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U.S. Tax Treatment of Gifts and Inheritances From Nonresidents

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US TAX TREATMENT OF GIFTS AND INHERITANCES FROM NONRESIDENTS

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INTRODUCTION

- The transfer tax positions of nonresidents who are not citizens of the US who are not expatriated US citizens often is overlooked, as the estate and gift tax exemption for US citizens and residents has increased to its current $11.7 million amount in 2021.
- For nonresidents who are not citizens of the US (a nonresident alien or **"NRA**"), however, there is no gift tax exemption, other than the current annual exclusion amount of $15,000 per donee, no gift splitting between spouses, and no unlimited marital deduction.
- Further, the US estate tax exclusion is limited to a paltry $60,000.
- Can be very difficult to explain to someone who comes from the many countries that do not impose tax when a gift is made that property acquired with income on which income tax has been properly paid is subject to an additional US tax when that property is gifted, as well as the concept that the US tax will be imposed based on the value of the gifted property when gifted, regardless of what was paid to acquire the property.
  - Only 19 of the 37 OECD countries impose an estate or inheritance tax and/or gift tax.

DOMICILE

WHO IS A "NONRESIDENT" FOR US TRANSFER TAX PURPOSES

- For US transfer tax (estate, gift, and generation-skipping transfer tax) purposes, a "resident" *of the US* is defined by the Treasury Regulations as someone who is not a citizen but who nonetheless has a US "domicile." Treas. Reg. §25.2501-1(b).

WHAT IS "DOMICILE"?

- "Domicile" is defined as a place where a person lives "for even a brief period of time, with no definite present intention of later removing therefrom" by section 20.0-1(b)(1) of the Treasury Regulations.
  - Note that this determination differs significantly from the definition of a US resident for US income tax purposes, which is determined on a year-by-year basis pursuant to the relatively objective tests set forth in section 7701(b) of the Internal Revenue Code of 1986 (the **"Code"**).

“DOMICILE” CONTINUED

- The US test for domicile consists of two components:
  - First, a person must have lived in the US; and
  - Second, the person must have intended to remain in the US indefinitely.
- As stated in *Estate of Khan v. Comm’r*, T.C. Memo. 1998-22, “Both elements must be present, and one without the other is insufficient to establish a new domicile. [Citations omitted.]”

DETERMINING DOMICILE

- Determining domicile, and whether a domicile has changed, is a question of balancing facts, with a fact-finder having to weigh a variety of factors.
  - As will be noted from the definition provided by section 20.0-1(b)(1) of the Treasury Regulations ("for even a brief period of time"), the length of time a NRA has spent living in the US (or abroad) is not a significant factor in determining where that person is domiciled.

FACTORS THAT MAY BE USED TO DETERMINE DOMICILE

- Factors that have been cited by courts as factors to be taken into account for purposes of determining domicile, at least in a specific case, include, in no particular order of priority:
  - (I) location of primary residence; (ii) presence or absence of other places of residence; (iii) primary business location; (iv) location of investment properties; (v) location of banking and other financial relationships; (vi) original reason for traveling from jurisdiction in which domicile is claimed by the taxpayer to the jurisdiction in which domicile is asserted by the taxing authority; (vii) place of citizenship, particularly when that citizenship is maintained despite long-term residency in another country; (viii) location where immediate and extended family reside; (ix) location of social relationships (membership clubs, religious institutions, etc.); (x) statements on government documents, such as visas, income tax returns, etc.; and (xi) jurisdiction issuing driver’s license, library cards, etc.
- Any resemblance between factors indicating domicile and factors indicating a closer connection to another jurisdiction for income tax purposes is intentional, as both tests intend to determine to which jurisdiction an individual has the closest ties.
  - Income tax considers, however, a specific tax period, while transfer tax considers a lifetime.

US GIFT TAXATION

DETERMINING WHETHER A TRANSFER IS A GIFT

- A transfer by a person to another person is a gift to the extent that property is transferred gratuitously, regardless of whether the property is transferred directly or indirectly, and regardless of the nature of the property as tangible or intangible. Treas. Reg. §25.2511-1(a), (c).
- Donative intent on the part of the transferor is not an essential element for US gift tax to apply to the transfer. Treas. Reg. §25.2511-1(g)(1). That provision strikes us as nonsense, since the very concept of gifting involves a donative intent. A transfer without a donative intent by the transferor is something, but it sure isn't a gift.

