Tax rates have increased
- Are foreign taxes creditable
- Preparing for U.S. reporting requirements

# U.S. Expatriation Tax Regime

- Exit tax on expatriation of covered expatriates
- Taxed as if sold assets on date of expatriation
- US recipient taxed on gifts/bequest from Covered Expatriate
- Gifts/bequests to foreign trust
  - Not taxable at time made
  - Tax imposed on distributions to U.S. persons attributable to gift
  - Gifts/bequests subject to reporting even if no tax owed at time of gift

# Definition of Covered Expatriate

- U.S. Citizen or Long-term resident (“LTR”)
- LTR:  Green card holder for 8 calendar years during 15-year period before expatriation
- Meets one of following:
  - Assets over $2,000,000
  - Average annual income over threshold ($168,000 for 2019)
  - Failure to certify compliant for 5 years preceding expatriation

# Tax Treaties

# Tax Treaties

- The US has income tax treaties with Canada, China, Japan, and South Korea
- US has an estate tax treaties with Japan and South Korea and an income tax treaty with Canada that addresses estate taxes.
- Non-residents of a country can benefit from a tax treaty between that country and the country of residence.
- Citizens and residents of the US generally cannot benefit from a treaty.

# Modern Tax Treaty Residence

If an individual is considered to be resident in two tax treaty countries according to their domestic law, residence should be determined by the relevant tax treaty, which is generally as follows:

- An individual will be considered a resident of the country where he has a permanent home available to him.
- If he has a permanent home in both countries, he would be considered resident where his personal and economic relations are closer.
- If the above criterion cannot be determined, he would be considered resident where he has a habitual abode.
- If the above criterion cannot be determined, he would be considered resident of the country of which he is a national.
- If he is a national of both countries or of neither of them, the competent authorities shall settle the question by mutual agreement.

# Tax System Imposed by Treaties

- Tax treaties contemplate two methods to avoid double taxation: the exemption method and the credit method.
  - Under the *exemption method,* the country of residence of the taxpayer has to exempt from tax those items of income and capital which are taxed in the country where the items have their source.
  - The *credit method* implies that the country of residence of the taxpayer has to credit the tax paid in the source country against its own taxes.
- As an example, under the treaty with Spain, the different items of income and capital are taxed as follows:
  - Capital gains sourced in Spain by a US resident would not be subject to Spanish taxation, although it depends on the percentage of participation held in the Spanish company (usually less than 25%) and on the composition of the Spanish company's assets (principally real estate located in Spain).
  - Earned income is not subject to Non-Resident Income Tax if the income is borne by a non-resident company, entrepreneur or permanent establishment.
  - Service income is not subject to Spanish taxation.
  - Investment income such as dividends, interest and royalties are usually subject to the reduced tax rate provided for in the relevant tax treaty in the source country.

Questions

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