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Probate Strategies When Nonresident/ Non-Citizen Decedents Own U.S. Assets: Legal, Tax, and Practical Issues

TUESDAY, APRIL 28, 2020

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

James I. Dougherty, Partner, **Withers Bergman**, Greenwich, Conn.

T. Sandra Fung, Attorney, **Withers Bergman**, New York

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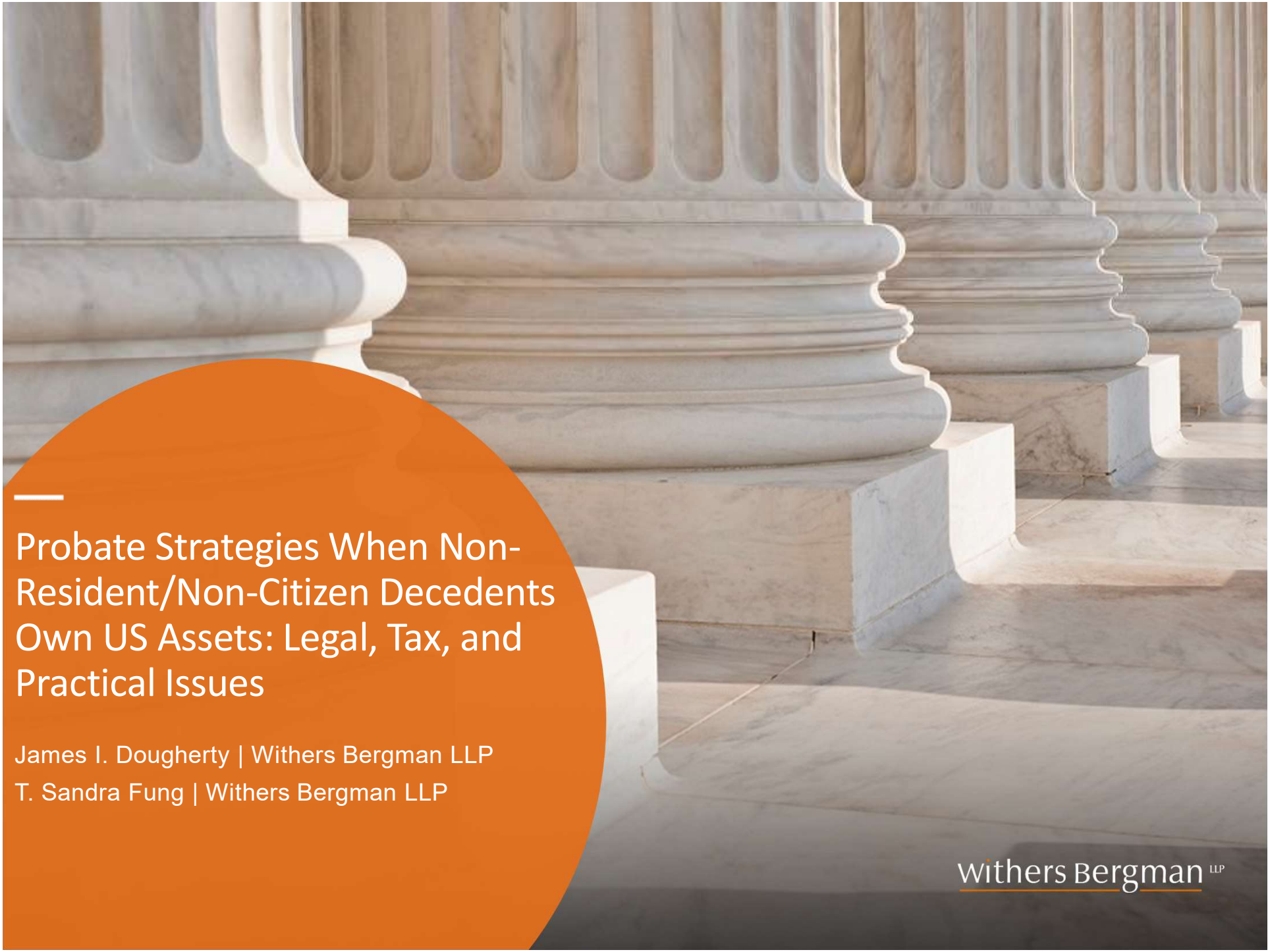

Probate Strategies When Non-Resident/Non-Citizen Decedents Own US Assets: Legal, Tax, and Practical Issues

James I. Dougherty | Withers Bergman LLP
T. Sandra Fung | Withers Bergman LLP

Withers Bergman LLP

Agenda

- Non-tax issues
  - Probate
  - Choice of law
  - Testamentary and foreign property marital rules
  - Issues with cross-border litigation
- Estate tax issues and reporting
  - What is a non-resident/non-citizen
  - Filing requirements
  - Definition of “gross estate”
  - Determining the “taxable estate”
  - Tax computation and payment
  - GST Issues
  - State estate tax issues
  - Treaty benefits
  - Form 706-NA
- Income tax concepts and reporting
- Recent developments/current events
- Q&A

Non-Tax Issues

- Probate
- Choice of law
- Testamentary freedom and US enforcement of foreign succession rules

Is Probate Required?

- Depends on the assets, value of property, and the laws of the state
- Non-probate assets
  - Assets passing by beneficiary designation
  - Assets owned jointly with rights of survivorship
  - Assets in trusts and entities
- Small estate administration
  - Simplified procedures are available in all states for smaller estates and certain kinds of assets
    - Summary administration
    - Small estate affidavit
  - Custodian of assets may ask for additional documentation
- Ability of foreign fiduciaries
  - Some states authorize the custodian of assets to deliver property to a fiduciary who is authorized by the laws of a foreign jurisdiction to receive the property of a decedent
  - Example: N.Y. Est. Pow. & Trusts L. § 13-3.4 provides that a person or fiduciary in New York may pay or deliver property to a foreign fiduciary who is authorized to receive such personal property under the possession or control of a person or fiduciary in NY. However, the custodian will not be released and discharged if such custodian has received written notice of the appointment of an ancillary representative or the existence of any creditors
- Otherwise, probate may be required

Who May Serve as Fiduciary?

- States have different requirements as to who may serve as fiduciary
- Domiciliary status – some states have restrictions on non-domiciliaries serving as a fiduciary
  - Examples:
    - Non-domiciliary aliens cannot serve alone as an executor in New York (N.Y. SCPA § 707)
    - Non-domiciliaries of Florida cannot serve as personal representative unless the individual is a family member (Fla. Stat. § 733.304)
- Incompetency and other disqualifying factors
  - States may prohibit the following individuals from serving:
    - Minors
    - Legally incompetent individuals
    - Felons
    - Substance abusers
    - Persons ineligible in the court's discretion

Multiple Will Issues

- Inadvertent revocation
  - It is common for US wills to revoke any prior wills by default
- Wills by jurisdiction
- Coordination of provisions
  - Provisions governing the payment of debts and tax liability
  - Dispositive provisions
  - Ability to request assets governed by another will
- Differences in interpretation caused by application of local substantive law

Potential Issues with Clients with Connections to Civil Law Jurisdictions

- Forced heirship
  - Countries with forced heirship restrict the decedent's testamentary freedom. Family members are entitled to a share of the estate that is defined under forced heirship rules
  - Lifetime gifts may be clawed back if the shares required under forced heirship are not satisfied
- Universal succession
  - Property generally passes to the heirs automatically. The beneficiaries become personally liable for the debts of the decedent
  - Probate only occurs if there is a controversy regarding the validity of a will
  - Some countries may provide for a beneficiary to receive a certificate of inheritance that is used to reflect changes in ownership

Affidavits of Law to Prove Wills or Inheritance Rights

- In order to admit foreign wills to probate, some states may require an affidavit attesting as to due execution and validity of the will
- For a non-resident decent dying interstate, affidavits of heirship identify the distributees of the decedent's estate under the laws of intestacy of the relevant estate
- States have different requirements as to affidavits pertaining to due execution of a foreign will and affidavits of heirship

Choice of Law Issues

- The choice of law rules of the applicable jurisdictions will determine the validity of a will
- In the US, a forum court will apply the law of the situs of real property in determining the disposition of real property. A forum court will apply the law of the decedent's domicile on the date of death in determining the disposition of personal property
- Civil law countries generally apply the law of the country of which the decedent is a citizen
- The doctrine of *renvoi*: the principle by which the law of another jurisdiction is applied. The doctrine is meant to prevent forum shopping
- Common choice of law issues:
  - Capacity to make a will
  - Revocations by operation of law
  - Validity of bequests to an interested witness