COMPLETION OF GIFT

- To be a gift for US gift tax purposes, the gift must be completed. Treas. Reg. §25.2511-2.
  - Generally, completion of a gift requires that dominion and control of the subject property must be irrevocably transferred by delivery to the recipient of the gift or the recipient's agent. Treas. Reg. §25.2511-2(b).
  - Rev. Rul. 67-396, 1967-2 C.B. 351, addresses when a gift is completed in the context of gifts of a check or a promissory note.

GIFTS BY NRAs THAT ARE SUBJECT TO US GIFT *TAX*

- NRAs who make a gift to a US person are subject to US gift tax when what is transferred is tangible property located in the US.
  - Code §2501(a)(2) provides that NRAs are not subject to US gift tax on transfers of intangible property, without any territorial limitation on the location of the property at the time of the transfer. Notice how critical that rule is. The estate tax rule is different; under the estate tax rules, as discussed below, all US based property, tangible and intangible, in the hands of an NRA who dies is subject to U.S estate tax. So, a gift of stock of a domestic corporation is tax free while a devise of that stock is subject to estate tax. Odd, to say the least.
  - Code §2511(a) provides that a NRA is only subject to US gift tax if the property is situated within the US at the time of the gift.
- See later discussion, however, of US gift tax liability of recipients of gifts received from "covered expatriates."

TRANSFERS BY NRAs OF INTANGIBLE PROPERTY

- "Intangible property" is not a term that is defined by the Code or Treasury Regulations.
  - Stocks, bonds, debt obligations, and bank accounts are examples of "intangible property" that are provided in Treas. Reg. §25.2511-3(b).
  - More generally, courts have stated for other US income tax purposes that "property is intangible if its intrinsic value is attributable to its intangible elements rather than to any of its specific tangible embodiments." *Tex. Instruments Inc. v. US*, 551 F.2d 599, 609-11 (5th Cir. 1977) (concluding that seismic data tapes and films were tangible property because the value of the seismic data was determined by the court to be entirely dependent on the ability to access that information through the tapes and films on which the data was recorded). As that case suggests, virtually all intangible property is embodied in a tangible item (paper, usually) so one needs to look at the intrinsic value of the tangible item separate from the underlying property described in the paper.
  - Notwithstanding that rather obvious conclusion, the IRS, as we discuss below, has held that cash is tangible. Treas Reg. § 25.2511-3(a)(1).
  - IRS, however, has for many years stated that it will not rule on whether a partnership interest is intangible property for purposes of Code §2501(a)(2), most recently in §4.01(29) of Rev. Proc. 2021-7, 2021-01 IRB 290.

GIFTS OF MONEY

- Gifts of money are a difficult area.
- Unclear what US policy goals would be supported by treating money as tangible property, such that gifts of money by a NRA that are completed in the US are subject to US gift tax.
  - If that is the case, then gifts of money by NRAs that are completed in the US are a definite trap for the unwary and unadvised.
- Section 25.2511-3(b)(4)(iv) of the Treasury Regulations specifically provides that currency is not included as a debt obligation, so cannot be considered to be intangible property on that basis (if the Regulation is correct).
- In IRS General Counsel Memorandum 34845 (Apr. 1972), IRS discussed at length the treatment of money as intangible property for purposes of the US gift tax, including consideration of US Supreme Court cases and the legislative history of Code §2501(a)(2).
  - On the one hand, the GCM states that, in adopting Code §2501(a)(2), "Congress may have intended a liberal interpretation of 'intangibles' so as to include money."
  - On the other hand, the GCM also states that, "Arguably, if Congress had intended section 2501(a) to apply to 'money,' which has not been defined consistently as tangible personal property, if would have done so explicitly."
  - The GCM then concludes in the next paragraph, without any further discussion, that, "We concur with your position that for purposes of section 2501(a)(2), American money is tangible property." The GCM, however, recommends that the statement be rephrased to be "that a transfer of money is not a gift of 'intangible property' within the meaning of section 2501(a)(2)."
  - The Revenue Ruling considered in GCM 34845 was not issued.

