WHAT EVERY TRUSTS AND ESTATES LAWYER SHOULD KNOW ABOUT INTERNATIONAL ESTATE PLANNING AND ADMINISTRATION

Description: This course will provide an overview of the issues commonly encountered by trusts and estates practitioners who plan for international families. Many of our clients are foreign-born, green-card holders, or have spouses or other family members who are non-citizens, and many of our clients have family or financial interests abroad. This presentation will assist practitioners in identifying and addressing issues in international estate planning. Topics covered will include an overview of both international transfer tax planning and international income tax planning, foreign trusts, expatriation rules, and reporting requirements. It will also highlight planning strategies available to clients with international ties.

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Introduction

Of the approximately 330 million people currently living in the United States, over 44 million were born in a foreign country. This equates to a little over 13% of the population, nearly triple the share (4.8%) in 1970. Of that foreign-born population, 20.7 million are naturalized U.S. citizens and 22.6 million are non-citizens. Of the non-citizens, approximately 13.1 million are lawful permanent residents, 11.1 million are unauthorized migrants, and 1.7 million hold temporary visas. The number of foreign-born individuals in the U.S. population is expected to reach 78 million by 2065.[1]

The world is increasingly interconnected and many of our clients are foreign-born. Some have become naturalized as U.S. citizens and some have become green-card holders (permanent residents). Our clients have family and financial interests abroad and our international client base will continue to grow as the demographics of our country evolve. U.S. citizen clients often have spouses who are not U.S. citizens, and often own real estate or bank accounts in foreign countries. Occasionally, U.S. citizens will want to expatriate, move permanently outside of the U.S., and give up their U.S. citizenship to avoid U.S. taxation. Non-U.S. citizens may want to make gifts or estate transfers to U.S.- resident family members, and they may want to invest in U.S. assets, such as real estate or securities or bank accounts. In these circumstances, they may be subject to either U.S. transfer tax or U.S. income tax or both. The U.S. income, gift, estate, and generation-skipping taxation in these situations is highly complex and minimization of these taxes requires careful planning. The U.S. tax reporting and compliance obligations are elaborate and penalties for failure to comply are severe.

Trusts and estates practitioners must understand the fundamentals of international estate planning in order to competently and thoroughly advise our clients. Oftentimes international estate planning requires a collaborative approach, and practitioners should seek to work as a team with the client's other tax and financial advisors.

[1] Pew Research and Center for American Progress

I. ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXATION OF CITIZENS, RESIDENT ALIENS, AND NON-RESIDENT ALIENS

A. Overview. The United States (U.S.) taxes its citizens and residents on transfers of wealth both during life and at death. Taxation occurs regardless of where the property is located, i.e. whether the property is located in the U.S. or in a foreign country. As discussed in more detail below, the residency test for U.S. income tax purposes is objective. However, the residency test for U.S. transfer tax purposes is subjective and is based on an individual's domicile. As planners, we must evaluate the status of clients to determine whether the clients are U.S. citizens. We must also evaluate the status of non-citizens to determine whether the individuals are considered residents or non-residents for estate and gift tax purposes. The residency of the individual will affect the planning strategies and the tax obligations.

B. Determining Residency and Domicile. The transfer tax provisions of the Internal Revenue Code (the "Code") do not use the term non-resident alien to describe an individual who is neither domiciled in the U.S. nor a citizen of the U.S., and the Code does not use the terms "domicile" or "domiciliary" for transfer tax purposes. Instead, the Code and the Regulations use the words "nonresident not a citizen of the United States."[2] However, for transfer tax purposes, the residency test is based on an individual's domicile.

An individual is considered domiciled in the U.S. if she lives or has lived in the U.S. and intends to remain in the U.S. indefinitely or return to the U.S. if temporarily absent from the U.S. The Regulations state that:

> "A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of moving therefrom. Residence without the requisite intention to remain indefinitely will not constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal."[3]

In summary, there are two requirements for domicile:

1. living in a place (even for a brief period), i.e. physical presence, and

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[2] I.R.C. §2511(a) and §2101 and Regs. §20.2105-1

[3] Treas. Reg. §25.2501-1(b)

2. No definite present intention of leaving that place, i.e. intent to remain.

Quite obviously, determining intent can prove challenging. Courts will consider a variety of factors in analyzing an individual's intent. These include, but are not limited to, the following:

1. length of time an individual spends in the U.S. and in other countries
2. location of residences and cost and nature of residences
3. location of expensive possessions
4. location of investments
5. location of family and friends
6. location of church, club memberships, and business activities
7. declaration or statements of residence or intent in important documents such as estate planning documents, visa applications, tax returns, and oral statements
8. jurisdiction of driver's license and voter's registration.

Importantly, the visa status of a non-citizen is relevant but not determinative in the analysis of domicile for transfer tax purposes. Case law has found that a person may be treated as domiciled in the U.S. for transfer tax purposes even if she is illegally present in the U.S., provided that she intends to remain in the U.S. permanently. Case law has also found that individuals in the U.S. under a G-4 visa (such as employees of the World Bank, International Monetary Fund, or Inter-American Development Bank) may be considered domiciled in the U.S. for transfer tax purposes.

Additionally, an individual may be domiciled in multiple countries for transfer tax purposes. This could result in double taxation, as many countries impose transfer taxes based on domicile or residence. In this case, estate, and gift tax treaties (discussed in more detail below) may provide tie-breaking rules or provide economic relief. Note that §2014 of the Code provides a foreign death tax credit. The decedent receives a credit for any taxes paid to a foreign country in respect to property situated in the foreign country.

C. Estate and Gift Tax of Citizens and Resident Aliens. U.S. citizens and resident aliens are treated in the same manner for purposes of U.S. estate and gift tax.[4] The estate of a U.S. citizen or a resident alien will be subject to tax on the value of its worldwide assets, not only

[4] I.R.C. §2001(a)

those assets located in the U.S.[5] Both U.S. citizens and resident aliens enjoy an exclusion of $11.58 million. A U.S. citizen or resident alien will be subject to tax on gifts of property, wherever situated, if the value of the gifts exceeds the $15,000 annual exclusion.[6] A resident alien may split gifts with a U.S. citizen or a resident alien spouse.[7]

D. Estate and Gift Tax of Non-Resident Aliens. Non-resident aliens are subject to U.S. gift and estate tax.[8] However, they are taxed only on gifts of real and tangible personal property situated within and transferred within the U.S., and their estates only pay tax on property situated or deemed to be situated in the U.S. which the decedent owned at the time of his death.[9] Non-resident aliens enjoy an estate tax exclusion amount of $60,000. Certain deductions and credits which are available to citizens and resident aliens are limited or not available to non-resident aliens.[10]

As stated above, non-resident aliens are subject to gift tax only on transfers of real or tangible personal property situated in the U.S.[11] Gifts of intangible personal property such as stock in a U.S. corporation and debt obligations such as bonds and notes are not subject to gift tax.[12] Gift tax rates for non-resident aliens are identical to those for U.S. citizens and resident aliens, but non-resident aliens are not entitled to use any portion of the unified credit for inter vivos transfers. Non-resident aliens are entitled to the annual gift tax exclusion amount, presently $15,000, and are entitled to the unlimited exclusion for gifts for educational and medical expenses, and unlimited exclusion for gifts to citizen spouses.[13] The annual exclusion available for gifts to a non-citizen spouse has increased in 2020 to $157,000 (from $155,000 in 2019). Gift-splitting is not allowed.

E. Generation-Skipping Transfer Tax ("GST") of Non-Resident Aliens. A direct skip by a non-resident alien transferor will be subject to GST tax only if it is also subject to estate or gift

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[5] Treas. Reg. §20.0-2(b)(2)
[6] I.R.C. §2503 and Regs. §25.2501-1(a)
[7] I.R.C. §2513(a)(1)
[8] I.R.C. §2101
[9] I.R.C. §2501(a)(2) and §2106(a)
[10] I.R.C. §2106(b)
[11] I.R.C. §2501(a)(1), §2511(a), Treas. Reg. §25.2511-1(b)
[12] I.R.C. §2501(a)(2)
[13] I.R.C. §2503(b), 2403(e), Treas. Reg. §25.2523(i)-1(a) and (c)(2)

tax, and a taxable termination or taxable distribution of which a non-resident alien is the transferor will be subject to GST tax only if the initial transfer by the non-resident alien was subject to estate or gift tax. Essentially, if we as practitioners successfully plan for a non-resident alien to avoid any estate or gift tax, we also will have successfully avoided the imposition of any GST tax.

F. Determination of Gross Estate of Non-Resident Aliens. The gross estate of a non-resident alien includes only property situated in the U.S.[14] While this rule may seem straightforward, the determination of the situs of property is complicated. The Code does provide some guidance as to how to determine the situs of certain types of assets. Note that treaties may also alter the rules for determining the situs of property.