Testamentary Freedom and US Enforcement

- Testamentary freedom is a concept primarily found in common law countries. Civil law countries generally do not allow for full testamentary freedom on account of forced heirship rules (unless no descendants or ascendants are living)
- US courts will generally apply the law of the forum for substantive law questions
- Spousal inheritance rights
  - US courts tend to respect spousal inheritance rights. US states statutorily protect the rights of the spouse to a share of the estate of the decedent (i.e., the elective share). The relevant public policy considerations of US states is aligned with the objectives of the forced heirship rules
- Forced heirship
  - US courts tend to decline enforcing forced heirship rights by reason of a countervailing public policy in favor of testamentary freedom

Relevance of Foreign Marital Regimes

- Many civil jurisdictions, as well as some US states, have community property regimes
  - Though, there is an overarching theme to community property styled systems, there are still enough differences among them that local counsel will be needed to provide competent advice
  - Even if property is located in a US separate property state, community property regime may still apply (see the Uniform Disposition of Community Property Rights at Death Act)
- Many US separate property regimes have elective share regimes, but they are designed to protect domiciliaries
- Generally, the law of domicile applies to a decedent's estate; however, different jurisdictions take various approaches as to how to define and apply domicile for marital property right purposes
- Note that in common law jurisdictions, for choice of law purposes, there can be a division between real property and personal property
- The validity and enforceability of marital agreements is also an issue where choice of law issues can arise

Choice of Law Provisions

- US
  - Some US states permit non-resident testators to select the law of such state to govern the administration and/or disposition of the estate
  - Examples:
    - Non-domiciliary testators may elect for Connecticut law to govern the administration and disposition of the estate pursuant to Conn. Gen. Stat § 45a-287(c)
    - Non-domiciliary testators may elect for New York law to govern the disposition of New York situs property (N.Y. Est. Pow. & Trusts L. § 3-5.1)
- EU
  - Regulation (EU) 650/2012 (known as "Brussels IV"): a testator may choose the law of the testator's state of nationality to govern such testator's succession. A person with multiple nationalities may choose the law of any state of nationality

Issues with Cross-Border Litigation

- Jurisdiction
  - Generally, will should be admitted for original probate in the country of domicile
  - Courts of jurisdictions in which a decedent has property also have jurisdiction over such property
  - Many US states have statutory provisions authorizing original probate of the will of a non-resident decedent. Courts may decline to exercise this jurisdiction. Courts may also decline original probate if the will has been admitted for probate in the jurisdiction of domicile
- Choice of law
  - For procedural questions, courts will generally apply the law of the forum
  - For substantive questions, courts will use a balancing test to determine the appropriate law to apply

Why Do We Care Whether a Person is a Non-Citizen/Non-Resident

The US Citizen/US Resident	The Non-Citizen/Non-Resident
Estate tax imposed on worldwide estate	Estate/gift tax imposed on only US state assets
Deductions not prorated	Certain deductions prorate
Current exemption of $11.58 million	Exemption of $60,000 for estate tax/none for gift tax
Credit allowed for foreign taxes	No credit for foreign taxes
Generally no requirement for transfer certificate	Transfer certificates often required
Form 706	Form 706-NA
Same filing deadlines	
Same rate table	
Potential availability of treaty benefits	
Income tax basis step up allowable to both	
Death is the triggering event for the estate tax	

Residency for Transfer Tax Purposes

- Two different regimes
  - US Residents/US Citizens (Chapter 11, Subchapter A, I.R.C. §§ 2001-2058)
  - Non-US Residents/Non-US Citizens (Chapter 11, Subchapter B, I.R.C §§ 2101 – 2108)
- Domicile
  - The terms resident/non-resident are misleading
  - Treas. Reg. § 20.0-1(b)(1): "A 'resident' decedent is a decedent who, at the time of his death, had his domicile in the United States"
  - Treas. Reg. § 20.0-1(b)(2): "A 'nonresident' decedent is a decedent who, at the time of his death, had his domicile outside the United States under the principles set forth in subparagraph (1) of this paragraph"
- Citizenship
  - Definition: Estate tax provisions do not define the term US citizen, but Treas. Reg. § 1.1-1(c) (an income tax regulation) defines the term as "Every person born or naturalized in the United States and subject to its jurisdiction is a citizen"
  - Dual Citizens: If a person has US citizenship and the citizenship of another country, they are treated as a US citizen for estate tax purposes (Estate of Vriniotis, 79 T.C. 298 (1982))
  - US Possessions: I.R.C. §§ 2208 and 2209 provide special provisions for those who acquired citizenship as a result of citizenship of the possession

Domicile

- Concept of resident for gift and estate tax purposes is different than for income tax purposes – here, we look to the person's domicile
  - Treas. Reg. § 20.0-1(b)(1): "A 'resident' decedent is a decedent who, at the time of his death, had his domicile in the United States"
  - Treas. Reg. § 20.0-1(b)(2): "A 'nonresident' decedent is a decedent who, at the time of his death, had his domicile outside the United States under the principles set forth in subparagraph (1) of this paragraph"
- Two requirements for domicile, Treas. Reg. § 25.2501-1(b):
  - Living in a place, even for a *brief period of time*
  - No definite *present intention* of leaving the place
- Difficulty in determining **intent**
- Courts look to many factors (highly subjective)
  - Location of residencies, expensive possessions and investments
  - Relative amount of time spent at claimed domicile and in other countries
  - Location of family and friends
  - Location of church, business activities and club memberships
  - Jurisdiction of voter's registration and driver's license
  - Declarations of residence or intent (visa applications, wills, tax returns, etc.)
  - Domicile of Origin (i.e. where the person was born)

Overlap with Immigration Law Concepts

- "Green cards": Permanent resident cards allow for holder to permanently remain in the US and is controlling for US income tax purposes. It is not controlling for estate tax purposes (*Estate of Khan,* TC Memo 1998-22)
- Temporary Visas: Visa programs which explicitly require a visa holder to retain domicile in their home country generally suggest the intent to remain in the US is not present, but it is not controlling for estate tax purposes as facts can demonstrate domicile (*Estate of Jack v. US*, 54 Fed. Cl. 590 (2002))
- Illegal Aliens: Can be US domiciled for estate tax purposes based on facts despite being potentially subject to deportation (Rev. Rul. 80-209)

Gift Taxation of US Residents – Rates and Exclusion Amounts

- Unified gift and estate tax credit – basic exclusion amount is $11.58 Million in 2020, which is indexed for inflation (scheduled to be reduced in 2026)
- Taxable gifts over credit amount are taxed at a 40% rate, I.R.C. § 2502
- Other exclusions and deductions from gift tax
  - Annual exclusion
  - Exclusion for qualified medical and education expenses
  - Marital deduction
  - Charitable deduction

Estate Taxation – Rates and Exclusion Amounts

- Unified gift and estate tax credit – basic exclusion amount is $11.58 Million in 2020, which is indexed for inflation (scheduled to be reduced in 2026)
- Taxable estate over credit amount is taxed at a 40% rate, I.R.C. § 2001
- Important terms:
  - Gross estate: value of all property subject to estate tax regime
  - Taxable estate: value of gross estate less allowable deductions
- Deduction available from estate tax
  - Marital deduction (I.R.C. §§ 2056 and 2056A)
  - Charitable deduction (I.R.C. § 2055)
  - Administration expenses (I.R.C. § 2053)
  - Debts (I.R.C. § 2053)
  - State death taxes (I.R.C. § 2058)
  - Certain losses (I.R.C. § 2054)

Filing Obligations for Non-Residents

- In the case of the estate of every non-resident not a citizen of the United States if that part of the gross estate which is situated in the United States exceeds $60,000 the executor shall make a return with respect to the estate tax imposed by subtitle B
- Take away points:
  - Low value but only looking at US situs assets
  - Like with US persons, the filing threshold is reduced by lifetime gifts (I.R.C. § 6018(a)(3))
- Is filing necessary?