CONVERSION OF TANGIBLE PROPERTY TO INTANGIBLE PROPERTY

- In *Davies v. Commissioner*, 40 T.C. 525, after extensive discussions between father and son, father (UK citizen and resident) agreed to transfer long-held family real estate in Hawai'i to son (UK citizen, US resident), who could not afford to purchase the real estate.
- The agreed transfer was effected by father transferring cash to son in the UK, which son then used to satisfy a purchase money note issued to father to purchase the real estate.
- The $5,000 amount of the downpayment gifted by father to son conditioned on son using that amount as a downpayment to acquire the Hawaiian real property was determined by the Tax Court to be, effectively, a taxable gift of $5,000 of the value of the Hawaiian real property.
- Also subject to US gift tax was the difference between the fair market value of the Hawaiian property and the amount of the promissory note that son issued to father in connection with the purchase of the Hawaiian real property.
- Subsequent cash gifts by father to son that were completed in the UK, however, were not determined to be subject to US gift tax because they were not expressly made on the condition that those cash gifts be applied to the note that son issued to father in connection with the purchase of the Hawaiian real property (even though each of the gifts were so applied).
- Apparently critical to the Tax Court's conclusion was that son entered into a legally enforceable promissory note with no preexisting agreement that father would transfer funds to son to allow him to pay the note, and that the note was not forgiven, but instead was paid with subsequent unrestricted gifts of cash made in the UK.

DEDUCTIONS AND EXCLUSIONS

- NRAs are entitled to take advantage of the Code §2503(b) annual gift tax exclusion ($15,000 in 2021), which excludes gifts of future interests.
- NRAs also are entitled to take advantage of the Code §2503(e) exclusion for certain transfers for educational expenses or medical expenses.
- Gift splitting is permitted by Code §2513(a)(1) only if each spouse is a citizen or resident of the US.
- Nonresidents are not able to take advantage of the applicable credit amount provided by Code §2010, which is available only to a citizen or resident of the US (Code §2505(a)).

CHARITABLE CONTRIBUTIONS BY NRAs

- Code §2522(b) sets forth the rules for NRAs to make gifts to charities.
- To be deductible from gifts subject to US gift tax, the gift must be to:
  - The US, any state of the US, any political subdivision of a state of the US, or the District of Columbia, exclusively for public purposes;
  - A domestic Code §501(c)(3) corporation;
  - A Code §501(c)(3) trust, or community chest, fund, or foundation, but only if the gift is to be used within the US exclusively for charitable purposes;
  - Fraternal societies, orders, or associations, operating under the lodge system, but only if the gift is to be used within the US exclusively for charitable purposes; and
  - War veteran organizations organized within the US, but only if no part of their net earnings inures to the benefit of any private shareholder or individual.

MARITAL DEDUCTION

- Regardless of the donor's identity, the marital deduction for gifts to a spouse is limited by Code §2525(i) if the gift is to a noncitizen spouse, whether or not either the donor or donee is a US resident.
- The limit is achieved by increasing the annual gift tax exclusion to an inflation-adjusted $159,000 in 2021.
  - Annual gift tax exclusion does not apply to gifts of future interests in property.

GIFT TAX PLANNING

OPTIONS FOR NRAs TO MAKE GIFTS OF MONEY

- The most conservative option for a NRA to make a gift of money is to complete the transfer of money outside of the US, for example by making a transfer of the money to a non-US bank account of the transferee.
- Another alternative is for the NRA to establish a bank account, wait for a reasonable interval, then transfer ownership of the bank account to the desired recipient.
- Many commentators have informally opined that transferring funds by a wire transfer from the NRA's bank to the recipient's bank should fall outside the logic of GCM 34845.
- Other commentators believe that there is not sufficient logic underlying GCM 34845 to make it enforceable.

