THE IMPORTANCE OF
INTERNATIONAL TAX AND ESTATE PLANNING

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The current global economic environment demands that legal, accounting and financial professionals be well versed in international tax and estate planning. Even experienced advisors must pay special attention to the very technical laws and rules to ensure they are providing proper counsel. Sound planning and creative structuring will potentially save clients millions in tax dollars and significant reporting obligations, as well as help clients avoid serious criminal consequences. The Long Island Branch of the Society of Trust and Estate Practitioners ("STEP") was established to help promote a better understanding of sophisticated international tax, estate, and asset preservation planning. STEP has branches in over 65 countries with more than 14,000 members worldwide. STEP represents a brain trust of top practitioners and leaders from the world's major trusts and estates jurisdictions.

The following information briefly highlights some of the critical points in international tax and estate planning:

U.S. vs. Non-U.S. Persons

The application of U.S. tax laws depends on whether an individual is a U.S. person or a non-U.S. person. U.S. citizens and U.S. "residents" are always U.S. persons. For U.S. income tax purposes, the definition of "residency" is fairly mechanical and statutory.[1] For U.S. estate and gift tax purposes, "residency" is based on the doctrine of "domicile". Domicile means residence in the U.S. with no definite present intention of later moving, a highly fact-intensive inquiry.[2]

Individuals who are neither U.S. citizens nor U.S. residents are not U.S. persons, but may still be subject to U.S. taxation under certain circumstances as further explained in this article.

General Income Taxation

The U.S. taxes its citizens and residents on their worldwide income. An individual, who is neither a citizen nor a resident of the U.S., is generally taxed only on his or her "U.S. source income." Determining what qualifies as U.S. source income, as well as the tax liability and reporting obligations requires a thorough understanding of the rules.

[1] See Section 7701(b) of the Internal Revenue Code of 1986, as amended (the "Code").
[2] See Treas. Reg. Section 20.0-1(b).

Gift & Estate Taxes

Non-U.S. citizens who are U.S. residents are subject to the usual U.S. gift and estate taxes. Under certain circumstances, non-U.S. citizens who are not U.S. residents may still be subject to U.S. estate taxes (e.g., ownership of shares of a U.S. corporation and real estate in the U.S.) and U.S. gift taxes (e.g., gifts of tangible personal property located in the U.S., real property in the U.S., and cash drawn from U.S. bank accounts). A gift to a spouse who is not a U.S. citizen is also not eligible for the unlimited marital deduction. Furthermore, a transfer at death to a non-citizen spouse does not qualify for the unlimited martial deduction unless a QDOT (Qualified Domestic Trust) is utilized.

Foreign Investment in the U.S.

The following is a brief synopsis of the rules for foreign individuals who are considering investment in the U.S.:

- Gain from the sale of U.S. corporate stock is generally not subject to U.S. capital gains taxes;
- Dividends from a U.S. corporation paid to a foreigner are subject to withholding taxes subject to tax treaty limitations;
- Income that is "effectively connected with U.S. trade or business" is subject to income taxes at graduated rates;
- Gain from the disposition of U.S. real estate is subject to withholding taxes FIRPTA. Furthermore, the gain is generally taxed at the applicable short-term and long-term capital gains rates.
- Foreign corporate entities may be subject to U.S. corporate tax rates (as high as 35%).

Foreigners Living in the U.S.

Unlike most other countries, the U.S. taxes non-citizen residents on their worldwide income even if the gains accrued prior to their move to the U.S. and even if the proceeds are not remitted to the U.S. Furthermore, U.S. persons who are not citizens must still report and disclose the ownership of financial assets in foreign countries and risk substantial penalties for non-compliance (e.g., IRS Form 5471 and FBAR[3]).

Tax Consequences of a U.S. Green Card

The privileges afforded by a green card also bestow significant obligations. The holder of a green card is subject to U.S. taxation and IRS reporting obligations on his or her worldwide income. These obligations apply even if the green card expires under U.S. immigration laws.

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[3] Report of Foreign Bank and Financial Accounts.

Matrimonial Issues

Adverse tax consequences may arise from a divorce when non-residents are involved. For example, the transfer of appreciated property to a non-resident as part of a divorce settlement can trigger a U.S. income tax liability for the transferor. Furthermore, absent treaty relief, alimony payments to a non-resident are subject to withholding tax. As previously mentioned, there is no unlimited gift tax or estate tax exemption if a non-U.S. citizen spouse is the recipient.

Departure from the U.S. and Expatriation

U.S. citizens and U.S. green card holders who intend to permanently leave the U.S. must formally terminate their respective citizenship and resident status or they will continue to be taxed as U.S. persons even if they live abroad. Termination of U.S. status (expatriation) may subject an individual to an "exit tax" and the individual may incur a substantial tax liability due to the "deemed sale" of appreciated assets.

Tax Disclosure and Compliance

U.S. citizens and residents who have offshore accounts with an aggregate value of $10,000 at any time during the year must file the FBAR with the IRS. Also, all foreign source income must be disclosed on an individual's income tax return (e.g., IRS Form 1040, Line 7 and Schedule B, Part III). Furthermore, if a U.S. citizen or resident owns shares of a foreign entity or transacts business overseas, there may be significant tax reporting requirements that carry severe penalties for failure to comply.

State and Local Taxation

Generally, a state like New York will impose income and estate taxes on foreigners with a substantial level of connection with that state.

Tax Treaties

The United States has tax treaties in effect with a number of other countries. Tax treaties provide income, estate, and gift tax relief from double taxation under certain circumstances. These treaties must be consulted before offering advice on international tax matters.

Examples

Please note that the following examples are all subject to treaty exemptions and limitations in effect between the U.S. and the respective country.

1. Huang Chan is a citizen and resident of the People's Republic of China. His children have immigrated to the United States and are United States

citizens living in Mineola, New York. If Huang transfers U.S. situs property to them during life or at death, the United States will impose gift or estate taxes as the case may be, unless the transfers are properly structured. Furthermore, if the gifts "land" here, the future income arising from the assets is subject to U.S. income taxes. Furthermore, if Huang purchases real property in the United States, perhaps an apartment in Manhattan, or a commercial building in Los Angeles, he will be subject to U.S. income and estate taxes and reporting (without proper planning).

2. Tom Jones is a U.S. citizen who lives in Garden City. If Tom owns 10 percent or more of a foreign corporation he may be subject to U.S. taxes and significant reporting obligations in the U.S. even if no income is distributed from the foreign corporation to him. If he owns 50 percent or more of a foreign corporation, there are even more stringent rules and tax reporting obligations. Of course, this is in addition to any taxes and reporting requirements imposed by the foreign country.

3. John Smith was born in Memphis, Tennessee, and is a U.S. citizen. When he was 2 years old he moved with his family to Sweden. As a U.S. citizen, John is obligated to pay U.S. taxes and report his worldwide income to the U.S. If John has a bank account in Sweden with $10,000 or more, he must file the FBAR. He is also subject to U.S. gift and estate taxes.

While this is just a brief summary to illustrate the importance of international tax and estate planning, it should be emphasized that the rules are very complex, highly technical and proper guidance and counsel should be sought from an experienced advisor.

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