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

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Today’s faculty features:

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

James I. Dougherty  
T. Sandra Fung
Agenda

• Non-tax issues
  • Probate
  • Choice of law
  • Testamentary freedom and foreign property marital rules

• 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
• Multi-jurisdictional estate litigation
• 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 to receive property
  - 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.

• 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 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 intestate, affidavits of heirship identify the distributees of the decedent’s estate under the laws of intestacy of the relevant state.

• 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 application 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 do not allow for 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. 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 law jurisdictions, as well as some US states, have community property regimes.
  • Though there is an overarching theme to community property styled systems, there is still differences between them that local counsel will be needed to provide competent advice.
  • Even if property is located in US separate property state, community property 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

• While generally the law of domicile applies to a decedent’s estate, 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.
Why do we care whether a person is a non-citizen/non-resident

<table>
<thead>
<tr>
<th>The US Citizen/US Resident</th>
<th>The non-citizen/non-resident</th>
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<tr>
<td>Estate tax imposed on worldwide estate</td>
<td>Estate tax imposed on only US situs assets</td>
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<tr>
<td>Deductions not prorated</td>
<td>Certain deductions prorates</td>
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<td>Current exemption of $11.18 million</td>
<td>Current exemption of $60,000</td>
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<tr>
<td>Credit allowed for foreign taxes</td>
<td>No credit for foreign taxes</td>
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<tr>
<td>Generally no requirement for transfer certificate</td>
<td>Transfer certificates often required</td>
</tr>
<tr>
<td>Form 706</td>
<td>Form 706-NA</td>
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Same filing deadlines
Same rate table
Potential availability of treaty benefits
Income tax basis step up allowable to both
Death is the triggering event
Applicable Provisions

• Two different regimes
  • Non-US Residents/Non-US Citizens (Chapter 11, Subchapter B, I.R.C. §§ 2101-2108)

• Note there is overlap
  • Subchapter B often refers to/incorporates the rules of Subchapter A
  • Parts of Subchapter C (I.R.C. §§ 2201-2207B)
Who is a Non-Resident/Non-Citizen

• Code provisions:

• I.R.C. § 2001(a): “A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.”

• I.R.C. § 2101(a): “… a tax is hereby imposed on the transfer of the taxable estate (determined as provided in I.R.C. § 2106) of every decedent nonresident not a citizen of the United States.”
Citizenship

• **Definition**: Estate tax provisions do not define the term US citizen, but Treas. Reg. § 1.1-1(c) (an income tax regulation) accurately 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
“Resident” “Domiciliary”

• 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.”
Test to Determine Domicile—Treas. Reg. § 20.0-1(b)(1)

• “United States” means the 50 states and the District of Columbia (not territorial possessions)

• Physical Presence Plus Intent: “A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.”
No Clear Test

• “The term ‘residence’ as contemplated by the tax statutes, so far as we have been able to ascertain, has never been construed, or defined, by an all-inclusive and all-exclusive definition. In fact, it seems that such a definition is impossible. Every case possesses peculiarities different from any other case, and the issue must be decided in the light of the facts peculiar to each case” (Bank of New York & Trust Co. v. Comm’r, 21 B.T.A. 197, 203 (1930)).
Factors to Consider

- Length of time residing in US as compared to where another domicile may be
- “Domicile of origin” (i.e. where was the person born)
- Existence of permanent abode
- Value of assets in various jurisdictions
- Location of family and friends
- Social and religious organizations and relationships
- Employment
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.

• 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. U.S., 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).
Filing Obligation (I.R.C. § 6018(a)(2))

• “In the case of the estate of every nonresident 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)).
Requirement for a Transfer Certificate

- Overriding Theory to Keep in Mind: The federal government must be paid, therefore, someone who is subject to US jurisdiction must be the party held liable.
- If there is no executor/administrator appointed by a US jurisdiction, then “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).
Requirement for a Transfer Certificate

- Treas. Reg. § 20.6325-1(a): “A transfer certificate is a certificate permitting the transfer of property of a nonresident decedent without liability. Except as provided in paragraph (b) of this section, 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

• There are 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.
Small Estate Transfer Certificate Procedure

• Do NOT file a Form 706-NA if the value of the estate is does not exceed $60,000.

