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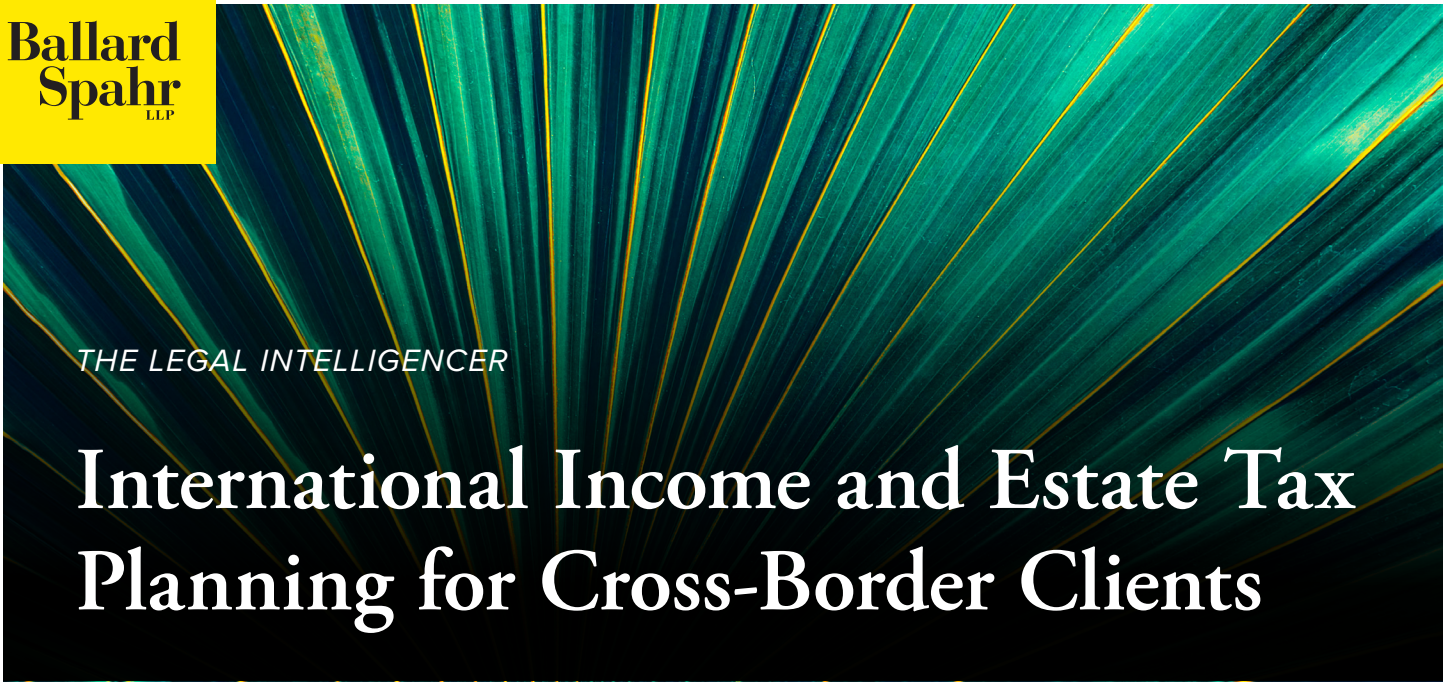

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International Income and Estate Tax Planning for Cross-Border Clients

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As noncitizens and nonresidents of the United States have increasingly acquired global assets, they may unknowingly be subjecting themselves to various income and transfer tax laws across multiple jurisdictions. The United States has specific income tax rules for noncitizen nonresidents (NCNRs), and it has an entirely different estate and gift tax regime for NCNRs, creating traps for the unwary cross-border client.

Income Tax Considerations

The United States taxes all income earned by its citizens and residents (U.S. persons) on a worldwide basis. This means that for U.S. persons, all income is subject to U.S. income tax, regardless of where it is earned worldwide.

U.S. citizens, wherever they are located, are subject to the U.S. income tax regime and must annually file an IRS Form 1040 to report their foreign income. This can be especially problematic when U.S. citizens living abroad may also be subject to taxation in the country in which they reside. Although there are many income tax treaties in place that would eliminate double taxation, a U.S. citizen will likely pay income tax at the highest rate of the two countries. This can also present issues for individuals who reside abroad and are unknowingly U.S. citizens. Because being born in the United States or being born to a U.S. citizen parent can result in U.S. citizenship, an individual may be an "accidental American" and unknowingly be subject to the U.S. income regime.