1. Property Deemed Within the U.S.

a. Intangible Personal Property: In general, intangible personal property is deemed to be situated within the U.S. if it is issued by or enforceable against a U.S. resident.[15]

(1) Stock: Shares of stock owned and held by a non-resident alien shall be deemed property within the U.S. only if issued by a domestic corporation.[16] Note that if a non-resident alien holds shares issued by a U.S. corporation through a foreign holding company, she will not be subject to U.S. estate tax on such asset because she owns shares of a foreign company.

(2) Trust Interests: In order for a trust interest of a non-resident alien to be subject to U.S. estate tax, her interest must be an indefeasibly vested interest that would be includible in the gross estate of a U.S. citizen or domiciliary under §2033-2046. If it is an indefeasibly vested interest, the situs rules of §2104 and §2105 apply to determine the U.S. tax liability. The rules apply to both the trust grantor and beneficiary. Therefore, any property which the decedent has transferred by trust or otherwise within the meaning of §2035-2038 is deemed to be situated in the U.S. if it was situated in the U.S. at the time of the decedent's death, or at the time of the lifetime transfer for gift tax purposes.[17]

[14] I.R.C. §2103
[15] Treas. Reg. §20.2104-1(a)(4)
[16] I.R.C. §2104(a)
[17] I.R.C. §2104(b)

(3) Debt Obligations: Debt Obligations issued by a U.S. person or the U.S., a state or any political subdivision thereof, or the District of Columbia, owned by a non-resident alien will be deemed to be situated in the U.S.[18] The situs of the actual instrument is not relevant.

b. Real Property: The situs of real property is generally determined by its physical location. U.S. real estate owned by a non-resident is subject to U.S. estate tax.[19] The full value of property subject to a mortgage is includable in the non-resident alien's estate. The amount of the lien is generally deductible only to the extent the ratio U.S. situs property bears to worldwide assets. If worldwide assets are not disclosed (and non-citizens are notoriously hesitant to disclose to any government their worldwide assets), no deduction may be claimed. One case, however, held that only the equity was includable in a non-resident alien's gross estate because the decedent was not personally liable for the mortgage, i.e., it was non-recourse.[20]

c. Tangible Personal Property: The situs of tangible personal property is generally determined by the physical location of the property at the time of death or the time of the gift. [21] Consequently, tangible personal property owned by a non-resident alien and physically in the U.S. at the time of death is subject to U.S. estate tax. However, tangible personal property brought to the U.S. by a visitor who dies in the U.S. is not subject to estate tax simply by reason of situs.[22]

2. Property Deemed Outside of the U.S.

a. Life Insurance: The amount receivable as insurance on the life of a non-resident alien is not be deemed property within the U.S.[23]

b. Bank Deposits: Bank deposits in U.S. banks are deemed to be situated outside the U.S. unless the deposits are effectively connected with the conduct of a U.S. trade or

[18] I.R.C. §2104(b)
[19] Treas. Reg. §20.2104-1(a)(1)
[20] Estate of Johnstone v. Comr., 19 T.C. 44 (1952); See Treas. Reg. §20.2053.7
[21] Treas. Reg. §20.2104-1(a)(2), §20.2105-1(a)(2), §25.2511-3(b)(1)
[22] *Delaney v. Murchie*, 177 F.2d 444 (1st Cir., 1947); *Estate of Paquette v. Comm'r*, 46 T.C.M. 1400 (1983).
[23] I.R.C. §2105(a)

business.[24] Note, however, that where a U.S. bank holds funds as a fiduciary or custodian, the deposit would be treated as U.S. property.[25] Cash in a U.S. safe deposit box is subject to U.S. estate tax.[26]

c. Foreign Bank Deposits: Deposits with a foreign branch of a domestic corporation or domestic partnership are deemed situated outside of the U.S. if such branch is engaged in the commercial banking business.[27]

d. Works of art on loan for exhibition: Works of art on loan for exhibition are not deemed property within the U.S. if such works of art are imported into the U.S. solely for exhibition purposes, loaned for such purposes to a public gallery or museum, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and at the time of the death of the owner, on exhibition, or en route to or from exhibition, in a public gallery or museum.[28]

e. Portfolio Interest and Corporate Debt Obligations: Debt instruments that generate interest qualifying as "portfolio interest" are excludible from the U.S. taxable estate of a non-resident alien.[29] The qualification rules are complex and can be found in §163(f)(2)(B). Debt obligations issued by U.S. corporations will not be considered U.S. situs property if the corporation meets the tests of §2104(c)(2).[30]

G. Deductions and Credits for Non-Resident Aliens. Non-resident aliens are subject to different deductions and credits against their estate and gift taxes than U.S. citizens and resident aliens. These deductions and credits are sometimes allocated on the basis of U.S. and foreign situs property and sometimes based on different rules.

1. Expenses, Losses, and Taxes. The estate of a non-resident alien is permitted a proportion of the deductions allowed in §2053 and §2054 for expenses, indebtedness, taxes, and losses. The proportion of the allowable deductions is the value of the decedent’s estate

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[24] I.R.C. §2105(b)(1)
[25] Rev. Rul. 69-596
[26] Rev. Rul. 55-143
[27] I.R.C. §2105(b)(2)
[28] I.R.C. §2105(c)
[29] I.R.C. §2105(b)(3)
[30] The author thanks Frederick J. Tansill for his contributions to this section and other sections of the outline.

located in the U.S. as compared to the value of the decedent's estate worldwide.[31] The deduction is taken on IRS Form 706-NA. If the personal representative of the estate is unable or refuses to disclose the decedent's worldwide assets, the deduction cannot be taken. No deductions are allowed for debts or expenses associated with property not situated in the U.S.

2. Charitable Contributions. The non-resident alien's estate may take the full value of charitable gifts or bequests as a deduction against estate taxes. The deduction is not based on the proportion of the assets located in the US., but there are still some restrictions. A charitable bequest only earns the estate a tax deduction if it is made solely for public purposes to a governmental entity within the U.S., a domestic corporation or a trustee, fraternal society, order or an association to be used within the U.S.[32] While a charitable transfer made to a foreign organization is not eligible for the deduction, a transfer to a domestic organization for use in a foreign country is allowable as a deduction.

3. Marital Deductions. Under prior law, the citizenship or residence of the decedent controlled whether the federal estate tax marital deduction was available. Since the passage of the Technical and Miscellaneous Revenue Act of 1998 ("TAMRA"), the surviving spouse's status determines whether the marital deduction is available.

If the decedent is a non-resident alien, the marital deduction is permitted "under the principals of §2056" if the surviving spouse is a U.S. citizen.[33]

If the decedent is a U.S. citizen or resident alien but the surviving spouse is not a U.S. citizen, the marital deduction is generally not permitted.[34] Importantly, there are exceptions to this rule. The marital deduction is available if two requirements are met:

(a) the transfer would have qualified for the deduction if the surviving spouse had been a U.S. citizen[35]; and either

(b-1) the surviving spouse becomes a U.S. citizen before the date on which the federal estate tax is made[36] or

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[31] I.R.C. §2106(a)(1)
[32] I.R.C. §2106(a)(2)
[33] I.R.C. §2106(a)(3)
[34] I.R.C. §2056(d) and §2056A
[35] Treas. Reg. §20.2056A-2(b)
[36] I.R.C. §2056(d)(4), Treas. Reg. §20.2056A-1(b)

(b-2) the property passes from the decedent to the surviving spouse in a Qualified Domestic Trust ("QDOT") with respect to which an election is made.[37]

The alternative "passing to the surviving spouse in a QDOT" is satisfied in one of four ways:

(i) Direct transfer to a QDOT established by the decedent spouse, e.g., a QDOT set forth in decedent's will or revocable trust.[38]

(ii) Direct transfer to a trust that is not a QDOT but is reformed in a timely manner, e.g., a QTIP trust which does not include the required QDOT provisions.[39]

(iii) By transfer to the surviving spouse in an otherwise qualifying disposition, followed by a transfer or irrevocable assignment by the surviving spouse of the property to a QDOT before the federal estate tax return is filed.[40]

(iv) By satisfying various special requirements if the assets passing to the surviving spouse consist of non-assignable or non-transferable annuities, pension plan benefits or similar rights.[41]

It is important to note that certain estate tax treaties recognize some form of marital deduction and the rules vary from treaty to treaty. It is necessary for practitioners to review appropriate treaty provisions to determine the applicable marital deduction rules. The executor may choose the rules and deduction of §2056A or the treaty provisions and deduction, but not both.[42]

4. Special Rules Regarding the Marital Deduction.

(a) Credit for Tax on Prior Transfer if Surviving Spouse Dies a U.S. Resident. If a U.S. citizen or resident alien decedent leaves property to her alien spouse which is taxed in her estate but would have qualified for the marital deduction had the surviving spouse been a citizen, and her spouse later dies a citizen or alien resident in the U.S., the surviving spouse's

[37] I.R.C. §2056(d)(2)
[38] I.R.C. §2056(d)(2)(A)
[39] I.R.C. §2056(d)(5); Treas. Reg. §20.2056A-4(a)
[40] I.R.C. §2056(d)(2)(B); Treas. Reg. §20.2056A-4(b)
[41] Treas. Reg. §20.2056A-4(c)
[42] Treas. Reg. §20.2056A-1(c)

estate is entitled to a §2013 credit for the tax on the prior transfer irrespective of the amount of time that has passed since the first decedent's death.[43]

(b) Lifetime Gift to Non-Citizen Spouse. If an inter vivos gift is made to an alien spouse, no marital deduction is available, even if the transfer is to a trust which meets all the requirements for a qualified domestic trust. However, under §2523(i) a gift tax annual exclusion is available for gifts to a non-citizen spouse.