• Send the following items to Department of the Treasury, Department of the Treasury, Internal Revenue Service, STOP 824G, Cincinnati, OH 45999:
  • Copy of testamentary instrument(s) if any (must be translated)
  • Copy of death/estate/inheritance tax return and any adjustments filed in foreign country (translated)
  • Copy of the death certificate (translated)
  • An affidavit by the “executor, administrator, or other personal representative” which is notarized stating the following:
    1) “The decedent's date and country of birth.
    2) The date of the decedent's naturalization as a United States citizen, or a statement that the decedent had never become a naturalized US citizen.
    3) A list of all the decedent's United States assets in which the decedent had any interest at the date of death (whatever may be their legal situs for US estate tax purposes) and their values at the decedent's date of death. For any US bank or investment account, please include the account number.
    4) The decedent's citizenship and residence at the date of death.
    5) Whether any of the decedent's US bank accounts were used in connection with a trade or business in the United States.”

• Need to explain in writing reason any of the above cannot be answered
Definition of Executor I.R.C. § 2203

- Under I.R.C. § 2203, for estate tax purposes, the executor is:
  - The fiduciary “appointed, qualified, and acting within the United States…” or if there is none, then
  - “any person in actual or constructive possession of any property of the decedent.”

- Benefit of Definition: Allows for US estate tax proceedings without US probate

- Criticism of Definition (set out in the 2015-2017 Obama Administration Greenbooks)
  - Technically I.R.C. § 2203 only applies to estate taxes
  - There is no priority order established for who is the executor if there is none appointed in the US
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).
Form 8971 Generally

- I.R.C. § 1014: the basis of property acquired from a decedent is its FMV on the decedent’s date of death (or alternate valuation date, if used)
- I.R.C. § 1014(f) and Form 8971
  - For estates required to file an estate tax return (see I.R.C § 6018) 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(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
Form 8971 as it Applies to Non-Resident/Non-Citizen Estates

- If you need to file a Form 706-NA—you need to file a Form 8971 and accompanying Schedule A’s (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 is only the US situs assets
  - Basis step still applies for worldwide estate under I.R.C. § 1014(b)—just no Form 8971 reporting requirement
- More likely to run into issues with reporting of social security/taxpayer identification numbers
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-domiciled 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)).
Situs of Partnership Interests—2 approaches and ~4 theories

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)).
## Summary of Situs Rules

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<tr>
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<th>US-situs</th>
<th>Non US-situs</th>
<th>Notes</th>
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<tbody>
<tr>
<td>Tangible personal property</td>
<td>Located in US at time of death (unless temporarily located in US)</td>
<td>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</td>
<td>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.</td>
</tr>
<tr>
<td>Real property</td>
<td>US situated real property</td>
<td>Non-US situated real property</td>
<td></td>
</tr>
<tr>
<td>Corporate stock</td>
<td>Shares issued by a U.S. corporation and owned, directly or indirectly, by the NRA</td>
<td>Shares issued by a foreign corporation and owned, directly or indirectly, by the NRA</td>
<td></td>
</tr>
<tr>
<td>Life insurance proceeds on decedent’s life</td>
<td>N/A</td>
<td>Life insurance proceeds are non-US situs regardless of whether the issuing company is domestic or foreign (See I.R.C. § 2105(a)).</td>
<td>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. § 20.2105-1(g)).</td>
</tr>
<tr>
<td></td>
<td>US-situs</td>
<td>Non-US situs</td>
<td>Notes</td>
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</tr>
<tr>
<td>Debt obligations</td>
<td>Obligations of a US person</td>
<td>Debt obligation of a non-US person; portfolio debt obligations (even if issued by a US person)</td>
<td></td>
</tr>
<tr>
<td>Intangible personal property</td>
<td>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)</td>
<td>Intellectual property that is not issued by or not enforceable against a non-US person, US corporation, or governmental unit</td>
<td></td>
</tr>
<tr>
<td>Partnership interests</td>
<td>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.</td>
<td>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.</td>
<td></td>
</tr>
<tr>
<td>Mutual fund interests</td>
<td>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).</td>
<td>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).</td>
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The Taxable Estate

