International Visitor? Minimize Liability for US Transfer Taxes on Worldwide Assets

~ Douglas J. Elmore

You have a residence in Southwest Florida but live elsewhere more than half the year. You are not a United States citizen and do not have a US "Green Card." Could your worldwide assets still be subject to US estate and gift tax? Surprisingly, the answer is "yes." Depending on the facts and circumstances, your activities and connections in the US could reach a level that subjects all of your assets to the US estate and gift tax regime. And in this event, your assets could be subject to US transfer tax regardless of where they are located and how they are titled. Let's review the facts and circumstances to determine the legal and tax implications of your residency status.

Understanding Domicile

As a multinational person, one of the threshold questions you face is whether you are a US domiciliary for estate and gift tax purposes. Domiciliary status is important because it causes you to be taxed as a US citizen relative to your worldwide assets, irrespective of where your assets are located.

To be a US domiciliary for estate and gift tax purposes, you must maintain a permanent home in the US with an intent to remain in the country indefinitely. Having the requisite intent depends upon the facts and circumstances in play at the time of your relevant transfer. This test differs greatly from the "bright line" tests that may establish residency for income tax purposes, which consider the number of days you spend in the US and whether you are a "Green Card" holder (i.e., permanent resident). Understanding this distinction is critical, as you may be classified as a US resident for income tax purposes, but not as a US domiciliary for estate and gift tax purposes, and vice versa.

Your desire to be or not to be a US domiciliary is just one aspect of determining domicile for estate and gift tax purposes. To be a US domiciliary, the entirety of your circumstances must support that your residence is permanent and that you intend to remain in the US indefinitely. Case law suggests some of the most important factors are the time you spend in the US relative to other countries, the location of your business and social contacts, the location of your family and relatives, the location of your cherished personal possessions, and the location where you engage in activities such as voting, public service, and charitable giving. Your immigration status relates to this analysis but is not determinative. In evaluating domicile, coordinate closely with legal and tax advisors from all relevant countries to thoroughly assess the factors that may sway a determination.

The fact-intensive nature of this domicile test can produce unexpected results. A person who lives in the US for a limited amount of time may still be a US domiciliary for estate and gift tax purposes. For example, in the often-cited case of *Estate of Fokker*, Mr. Fokker was a Dutch citizen who lived in St. Moritz, Switzerland, for eight months per year. Despite this, he was held to be a US domiciliary at the time of his death. Mr. Fokker's largest and most valuable home was in New York, and the home was fully staffed with servants whether or not he was in the US. Mr. Fokker's case was not helped by the fact he repeatedly claimed New York residency to US immigration officials, although it was apparently commonplace to do so at the time to facilitate business travel. While the result in Mr. Fokker's case may be uncommon, the case stands as a glaring reminder that spending even a small amount of time in the US could cause you or any taxpayer to be a US domiciliary if the totality of the facts and circumstances supports this result.

Transfer Tax Rules: The Basics

Rules Applicable to Domiciliaries. A US domiciliary (sometimes referred to as a "resident alien") is subject to the same estate and gift tax rules that apply to US citizens. Both US citizens and domiciliaries are subject to estate tax on the fair market value of their worldwide assets, regardless of where such assets are located. In addition, lifetime gifts made by a domiciliary are subject to US gift tax regardless of where the gifted assets are located.

If you are a US domiciliary, you are entitled to the same exemptions and deductions available to a US citizen. You may claim the full US estate and gift tax exemption of $5,430,000, and you may also claim an unlimited marital deduction on assets transferred to a US citizen-spouse. However, a transfer by gift or bequest to a spouse qualifies for the unlimited marital deduction only if the recipient spouse is a US citizen.

Portability is also available to US domiciliaries. Thus, if proper procedures are followed, a surviving spouse may claim the unused estate tax exemption of a deceased domiciliary spouse, even if neither of you is a US citizen.

Rules Applicable to a Non-Domiciliary. Avoiding domiciliary status, however, does not cause a person to avoid the US estate and gift tax system altogether. A non-US domiciliary (sometimes referred to as a "nonresident alien") is subject to tax on transfers of "US situs assets." A US situs asset is an asset that is legally considered to be in the US for estate and gift tax purposes and, therefore, may cause a taxable event when you transfer it. As you may expect, US real estate and tangible personal property (e.g., cars, jewelry, artwork) physically in the US are US situs assets, as are certain business assets.

Determining the status of an asset is not as straightforward as it may seem. An asset's situs depends on an intricate set of rules from numerous authorities—statutes, regulations, rulings, and case law. Estate and gift tax treaties may alter the default situs rules, sometimes so only US real property interests and certain US-based business interests are subject to US transfer tax. Depending upon various factors, a tax credit or treaty may reduce or eliminate double taxation if the same asset is subject to estate or gift tax in another country.

In addition, the complexity of the situs rules can sometimes produce counterintuitive results. For example, if you are a non-domiciliary, a special rule permits you to make a gift of intangible personal property without triggering US gift tax consequences. If you make a gift of stock of a US corporation, this transfer will not constitute a taxable gift. However, if you do not make a gift of the stock and instead transfer it upon your death, this transfer will be subject to US estate taxation under the general statutory rules.