OPTIONS FOR NRAs TO MAKE GIFTS OF REAL ESTATE

- Let’s say that Mr. Chen, a citizen of China and a resident of Hong Kong, owns a house in Beverly Hills free and clear that his daughter used while attending UCLA. She has decided to stay in the US as a resident, and Mr. Chen wants to give her the house. To do that would generate a significant gift tax so you advise him to take a different tack.
- Your advice is to cause Mr. Chen to create a corporation in the US (Nevada? California?) and transfer the house to the corporation. Although the transfer technically is a disposition, Treas. Reg. §11445-2(d)(2) provides that Mr. Chen can avoid FIRPTA withholding by giving notice to the corporation and IRS that a nonrecognition transfer has occurred. Mr. Chen then holds the stock for awhile, perhaps a year, and then he gives the stock to his daughter. She, in turn, makes the S election and either remains in or moves into the house.
- The gift of the shares is not a taxable event to anyone, provided that neither the real property nor the shares are subject to an encumbrance. Treas. Reg. §1.1445-1(b)(1).

OPTIONS FOR NRAs TO MAKE GIFTS OF PARTNERSHIP INTERESTS

- Partnership interests, in the gift tax arena, are tricky. None of us knows whether a gift of the interest is a gift of the underlying assets or is a gift of a partnership interest. IF the latter, then one can argue rather persuasively, in our view, that the partnership interest is an intangible.
- Since we don't know, however, we need to look in another direction. Suppose that the NRA is a partner of a partnership that owns US real estate. He wants to give that interest to his child. In order to limit the risks of gift tax, the NRA transfers his partnership interest into a partnership created in the Cayman Islands. As a result, the NRA no longer owns an interest—at least, a direct interest–in a US partnership. As the next step, let's say that the NRA gives his Cayman partnership interest to his child. Is that a taxable gift? It is only if the IRS successfully argues that the gift was the underlying US real estate. That strikes us as a difficult burden for the IRS to carry, especially, if the partnerships are properly fleshed out and viable.
- Note the FIRPTA requirements discussed on the previous slides, however, for the transfers to avoid US FIRPTA withholding.

US ESTATE TAXATION

US GROSS ESTATE OF NRAs

- Code §2103 provides that the gross estate of a NRA are the NRA's assets that are located or deemed to be located in the US.
- Code §2104 and Treas. Reg. §20.2104-1 provide that US-situs assets include:
  - Stock in a US corporation;
  - Property that is transferred in a revocable transfer or within 3 years of the decedent's death, if the property was located in the US at either the time of the transfer or the time of the decedent's death;
  - Debt obligations issued by a US person, but:
    - Code §2105(b) specifically provides that US bank accounts not effectively connected with the conduct of a US trade or business and US debt instruments that qualify for portfolio debt treatment under Code §871(h) (**"portfolio debt"**) are not property within the US for US estate tax purposes; and
  - Tangible property located in the US, unless that property is jewelry or similar personal property in the possession of a NRA who is in transit at the time of death. *Delaney v. Murchie*, 177 F.2d 444 (1st Cir. 1949).

PROPERTY NOT LOCATED IN US

- In addition to certain bank deposits and portfolio debt, Code §2105 and Treas. Reg. §20.2105-1 provide that the following types of property owned by a NRA are situated outside the US:
  - Life insurance proceeds from a policy on the life of a NRA are not located in the US;
  - Works of art on loan for exhibition in the US at the time of death are not considered to be located in the US;
  - Interests in mutual funds, in the proportion that the mutual fund is invested in assets that are situated outside the US;
  - Tangible property located outside the US; and
  - Except as provided in Treas. Reg. §20.2104-1, "intangible personal property the written evidence of which is not treated as being the property itself, if it is not issued by or enforceable against a resident or the United States or a domestic corporation or governmental unit." Treas. Reg. §20.2105-1(e).
    - Typical bureaucratic mumbo jumbo. What those phrases mean is that patents issued by the US are US property.

SITUS OF PARTNERSHIPS

- An interest in a partnership organized outside the US seems to literally qualify as a non-US asset for US estate tax purposes pursuant to Treas. Reg. §20.2105-1(e).
- In Rev. Rul. 55-701, 1955-2 C.B. 836, however, IRS concluded that for purposes of the US-United Kingdom Estate Tax Convention the situs of a partnership interest for US estate tax purposes is where the partnership business is conducted.
  - As noted previously, IRS generally refuses to rule whether a partnership interest is intangible property for purposes of Code §2501(a)(2).
  - As old as that ruling is, it seems to be in line with IRC § 864(c)(8) that taxes the sale of a US partnership interest as effectively connected income.