- The taxable estate of a decedent non-resident, non-citizen is determined by subtracting any allowable deductions from the 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.
Debt Secured by US Situs Property

• Special rule for indebtedness in respect of property included in the decedent’s gross estate
  • 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
- 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
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. § 2106(b); Treas. Reg. § 20.2106-1(b)).
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)).
Tax 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

• 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).

• 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.
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.
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
Computing 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).
  • 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 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.
- 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.
- 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.
- Methods of filing
  - Complete Schedule PC and attach to Form 706-NA.
  - Form 843
Applicability of Generation-Skipping Transfer (GST) Taxes

• Unlike estate and gift taxes, 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
Exemption Amount and Inclusion Ratio

• Non-citizens/non-domiciliaries have the same exemption amount ($11.18 million) as US citizens/domiciliaries
  • Treas. Reg. § 26.2663-2(a) lists the exemption as $1 million—this is a historical artifact—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
• Special mixed inclusion ratio under Treas. Reg. § 26.2663-2(c) when trust funded with both US situs and non-situs property
Filing Requirement and Allocation Rules

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

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

<table>
<thead>
<tr>
<th>A</th>
<th>Name of trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>Trust’s EIN (if any)</td>
</tr>
<tr>
<td>C</td>
<td>GST exemption allocated on lines 2-6, above (see instructions)</td>
</tr>
<tr>
<td>D</td>
<td>Additional GST exemption allocated (see instructions)</td>
</tr>
<tr>
<td>E</td>
<td>Trust’s inclusion ratio (optional—see instructions)</td>
</tr>
</tbody>
</table>
# State Estate Tax Issues for Non-Resident Non-Citizens

<table>
<thead>
<tr>
<th>State</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>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 $2.6 million in 2018, $3.6 million in 2019, and “the dollar amount published annually by the Internal Revenue Service at which a decedent would be required to file a federal estate tax return based on the value of the decedent's gross estate and federally taxable gifts” for 2020 and after.</td>
</tr>
<tr>
<td>Conn. Gen. Stat. § 12-391</td>
<td>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.</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>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.</td>
</tr>
<tr>
<td>D.C. Code Ann. § 47-3703</td>
<td>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.</td>
</tr>
<tr>
<td>Hawaii</td>
<td>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.</td>
</tr>
<tr>
<td>Haw. Rev. Stat. § 236E-8; Haw. Rev. Stat. § 236D-4</td>
<td>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.</td>
</tr>
</tbody>
</table>
State Estate Tax Issues for Non-Resident Non-Citizens (Continued)

<table>
<thead>
<tr>
<th>State</th>
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<tbody>
<tr>
<td>Illinois</td>
<td>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. <strong>Computation:</strong> 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.</td>
</tr>
<tr>
<td>Maine</td>
<td>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. <strong>Computation:</strong> 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.</td>
</tr>
<tr>
<td>Maryland</td>
<td>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…” In 2018 there is a $4 million exemption and it will match the federal exemption in 2019 and beyond. <strong>Computation:</strong> 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.</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>Nonresident decedents owning real estate or tangible personal property located in Massachusetts are subject to the estate tax regime. <strong>Computation:</strong> 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.</td>
</tr>
</tbody>
</table>
# State Estate Tax Issues for Non-Resident Non-Citizens (Continued)

<table>
<thead>
<tr>
<th>State</th>
<th>Details</th>
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| Minnesota  | 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 entities 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   | 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     | 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)