Requirement for a Transfer Certificate

- Executor is liable for the payment of the estate tax (I.R.C. § 2002; Treas. Reg. § 20.2002-1)
- If there is no executor/administrator appointed by a US jurisdiction, “then any person in actual or constructive possession of any property of the decedent” is considered the executor and could be liable for the payment of any estate tax liability (I.R.C. § 2203)
- Obtaining a transfer certificate will avoid liability to custodians in actual or construction possession of property of the decedent. Treas. Reg. § 20.6325-1(a) provides that “no domestic corporation or its transfer agent should transfer stock registered in the name of a nonresident decedent (regardless of citizenship) except such shares which have been submitted for transfer by a duly qualified executor or administrator who has been appointed and is acting in the United States, without first requiring a transfer certificate covering all of the decedent's stock of the corporation and showing that the transfer may be made without liability. Corporations, transfer agents of domestic corporations, transfer agents of foreign corporations (except as to shares held in the name of a nonresident decedent not a citizen of the United States), banks, trust companies, or other custodians in actual or constructive possession of property, of such a decedent can insure avoidance of liability for taxes and penalties only by demanding and receiving transfer certificates before transfer of property of nonresident decedents”
- This includes property which is jointly owned with rights of survivorship (Rev. Rul. 55-160)
- Most important exception to the need for a transfer certificate is a transfer is to an executor appointed by a US jurisdiction who is acting at the time

Procedure to Obtain Transfer Certificate

- Two different procedures, depending on the size of the gross estate:
  - For estates that exceed $60,000, a Form 706-NA must be filed (preparation of this form is discussed later)
  - For estates that do not exceed $60,000, a transfer certificate is technically not required (Treas. Reg. § 20.6325-1(b)), but in practice it is needed

Estate Tax Return – Deadlines and Extension Requests to File

- Estate tax return is due 9 months after date of death (I.R.C. § 6075(a))
- Automatic 6 month extension (Treas. Reg. § 20.6081-1(b)) by filing Form 4768
- Additional time allowed if good cause shown
  - The "executor" being abroad is a good fact (Treas. Reg. § 20.6081-1(c))
  - Can be granted if automatic extension not filed, but failure to file automatic extension "may indicate negligence and constitute sufficient cause for denial of the extension"
- Penalty for late filing without extension granted is 5% per month on the amount of tax owed with a maximum penalty of 25% (I.R.C. § 6651(a)(1) (higher if due to fraud)

Estate Tax Return – Form 8971

- For estates required to file an estate tax return (see I.R.C. § 6081) the fiduciary of the estate has an obligation to report the estate tax valuation of the property to the beneficiary receiving property using Form 8971 and accompanying Schedule A
- Income tax basis adjusted to value of property for estate tax purposes
- I.R.C. § 1014: the basis of property acquired from a decedent is its FMV on the decedent's date of death (or alternative valuation date, if used)
- I.R.C. § 1014(f) requires the step up in basis may not exceed value determined for estate tax purposes
  - Rule does not apply to property which qualifies for marital or charitable deduction, prior law would apply
- For a non-resident, if there is a filing obligation for Form 706-NA, a Form 8971 and accompanying Schedule A must be filed (I.R.C. § 6035(a))
- Only need to report assets included in the federal gross estate (I.R.C. § 6035(a); Treas. Reg. § 1.6035-1(a)(1))
  - For a non-resident/non-citizen, this includes only the US situs assets
  - Basis step-up still applies for worldwide estate under I.R.C. § 1014(b) – just no Form 8971 reporting requirement

Definition of Gross Estate and Situs Rules

- A non-resident, non-citizen is taxed on the gross US estate (I.R.C. § 2103)
- The gross US estate for a non-citizen/non-domiciliary decedent is all property, tangible or intangible, situated or deemed situated in the US
- Property to be included in the gross estate is determined as provided in I.R.C. § 2031
  - Result is that the valuation concepts and rules that apply to US persons also apply to non-citizen/non-domiciled decedents

Assets Considered US Situs for Estate Tax Purposes

- Real property
  - Characterization of real property (i.e., whether mineral interests, fixtures, etc. are real property) is based on the law of the jurisdiction in which the real property is situated
- Tangible personal property (including currency)
  - If located in the US
  - Exception for tangible personal property in transit and artwork on loan
- Certain intangible property
  - Stock of domestic corporation
  - Other intangible personal property if the written evidence of the property is not treated as being the property itself, and it is issued by or enforceable against a resident of the US or a US corporation or governmental unit (Treas. Reg. § 20.2104-1(a)(4))

Special Situs Rules – Partnership Interests

- Various theories exist
  - Entity Theory: Worldwide value of partnership taxed if it is US situs and none of it is taxed if not US situs—three theories to determine situs under their approach
    - Situs is at domicile of decedent—following the common law maxim, *mobilia sequuntur personam,* the interest in the partnership has situs where the owner is domiciled (*Blodgett v. Silberman*, 27 U.S. 1 (1928))
    - Situs is where entity is organized—argument in favor of this approach is that it would be the same as the rule for corporations and the definitional rules in I.R.C. § 7701(a)(4) would support this position
    - Situs is where partnership is engaged in trade or business—IRS pronounced this in the rule under Rev. Rul. 55-701 (note that this was an analysis of the situs rules of the former US-UK estate tax treaty)
  - Aggregate Theory: Disregard the entity and look at tax the assets which have US situs
    - *Sanchez v. Bowers*, 70 F.2d 715 (2d Cir. 1934) – disregarded a Cuban entity which was the equivalent of a partnership BUT in that case the entity terminated at the death of the decedent
- OECD Model Estate and Gift Tax Treaty generally uses the domicile of the decedent (OECD Model Estate Tax Treaty, Art. 8 (1966))

Taxable Estate

- Adjusted gross estate is the gross estate less debts, expenses and losses
- Taxable estate – adjust gross estate less deductions
  - Unlimited marital deduction, I.R.C. §§ 2056 and 2056A
    - Only applies to transfers to US **Citizen** Spouse (i.e. resident is not enough)
    - Present interest or qualified terminable interest
  - Unlimited charitable deduction, I.R.C. § 2055
    - Generally the same principles that apply in the context of gifts
  - Other deductions:
    - I.R.C. § 2053: administration expenses, funeral expenses
    - I.R.C. § 2054: certain losses incurred during administration
    - I.R.C. § 2058: state transfer taxes paid on property included in the federal gross estate

Summary of Situs Rules

	US Situs	Non US Situs	Notes
Tangible personal property	Located in US at time of death (unless temporarily located in US)	Property not located in US at time of death; tangible personal property temporarily located in US (i.e., accompanying a visitor); artwork imported for exhibition purposes	
Real property	US situated real property	Non-US situated real property	For a cooperative apartment, whether it is classified as real property or intangible property is a question of local law. Even if a cooperative apartment interest is intangible personal property, such interests will still be US situs as interests in a US corporation
Corporate stock	Shares issued by a US corporation and owned, directly or indirectly, by the NRA	Shares issued by a foreign corporation and owned, directly or indirectly, by the NRA	
Life insurance proceeds on decedent's life	N/A	Life insurance proceeds are non-US situs regardless of whether the issuing company is domestic or foreign (See I.R.C. § 2105(a))	If a non-resident alien owns a policy issued by a domestic insurer on the life of another person, the value of the policy is includible (See Treas. Reg. § 20.2105(g))

Summary of Situs Rules (continued)

	US Situs	Non US Situs	Notes
Debt obligations	Obligations of a US person	Debt obligation of a non-US person; portfolio debt obligations (even if issued by a US person)	
Intangible personal property	Generally includes property that is issued by or enforceable against a US person, US corporation, or governmental unit; intellectual property that is issued in the US (factual analysis)	Intellectual property that is not issued by or not enforceable against a non-US person, US corporation, or governmental unit	
Partnership interests	If partnership survives the death of the decedent: US situs if the partnership's primary place of business is US. If partnership does not survive the death of the decedent: US situs if the partnership's underlying assets are US situs	Partnership organized outside of the US, with no US underlying assets, and conducting business outside the US. If partnership survives the death of the decedent, non-US situs if the partnership's primary place of business is non-US	
Mutual fund interests	Shares in mutual funds that are organized in corporate form if incorporated in the US (I.R.C. § 2104(a)) Interests in mutual funds organized as a trust will be US situs to the extent that underlying interests are US situs (TAM 9748004)	Shares in foreign mutual fund holding shares of US corporations if the fund interest is treated as an interest in a corporation under Treas. Reg. §§ 301.7701-1–4 (CCA 20100013) Interests in mutual funds organized as a trust will be non-US situs to the extent that underlying assets are non-US situs (TAM 9748004)	