(c) Joint Property Presumption. If a U.S. citizen or resident alien decedent's surviving spouse is an alien (resident or nonresident), and the spouses had a tenancy by the entirety or joint tenancy with right of survivorship in real estate or a joint interest in personal property with right of survivorship, the rule that one-half (1/2) of the value of the jointly-owned property shall be included in the gross estate of a decedent co-owner is inapplicable, and instead the decedent's estate will be taxed on the entire value of the jointly-owned property except to the extent that the estate can show that the survivor provided consideration or the property was given or devised or bequeathed to them jointly by another person.[44] The rule applies whether the decedent is a U.S. citizen, a resident alien, or a non-resident alien.

(d) Unified Credit. The same tax rates are now applicable to the estate of non-resident aliens as are applicable to the estate of citizens and resident aliens.[45] The lower rates which used to apply to non-resident aliens are no longer applicable. Every non-resident alien is allowed a unified credit in the amount of $13,000 which can be used as a credit against the first $60,000 of estate taxes, not gift taxes.[46] An estate tax treaty between the U.S. and the country of which the decedent is a citizen may provide for a unified credit equal to a proportionate share of the estate tax exemption available to citizens and resident aliens, the proportion being the value the decedent's estate located in the U.S. bears to the value of the decedent's estate around the world.[47]

[43] I.R.C. §2056(d)(3)
[44] Treas. Reg. §2523(i)-2(b)(1), (b)(2)(i) and (b)(4)(ii) Ex. 1.
[45] I.R.C. §2101(b)
[46] I.R.C. §2102(c)(1); I.R.C. §2505(a)
[47] I.R.C. §2102(c)(3)(A)

H. Qualified Domestic Trust ("QDOT"). As stated above, if a surviving spouse is not a U.S. citizen, there is no marital deduction unless an exception applies.[48] One of the exceptions involves the use of a "qualified domestic trust." There are a number of requirements for a trust to qualify as a QDOT.[49]

1. It must be an ordinary trust as defined in Treas. Reg. §301.7701-4(a) and 20.2056A-1(a).

2. The trust must be "maintained" under the laws of a state or the District of Columbia and the administration of the trust must be governed under the laws of such a jurisdiction.[50]

3. At least one trustee must be an individual U.S. citizen with a tax home in the U.S. or a domestic corporation.[51]

4. The U.S. Trustee must have the right to withhold the special QDOT tax on any distribution subject to that tax.[52]

5. The trust must contain detailed requirements to ensure the collection of the QDOT tax.[53] The exact nature of these requirements turns on whether the adjusted fair market value of QDOT assets, as finally determined at the decedent's death, exceeds $2 million, with the executor having the ability to exclude up to $600,000 attributable to a personal residence and furnishings. If total QDOT assets are less than $2 million, the less onerous rules are only applicable if foreign real estate holdings are less than 35% of the fair market value of the trust assets. The latter determination is made annually on the last day of the taxable year of the trust. Accordingly, foreign real estate holdings can cause a trust to move from one set of compliance requirements to another as asset valuations fluctuate.

6. The final requirement concerns an election to qualify the trust that must be made by the Executor.[54]

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[48] I.R.C. §2056(d)(1)
[49] I.R.C. §2056(A)
[50] Treas. Reg. §20.2056A-2(a)
[51] Treas. Reg. §5205A-2(c)
[52] I.R.C. §2056A(a)(1)(B)
[53] Treas. Reg. §20.2056A-2(d)
[54] Treas. Reg. §20.2056A-3

(a) Timing: the election must be made on the last federal estate tax return filed before the due date (including extensions granted), or if a timely return is not filed, the first return filed after the due date, but no later than one year after the date that the return was required to be filed.[55]

(b) No partial elections: the election cannot be partial, but if a single trust is severed into two or more trusts in a timely fashion, an election may be made with respect to one or more of the severed trusts.[56]

(c) Protective elections: a protective election is permitted but only if the executor believes that there is a bona fide issue concerning the residency/citizenship of the decedent or the citizenship of the surviving spouse, or whether an asset is includable in the decedent's estate, or the amount or nature of the property the surviving spouse is entitled to receive.[57]

(d) Irrevocable nature: once made, the election cannot be revoked.[58]

I. Taxation of QDOT. The QDOT allows postponement of the estate tax until a subsequent taxable event, typically the death of the surviving spouse, but the tax that is ultimately assessed is that of the first spouse to die. (This should be contrasted with the treatment of QTIP trusts.) A QDOT tax is imposed at the following events:

1. Lifetime distributions, plus the amount withheld by the U.S. Trustee to pay the tax, subject to important exceptions for hardship distributions."[59] Hardship distributions are made in response to "immediate and substantial financial need relating to health, education, maintenance or support of the surviving spouse or anyone the surviving spouse is legally obligated to support."[60] The amount must not be obtainable from another reasonably available source.

2. Distributions at the surviving spouse's later death.

3. Cessation of QDOT status during the surviving spouse's lifetime.

[55] Treas. Reg. §20.2056A-3(a).
[56] Treas. Reg. §20.2056A-3(b).
[57] Treas. Reg. §20.2056A-3(c).
[58] Treas. Reg. §20.2056A-3(a).
[59] Treas. Reg. §20.2056A-5(b), (c)
[60] I.R.C. §2056(A)(b)(3)(B), Treas. Reg. §20.2056A-5(c)(1)

J. Naturalization of Surviving Spouse After QDOT Election. If a spouse is a U.S. resident and becomes a citizen after the QDOT is established (and after the decedent's estate tax return was filed), no additional tax will be incurred; instead taxes will be incurred under the normal tax rules for a U.S. citizen or resident, as if the trust belonged to the surviving spouse, meaning there will be no income tax to the surviving spouse on a principal distribution.[61]

Recognizing that surviving non-citizen spouses may want to become naturalized to be eligible to receive the principal distributions without onerous tax consequences, QDOTs should be drafted to anticipate the possible conversion to simple QTIP status in the event of naturalization, and to permit the principal distributions in the event the QDOT converts to a simple QTIP.

K. Income Distribution Requirement in a QDOT. A spouse must have a qualifying income interest for life in a trust in order to have it qualify for the marital deduction, and in addition to meeting the requirements of §2056A, a QDOT must qualify for the marital deduction under §2056(a). A spouse has a qualifying income interest for life if such spouse is entitled to all of the income from the property payable at least annually, and no person has the power to appoint any part of the property to anyone other than the spouse.[62] Therefore it is necessary to express this income distribution requirement in a QDOT.

L. Cross-Border Considerations and Treaties. The U.S. is party to several estate and gift tax treaties which are designed to reduce exposure to double taxation that could result when both the U.S. and another country aim to impose transfer tax. When planning the estate of a non-resident alien, it is important to determine whether a gift and estate tax treaty is in force between the U.S. and the country of which the non-resident alien is a citizen because treaty provisions often alter the statutory scheme for the taxation of these individuals. Many treaties offer more favorable exemptions and change situs of the asset so that the asset could be excluded from U.S. estate tax. Analysis is particularly important if a client or a client's spouse is treated as a tax resident of another country, if a client owns property in another country, or if a

[61] I.R.C. §2056A(b)(12)
[62] I.R.C. §2056(b)(7)(B)(ii)

client is considering making gifts or bequests to residents of another country. In order to take advantage of tax treaty rules, one must file an IRS Form 8833.

For a comprehensive list of the countries that the U.S. has an estate and/or gift tax treaty with, visit this website: https://www.irs.gov/businesses/small-businesses-self-employed/estate-gift-tax-treaties-international

II. INCOME TAXATION

A. Overview. The U.S. taxes its citizens and resident aliens on worldwide income regardless of where the income is derived or where its citizens live. Consequently, a U.S. citizen living or working in another country may have her income subject to tax in both the U.S. and in another country. The U.S. also taxes non-citizens who are considered U.S. residents for income tax purposes on worldwide income. Non-citizens include permanent residents who have green cards or individuals who spend a certain number of days physically in the U.S.

The U.S. taxes non-resident aliens only on their U.S. source income. This includes income that is derived from a source in the U.S. (for example, from services performed in the U.S.), or income that is effectively connected with a U.S. trade or business.

B. Worldwide Scope of U.S. Taxation. The U.S. taxes worldwide income of individuals, corporations, and decedents and donors. There are generally two taxation theories, residence-based taxation theory and source-based taxation theory.

