

Estate Planning for International Clients: Three Traps for the Unwary

International clients living in the United States face a number of Estate Planning challenges. For the unwary, a lack of planning can lead to disaster. Imagine, for instance, the shock of a British citizen working at a Silicon Valley startup when he learns that only \$60,000 of his estate will be shielded from estate tax. In this article, the author discusses three traps for the unwary expatriate who passes through, lives, or works in the United States.

First Trap: It's Not What you Know, it's What you Don't Know

Often times, non-US citizens are uncertain whether they will be subject to different kinds of tax, and at what amount. Perhaps a nonresident working on a business visa pays income tax on their worldwide earnings, and reckons that they therefore are treated the same as a US citizen for all other types of tax. Wrong. The rules subjecting one to income tax differ from those for transfer tax. An individual has to pay income tax if they meet one of the following tests:

- (1) He or she has a green card (is a lawful permanent resident);
- (2) He or she has "substantial presence" in the States, measured by the number of days a person is present in the country;
- (3) He or she makes a special election to be treated as a permanent resident for income tax purposes.

Non-US citizens who meet one of these tests are then taxed at a flat 30 percent rate! Of course, if an estate tax treaty is in place, the toll may be reduced.

On the other hand, an individual is subject transfer tax based on a much different test. What is *transfer tax*? Transfer tax includes the many types of taxes that Estate Planning attorneys are hired to reduce or eliminate. They include gift tax, estate tax, and generation skipping transfer tax (GSTT). Capital gains tax is not a "transfer tax," but it sometimes comes into play when a transfer of assets is made. Who will be subject to transfer tax? The internal revenue code, section 2001(a), provides that 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." But a "resident" for income tax purposes, discussed above, is different from a "resident" for transfer tax purposes. The more important question for transfer tax purposes is whether one is *domiciled* in the country. To be domiciled in the United States:

- (1) The person must intend to permanently live in the United States;
- (2) At the time the person intends to remain permanently in the United States, the person must also actually be physically present in the United States; and
- (3) The person must be capable of making an informed, intelligent decision about living permanently in one place or another.

Does this mean that a person who maintains a residence in the United States might not be domiciled there for transfer tax purposes? Yes. If the individual intended to move back to their country of origin, and that fact could be clearly demonstrated by the facts and circumstances, then the IRS might consider the person to be domiciled in their country of origin. As we will see below, this determination is important for the types of tax that can be imposed on transfers and at what amount.

Second Trap: The \$60,000 Estate Tax Exemption for non-Residents

For United States permanent residents and citizens, the 2009 estate tax exemption is equal to \$3,500,000. That means that estates valued at less than \$3,500,000 will not be subject to estate tax for decedents dying in 2009. Non-residents, however, can only transfer up to \$60,000 without paying an estate tax. Thus, many non-residents living in the United States, some only with modest assets, will leave their heirs with a 45% bill on sizable taxable estates!

If a non-resident has a US Citizen spouse, they can take advantage of the IRC §2523 unlimited marital deduction, which defers all estate tax until the death of the second spouse. Yet, many non-residents do not have a US citizen spouse. For those with non-citizen spouses, a Qualified Domestic Trust ("QDOT") can be established to make qualified transfers to one's spouse to reduce or eliminate the estate tax bill. Together with a Credit Shelter Trust that sets aside the \$60,000 exemption amount, the QDOT can be a powerful planning strategy. Nevertheless, upon his or her death, the non-Citizen spouse will still leave their heirs with a large taxable estate.

Third Trap: Gift Tax on taxable transfers

Non residents cannot make any "taxable transfers" for gift-tax purposes without incurring a gift tax. IRC §§2102, 2106(a)(3), 2505. However, they should keep in mind that they can take advantage of gift-tax exclusions, such as the IRC §2503(b) annual exclusion, and the special IRC §2523(i) for non citizen spouses.

Also, the type of property will make a difference on whether a taxable transfer is subject to gift tax. For non-resident non-domiciliaries, only those assets regarded to be situated within the United States are subject to gift tax. Gifts of *intangible* assets, on the other hand, will not be subject to gift tax. Why is that important? Since shares of stock are considered intangible assets, they may be transferred in certain circumstances without triggering any gift tax. Non-residents should review which assets will be subject to gift tax in order to plan accordingly.

Conclusion: Be Prepared

Non-residents should seek education in order to minimize an unfavorable level of exposure to transfer tax both now and upon their death. Consulting with an estate planning attorney who works with international clients can help mitigate these and other issues.

This article is intended to provide general information about estate planning strategies and should not be relied upon as a substitute for legal advice from a qualified attorney. Treasury regulations require a disclaimer that to the extent this article concerns tax matters, it is not intended to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by law.

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