The Taxable Estate

- The taxable estate of a decedent non-resident, non-citizen is determined by subtracting any allowable deductions from gross US estate (I.R.C. § 2106)
- Allowable deductions include:
  - Deduction for administration expenses (prorated basis)
  - Certain debts
  - Marital deduction
  - Charitable deduction to US charities
  - State death tax deduction

Administration Expenses and Debts

- Administration expenses are deductible on a proportional basis to the worldwide estate. If the US estate is 20 percent of the worldwide estate, 20 percent of the administration expenses (whether or not directly attributable to the administration of the US estate) will be deductible
- I.R.C. § 2053 of the Code allows the following deductions:
  - Funeral expenses
  - Administration expenses
  - Claims against the estate
- In order to take any I.R.C. § 2053 deductions (and I.R.C. § 2054 deductions for certain casualty losses), the entire worldwide estate must be disclosed (Treas. Reg. § 20.2106-1(b))
- Depending on the circumstances of the estate, the executor may decide to refrain from taking this deduction given the cost/effort in disclosure when compared to the value of the deduction

Special Rule for Debt Secured by US Property

- If estate is not liable for debt which is secured by property includable in gross estate, then only report net value of the property I.R.C. §§ 2016(a), 2053; Treas. Reg. § 20.2053-7)
- Only a proportionate deduction allowed if the estate is liable (i.e. recourse debt) (*Estate of Fung,* 117 T.C. 247 (2001))

Marital Deduction

- I.R.C. § 2106(a)(3) provides a deduction for:
  - Transfers to US Citizen surviving spouses
    - Unlimited marital deduction available
  - Transfers to non-US Citizens surviving spouses
    - Eligible for deduction only if property is held in a Qualifying Domestic Trust
    - No deduction available for jointly-held property
- Deduction is related to the value of the property passing:
  - Not a proportional deduction
  - No deduction for amount of non-US situs property passing
- Treaties may provide varying marital deduction rules

Qualified Domestic Trust ("QDOT")

- Must otherwise meet requirements that apply to other marital deduction qualifying trusts under I.R.C. §§ 2056(b)(5), (b)(7) or (b)(8) (where spouse as sole non-charitable beneficiary of charitable remainder trust), in addition the trust instrument must:
  - Require that at least 1 trustee be an individual US citizen or a domestic corporation
  - Provide that no distribution of principal may be made from the trust unless the US trustee has the right to withhold estate tax on the distribution
  - Be maintained under the laws of a state of the United States or the District of Columbia, and the administration of the trust must be governed by the laws of a particular state of the United States or the District of Columbia
- Election on estate tax return establishing requirements are satisfied
- Security if assets exceed $2 million
  - At least one US trustee must be a bank;
  - US trustee must furnish a bond in favor of the IRS in an amount equal to 65% of the fair market value of the trust assets (without taking into account indebtedness attributable to such property) as of the decedent's date of death; or
  - A US trustee must furnish an irrevocable letter of credit issued by a bank

QDOT continued

- Estate tax
  - Imposed on principal distributions and on balance remaining at death of surviving spouse
  - Tax rate is based on estate tax laws in effect on decedent's death (not death of surviving spouse)
  - No tax is imposed on income distributions or distributions on account of hardship
- Reformations permitted if property passes outright or in a trust that does not qualify as a QDOT
- If non-US citizen is a resident and becomes a citizen, it is possible to have trust no longer need to satisfy requirements of a QDOT

Charitable Deduction

- Under I.R.C. § 2016(a)(2), a charitable deduction is allowed for:
  - Transfers to the US or any political subdivision
  - Transfers to a corporation organized in the US for charitable purposes
  - Transfers to a charitable trust or fraternal society, order, or association operating under the lodge system, for charitable purposes within the US
- Transferred property must be included in the gross US estate
- The charitable deduction is not proportionally limited
- No deduction allowed for transfers to foreign charities – note this is different than the charitable deduction under I.R.C. § 2055 for US citizens/US domiciliaries
- Similar to the deduction for administration expenses, taking the charitable deduction requires disclosure of the entire worldwide estate even though it is not a deduction that is prorated (I.R.C. § 20.2106-1(b))

Credits

- Credits allowed exclusively under I.R.C. § 2102 (which allows credits under I.R.C. §§ 2012 and 2013)
  - I.R.C. § 2102(b)(1): NRA estates have a credit of $13,000 (i.e. an exemption of $60,000)
  - I.R.C. § 2012: Credit for gift tax paid
  - I.R.C. § 2013: Credit for taxes paid on prior transfers
- Treaties may provide for differing exemption amounts
  - Full disclosure of worldwide assets required for use of the treaty exemption amounts

Credit for Gift Tax Paid

- Pre-1977 Transfers (I.R.C. § 2012)
  - A credit is available for gift taxes paid on pre-1977 transfers
  - Equal to the lesser of the gift tax paid on the prior gift, or the estate tax attributable to the inclusion of the gift in the NRA's gross estate
- Introduction of Unified Credit
  - Post-1976 taxable gifts are added to the taxable estate
  - Gift tax paid is then subtracted from the estate tax

Credit for Estate Tax Paid on Prior Transfers

- Common scenario with non-citizen/non-domiciled decedents: Decedent was surviving spouse or child who inherited US situs property from spouse/parent within decade of death and did not dispose of it prior to own death
  - I.R.C. § 2013 provides a credit is available for federal estate taxes paid by another estate that passed to the decedent, provided that the transferor died within the period ten years prior to, and two years after, the death of the decedent
    - The credit is equal to the amount which bears the same ratio to the estate tax paid with respect to the transferor's estate as the value of the property transferred bears to the transferor's taxable estate, decreased by any death taxes paid. This amount is limited by a 20 percent reduction for each two year period following the death of the transferor (i.e., no credit is available if the transferor died 10 years prior to the decedent)

Foreign Death Tax Credit

- Credits are allowed exclusively under I.R.C. § 2102
- Per Treas. Reg. § 20.2102-1(a), no credit is allowed for foreign death taxes
- Without an available credit for foreign death taxes paid, there is a risk of double taxation without an applicable estate tax treaty or credit from foreign jurisdiction

State Death Tax Deduction

- Under I.R.C. § 2106(a)(4), a deduction is allowed for "the amount which bears the same ratio to the State death taxes as the value of the property, as determined for purposes of this chapter, upon which State death taxes were paid and which is included in the gross estate under I.R.C. § 2103 bears to the value of the total gross estate under I.R.C. § 2103"
- State death taxes are defined by I.R.C. § 2058 (a)
- Must generally be claimed within four years (I.R.C. § 2058(b))

State Estate Tax Issues for Non-Resident Non-Citizens

State	
Connecticut Conn. Gen. Stat. § 12-391	Estate tax is imposed on the transfer of Connecticut situs real property and tangible personal property. No Connecticut estate tax due if the Connecticut taxable estate (which is based on the decedent's gross US estate, with adjustments) is less than $5.1 million in 2020, $7.1 million in 2021, $9.1 million in 2022 and the federal exemption for 2023 and after. Computation: The amount of Connecticut estate tax is computed by multiplying (i) the amount of tax on the decedent's estate by (ii) a fraction, the numerator of which is the value of that part of the decedent's gross estate over which the state has jurisdiction for estate tax purposes, and the denominator of which is the value of the decedent's gross estate. A credit shall be allowed against such tax for any taxes paid to Connecticut for Connecticut taxable gifts made on or after January 1, 2005, provided such credit shall not exceed the amount of tax imposed.
District of Columbia D.C. Code Ann. § 47-3703	Estate tax is imposed on the transfer of DC situs property. Intangible personal property used in a DC trade or business is deemed to be DC situs property. Computation: For every nonresident decedent dying after December 31, 2015, the tax shall be an amount computed by multiplying the tax determined under § 47-3702(a-1) by a fraction, the numerator of which shall be the value of that part of the gross estate that has its taxable situs in D.C. and the denominator of which shall be the value of the nonresident decedent's gross estate.
Hawaii Haw. Rev. Stat. § 236E-8; Haw. Rev. Stat. § 236D-4	A non-citizen, non-resident of Hawaii with a taxable US estate of $60,000 or less does not have to file a Hawaii estate tax return. No estate tax is imposed on the transfer of a non-resident, non-citizen if the non-resident's state of domicile exempts property from taxation, except for real property in Hawaii, a beneficial interest in a land trust owning Hawaiian real property, and tangible and intangible personal property with Hawaii situs. Computation: The amount of Hawaii estate tax due is as provided in the schedule in Haw. Rev. Stat. § 236E-8(b). The Hawaii estate tax due is computed by multiplying the federal credit by a fraction, the numerator of which is the value of the Hawaii situs property, and the denominator of which is the value of the gross US estate.