1. Residence: idea that taxation is the price you pay for things you get when your primary affiliation is with the U.S.

2. Source: idea that taxation is the price you pay for carrying on business or investment activities in the U.S.

When a U.S. person works and travels abroad, the U.S. taxes her on the residence-based taxation theory. When a non-U.S. person comes to the U.S., the U.S. taxes her on the source-based taxation theory. If an individual pays or accrues foreign taxes to a foreign country and is subject to U.S. tax on the same income, the individual may be able to take either a credit or an itemized deduction for those taxes. This is known as the foreign tax credit, discussed in more detail below.

C. Determining Residency and Domicile. The definition of residence and domicile for income tax purposes is different than the definition for transfer tax purposes. As discussed above, the residency test for transfer tax purposes is highly subjective based on the intent of the transferor, whereas the test for income tax purposes is highly objective. A non-U.S. citizen is deemed to be a U.S. resident for income tax purposes if (1) the individual is a lawful permanent resident of the U.S. at any time during the calendar year, i.e. a green card holder, (2) if the individual meets the substantial presence test, or (3) if the individual makes a first year election to be treated as a resident.[63] Note that treaties may impact on the issue of residency for income tax purposes.

D. Green Card Test. An individual is a resident for income tax purposes if such individual is a lawful permanent resident of the U.S. at any time during the calendar year. An individual is a lawful permanent resident of the U.S., at any time, if the individual has been given the privilege, according to the immigration laws, of residing permanently in the U.S. as an immigrant. An individual generally has this status if the U.S. Citizenship and Immigration Services (USCIS) issued the individual an alien registration card, Form I-551, also known as a "green card." An individual continues to have U.S. resident status, under this test, unless: (1) the individual voluntarily renounces and abandons this status in writing to the USCIS, (2) the individual's immigrant status is administratively terminated by the USCIS, or (3) the immigrant status is judicially terminated by a U.S. federal court.

E. Substantial Presence Test. The substantial presence test provides predictability regarding when a non-resident will be treated as a resident for tax purposes. The criteria is the number of days the individual has spent in the U.S. An alien individual is a U.S. resident under the substantial presence test in the tested calendar year if:

1. The individual is present in the U.S. on at least 31 days during the tested calendar year; and
2. The sum of
    (a) The number of days of presence in the tested calendar year;

[63] I.R.C. §7701(b)

(b) one-third of the number of days of presence in the preceding calendar year; and

(c) one-sixth of the number of days in the second preceding calendar year

totals 183 or more days.[64]

Alien individuals who meet the substantial presence test for a given calendar year by virtue of having spent enough time in the U.S. are generally treated as U.S. residents for that year.[65] There are two exceptions to the substantial presence rule. An individual is not treated as a resident for income tax purposes if (1) the individual does not spend at least 30 days a year in the U.S. during the year in question, and (2) if the individual is in the U.S. for more than 183 days but can show that she maintains a tax home in a foreign country with which that person has a closer connection.

An alien individual's physical presence in the U.S. is disregarded in the following capacities:

1. as a foreign government-related individual (A-visa or G-visa holders)
2. as a teacher or trainee (only for a limited number of years)
3. as a student (only for a limited number of years)
4. as a professional athlete
5. an individual with a medical condition that arose in the U.S.
6. as a commuter from Canada or Mexico
7. as an individual in transit between two foreign points. [66]

F. <u>Income Taxation of Non-Resident Aliens</u>. Non-resident aliens are generally subject to U.S. income tax only on their U.S. source income. They are subject to two different tax rates, one for effectively connected income (ECI), and one for fixed or determinable, annual, or periodic (FDAP) income. ECI is earned in the U.S. from the operation of a business in the U.S. or is personal service income earned in the U.S. such as wages or self-employment income. [67] The

[64] I.R.C. §7701(b)(3)
[65] I.R.C. §7701(b)(1)(A)(ii)
[66] I.R.C. §7701
[67] I.R.C. §871(b)(2)

tax on such income is imposed at the same graduated rates used for a U.S. citizen. [68] FDAP income is passive income such as interest, dividends, rents or royalties (such as income earned by a foreign investor). This income is taxed at a flat 30% rate and is withheld at the source. [69] unless a tax treaty specifies a lower rate. Note that treaties frequently reduce or eliminate the 30% withholding tax on certain types of investment income.

1. Portfolio and Interest Income. Non-resident aliens are exempt from this 30% withholding tax for interest earned from certain portfolio debt investments and other interest producing investments.[70] The interest exclusions almost swallow up the general rule as it pertains to interest income. As a result, investments which produce excluded and non-taxable interest income are tax-favored and popular instruments from non-resident aliens. The exclusions include the following:

(a) Portfolio Interest: Portfolio investments are passive, as opposed to direct investments in which the investor influences or controls the investment. Portfolio interest income is exempt from taxation if it received by a foreign taxpayer who owns either directly or indirectly less than 10% of the stock of the obligor U.S. corporation and the interest is paid either on (1) an obligation which is not registered but is issued under arrangements intended to insure that it will not be sold to U.S. persons and satisfies certain other restrictions or (2) an obligation which is registered and a statement is provided that the beneficial owner is not a U.S. person. These portfolio investments are basically specifically qualified corporate bonds, debentures, and notes. The 1993 Tax Act clarified the law to the effect that contingent interest is generally not exempt.[71]

(b) Certain Bank Deposit Interest: Certain interest-generating deposits of non-resident aliens not involved in a U.S. trade or business are excluded from U.S. income tax. The deposits excluded are (i) deposits with banks, (ii) deposits with savings and loan institutions, and (iii) amounts held by an insurance company under an agreement to pay interest thereon.

[68] I.R.C. §871(b)(1)
[69] I.R.C. §871(a)(1), §1441, §1442
[70] I.C.C. §871, §881, §864(c)(2), §1441, and §1442
[71] I.R.C. §871(h), §881(c), §1441(c)(9), §1442, §2105(b)

(c) Interest on Government Debt: Traditionally, interest from any state, territory or possession of the U.S. was not considered to be included in gross income so it was not taxable in the hands of a non-resident alien.[72]

(d) Original Issue Discount Income: Original issue discount (within the meaning of §1233) on any bond or other indebtedness is exempt from taxation if the debt instrument matures within 183 days from its issue, without regard to the taxpayer's holding period. Three- and six-month Treasury Bills produce original issue discount income that is not taxable to a foreign investor.[73]

2. Dividend Income. Non-resident aliens are subject to a flat 30% income tax (unless otherwise modified by applicable treaty, which frequently reduce the rate to 15% or even 5%) on U.S. source dividend income, to the extent such income is not effectively connected with a trade or business. Dividend income is U.S. source income if it paid with respect to stock in a U.S. corporation. Dividend income paid by a foreign corporation is sourced in the U.S. if 25% or more of a corporation's gross income for the period is income effectively connected with the corporation's U.S. business. The various types of dividend paying investments available to non-resident aliens include the following when held for investment, not effectively connected with the conduct of U.S. trade or business:

(a) Individual issues or mutual funds of common stock in U.S. corporation.

(b) Individual issues or mutual funds of preferred stock in U.S. corporation.

(c) Money-market mutual funds.[74]

3. Capital Gains. Capital gains from U.S. sources other than U.S. real estate and business activities actively conducted by the non-resident alien in the U.S. are not subject to U.S. income tax.[75]

4. Real Estate. U.S. real estate investments by foreign investors are subject to the highly complex provisions of the Foreign Investors in U.S. Real Property Tax Act (FIRPTA).[76] FIRPTA

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[72] I.R.C. §871(g)(1)(B)(ii)
[73] I.R.C. §871(g)(1)(B)
[74] I.R.C. §871
[75] I.R.C. §871
[76] I.R.C. §897

imposes income tax on foreign persons disposing of U.S. real property interests. Broadly stated, when a non-resident alien sells U.S. real estate, capital gains tax is owed.

G. Sources of Relief from Double Taxation. Non-resident aliens who have U.S. source income or income effectively connected with a U.S. trade or business often receive relief from certain provisions of the tax code, as well as from income tax treaties entered into between the U.S. and foreign countries.

1. Relief Provided by U.S. Tax Law. The Code provides relief for U.S. citizens and tax residents who receive income from foreign sources, with the goal of avoiding taxation by multiple jurisdictions. The primary relief available is the foreign tax credit. It reconciles the issue of double taxation resulting from the residence and source-based taxes. Oftentimes, the source country gets the tax first, then the U.S. gives credit against the U.S. tax liability for foreign taxes imposed on foreign source income or property of U.S. residents and domestic corporations. The foreign tax credit is available to income and estate tax, but not gift tax purposes.

Another form of relief is the foreign earned income exclusion. A U.S. citizen or a resident alien of the U.S. living abroad is taxed on worldwide income. But such individual may qualify to exclude her foreign earnings from income up to an amount that is adjusted annually for inflation ($107,600 for 2020). In addition, the individual can exclude or deduct certain foreign housing amounts.