DEDUCTIONS - GENERALLY

- Code §2107 permits the estate of a NRA to claim a proportion of many of the expenses allowable to a US estate, including for funeral expenses, administrative expenses, claims against the estate, mortgages on, and indebtedness with respect to, property included in the NRA's gross estate, and uninsured casualty losses.
  - The proportion that may be taken is equal to a fraction, the numerator of which is the value of the NRA's US gross estate and the denominator of which is the value of the NRA's worldwide estate.
- The estate of a NRA also is able to deduct all of its testamentary charitable contributions to US charities, subject to the same rules as discussed above with respect to the exclusion of charitable gifts to US charities from US gift tax.

MARITAL DEDUCTION

- Code §2106(a)(3) also provides the marital deduction to a NRA's estate for property located in the US and transferred to a surviving spouse, to the extent the deduction would be available pursuant to Code §2056.
- If the surviving spouse is not a citizen of the US at the time of the decedent's death, Code §2056(d) provides that the marital deduction only will be available to the decedent (whether a NRA or citizen) only if either:
  - The surviving spouse was a NRA at all times after the date of death and, while maintaining NRA status, becomes a US citizen before the filing of the US estate tax return for the NRA decedent; or
  - The property passes from the NRA decedent to a qualified domestic trust (commonly know as a "QDOT").

CREDITS

- The US estate tax credit available to NRAs pursuant to Code §2102(b)(1) is $13,000, equivalent to a taxable estate of $60,000.
- Code §2102(b)(1) is the sole authority for the estate of a NRA to claim credits against US estate tax, and does not provide for any credit for non-US taxes imposed on property included in the US estate. Treas. Reg. §20.2102-1(a).
- As discussed below, estate tax conventions to which the US is a party generally expand the availability of credits against US estate tax for NRAs domiciled at death in those countries.

US INCOME TAXATION OF ESTATES

DEFINITIONS

- Non-US ("foreign") estates are defined by Code §7701(a)(31)(A) as, "an estate, the income of which, from sources outside the United States, which is not effectively connected with the conduct of a trade or business in the United States, is not includible in gross income" for US income tax purposes. As you will note, that definition is circulatory and, hence, worthless. To determine whether an estate owes US income tax, one needs to look at various factors, such as where the executor lives, where the assets are located, and other items.
- An estate that is included in the definition of "United States person" is defined by Code §7701(a)(30)(D) as any estate, other than a "foreign estate."

DETERMINING IF AN ESTATE IS "FOREIGN"

- Decedent's citizenship is irrelevant.
- An estate is treated as a person, so if the estate actually were a person and that person would be required to file as a resident of the US, so will the estate.
- Conversely, if the hypothetical person would not be required to file a US income tax return as a resident, neither will the estate.
  - Foreign estate still may need to file a US income tax return with respect to US-source income.
  - Foreign estate will not need to file a FinCEN Form 114, Report of Foreign Bank and Financial Accounts ("FBAR") any more than any other non-US person would.
- Foreign estate will not be required to withhold US tax on distributions it makes.

SUMMARY OF US INCOME TAXATION OF US ESTATE

- US estates are taxable on worldwide income, and file IRS Form 1041, US Income Tax Return for Estates and Trusts, to report their income, in addition to any obligation to file a US Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, to pay US estate tax.
- US estates are required to withhold US tax on some distributions made to non-US persons, pursuant to the rules set forth in Treas. Reg. §1.1441-5.

US GENERATION-SKIPPING TRANSFER TAX

APPLICATION TO DIRECT SKIP TRANSFERS BY NRAs

- A direct skip transfer by a NRA is subject to the generation-skipping transfer tax (**"GST"**) only to the extent that the transfer is subject to US estate or gift tax at the time of transfer, pursuant to Treas. Reg. §26.2663-2(b)(1).
  - Section 26.2663-2(a) of the Treasury Regulations provides that every NRA is entitled to a $1,000,000 GST exemption; however, that section of the Regulations was adopted before the GST exemption amount was indexed for inflation.