State Estate Tax Issues for Non-Resident Non-Citizens (continued)

State	
Illinois 35 ILCS 405/5; 35 ILCS 405/3	Estate tax is imposed on the transfer of any Illinois situs real property, tangible personal property, and intangible personal property having a business situs or evidenced by an instrument in Illinois. Computation: The amount of Illinois estate tax due is equal to the Illinois state tax credit, less the amount determined by multiplying the Illinois state tax credit by the percentage that the gross value of non-Illinois situs property bears to the gross value of all US situs property.
Maine Me. Rev. Stat. Ann. Tit. 36, § 4104; Me. Rev. Stat. Ann. Tit. 36, § 4102	Maine imposes an estate tax on real property and tangible property located in Maine. The state disregards pass-through entities owning real or tangible personal property – such property will be treated as personally owned if the entity does not meet certain exceptions. Computation: Maine estate tax is calculated based on the federal taxable estate of the non-resident (treated as though the decedent were a resident), which is then multiplied by the proportion of Maine situs real and tangible personal property to the adjusted gross US estate for federal tax purposes.
Maryland Md. Code Ann., Tax Gen. § 7-301; Md. Code Ann., Tax Gen. § 7-302; Md. Code Ann., Tax-Gen. § 7-304(b)	Estate tax return is required for every estate of a nonresident who owned real or tangible personal property with Maryland situs with a gross US estate, with certain adjustments, that exceeds the Maryland estate tax exemption amount. The estate is defined as "the federal gross estate of a decedent, as determined by Subtitle B of the Internal Revenue Code…" $5 million exemption after 2019. Computation: Maryland estate tax is calculated with a flat rate on federal taxable estate less exemption amount, which is then multiplied by 16%. The liability is then reduced by a proportion to reflect the non-Maryland property used in the tax base.
Massachusetts Mass. Gen. L. Ch. 65C § 2A(b); Mass. Gen. L. ch. 65C, § 4(b)	Nonresident decedents owning real estate or tangible personal property located in Massachusetts are subject to the estate tax regime. Computation: The Massachusetts estate tax is calculated using the credit for state death taxes under the now repealed Internal Revenue Code Section 2011. This is multiplied by a proportion that the gross value of Massachusetts situs property bears to the gross estate for federal tax purposes.

State Estate Tax Issues for Non-Resident Non-Citizens (continued)

State	
Minnesota Minn. Stat. § 291.03; Minn. Stat. § 291.005; Minn. Stat. § 291.016.	Nonresident decedents with Minnesota situs property included in the gross US estate, with adjustments, are subject to Minnesota estate tax if the gross US estate meets the Minnesota filing requirement. Minnesota looks through pass-through entitles to determine the situs of real property. The Minnesota taxable estate is the federal taxable estate less non-Minnesota situs property. Computation: Minnesota estate tax is calculated by applying the rate schedule in Minn. Stat. § 291.03 to the Minnesota taxable estate and multiplying the result by a fraction, the numerator of which is the value of the Minnesota property, with certain adjustments for taxable gifts, and the denominator of which is the gross US estate, with certain adjustments for taxable gifts.
New York NY Tax Law § 960(a), NY Tax Law § 952(b)	Estate tax is imposed on the New York situs real or tangible personal property of a nonresident decedent. Real property owned by a single member LLC treated as a disregarded entity for income tax purposes, which in turn is owned by the decedent, is treated as real property held by the decedent. Computation: The New York taxable estate of a non-resident is computed as though the non-resident is a resident, but does not include intangible personal property, deductions related to such intangible personal property that is otherwise includible in the New York gross estate, and any gifts that are otherwise includible unless such gifts consist of NY situs real or tangible personal property or intangible personal property employed in a NY business, trade, or profession. The New York estate tax is calculated by applying the rate table in NY Tax Law § 952(b) to the New York taxable estate.
Oregon Or. Rev. Stat. § 118.010	Estate tax is imposed on the Oregon situs real property or tangible personal property of a nonresident decedent. The Oregon taxable estate is the federal taxable estate increased by the deduction under I.R.C. § 2058 (state death taxes), with certain adjustments for marital property. Computation: Oregon estate tax is determined by applying the rate table in Or. Rev. Stat. § 118.010(4) to the Oregon taxable estate, which is the federal taxable estate increased by the deduction for state death taxes. The result will then be multiplied by a fraction, the numerator of which is the value of Oregon situs real and tangible personal property and the denominator of which is the total value of the gross US estate.

State Estate Tax Issues for Non-Resident Non-Citizens (continued)

State	
Rhode Island R.I. Gen. Laws § 44-22-1.1(b)	Estate tax is imposed on Rhode Island situs property. The Rhode Island net estate is defined to "have the same meaning as when used in a comparable context in the laws of the United States." Computation: The Rhode Island estate tax is equal to the maximum state death tax credit, provided that a Rhode Island credit (currently $66,810) is allowed against such tax. The estate tax due is then determined by multiplying that amount by a fraction where the numerator is the gross estate (excluding property that does not have Rhode Island situs) and the denominator is the gross estate.
Vermont Vt. Stat. Ann. § 7402; Vt. Stat. Ann. § 7442a(b)	Estate tax is imposed on the estate of any decedent owning Vermont situs real or personal property. Computation: The Vermont gross estate is the federal gross estate, less non-Vermont situs property. The Vermont estate tax is computed by applying the rate in § 7442a to the Vermont taxable estate. That amount is then multiplied by a fraction, the numerator of which is the Vermont gross estate, with certain adjustments for taxable gifts, and the denominator is the gross US estate, with adjustments for certain taxable gifts.
Washington Wash. Rev. Code § 83.100.020(14); Wash. Rev. Code § 83.100.040	Estate tax is imposed on the transfer of any Washington situs property. The Washington taxable estate is the federal taxable estate, with certain adjustments. Computation: The Washington estate tax is calculated by applying the rate table in Wash. Rev. Code § 83.100.040(2)(a) to the Washington taxable estate. The result is multiplied by a fraction, the numerator of which is the value of Washington situs property, and the denominator of which is the decedent's gross US estate.

Tax Liability and Payment

- Computation of tax liability
- Payment due date and extension requests
- Liability for payment
- Discharge of lien to generate liquidity to pay taxes
- Use of protective claims

Computation of Tax Liability

- Determine gross US estate (all US-situated property)
- Subtract applicable deductions to determine total taxable US estate
- Apply the applicable rate from the rate table in I.R.C. § 2001(c) to determine the tentative tax
- Subtract the amount of tax attributable to taxable gifts
- Apply allowable credits

Payment Due Date and Extension Requests

- Payment of tax liability is due within 9 months after the decedent's death (I.R.C. § 6151; Treas. Reg. § 20.6151-1)
- An extension of time to pay may be requested (no more than 12 months) using Form 4768: Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes. Payments after 9 months will incur interest
- An extension of time to pay for reasonable cause may be granted, for up to 10 years (granted one year at a time). Reasonable cause is outlined in Treas. Reg. § 20.6161-1(a), which could include situations common in estates of a non-resident/non-citizen:
  - Estate's liquid assets are located in multiple jurisdictions and are not immediately controlled by the executor (Treas. Reg. § 20.6161-1(a)(1)(Ex. 1)
  - Avoiding a sale of property at sacrifice price (Treas. Reg. § 20.6161-1(a)(2)(ii))
- Installment payments under Section 6166 are not permitted (I.R.C. § 6166(a)(1))
- Penalty for late payment without extension is 0.5% per month on tax liability owed with a maximum of 25% (I.R.C. § 6651(a)(2))

Liability for Payment

- The executor (and any fiduciary or person deemed to be an executor) is personally liable for payment of the estate tax liability (I.R.C. § 6901(b))
- The executor may request a discharge from liability using Form 5495: Request for Discharge From Personal Liability Under I.R.C. §§ 2204 or 6905. Form 5495 should be filed with the Service Center where the estate tax return is required to be filed
- The IRS has 9 months to assess the tax due. If no notice of amount due is issued, the fiduciary is discharged; if a notice of amount due is issued, the fiduciary is discharged upon payment of the liability
- Discharge is only effective to the executor in the executor's personal capacity and as to the executor's personal assets. The executor is not discharged in his fiduciary capacity. Beneficiaries are also not protected from transferee liability