2. Treaties. The U.S. is party to several income tax treaties which are designed to mitigate the effects of double taxation in two jurisdictions which results from international economic activity. These tax treaties often contain provisions that exclude certain types of income from U.S. taxation, provisions that avoid double taxation, and provisions that subject the income to lower tax rates. For a comprehensive list of the countries that the U.S. has an income tax treaty with, visit this website: https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z

3. Tax Information Exchange Agreements (TIEA). The U.S. also enters into Tax Information Exchange Agreements (TIEA) when it is not practical to have a full-scale treaty. TIEAs allow the U.S. and the TIEA partner to exchange information on tax matters in order to provide assistance to each other in the administration and enforcement of domestic tax laws.

4. Mutual Agreement Procedure (MAP). Additionally, if a U.S. resident for purposes of a U.S. income tax treaty can request assistance from the U.S. competent authority if she thinks that the actions of the U.S., a treaty country, or both, cause or will cause double taxation or taxation otherwise inconsistent with the treaty. This procedure allows the individual to seek relief. The two competent authorities in the respective countries convene and try to eliminate double taxation by allocating the tax between the two countries. The competent authorities have the power to negotiate a resolution.

III. FOREIGN TRUSTS

A. Overview. Under prior law, the use of foreign trusts by U.S. taxpayers could provide substantial income tax advantages. If a U.S. grantor established a trust for the benefit of a U.S. beneficiary in another country that did not impose income tax on trusts, the trust was not subject to income tax in either the U.S. or in the foreign country. Since 1976, the law has altered the tax treatment of foreign trusts. U.S. taxpayers who establish foreign trusts and U.S. taxpayers who are the beneficiaries of foreign trusts have extensive reporting obligations. Foreign trusts can be useful estate planning tools, but they also present tax traps for the unwary, and such trusts must be carefully monitored. Practitioners must be particularly mindful of the potential problems that arise when a U.S. trust inadvertently becomes a foreign trust.

B. Classification of Trusts. For federal income tax purposes, there are two characteristics for a trust:

1. Foreign or Domestic (U.S.)
2. Grantor or Nongrantor

Taxation of a trust and its beneficiaries depends on these characteristics. The classification of a trust as foreign or domestic impacts how the activities of the trust should be reported and taxed for U.S. tax purposes. A U.S. person who creates a foreign trust, even if she has no control over the trust, may be subject to tax on all income and gains on the property transferred to the trust under the grantor trust rules.

C. Foreign or Domestic: Pre-1997, in order to determine whether a trust was foreign or domestic, consideration was given to a variety of facts and circumstances, including the country where the trust was created and administered, where the trust assets were located, and the

nationality and residence of the grantor, beneficiaries, and trustee. These rules made it difficult to determine definitively whether a trust was foreign or domestic.

The Small Business Job Protection Act of 1996 established a two-part test on this issue, and the law added §7701(a)(30)(E). Under this section, an objective test is applied. A trust is considered a foreign trust unless it meets the following two tests:

1. The Court Test
2. The Control Test

In order to have a U.S. trust, both tests must be satisfied. If either test fails, the trust is a foreign trust.[77]

1. The Court Test: A trust meets the court test if "A court within the U.S. is able to exercise primary supervision over the administration of the trust."[78]

If a U.S. court has authority under applicable law to render orders or judgments resolving issues concerning administration of the trust and to determine substantially all issues regarding the administration of the entire trust, the court test is satisfied. There is a safe harbor in the Regulations which provides that a trust satisfies the court test if

(a) the trust instrument does not direct that the trust be administered outside of the U.S.;

(b) the trust is administered exclusively in the U.S.; and

(c) the trust is not subject to an automatic migration rule.[79]

There are certain situations in which a trust satisfies the court test. The four situations described are not intended to be an exclusive list. [80]

(a) Uniform Probate Code: if the trust is registered by an authorized fiduciary or fiduciaries of the trust in a court within the U.S.

(b) Testamentary trust: if all fiduciaries of the trust have been qualified as trustees of the trust by a court within the U.S.

[77] I.R.C. §7701(a)(31)(B)
[78] Treas. Reg. §301.7701-7 (a)(1)(i)
[79] Treas. Reg. §301.7701-7 (c)(1)
[80] Treas. Reg. §301.7701-7 (c)(4)

(c) Inter vivos trust: if the fiduciaries and/or beneficiaries take steps with a court within the U.S. that cause the administration of the trust to be subject to the primary supervision of the court.

(d) A U.S. court and a foreign court are able to exercise primary supervision over the administration of the trust.

2. The Control Test: A trust meets the control test if "One or more United States persons have the authority to control all substantial decisions of the trust."[81]

(a) The term "United States person" means a U.S. person within the meaning of IRC §7701(a)(30)

(b) "Substantial decisions" are fiduciary decisions authorized or required under the terms of the trust agreement and applicable law, such as the timing or amount of distributions, the selection of beneficiaries, the additional or removal of trustees, investment decisions, and the allocation of amounts to principal or income.[82]Substantial decisions do not include acts that are ministerial such as book-keeping, collection of rent, and execution of investment decisions made by others.

(c) "Control" means having the power, by vote or otherwise, to make all of the substantial decisions of the trust, with no other person having the power to veto any of those substantial decisions.[83]

(d) To determine whether a U.S. person has authority to control all substantial decisions, consideration must be given to all persons who have authority to make a substantial decision of the trust, not only the trustees (i.e. a trust protector).

(e) In the event of an inadvertent change in any person that has the power to make a substantial decision of the trust that would cause the domestic or foreign residency of the trust to change, the trust is allowed twelve (12) months from the date of the change to make necessary changes either with respect to the persons who control the substantial decisions or with respect to the residence of such persons to avoid a change in the trust's residency.

[81] Treas. Reg. §301.7701-7 (a)(1)(ii)
[82] Treas. Reg. §301.7701-7 (d)(1)(ii)
[83] Treas. Reg. §301.7701-7 (d)(1)(iii)

3. Observation about the Court and Control Tests. Note that under these tests, a trust may be a foreign trust for U.S. tax purposes even if it as created by a U.S. person, all of its beneficiaries are U.S. persons, and all of its assets are situated in the U.S., if one foreign person possesses an element of control over one substantial type of trust decision.

4. Special Rule: A trust is not considered to have met the court test nor the control test if the trust instrument contains an automatic migration provision or "flee clause."[84] An automatic migration rule or flee clause transfers jurisdiction and control of the trust to a different (foreign) jurisdiction under certain circumstances, such as

(a) an attempt by a U.S. Court to assert jurisdiction or otherwise supervise the administration of the trust (except in the case of foreign invasion of the U.S. or widespread confiscation or nationalization of property in the U.S.)

(b) an attempt by any government agency or creditor to collect information from the trust

(c) an attempt by any government agency or creditor to assert a claim against the trust.

D. Grantor or Non-Grantor. After determining that a trust is a foreign trust, the next determination is whether the foreign trust is a grantor or nongrantor trust. Determining whether a trust is a grantor or nongrantor trust is necessary because it affects who is taxed on the trust income and when they are taxed. If a foreign trust is characterized as a grantor trust under §671–679, the grantor is treated as the owner of the trust for U.S. tax purposes. If a U.S. person is treated as the owner of a trust for U.S. tax purposes under the grantor trust rules, then the U.S. person must report its share of trust income, deductions and credits on its income tax return as if those items were directly received by or paid to that U.S. person.[85]

1. A foreign trust is a grantor trust if:

(a) established by a U.S. person and:

- the grantor is treated as owner under the grantor trust rules, or
- the trust has, or is deemed to have, U.S beneficiaries[86]

[84] Treas. Reg. §301.7701-7 (c)(4)(ii) and Treas. Reg. §301.7701-7 (d)(v)(3)
[85] https://www.irs.gov/pub/int_practice_units/FEN9432_02_07R.pdf
[86] I.R.C. §679

(b) established by a non-U.S. person and;

- revocable by the grantor, or

-distributions may be made only to the grantor or grantor's spouse during the grantor's lifetime.[87]

2. Any foreign trust not determined to be a grantor trust will be treated as a foreign nongrantor trust for U.S. tax purposes. Nongrantor trusts are separate taxpayers. Income and gains accumulated in the trust are taxable to the trust. If income and gains are distributed to beneficiaries, then the trust receives a deduction and the beneficiaries are taxed on the distributions of income. Nongrantor trusts are subject to tax as a non-resident alien individual, i.e. taxed in the U.S. on the U.S. source income, and non-U.S. source is not subject to tax. Note that the tax rules regarding nongrantor foreign trusts are incredibly complicated and practitioners should consult with tax experts on such matters.

E. Reporting Requirements. Reporting is required by U.S. persons who transfer assets to foreign trusts, U.S. owners of foreign trusts, U.S. beneficiaries of foreign trusts, and U.S. persons who receive large gifts or bequests from foreign persons. Failure to comply with these reporting requirements can have severe penalties. Some of the most common reporting requirements are listed below.

1. Form 3520: Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. This form is required for any U.S. person who makes a transfer or loan to a foreign trust, receives a distribution from a foreign trust, receives the uncompensated use of property of a foreign trust, receives a loan from a foreign trust, is treated as an owner of a foreign trust under the grantor trust rules, or receives a large gift or bequest from a foreign person.