<table>
<thead>
<tr>
<th>State</th>
<th>Description</th>
</tr>
</thead>
</table>
| **Rhode Island** | 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.”  
R.I. Gen. Laws § 44-22-1.1(b)                                                                 |
| **Vermont**   | Estate tax is imposed on the estate of any decedent owning Vermont situs real or personal property.  
| **Washington** | Estate tax is imposed on the transfer of any Washington situs property. The Washington taxable estate is the federal taxable estate, with certain adjustments.  
Wash. Rev. Code § 83.100.020(14); Wash. Rev. Code § 83.100.040                                                                 |

**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.

**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.

**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.
Treaty Benefits

- 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^  
  • Belgium#  
  • 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 treaty not yet in effect  
+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
Generalizations of Situs Rules Based on Treaty Type

• Other property
  • Situs-type:
    • Ships and aircraft are deemed to be situated where registered
    • Goodwill deemed to be situated where the trade or business is located
    • Intellectual property deemed to be situated where registered or used (in the case of patents and trademarks), or where rights arising from them are exercisable (in the case of copyrights)
    • All other property: deemed to be situated where the decedent was domiciled.
  • Domicile-type: except for immovable property and tangible property, all other property may be taxed by a country only if the decedent was a citizen or domiciliary of that country.
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 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. A return position is a treaty-based return position unless the taxpayer’s determination that the foregoing do not apply has a substantial probability of successful defense if challenged (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, Cincinnati, OH 45999.
Income Taxation of Estates

Key issues covered in this presentation

• 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
• Changes to Post-Mortem CFC Planning
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. § 2203
    - 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)).
Basis Rules

• Basis step-up
  • Basis step-up for property received directly from the nonresident decedent is generally available. I.R.C. §§ 1014(a) and (b)—estate tax inclusion is not a requirement for a basis adjustment
  • However, a basis adjustment will not be available for non-US property that is not included in the decedent’s gross estate for federal estate tax purposes unless the transfer of property meets one of the factors in I.R.C. § 1014(b) (Treas. Reg. § 1.1014-2(b)(2)).

• Basis consistency
  • Estate must report basis that is consistent with the basis of the asset received by any beneficiary.
  • Estate must file Form 8971: Information Regarding Beneficiaries Acquiring Property from a Decedent, if it is required to file an estate tax return.
  • There is a risk that if a US estate tax return was not filed despite the estate having a filing obligation, the basis of inherited property is deemed to be zero. (See Prop. Treas. Reg. § 1.1014-10(c)(3)(ii)).
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.
Changes to 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)).

- 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)).
Reporting Requirements for Fiduciaries and Beneficiaries of Foreign Estates

- **Form 3520:** U.S. Recipients of Bequests from Foreign Estates
  - US persons receiving bequests from foreign estates may need to file Form 3520.

- **Form 56:** Notice Concerning Fiduciary Relationship
  - As discussed above, a fiduciary of a foreign estate must notify the IRS of the fiduciary relationship.

- **Form 8938:** Statement of Specified Foreign Financial Assets
  - US persons with interests in foreign financial accounts and assets of a foreign estate may need to file Form 8938.

- **FinCEN Form 114:** Report of Foreign Bank and Financial Accounts
  - US persons inheriting an interest or obtaining signature authority over a foreign account may need to file a FinCEN Form 114.
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.
Issues with Cross Border Litigation

• Ancillary Probate
  • Probate may be required in multiple situs jurisdictions

• Claim and Issue Preclusion
  • These issues may arise where a claim is litigated in a foreign jurisdiction. Identical parties to litigation are precluded from re-litigating a matter which has been adjudicated to final judgment.
  • States may invoke claim preclusion to bar a proceeding based on the principle of comity.
  • If all parties in the second proceeding are not identical to the parties of the first proceeding, claim preclusion will not apply. Issue preclusion may apply.
Thank you

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