Discharge of Lien

- I.R.C. § 6324(a): The estate tax is an automatic lien against the property of the decedent for 10 years (unless the estate tax is paid)
- I.R.C. § 6325 allows for a discharge of the lien provided certain conditions are met:
  - In order to generate liquidity for the estate, it may become necessary to obtain a release of the of lien to liquidate or transfer property
  - To apply for a discharge, the executor may submit Form 4422: Application for Certificate Discharging Property Subject to Estate Tax Lien
  - Form 4422 should be submitted at least 45 days prior to the transaction date for which the discharge of lien is required

Transferee Liability

- Transferees of property included in the gross estate of a decedent are liable for any unpaid estate tax to the extent of property received valued as of date of death. Transferee liability includes liability for unpaid interest on unpaid estate tax liability (I.R.C. § 6324(a)(2))
- Transferee liability also includes penalties (Estate of Glass v. Comm'r, 55 T.C. 543 (1970), aff'd per curiam, 453 F.2d 1375 (5th Cir. 1972))
- Transferees are subject to the same assessment and collection procedures as transferors (I.R.C. § 6901(a))

Use of Protective Claims

- Deductions under I.R.C. § 2053 are allowed only for amounts actually paid or for amounts to be paid that are ascertainable with reasonable certainty
- Amounts that may be paid or amounts that are not yet ascertainable with reasonable certainty cannot be deducted
- A protective claim for refund preserves the estate's ability to claim a refund after the deadline in I.R.C. § 6511 for amounts that become payable or ascertainable after the deadline
- I.R.C. § 6511 provides that the deadline for filing refund claims is the later of 3 years after the filing of the return or 2 years after the payment of the tax
- Rev. Proc. 2011-48 sets forth the procedures to file a protective claim for refund
- Methods of filing:
  - Complete Schedule PC and attach to Form 706-NA.
  - Form 843

Applicability of Generation-Skipping Transfer (GST) Taxes

- Unlike the estate and gift taxes sections, the GST Code Sections do not explicitly distinguish how the GST regime applies to US citizens/domiciliaries and non-US citizen/domiciliaries
- Treas. Reg. § 26.2663-2 provides regulatory guidance on how GST applies to non-US citizen/domiciliaries
- GST Tax applies only to transfers of US situs property
- Non-citizens/non-domiciliaries have the same exemption amount as US citizens/domiciliaries ($11.58 million)
  - Treas. Reg. § 26.2663-2(a) lists the exemption as $1 million—this is not the rule as the Regulation became effective in 1995 when the exemption was $1 million
  - Form 706-NA instructions as well as the fact that I.R.C. § 2631 sets only one exemption for the GST regime with reference to the unified credit allowed under I.R.C. § 2010

Allocation of GST Tax Exemption

- Pre-2001, had to affirmatively allocate GST tax exemption unless transfer was a direct skip
- Automatic allocation rules (See Treas. Reg. § 26.2632-1(d)(2)) apply if no allocation is made on a timely filed tax return; the general rules are:
  - Exemption is first applied pro rata (based on value for transfer tax purposes) to direct skips
  - Remaining exemption, if any, is applied pro rata to trusts of which the decedent was the transferor if there is a possibility for that trust to have a taxable distribution or taxable termination ("GST Trusts")
  - The donor or executor of the donor's estate may affirmatively allocate the donor's GST election on a timely filed gift or estate tax return

GST Filing Requirement and Allocation Rules

- On the Form 706-NA—GST is the subject of Part III, Question 11

11	Does the gross estate in the United States include any interests in property transferred to a "skip person" as defined in the instructions to Schedule R of Form 706? . . . . . *If "Yes," attach Schedules R and/or R-1, Form 706.*		

- Should consider whether to indicate inclusion ratio—will need to create own worksheet if special situs rules apply

9 Allocation of GST exemption to trusts (as defined for GST tax purposes):

A Name of trust	B Trust's EIN (if any)	C GST exemption allocated on lines 2–6, above (see instructions)	D Additional GST exemption allocated (see instructions)	E Trust's inclusion ratio (optional—see instructions)

Treaty Benefits - Overview

- Situs rules under various treaties
- Deduction rules under various treaties
- Allowance of additional exemption under treaties
- How to claim treaty benefits

Treaty Types

- "Each United States estate tax treaty is unique and must be consulted if applicable… However, each treaty is unique and if applicable, its specific provision should be consulted." Internal Revenue Manual 4.25.4.2(1)
- To generalize, treaties are one of two types:
  - "Situs-type" treaties
    - Generally, the country of situs of property will have taxing authority over such property
  - "Domicile-type" treaties
    - Generally, the country of fiscal domicile will have taxing authority

Treaty Types

- Situs-type (Pre-1966)
  - Australia^
  - Finland
  - Greece
  - Ireland
  - Italy
  - Japan
  - Norway*
  - South Africa
  - Switzerland

- Domicile Type (Post-1966)
  - Austria
  - Canada ⁺
  - Denmark
  - France
  - Germany
  - Netherlands
  - Sweden*
  - United Kingdom

* Denotes treaties that have been officially terminated

^ Denotes treaties that are not currently in force but are respected

⁺ Denotes income tax treaty with transfer tax applicability

Generalization of Taxing Rights Under Situs and Domicile Treaty

- Immovable (real) property
  - Definition of immovable property may vary from definition of real property
  - Situs-type: the country where the land is located will determine whether property is immovable property. Real property is located where the land is located
  - Domicile-type: the country where the land is located will determine whether property is immovable property and will have taxing authority
- Tangible personal property
  - Situs-type: generally deemed to be situated where located at the time of death
  - Domicile-type: generally taxed by the contrary where located unless it can be taxed as business property
- Debts
  - Situs-type: deemed to be situated in the country of residence of the debtor
  - Domicile-type: taxed by the country of domicile
- Corporate Stock
  - Situs-type: deemed to be situated in the place of incorporation
  - Domicile-type: taxed by the country of domicile

Generalization of Taxing Rights Under Situs and Domicile Treaty

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  - Domicile-type: taxed by the country of domicile
- Corporate Stock
  - Situs-type: deemed to be situated in the place of incorporation
  - Domicile-type: taxed by the country of domicile

Generalizations of Deduction Rules Based on Treaty Type

- Situs-type
  - Some situs-type treaties provide for deductions based on domestic law. Others require that the situs country allow the same deductions and adjustments as would be allowed to a domiciliary
- Domicile-type
  - Some domicile-type treaties provide for deductions based on domestic law. Other treaties only provide for debt deductions
  - Many domicile-type treaties allow a deduction from the gross US estate for transfers to foreign charities
  - Many domicile-type treaties provide that the decedent will be treated like a domiciliary for purposes of calculating any deduction for marital transfers

Allowance of Additional Exemption Under Treaties

- Availability of I.R.C. § 2010 credit
  - Certain situs-type treaties require that non-resident alien decedents are entitled to an “exemption” or “specific exemption” (meaning the unified credit)
    - Australia, Finland, Greece, Italy, Japan, Norway, and Switzerland
  - Other situs-type treaties without the reference to an exemption – usual $13,000 credit/$60,000 exemption applies
    - Ireland and South Africa
- Domicile-type treaties provide that the country of domicile will credit taxes imposed by the situs country
  - Canada, France, and Germany allow for a pro-rata amount of the US exemption

How to Claim Treaty Benefits

- In order to claim treaty benefits, the taxpayer must disclose a treaty-based return position
- A treaty-based return position must be reported and is identified where there is (i) a difference in (A) the tax liability reported on the return after applying the relevant treaty provision, and (B) the tax liability that would be reported if the relevant treaty provision was inapplicable, or where (ii) a treaty provision alters the scope of an I.R.C provision. Unless the taxpayer's conclusion that no reporting is required based on the foregoing is a conclusion with a substantial probability of successful defense on challenge, a return position is a treaty-based return position (Treas. Reg. § 301.6114-1(a)(2))
- Disclosure is made via Form 8833: Treaty-Based Return Position Disclosure Under I.R.C. §§ 6114 or 7701(b)
- Form 8833 requires information such as the specific treaty provision referenced, the I.R.C. Section to which the treaty position applies, and the applicable facts
- A separate Form 8833 must be filed as to each treaty-based return position

How Does Form 706-NA Work?