2. Form 3520A: Annual Information Return of Foreign Trust With a U.S. Owner. This form is required for a foreign trust with a U.S. owner. The U.S. owner is responsible for making sure that the foreign trust files the 3520A, and if the trust does not file, the U.S. owner can file it himself. The form reports a balance sheet of the foreign trust and an income statement.

[87] I.R.C. §672(f)

3. Form 1040: U.S. Individual Income Tax Return. A notation must be made on PART III of Schedule B ("Foreign Accounts and Trusts") of the grantor's 1040 disclosing that a transfer has been made to a foreign trust.

4. Form 1040NR: U.S. Nonresident Alien Income Tax Return. This form must be filed by the fiduciary of a foreign trust (and must also be filed by a non-resident alien who is engaged in a U.S. trade or business).

5. FBAR (FinCEN Form 114): Report of Foreign Bank and Financial Accounts. This form is required for any U.S. citizen or resident who has a financial interest in, signature authority over, or other authority over, foreign financial accounts with aggregate balances greater than $10,000 at any time during the year.

6. Form 8938: Statement of Specified Foreign Financial Assets. This form is required for individuals with an interest in a "specified foreign financial asset" disclosing the aggregate value of such assets over a threshold. "Specified foreign financial asset" includes bank accounts, stocks, hedge funds, foreign pensions, financial instruments, interests in foreign entities. This filing requirement stems from FATCA (discussed in more detail below).

F. Planning with Foreign Trusts. When Congress redefined the term "foreign trust" in 1997, a principal purpose was to enhance trust business in the U.S. Under this new definition, a foreign person can use a U.S. financial institution as trustee without creating a U.S. trust. The author notes that most foreign trusts encountered by trusts and estates practitioners counseling U.S. clients will be grantor trusts.

Below is a broad outline of the types of foreign trusts that may be encountered:

1. U.S. Grantors and U.S. Beneficiaries: most common use is an offshore asset protection trust established by a U.S. resident. This trust is typically a grantor trust under §679.

2. U.S. Grantors and Foreign Beneficiaries: could be used to accumulate tax-free income for eventual distribution to beneficiaries who live in a foreign country. This trust would generally not be a grantor trust under §679 unless there could be a U.S. beneficiary in the future.

3. Foreign Grantors and Foreign Beneficiaries: unless there is any connection to the U.S. which could trigger U.S. tax (such as investments in the U.S.), this type of foreign trust would escape U.S. taxation because the grantor, beneficiaries, and trust are all foreign.

4. Foreign Grantors and U.S. Beneficiaries: foreign trusts are an effective tool for foreign grantors whose children are U.S. residents or citizens. If the trust is a grantor trust, it will not be taxed in the U.S.

IV. REPORTING AND COMPLIANCE ISSUES

A. Overview. As stated above, U.S. citizens and resident aliens are taxed on their worldwide income. Some U.S. taxpayers use undisclosed foreign accounts and undisclosed foreign entities to avoid or evade tax compliance with U.S. tax laws. Of course this has the effect of reducing the tax revenue of the U.S. government. One IRS commissioner estimated that tax evasion by individuals with unreported financial accounts amounted to tens of billions of dollars. In the U.S., there had been a long period of neglect in confronting the issues of tax evasion and fraud. In recent years, however, the IRS has cracked down on tax fraud committed through undisclosed offshore accounts and assets. President Obama made it a priority of his administration and encouraged the adoption of broad disclosure requirements to be imposed on offshore banks with U.S. customers. Some of these disclosure programs are discussed below.

It is worth noting that the U.S. was the first country to take substantial steps to tackle the issue of cross-border tax avoidance. When the U.S. initiated some of these programs, there was international resistance from foreign countries and financial institutions who felt that the U.S. was over-reaching in instituting reporting requirements that foreign financial institutions had to comply with. They felt that complying with U.S. laws in disclosing the information of account owners could violate the laws of their own country, including privacy laws, and that the costs of compliance would be onerous. But over time, the governments of these countries realized that their own citizens were also evading tax and their own tax revenues were suffering as a result. Eventually, many foreign countries, including the G20, enthusiastically joined in the effort. Worldwide cooperation and coordinated efforts to enforce the reporting of financial

accounts and assets has many positive repercussions. Such efforts discourage money laundering, terrorist financial transfers, criminal activity, and tax evasion.

B. Voluntary Disclosure. The Offshore Voluntary Disclosure Program (OVDP) was introduced by the I.R.S. in 2009. This voluntary disclosure program was specifically designed for taxpayers with exposure to potential criminal liability and/or substantial civil penalties due to a willful failure to report foreign financial assets and pay all tax owed. OVDP is designed to provide to taxpayers with such exposure protection from criminal liability and terms for resolving their civil tax and penalty obligations.[88] Modifications to the program have been made in result years, and in 2018, the IRS closed the OVDP program. However, it continues to allow certain taxpayers (U.S. residents and nonresident taxpayers) to use its streamlined procedures. These procedures are available for those who meet certain requirements, but essentially they are available for those individuals whose failure to report foreign income and accurately file U.S. tax returns is non-willful and results from a good faith misunderstanding of tax requirements.

C. Foreign Account Tax Compliance Act (FATCA). The Foreign Account Tax Compliance Act (FATCA) was enacted in the U.S. in 2010 as part of the Hiring Incentives to Resort Employment (HIRE) Act. FATCA requires that accounts held by U.S. citizens and U.S. persons for tax purposes in another country's jurisdiction must be reported. FATCA seeks to combat tax evasion by U.S. persons holding financial assets outside of the U.S. FATCA regulations require that foreign financial institutions ("FFIs") meet the following requirements:

1. FFIs must identify accounts held by U.S. persons, directly or indirectly, through non-U.S. entities (trusts, corporations, limited partnerships, foundations) which they hold an interest in or over which they exercise control.

2. FFIs must identify accounts held by FFIs which are not complying with their FATCA obligations (classified as "nonparticipating foreign financial institutions" or "NPFFIs").

3. FFIs must report these accounts with all relevant financial information to the IRS directly or to the local competent authority, and must apply a 30% withholding on all U.S.

[88] https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program

source payments such as income and gross proceeds from the sale or disposal of U.S. assets of uncooperative U.S. accounts and NPFFIs.

FATCA was implemented by U.S. authorities through the U.S. Treasury Regulations. Because such regulations impacted foreign financial institutions, the U.S. Treasury released model framework intergovernmental agreements ("IGAs") which have been signed by numerous countries. Financial institutions in countries that sign an IGA with the U.S. are required to comply with the FATCA regime. This requires financial institutions to review all its pre-existing entity accounts, whether held by U.S. entities or non-U.S. entities. Since the institution of FATCA, other countries have attempted to implement the automatic exchange of financial account information.

D. Common Reporting Standard (CRS). The Common Reporting Standard (CRS) was developed by the Organization for Economic Cooperation and Development (OECD) in 2014. According to the OECD's website, the CRS "calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. It sets out the financial account information to be exchanged, the financial institutions required to report, the different types of accounts and taxpayers covered, as well as common due diligence procedures to be followed by financial institutions."[89] CRS is based on FATCA and its principal purpose is to combat tax evasion. Presently there are over 156 countries participating in the CRS, although the U.S. is not a participating country.

E. Reporting Requirements. Below is a list of some of the tax forms which taxpayers with interests in foreign assets, accounts, or entities may be required to file.

1. Form 3520: Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts (discussed in more detail above)

2. Form 3520A: Annual Information Return of Foreign Trust With a U.S. Owner (discussed in more detail above)

3. Fin CEN Report 114 (FBAR): Foreign Bank and Financial Accounts (discussed in more detail above)

[89] https://www.oecd.org/tax/automatic-exchange/common-reporting-standard/

4. Form 8938: Statement of Specified Foreign Financial Assets (discussed in more detail above)

5. Form 8848: Consent To Extend the Time To Assess the Branch Profits Tax Under Regulations Sections 1.884-2(a) and (c)

6. Form 5471: Information Return of U.S. Persons With Respect to Certain Foreign Corporations

7. Form 8865: Return of U.S. Persons With Respect to Certain Foreign Partnerships

8. Form 8621: Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

9. Form 8858: Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)

V. EXPATRIATION

A. Overview. Expatriation occurs when an American citizen relinquishes, renounces, or loses her U.S. citizenship, or when she terminates long-term permanent residency status (i.e. green card).

B. Common Reasons for Expatriation.

1. Wealthy citizens who want to avoid income and estates taxes and/or regulations and reporting requirements and move to a country with more favorable tax laws.

2. Citizens and residents of foreign countries that do not recognize dual citizenship.

3. "Accidental" Americans who are born and/or raised outside the U.S. but are U.S. citizens because a parent is a U.S. citizen. Sometimes they have no emotional connection with the U.S. and they do not want to comply with its laws and reporting requirements. Sometimes they do not even know they are an American citizen until some tax, immigration, or other administrative inquiry.