As a non-domiciliary, you are also treated differently than a citizen or domiciliary in terms of estate and gift tax exemptions. Unless an estate and gift tax treaty apply, as a default rule, you have available a $13,000 estate tax credit—the equivalent of a $60,000 estate tax exemption. In addition, your lifetime gifts are not sheltered by a gift tax exemption. These exemptions stand in stark contrast to those available to citizens and domiciliaries who may use a $5,430,000 exemption for transfers made during life or at death.

Further discussion of the rules applicable to non-US domicliaries in the context of ownership of US real estate can be found in the article entitled Tax Planning for Foreigners Purchasing Property in Florida *by Michael J. Wilson, beginning at page 42.*

Jointly Held Assets. Jointly held assets may also create issues for a multinational person or family. Assuming you are not a US citizen-spouse and you own a jointly held asset, this asset is subject to special tracing rules that determine the portion of the asset deemed to be "owned" by each joint tenant for estate and gift tax purposes. These tracing rules require both joint owners to document your original investments (or subsequent investments) in the joint asset to establish the extent of your ownership. Absent proper tracing or documentation, as a contributing joint tenant, you may not be deemed the owner of the portion of the asset corresponding to your actual investment.

Consider the death of a non-citizen spouse who was the joint owner of a vacation home but who contributed no funds towards the purchase of such home. Upon the non-citizen spouse's death, the entire value of the vacation home is presumed to be included in his or her gross estate for estate tax purposes. This presumption may be overcome, however, if the surviving spouse can prove his or her contribution towards the purchase price of the home. On the other hand, if the surviving spouse cannot properly trace his or her investment in the vacation home, the deceased spouse may be the deemed owner of 100 percent of the vacation home for estate tax purposes. Upon the acquisition of property (even if not jointly owned at the time of acquisition), a multinational should carefully assemble information pertaining to the original source of funds for acquisition and, over time, should maintain detailed records of contributions toward capital improvements.

Rules Applicable to Transfers to Non-Citizen Spouses. Regardless of whether you are a domiciliary or non-domiciliary, the citizenship status of your spouse can have a significant impact on the structure of your estate plan. If your spouse is a US citizen, transfers to your spouse during life or at death may qualify for the unlimited marital deduction. However, if your recipient spouse is not a US citizen, the unlimited marital deduction is not available for lifetime transfers. Additionally, for transfers at death, the unlimited marital deduction is only available if the property is left to a "qualified domestic trust" (QDOT), unless an estate and gift tax treaty provides otherwise.

A QDOT is a special trust designed to defer the payment of estate tax otherwise due with a transfer to a surviving spouse. Through a QDOT, estate tax may be deferred until the earlier of the surviving spouse's death or a distribution of principal from the trust. A QDOT is often created under the terms of a decedent's estate planning documents. A QDOT may also be created by a surviving spouse during the initial period of administration.

Fortunately, two tax provisions help soften the sting of these citizenship rules. For one, a lifetime transfer to a non-citizen spouse is eligible for an increased annual exclusion. Rather than applying a $14,000 annual exclusion to such transfer, you, as a taxpayer, may apply a $147,000 annual exclusion if the transfer is in a form meeting certain requirements. Both the annual exclusion and the supercharged spousal annual exclusion are indexed for inflation.

Additionally, under current law, when one spouse is a non-citizen, the purchase or joint ownership of US real estate by a married couple does not cause a completed gift. Instead, a taxable gift occurs only if, upon the termination of the tenancy, proceeds are distributed to the non-contributing spouse. Therefore, if you—or both you and your spouse—are not US citizens, you must remain cognizant of these rules to avoid unintended taxable gifts.

Treaty Relief. The statutory rules applicable to a non-domiciliary can be harsh. Fortunately, the US has entered into estate and gift tax treaties with at least 19 other countries. In general, when the US has a transfer tax treaty with another country, the rules of the treaty supersede the laws that would otherwise apply. Treaties seek to mitigate double taxation and reduce the imposition of US estate tax on non-domiciliaries by narrowing the situs rules; expanding credits, deductions, or exemptions; and by providing tiebreaker rules applicable when an individual is deemed domiciled in both treaty countries.

For example, under the United States-Canada Treaty, Canadian residents are entitled to a pro-rata share of the estate tax exemption available to US residents. This pro-rata amount is based on the value of the Canadian resident's US situs assets relative to the value of his or her worldwide assets. Under this treaty, a transfer to a Canadian citizen-spouse may qualify for a "marital credit." A decedent must elect the application of this credit, but if done properly, it may obviate the need for a transfer to a Canadian citizen-spouse to be made to a QDOT. This election may eliminate estate tax altogether, rather than just defer it.

The treaty with the United Kingdom also provides for various tax benefits. This treaty permits the estate of a UK resident to file a US estate tax return as if the decedent had been a US resident—reporting worldwide assets and claiming the full $5,430,000 exemption. This provision can eliminate US estate tax for many families from the UK who own Florida vacation homes.

Coordinated Planning Is a Must.

For you and other multinational persons, you must coordinate your US estate plans with the tax and administrative laws of other relevant jurisdictions. For instance, notwithstanding the provisions of a US will, if you are a non-domiciliary, your US property may be subject to another country's forced heirship or community property laws. Employing traditional US estate planning techniques (such as a revocable trust) may create problems in your home country, or vice versa. To fully understand the tax implications of lifetime and death transfers, engage in coordinated, deliberate planning involving proficient legal counsel from every country in which you own assets.

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