- Form 706-NA must be filed if the gross US estate exceeds $60,000
- Form 706-NA requires that a certified copy of the will be provided and a copy of the decedent's death certificate. If the assets include stock in closely held corporation, balance sheets and financial statements should be included. English language translations of all documents are required
- The gross US estate is listed on Schedule A. Amounts must be shown in US dollars
- The taxable estate is determined in Schedule B
- Filing requirement applies even if no tax is due on account of treaty applicability
- Form 706-NA allows an alternate valuation election

Schedules Required for Form 706-NA

- Asset Schedules
  - Jointly owned property: reported on Schedule E. If the surviving spouse is not a US citizen, the entire value of the property is included in the decedent's estate, less any contributions by the surviving spouse. If the surviving spouse is a US citizen, half of the value is included
  - Lifetime transfers: reported on Schedule G. Includible lifetime transfers include transfers within three years of the decedent's death, transfers with retained life estates, transfers taking effect at death, and revocable transfers
  - Powers of Appointment: Complete Schedule H of the Form 706
- Deduction Schedules
  - Charitable deduction: claimed on Schedule B; must complete and include Schedule O from Form 706. Must disclose worldwide assets to claim charitable deduction on Schedule B, line 3
  - Marital deduction: complete and include Schedule M. Form 706-QDT must also be completed for transfers to a QDOT for the benefit of a surviving spouse who is not a US citizen
- GST: If the gross US estate includes property transferred to a skip person, complete and include Schedule R and/or Schedule R-1

Form Affidavit for Small Estates

- If the gross US estate is less than $60,000, an affidavit must be submitted to the IRS instead of Form 706-NA
- The following information must be provided to the IRS:
  - Copies of the will;
  - Copies of any death or inheritance tax return filed with taxing authorities other than the US;
  - A copy of the death certificate of the decedent;
  - An affidavit signed by the executor, administrator, or other personal representative including the following information:
    - Date and country of birth of the decedent;
    - Date of naturalization as a US citizen or a statement that the decedent never became a US citizen;
    - List of all US assets and values of such assets;
    - Citizenship and residence of the decedent on the date of death;
    - Information indicating whether the decedent's US bank accounts were used in connection with a trade or business in the US
  - Any non-English documentation must be accompanied by English translations
- Affidavit should be sent to Department of the Treasury, Internal Revenue Service, STOP 824G, 7940 Kentucky Drive, Florence, KY 41042–2915

Income Taxation of Estates - Overview

- Determining whether an estate is foreign or domestic for US income tax purpose
- Income tax filing requirements for foreign estates
- Basis rules for non-US estates
- Managing UNI
- Post-Mortem CFC Planning
- PFICs
- Reporting requirements for fiduciaries and beneficiaries of foreign estates

Is an Estate Foreign or Domestic?

- I.R.C. § 7701(a)(31) which defines the term "foreign estate" speaks more to the tax treatment than what makes an estate "foreign" as it is defined as: "an estate the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income under subtitle A"

- IRS administrative pronouncements provide useful guidance:
  - The determination of whether an estate is foreign is fact-based. Factors to be considered include the location of the estate assets, the place of domiciliary administration, and the residency of the fiduciary (Rev. Rul. 81-112)
  - For US income tax purposes—there can be only one estate even if there are multiple estate proceedings in different jurisdictions with different fiduciaries (see Rev. Rul. 64-307 and Rev. Rul. 62-154)

Is an Estate Foreign or Domestic?

- Relevant factors:
  - Domicile of decedent at death
  - Location of the estate's assets
  - Location of the fiduciaries of the estate
  - Jurisdiction of the estate proceeding(s)
  - Location of the beneficiaries
- Note that many foreign jurisdictions don't have a concept of an estate existing for probate or local tax purposes, however an estate may still exist for federal income tax purposes but it is more difficult to define how long the "estate" exists under Treas. Reg. § 1.641(b)-3 which provide that "[t]income of an estate of a deceased person is that which is received by the estate during the period of administration or settlement. The period of administration or settlement is the period actually required by the administrator or executor to perform the ordinary duties of administration, such as the collection of assets and the payment of debts, taxes, legacies, and bequests, whether the period required is longer or shorter than the period specified under the applicable local law for the settlement of estates"

Definition of US Source Income

- The taxable income of a foreign estate will be computed in the same manner as for a non-resident individual (I.R.C. § 641(b))
- Foreign estates are:
  - Taxed on income effectively connected with the US ("ECI") (I.R.C. § 871(b)
  - Taxed on US sourced investment income, also known as fixed or determinable annual or periodical income ("FDAP") (I.R.C. § 871(a))
  - Not taxed on capital gains except (1) gains that are effectively connected with a US trade/business (I.R.C. § 871(b); Treas. Reg. § 1.871-8(b)) or (2) gains derived from sale of US property (I.R.C. § 897)
  - Not taxed in the US on foreign source income
- Computation of DNI for a Foreign Estate: Under I.R.C. § 7701(a)(32) (and further supported by I.R.C. § 643(a)(6) as it relates to foreign trusts), foreign source income should not be entered into the distributable net income (DNI) of a foreign estate. This means that foreign source income distributed to a beneficiary, including a US beneficiary, will not be taxed to that beneficiary even if that foreign income would have been taxed if received directly (instead of through the estate)

Income Tax Filing Requirements for Foreign Estates

- **Form 1040NR**, U.S. Nonresident Alien Income Tax Return must be filed by the foreign estate to report US-source income over $600 (I.R.C. § 6012(b)(3))
  - When you should file:
    - General rule of the 15th day of the fourth month after the close of the tax year applies (I.R.C. § 6072(a))
    - If there is no US office for the estate, then it is the 15th day of the sixth month after the close of the tax year (I.R.C. § 6072(c))
  - Who should file:
    - General rule is that the "fiduciary" must file the return (I.R.C. § 6012(b)(4))
      - See I.R.C. § 7701(a)(6) for the definition of a fiduciary—not I.R.C. § 220
    - An exception will likely apply if there is ancillary probate in the US under Treas. Reg. § 1.6012-3(a)(3) by which the ancillary administrator (if a US citizen or resident of the US) must file the return for the estate if the domiciliary fiduciary is a nonresident alien
- **Form 56**: The fiduciary of a foreign estate should file a Form 56: Notice Concerning Fiduciary Relationship (Treas. Reg. § 301.6903-1(a))

Managing UNI: Trust Domestication and 645 Elections

- For foreign non-grantor trusts, distributable net income that is accumulated, rather than distributed currently, becomes undistributed net income, or “UNI”
- Distributions of UNI are subject to the throwback rules, which tax distributions at ordinary income rates and impose a compounding interest charge (I.R.C. §§ 665 and 667)
- As US advisors, you need to advise of this issue when a non-resident alien dies with a foreign trust that has a US beneficiary
- Each trust will present its own issues that will call for its own solutions, which could include:
  - Making distributions to non-US beneficiaries
  - Use of the 65 day election to push out DNI (I.R.C. § 663(b))
  - Make distributions that are not in excess of trust accounting income (I.R.C. § 665(b))
  - Use of the “default method” over time (IRS Notice 97-34)
  - Domestication of the trust
  - 645 Election

Managing UNI: Trust Domestication and 645 Elections

- For a foreign grantor trust which was revocable during a grantor's lifetime, making a 645 election and domesticating the trust can eliminate the issue without any accumulation tax
- 645 Elections
  - A foreign qualified revocable trust becomes a foreign non-grantor trust upon the death of the decedent. Foreign non-grantor trusts are subject to the throwback rules
  - Estates are not subject to the throwback rule (I.R.C. § 665(a)). The 645 election allows deferral of this treatment until the end of 645 period by treating the trust as part of the estate
  - § 645 provides that a qualified revocable trust may be treated as part of the decedent's estate and not as a separate trust. A qualified revocable trust can include a foreign grantor trust provided it was revocable as defined by I.R.C. § 676
- Trust Domestication
  - UNI can be managed by decanting the entire principal of a foreign trust to a domestic trust. UNI will carry over, but further accumulation of UNI is prevented
  - To avoid the UNI issue entirely, domestication should take place before accumulation of UNI (i.e., upon the death of a foreign grantor), but the 645 election creates a window post death in which you can domesticate