C. Brief History of Expatriation Rules. Formerly under §877, if you expatriated (gave up your passport and your right to retain citizenship), the U.S. would continue taxing you for ten (10) years on your U.S. related income, but if you ever returned to be physically in the U.S. for thirty (30) days, you were taxed as a U.S. citizen again. This rule was deemed not strict enough,

which led to a new rule in 2010. This new rule is essentially an exit tax. The U.S. taxes you on the entire gain embedded in all of your assets; it treats you as if you had sold all of your assets on their fair market value in cash, totals up all gains and losses, and charges you an exit tax.

D. Expatriation Tax. Different rules apply depending on the date of expatriation. The expatriation date is the date one relinquishes U.S. citizenship (in the case of a former citizen) or the date one terminates her long-term U.S. residency (in the case of a former U.S. resident). The relevant date ranges are as follows:

1. On or after June 17, 2008.
2. After June 3, 2004 and before June 17, 2008.
3. On or before June 3, 2004.

For detailed information on each of these rules, please refer to the IRS website. This outline will address the current rule, i.e. the rule for those expatriating on or after June 17, 2008.

E. Current Rule: HEART Act. The Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART" Act) is the controlling law. It added §877A and §2801 to the Code, which imposed a "mark-to-market" regime and "succession tax" regime on U.S. persons who expatriate. U.S. citizens who expatriate are subject to the new rules under the HEART Act if they meet any of the following three tests:

1. Net Income Tax Test: for the five-year period prior to expatriation, the individual had an average annual net income exceeding a specified amount that is adjusted for inflation (that amount was $168,000 in 2019);

2. Net Worth Test: the individual's net worth is at least $2 million.

3. Certification Test: the individual fails to certify on Form 8854 that she satisfied all applicable U.S. tax obligations for the five years before expatriation.[90]

An individual who meets any of these tests is a "covered expatriate." Expatriating individuals must file IRS Form 8854: Initial and Annual Expatriation Statement in the year in which she relinquishes her U.S. citizenship or terminates her long-term residency.

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[90] I.R.C. §877(a)(2)

F. Relinquishing U.S. Citizenship. Under the HEART Act, the act of expatriating for a U.S. citizen for tax purposes occurs when the individual formally renounces U.S. citizenship. This occurs on the earliest of the following dates:

1. the date the individual renounces her U.S. nationality before a diplomatic or consular officer of the U.S.

2. the date the individual furnishes a signed statement of voluntary relinquishment to the U.S. Department of State.

3. the date the U.S. Department of State issues to the individual a certificate of loss of nationality.

4. the date a U.S. court cancels a naturalized citizen's certificate of naturalization.

G. Terminating Long-Term Residency. A long-term resident, as defined in §7701(b)(6), ceases to be a lawful permanent resident and is deemed to have expatriated on the earliest of the following dates:

1. the date a green card is determined to have been revoked or judicially or administratively abandoned; or

2. the individual (a) commences to be treated as a resident of a foreign country under a tax treaty between the U.S. and that country, (b) does not waive the benefits of the treaty applicable to residents of the foreign country; and (c) notifies the IRS of such treatment on IRS Forms 8833 and 8854.

H. Tax Treatment of "Covered Expatriates". For "covered expatriates," the following tax rules apply.

1. §877A imposes a mark-to-market regime. The expatriating individual is deemed to have sold all assets for fair market value on the day before the date of expatriation. Any gain resulting from the deemed sale is considered for the tax year of the sale, and any losses may also be considered. The first $600,000 of net gain is excluded for each expatriating individually, and this amount is indexed for inflation. A taxpayer may elect to defer payment of

tax attributed to the deemed sale. Special rules apply to certain deferred compensation, certain tax-deferred accounts, and certain interests in nongrantor trusts.[91]

2. §2801 imposes a tax on the receipt of gifts and bequests to a U.S. person from an individual who expatriated on or after June 17, 2008. The receiving U.S. person is responsible for paying the tax. Marital and charitable deductions are available for transfers to a U.S. citizen spouse or qualified charity.[92]

VI. INTERNATIONAL WILLS

A. Overview. In 1973 in Washington, DC, the International Institute for the Unification of Private Law (UNIDROIT) held the Convention Providing a Uniform Law on the Form of an International Will. The goal and purpose of the Washington Convention was to create an international Will that would make estate planning with international components less complicated and more uniform. Importantly, the Convention did not seek to override the local laws of the signatory countries. Rather, it aimed to establish a system of estate planning for individuals who owned property in countries other than their home country.

B. Virginia Law. Virginia adopted the Uniform International Wills Act (UIWA) as of July 1, 1995.[93] A Will executed in conformity with the UIWA will be valid as to form regardless of the place where it is made, the location of the assets, or the testator's nationality, domicile, or residence. The invalidity of the Will as an international Will does not affect its validity as a Will of another kind.

An international Will must comply with certain requirements[94]:

1. The Will must be in writing.
2. The testator must declare in the presence of two witnesses and of a person authorized to act in connection with international Wills that the document is his Will and that he knows the contents of the Will. A

[91] I.R.C. §877(A)
[92] I.R.C. §2801(e)(3)
[93] The Uniform International Wills Act can be found in Virginia Code §64.2-433 – 442.
[94] Virginia Code § 64.2-435

personal authorized to act is a Virginia lawyer in good standing. A notary public is not sufficient.

3. The testator must sign or acknowledge the Will in the presence of the witnesses and the authorized person.
4. The witnesses and the authorized person must attest the Will by signing in the presence of the testator.
5. If the testator is unable to sign the Will for himself, there are specific procedures that must be satisfied.

The authorized person must attach to the Will a signed certificate establishing that the requirements of the UIWA have been complied with.

C. Form of Certificate at End of Will. [95]

CERTIFICATE

I,……………… (name, address and capacity), a person authorized to act in connection with international wills
Certify that on…………….(date)………….. (place)
(testator)…………………….. (name, address, date and place of birth)in my presence and that of the witnesses
(a)………………………. (name, address, date and place of birth)
(b)………………………. (name, address, date and place of birth)
has declared that the attached document is his will and that he knows
the contents thereof.
I furthermore certify that:
(a) in my presence and in that of the witnesses
(1) the testator has signed the will or has acknowledged his signature previously affixed.
*(2) following a declaration of the testator stating that he was unable to sign his will for the following reason
………………………. I have mentioned this declaration on the will
*and the signature has been affixed by (name and address)
(b) the witnesses and I have signed the will;
*(c) each page of the will has been signed by
………………………. and numbered;
(d) I have satisfied myself as to the identity of the testator and of the witnesses as designated above;

[95] Virginia Code §64.2-437

(e) the witnesses met the conditions requisite to act as such according to the law under which I am acting;
(f) the testator has requested me to include the following statement concerning the safekeeping of his will:
PLACE OF EXECUTION
DATE
SIGNATURE and, if necessary, SEAL.

* to be completed if appropriate

APPENDIX A
Sample Qualified Domestic Trust (QDOT) For Non-Citizen Spouse

Qualified Domestic Trust (Marital Trust for Non-Citizen Spouse). If my spouse survives me, my Trustee shall allocate to the Qualified Domestic Trust (sometimes hereinafter referred to in this Paragraph C. as the "QDOT" or as the "trust") the remaining fractional share of the Trust Assets after funding the Family Trust as provided in Paragraph B. above. This bequest to the QDOT shall be satisfied only out of assets which qualify for the marital deduction.

It is my intention that the QDOT qualify for the marital deduction, and, therefore, notwithstanding anything else contained herein, no fiduciary hereunder shall have any authority to exercise any power in a manner which would disqualify the QDOT for the marital deduction.

The QDOT shall be administered as directed in the following subparagraphs.

1. At all times during the administration of the QDOT during which my spouse is not a citizen of the United States, at least one Trustee hereunder must be an individual citizen of the United States or a corporation incorporated and doing business in the United States. All Trustees so qualifying are referred to collectively herein as the "U.S. Trustee." From any distribution of principal from the QDOT the U.S. Trustee shall have the right to withhold, and will be expected to withhold, the tax imposed by Internal Revenue Code Section 2056A on such distribution.

2. During the lifetime of my spouse, my Trustee shall distribute all of the net income of the QDOT to my spouse in convenient installments not less frequently than quarterly. All net income of the QDOT which is accrued and undistributed at the death of my spouse shall be distributed to my spouse's estate.

3. By written instrument delivered to my Trustee, my spouse may require my Trustee to convert or make productive within a reasonable time after delivery of the notice any property that does not produce a reasonable income.