APPLICATION TO TAXABLE DISTRIBUTIONS AND TAXABLE TERMINATIONS

- If a NRA transfers property to a trust, Treas. Reg. §26.2663-2(b)(2) provides that a taxable distribution by, or a taxable termination of, that trust will be subject to GST to the extent that the initial transfer by the NRA was subject to US estate or gift tax within the meaning of Treas. Reg. §26.2652-1(a)(2).
  - A transfer is subject to US estate tax for this purpose if the value of the property is includible in the NRA's gross estate.
  - A transfer is subject to US gift tax for this purpose if a gift tax is imposed, without regard to exemptions, exclusions, deductions, and credits.
- Consequently, IRS has ruled privately that GST did not apply on the termination of a trust created by a NRA with real estate located outside the US, and also that GST did not apply when the NRA subsequently died and the remaining cash held by the NRA's estate (also outside the US) was made available for distribution to a second trust. Priv. Ltr. Rul. 201311004 (Mar. 15, 2013).

COVERED EXPATRIATES

BEQUESTS AND GIFTS BY COVERED EXPATRIATES

- US tax is imposed by Code §2801 on the **recipient** of a bequest or a gift from a "covered expatriate."
  - The Code §2801 tax applies to gifts from a covered expatriate to the extent the amount of the gift exceeds the annual gift tax exclusion provided by Code §2503(b) ($15,000 in 2021) and is not otherwise subject to US gift tax.
- The Code §2801 tax is imposed at the highest rate of gift tax provided by law.
  - Exceptions to imposition of the Code §2801 tax are provided for charitable gifts and gifts to spouses.
  - The Code §2801 tax also applies to transfers by a "covered expatriate" to a US trust, as well as to a non-US trust to the extent a distribution from the trust to a US citizen or resident is attributable to the gift.
- Character of property as tangible or intangible and location within or without US is not a factor in determining a recipient's liability for the Code §2801 tax on receipt of a gift or bequest from a covered expatriate.

"COVERED EXPATRIATE" DEFINED

- A "covered expatriate" is either a former citizen or a former long-term lawful US permanent resident ("green card" holder) who:
  - Had an average annual net income tax for the period of 5 taxable years ending before the loss of citizenship or surrender of green card ("expatriation date") of $172,000 (in 2021);
  - Had a net worth of $2,000,000 or more on the person's expatriation date; **or**
  - Fails to certify under penalties of perjury that all requirements of the Code for the 5 taxable years preceding the expatriation date were met or fails to comply with IRS requirements for evidence of such compliance.
- Actual liability for "exit tax" imposed by Code §877A is not relevant to determination of whether a person is a "covered expatriate."

GREEN CARD HOLDERS AS "LONG-TERM" RESIDENTS"

- A green card holder is a "long-term" resident if the holder was a lawful permanent resident of the US in at least 8 of the 15 taxable years ending with the taxable year in which the expatriation date occurs. Code §877(e).
  - Any year in which the green card holder is treated as the resident of another jurisdiction pursuant to a US income tax treaty is not included as a year of residence in the US for this purpose, unless the holder waives the benefits of such treaty.
  - Note that tax residency without a green card is not included in the "permanent resident" calculation.

ESTATE AND GIFT TAX TREATIES

US ESTATE GIFT TAX TREATIES

- US estate and gift tax (**"EGT"**) treaties are largely overlooked documents, especially as compared with US income tax treaties.
- US has EGT treaties (technically, "conventions") with 14 jurisdictions, plus Canada.
  - Canada imposes income tax at death as if assets of decedent sold, so Canadian estate tax provisions are part of the US-Canada income tax treaty.
- US has an EGT treaty with only 8 countries that include gift tax within its scope.
  - US has a specific gift tax treaty with Australia that is included , but Australia repealed its gift tax in 1999.
- Unlike US income tax treaties, there is no model US EGT treaty, nor is there a model OECD EGT treaty.