The United States also taxes its noncitizen "residents" on income earned on a worldwide basis. The test for determining income tax residency is objective. A noncitizen is deemed a "resident" for U.S. income tax purposes if the individual meets either: the "green card test" or the "substantial presence test." The possession of a green card automatically grants an individual U.S. resident status for income tax purposes, and the actual number of days present in the United States, or elsewhere, is irrelevant. Green card status continues until relinquished, officially revoked, or judicially determined to be abandoned. Under the substantial presence test, an individual is treated as a U.S. resident for a particular calendar year if he is physically present in the United States for 31 days or more in that year and 183 days or more during a three-year period (the year in question and the two preceding years). The three-year total is derived by counting all of the individual's days of physical presence in the United States for the current calendar year, one-third

of the days of presence in the preceding calendar year, and one-sixth of the days of presence in the year before that. Being present in the United States for even a moment on any given day may count as a full day of presence (there are some exceptions, and in special circumstances, certain days of presence may be excluded).

In addition to the potential income tax issues, U.S. persons are also subject to a number of informational reporting requirements. A U.S. person is required to annually file a Report of Foreign Bank and Financial Accounts (FBAR) if the U.S. person has a financial interest or signatory authority over any foreign financial accounts where the aggregate value of accounts exceeds $10,000. Certain trust beneficiaries are also required to file an FBAR with respect to a trust's foreign financial accounts if the beneficiary has a present beneficial interest in more than 50% of the trust assets or receives more than 50% of the trust's income. There are steep penalties for failure to file an FBAR. In addition, U.S. persons must file a Form 3520 to report transactions with foreign trusts and the receipt of foreign gifts in excess of $100,000. U.S. persons must also file an IRS Form 8938 if the U.S. person holds an interest in "specified foreign financial assets" having an aggregate value above a certain threshold. Specified foreign financial assets include foreign accounts at financial institutions, foreign-issued stock or securities, and interests in foreign entities.

Transfer Tax Considerations

Similar to income tax, U.S. persons are subject to federal transfer taxes (i.e., estate, gift and generation-skipping transfer taxes) on assets owned on a worldwide basis. This means that all transfers of property by a U.S. person (i.e., either a resident or a citizen of the United States), regardless of the location of the property, are subject to such transfer taxes. NCNRs are subject to transfer taxes only on transfers of certain property "situated" in the United States (U.S.-situs property).

The test for determining transfer tax residency of a noncitizen differs from the test for determining income tax residency. A resident for one such purpose is not necessarily a resident for the other. The test for determining residency of a non-citizen for transfer tax purposes is subjective. A resident for U.S. transfer taxes is a person who is domiciled in the United States. The U.S. Treasury regulations provide that "a person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom." A person's intent in this regard is determined by considering all relevant facts and circumstances. Important factors include, but are not limited to, the person's status for immigration purposes, the issuing country(ies) of his passport(s), where the individual is registered to vote, the location of the individual's assets and personal property, and the location of the person's family and friends. If a noncitizen is deemed a US resident for transfer tax purposes, the U.S. resident may avail himself or herself of the federal estate, gift, and generation skipping transfer tax exemptions afforded to U.S. citizens (currently $12.92 million in 2023).

Nonresidents (who are also noncitizens), on the other hand, are subject to transfer taxes only to the extent that the property transferred is U.S.-situs property. Such individuals may only avail themselves of the very small exemption for NCNRs (currently $60,000). To make things more complicated, the definition of U.S.-situs property differs for estate tax purposes and for gift tax purposes. U.S.-situs property for estate tax purposes includes, but is not limited to, real property located in the United States, tangible personal property located in the United States, stock in a U.S. corporation, and debt obligations of U.S. resident. U.S.-situs property for gift tax purposes generally includes only real property located in the United States, tangible personal property located in the United States, and cash deposits in a US bank account. Interestingly, U.S.-situs property for gift tax purposes does not include stock in a U.S. corporation or debt obligations of a U.S. person. This provides planning and gifting opportunities for NCNRs to avoid U.S. estate tax if the NCNR owns such U.S. situs-property.

NCNRs and their advisers need to be aware of the special income and transfer tax rules that impact cross border clients. It is critical that before structuring gifts, estate plans, or income tax planning, the cross border tax regimes should be considered so as to avoid unnecessary and often duplicative tax.

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