4. During the lifetime of my spouse, the U.S. Trustee may distribute to or for the benefit of my spouse so much of the principal of the QDOT as the U.S. Trustee in the exercise of its complete discretion deems appropriate or advisable for any reason. I suggest, but do not require, that in determining whether to make a distribution of principal to or for the benefit of my spouse, the U.S. Trustee shall take into consideration my spouse's needs with respect to: health, including medical, dental, hospital and nursing expenses and expenses of invalidism and custodial care; and care, comfort, support and maintenance of my spouse in the style and manner of living to which my spouse was accustomed during my lifetime. The U.S. Trustee may, but is not required to, take into consideration the principal, income, and resources otherwise available to my spouse in determining whether to make a distribution of principal to or for the benefit of my spouse. If my spouse becomes naturalized and it is possible to terminate the QDOT by a distribution of the entire principal balance to my spouse without the imposition of estate tax under Internal Revenue Code Section 2056A or if such a complete distribution of the QDOT without the imposition of estate tax otherwise (e.g., by change of law) becomes possible, my Trustee shall consider the wisdom and propriety of such a complete distribution, but my Trustee shall have the sole and absolute discretion to determine whether

or not to make such a complete distribution, and the Trustee's decision shall be binding and conclusive upon all parties.

5. While the U.S. Trustee is authorized to distribute principal of the QDOT to or for the benefit of my spouse, and I hereby indemnify the Trustee for doing so, I am aware that if the U.S. Trustee distributes principal, that distribution will trigger the imposition of a constructive estate tax on the amount distributed under Internal Revenue Code Section 2056A, unless either (i) my spouse is, at the time of such distribution, a citizen, or (ii) the distribution qualifies as a "hardship distribution" under Internal Revenue Code Section 2056A(b)(B) and the Treasury Regulations thereunder.

6. I intend that if my spouse is not a citizen at the time of my death and does not become a citizen before the filing due date of the federal estate tax return, this Trust shall be, and shall qualify as, a Qualified Domestic Trust, as that term is used in Sections 2056(d) and 2056A of the Internal Revenue Code, as amended. Therefore, the Trustees hereunder are authorized to make any changes to the terms of the QDOT that are required by then current law (statutory and judicial and Treasury Regulations) to make it or keep it eligible to be a Qualified Domestic Trust.

7. The Executor serving under my Will has the sole and absolute discretion to determine whether to elect under Internal Revenue Code Section 2056A to qualify the QDOT (or a specific portion hereof) as a Qualified Domestic Trust and/or whether to elect under Internal Revenue Code Section 2056(b)(7) to qualify this Trust (or a specific portion hereof) as a Qualified Terminable Interest Property Trust. I expect that my Executor will elect to minimize the federal estate tax payable by my estate. However, I further expect my Executor to give consideration to the federal estate tax that may be payable in my spouse's estate upon my spouse's death, particularly if my spouse should die prior to the time the election is made. The decision of my Executor with regard to exercise of the election shall be conclusive.

If my Executor determines that an election to qualify the QDOT as a Qualified Domestic Trust under the Internal Revenue Code Sections 2056(d) and 2056A is appropriate under all of the circumstances, I expect and authorize the Executor serving under my Will and the U.S. Trustee and any other Trustee(s) serving hereunder to take all steps necessary to so elect.

8. Notwithstanding any other provision of this document, at all times during which the Trustee hereunder intends for the QDOT to be a Qualified Domestic Trust, the QDOT shall be maintained under the laws of the state of the United States or under the laws of the District of Columbia and the administration of the QDOT shall be governed by the laws of a particular state of the United States or of the District of Columbia.

9. My Trustee shall comply with the requirements for security arrangements for qualified domestic trusts as set forth in Treas. Reg. § 20.2056A-2(d)(1)(i) or (ii), summarized as follows:

(a) Trust in Excess of $2 Million. If the fair market value of the assets passing to the trust (determined without reduction for any indebtedness thereon) exceeds $2 million on the relevant valuation date, then my Trustee must at all times during the term of the Trust either satisfy the U.S. Bank as Trustee requirement (see Treas. Reg. § 20.2056A-2(d)(1)(i)(A)), or furnish a bond that satisfies the requirements of Treas. Reg. § 20.2056A-2(d)(1)(i)(B), or furnish an irrevocable letter of credit that satisfies the requirements of Treas. Reg. § 20.2056A-2(d)(1)(i)(C), (hereinafter referred to as the U.S.

Bank, Bond or Letter of Credit Requirement). My Trustee may alternate between any of the security arrangements described in the preceding sentence provided that, at all times during the term of the trust, one of the arrangements is operative.

If my Trustee elects to furnish a bond or letter of credit as security, then in the event the Internal Revenue Service draws on the instrument in accordance with its terms, neither my U.S. Trustee nor any other person will seek a return of any part of the remittance until after April 15th of the calendar year following the year in which the bond or letter of credit is drawn upon.

(b) Trust of $2 Million or Less. If the fair market value of the assets passing to the trust (determined without reduction for any indebtedness) is $2 million or less on the relevant valuation date, then my Trustee must comply with either the U.S. Bank, Bond, or Letter of Credit Requirement only if more than 35% of the fair market value of the trust assets, determined annually on the last day of the taxable year of the trust, consists of real property located outside the United States. For purposes of determining whether more than 35% of the trust assets consist of foreign real property, Treas. Reg. § 20.2056A-2(d)(1)(ii)(B) applies.

(c) Determination of Value. For purposes of determining whether the fair market value of the trust assets exceeds $2 million, my Trustee is authorized to make the election under Treas. Reg. § 20.2056A-2(d)(1)(iv)(A) with respect to real property used as my spouse's personal residence.

(d) Amount of Bond or Letter of Credit. For purposes of determining the amount of the bond or letter of credit, my Trustee is authorized to make the election under Treas. Reg. § 20.2056A-2(d)(1)(iv)(B) with respect to real property used as my spouse's personal residence.

(e) Annual Statements. My Trustee is directed to file any annual statements required under Treas. Reg. § 20.2056A-2(d)(3).

(f) General Conduct. Notwithstanding anything contained herein to the contrary, my U.S. Trustee is hereby authorized to enter into alternative plans or arrangements with the Internal Revenue Service pursuant to Treas. Reg. § 20.2056A-2(d)(4) to assure collection of the deferred estate tax, in lieu of the provisions contained herein.

(g) References to Regulations. All references to "Treas. Reg." in this document shall be references to regulations published under 26 CFR as in effect on the date of execution of this document, or, in the event that any such regulation is amended or superseded thereafter, to the regulation (or any successor regulation) as so amended.

(h) Dollar Values. The use of the dollar sign ($) shall indicate amounts stated in U.S. dollars.

10. For purposes of determining whether the $2 million threshold has been exceeded, my Executor and/or my Trustee may elect to exclude up to $600,000 in value attributable to up to two residences, wherever situated, and related furnishings owned directly by the QDOT, if such real property is used by my spouse as a personal residence and if the residence and furnishings pass, or are treated as passing, to the QDOT under Section 2056(d) of the Internal Revenue Code.

11. If the fair market value of the assets passing to the QDOT is $2 million or less, no more than thirty-five percent (35%) of the fair market value of the trust assets, determined annually on the last day of the taxable year of the Trust, may consist of real property located outside of the United States, or, if this thirty-five percent (35%) limit is exceeded, the QDOT must meet the requirements of subparagraph 9. above.

12. Notwithstanding any other provision of this Trust Agreement, at all times during which the QDOT is intended to be administered as a Qualified Domestic Trust, the Trustee hereunder shall administer the Trust in all respects in accordance with the statutory law, case law and Treasury Regulations governing Qualified Domestic Trusts, and shall reform the QDOT as necessary to keep it in compliance and eligible as a Qualified Domestic Trust under such laws and Regulations. The Trustee is authorized and directed to follow all such requirements in administering the QDOT.

13. On the death of my spouse, the Trustee shall first pay from the principal of the QDOT, directly or to the legal representative of my spouse's estate as the Trustee deems advisable, the amount of the federal estate tax payable pursuant to Internal Revenue Code Section 2056A (or Code Section 2207A, if applicable) assessed by reason of my spouse's death. (In the case of a tax payable by Code Section 2207A, my spouse may by Will or Revocable Trust provide an alternative source of payment of such tax.) My Trustee shall divide the remaining principal of the QDOT after making any such payment of estate tax into a sufficient number of equal shares to provide one (1) such share for each of my children who is then living and one (1) such share for each of my children who is then deceased but who has one or more descendants then living. Each share set apart for a living child shall be held and/or distributed as provided in Paragraph D. below. Each share set apart for a deceased child shall be distributed to such child's then living descendants, per stirpes.

14. In the event that it is desirable for the trust to qualify as a qualified subchapter S trust described in Section 1361(e)(1)(A) of the Internal Revenue Code, the Trustee is directed to vote the stock of the S corporation held in trust so as to pay dividends to the trust which, under the terms of the trust, would have to be distributed hereunder to my spouse, to allow my spouse to pay individual income tax incurred by my spouse on the S corporation income. In addition, in such case, the Trustee may make distributions to my spouse from the principal of the Trust to pay any capital gains tax payable by such beneficiary in the event of a sale or exchange of the S corporation stock by this Trust, subject to the cautions and restrictions otherwise reflected in this Paragraph C.

15. The Trustee hereof shall accept for addition to the QDOT any property contributed to it by my spouse or by my Executor.