Making the 645 Election

- Election must be made on or before the filing date of the first Form 1040-NR
- An electing qualified foreign trust will be treated as part of the estate until (1) the later of two years after the date of death of the decedent, or six months after the final determination of US estate tax liability, if an estate tax return is required, or (2) two years after the date of the decedent's death, if an estate tax return is not required
- The executor and trustee of the trust to which the election will apply must make the election by completing Form 8855: Election to Treat a Qualified Revocable Trust as Part of an Estate
- A separate Form 8855 must be filed for each electing trust
- An EIN must be obtained for the electing trust

Foreign Trusts; the Court and Control Tests

- US Trust is trust that meets court and control test; all other trusts are foreign trusts
  - A Court within US exercises primary supervision over administration of the trust (the "Court Test"); and
  - One or more US persons have authority to control all substantial decisions of the trust (the "Control Test")
- Court Test
  - US court has:
    - authority to render orders or judgments concerning administration
    - authority to determine substantially all issues regarding administration and
  - The trust does not contain an automatic migration clause
- Control Test
  - US persons have authority to control all substantial decisions of the trust
    - Substantial decision is a decision made under the trust instrument and local law that is not ministerial, including:
      - timing or amount of distributions
      - choice of beneficiary
      - add or remove a trustee
      - investments
      - allocation of amounts to principal or income
  - Ministerial acts include:
    - bookkeeping
    - collection of rent
    - execution of investment decisions made by others
- **Beware of special power of appointments, fiduciary succession, unanimous decision-making authority where minority of fiduciaries are non-US persons**

Post-Mortem CFC Planning

- CFC issues may be implicated in the estate of a non-resident decedent holding an interest in foreign corporations at death with US beneficiaries
- A foreign corporation is now classified as a CFC if more than 50% of (i) the total combined voting power of all voting stock, or (ii) the total value of the stock of the corporation, is owned, directly or indirectly, by US shareholders. US shareholders are US persons who own 10% or more of the total combined voting power of all classes of stock, or 10% or more of the total value of the stock of the corporation (I.R.C. § 957)
- US shareholders of a CFC are taxed at ordinary income rates on the pro rata share of the CFC's undistributed subpart F income, which generally includes all investment income. (I.R.C. § 951(a))
- Historically, post-mortem CFC planning entailed using a check-the-box election or actual liquidation of the corporation within 30 days after the date of death, thus avoiding subpart F income
- The Tax Cuts and Jobs Act ("TCJA") eliminated the 30 day window. Accordingly, actual liquidation of a CFC or a check-the-box election will now generate subpart F income (I.R.C. § 951(a)(1)), even if the foreign corporation is only a CFC for a day. If the CFC does not hold US situs assets, a check-the-box election can still be done effective as of the day before the decedent stockholder's death to ensure a step-up in income tax basis on underlying assets
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- Downward attribution: TCJA added "downward attribution," so US persons will now be considered to own stock in a foreign corporation owned by a non-US person (I.R.C. § 958(b))

PFICs

- A PFIC is a foreign corporation that satisfies either:
  - Income test (75% or more of gross income is passive income) or
    - Includes dividends, interest, rents, royalties, gains (same definition as “foreign personal holding company income” for CFCs)
  - Asset test (average percentage of passive assets is 50% or more of total assets of the corporation)
    - Passive assets are those that (i) produce (or are reasonably expected to produce) passive income, or (ii) are held for the production of passive income
    - Working capital is deemed a passive asset so active businesses are not necessarily not PFICs

- Unlike CFCs, there is no minimum U.S. ownership threshold
  - There is attribution from foreign persons, including trusts and estates

- In general, if a foreign corporation satisfies both CFC and PFIC tests, it is a CFC

Recent Developments/Current Events

- The due date for any 706-NA, and any payments, due on or after April 1, 2020, and before July 15, 2020, is automatically postponed to July 15, 2020 (IRS Notice 2020-23)
- NRAs in the US during COVID-19
  - Residency for income tax purposes vs. residency for estate tax purposes.
  - For income tax purposes, a taxpayer can avoid residency under the closer connection exception and the medical condition exception
  - Probate court and IRS delays

James I. Dougherty

Partner | Greenwich, New York
Private Client and Tax

+1 203 974 0333
james.dougherty@withersworldwide.com

T. Sandra Fung

Associate | New York
Private Client and Tax

+1 212 848 9814
sandra.fung@withersworldwide.com

Global office locations

Greenwich | New York | New Haven | San Francisco | Los Angeles | Rancho Santa Fe | San Diego

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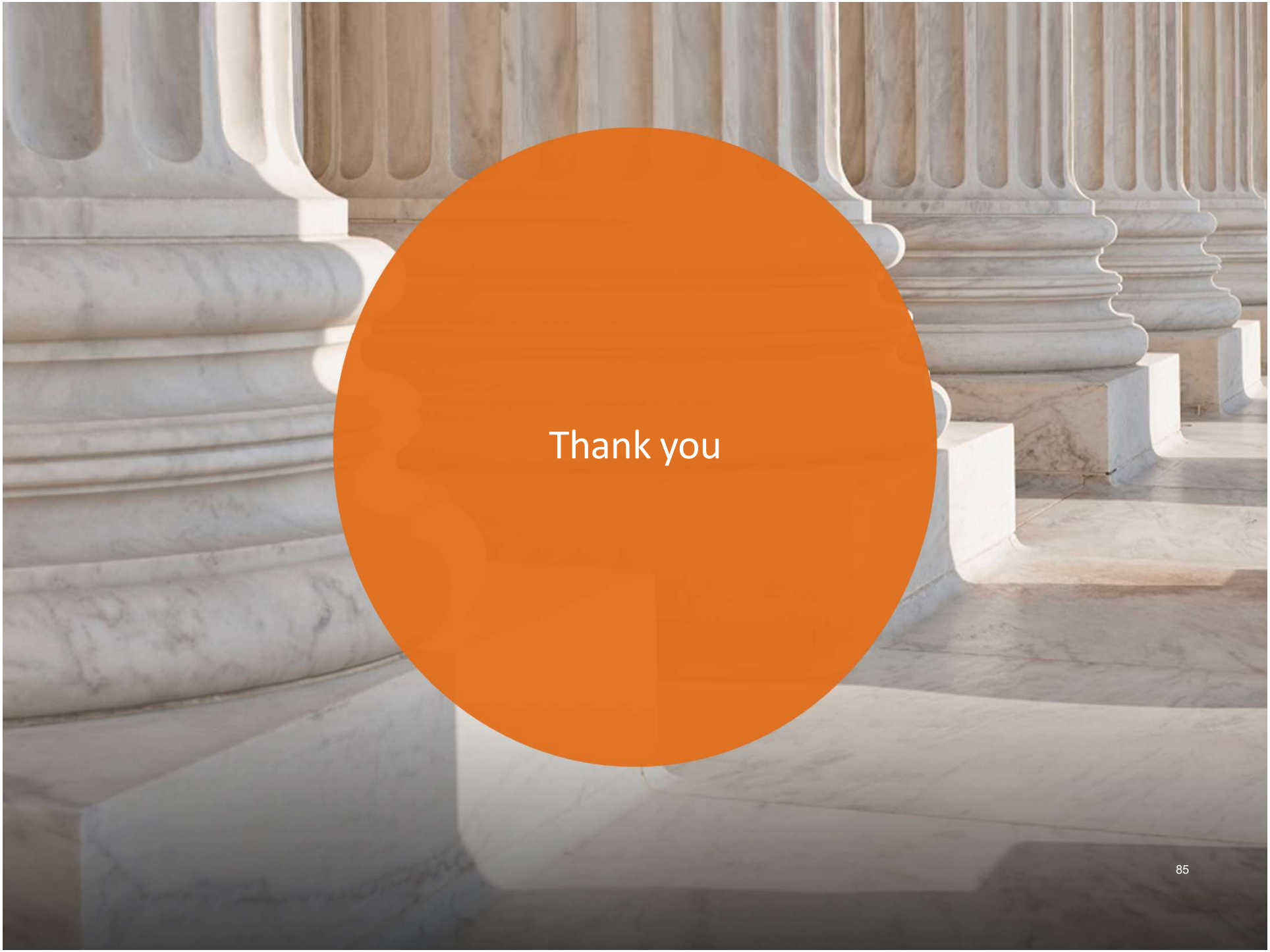
Thank you