EGT TREATIES PURPOSES

- Because EGT regimes of different countries impose tax based on the domicile/residence of the decedent (or heir, in the case of those jurisdictions that impose inheritance tax), and also impose tax on the basis of the location of assets at death (primarily, but not exclusively, real estate and business property), EGT treaties attempt to reduce double taxation by:
  - Assigning to one of the parties the primary right to impose its EGT.
  - Identifying specific classes of property that the other party has the right to subject to its EGT.
    - Real estate/immovable property and business property are usual types of property, but others apply.
  - Providing for credits and increasing existing credits.

SITUS- vs. DOMICILE-TYPE TREATIES

- Situs-type gift tax treaties (Australia and Japan) assign specific types of assets to a situs in either the taxpayer’s country of domicile or the other country.
- Domicile-type gift tax treaties (Denmark, France, Germany, Sweden, and the UK) assign the right to impose gift tax to the country in which the taxpayer is domiciled.

CREDITS PROVIDED BY EGT TREATIES

- EGT treaties generally provide for certainty of credits for the EGT imposed by the country in which property is located against the EGT imposed by the country in which the decedent was domiciled at death.
- Most EGT treaties also provide that US will provide a person domiciled in the other treaty country at death with a proportionate share of the US unified credit.
  - Proportion is determined by the percentage that the US estate represents of the worldwide estate.
  - Requires disclosure to IRS of all worldwide assets.
- An EGT treaty also may provide an increased marital deduction over US domestic law.
  - In this regard, see especially the US-Germany EGT treaty.

US TAX COMPLIANCE

FORM 709

- IRS Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, is used to report taxable gifts by both US residents and NRA.
  - Due date is no earlier than 1/1 and no later than 4/15 of the year after the gift was made.
- IRS Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b), is used by a taxpayer to claim that the benefits of any estate and gift tax treaty overrules or modifies any Code provision.
  - If no return otherwise is required to be filed by the Code, an appropriate return nevertheless must be filed by the taxpayer to accompany the Form 8833.

FORM 706-NA

- IRS Form 706-NA, United States Estate (and Generation-Skipping Transfer) Tax Return, is required of the executor of any NRA if the date of death value of the decedent's US-situs assets, together with the gift tax specific exemption (applicable to gifts made between 9/9/1976 and 12/31/1976, inclusive) and the amount of adjusted taxable gifts, exceeds $60,00.
- Due date is 9 months after the date of death.

FORM 3520 - REQUIREMENTS

- Part IV of IRS Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, required by Code §6039F, is used by a US person to report gifts and bequests that person receives from persons who are not US persons in amounts that exceed $16,815 (in 2021)
- IRS Notice 97-34, 1997-1 C.B. 422, in Section VI.B.1 increased the reporting threshold for aggregate gifts in a year from a single nonresident alien or a foreign estate to $100,000; that amount is not adjusted annually for inflation.
  - Aggregate gifts include gifts from related parties and nominees and intermediaries of a single nonresident alien or foreign estate.
  - Section 501(c)(3) organizations are exempt from the Form 3520 filing requirement with respect to gifts.
  - Reporting is only required for gifts that are actually or constructively received.
  - Reporting is not required unless the US person knows or has reason to know that the donor is a non-US person.
  - Foreign gifts do not include gifts that qualify for the unlimited exclusion for direct payment of educational or medical expenses.
  - Foreign gifts also do not include distributions from non-US trusts that are properly reported elsewhere on Form 3520.

FORM 3520 – FAILURE TO FILE

- Code §6501(c)(8) provides that failure to file Form 3520 to report information with respect to certain foreign trusts as required by Code §6048 will extend the statute of limitations until 3 years after Form 3520 is filed; that provision does not apply, however, to Form 3520 when used to report foreign gifts as required by Code §6039F.
- In the absence of reasonable cause, failure to file Form 3520 as required to report foreign gifts will result in:
  - IRS determining the tax consequences of receiving the gift; and
  - Payment of a penalty in the amount of 5% of the amount of the gift for each month it is not reported, up to a maximum of 25% of the amount of the gift.
  - Anecdotally, we understand that the IRS is imposing a penalty for late filing of the 3520 automatically, requiring the taxpayer to fight the penalty; frequently, an expensive requirement.

FOR MORE INFORMATION

- For more information, please contact either of the speakers at:

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