

**BDO TAX TALK**  
Summer Webinar Series

# ESTATE PLANNING POST TAX REFORM

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**BDO**

# With You Today



**JACK NUCKOLLS**  
Managing Director,  
Technical Tax Leader -  
Private Client Services

[jnuckolls@bdo.com](mailto:jnuckolls@bdo.com)  
415-490-3393



**TRACI KRATISH PUMO**  
Managing Director,  
National Tax Office -  
Private Client Services

[tkratish@bdo.com](mailto:tkratish@bdo.com)  
561-207-3239

# Estate, Gift, & Generation-Skipping Transfer Taxes

- ▶ Estate and gift taxes - beginning in 2018, the exemption for estate and gift taxes is increased to \$11,180,000 (adjusted for inflation).
  - \$15,000 annual exclusion starting January 1, 2018
  
- ▶ Generation-skipping transfer tax - beginning in 2018, the amount of the generation-skipping transfer tax exemption is increased to \$11,180,000 (adjusted for inflation).
  - \$15,000 annual exclusion starting January 1, 2018

# Keys to Current Estate Planning

- ▶ Remember that the increased exemption is set to expire on December 31, 2025, and will then return to the pre-tax reform amounts.
  - This makes the tried and true planning techniques still relevant, even for estates that do not exceed the increased exemption amount.
- ▶ Advantages of flexible planning.
  - Remember all the tax AND non-tax reasons to engage in planning
- ▶ Clawback?
- ▶ Philanthropic intentions.
- ▶ Review current plans
  - Consider outdated formula clauses
- ▶ Coordinate estate planning with income tax planning.

# Comprehensive Example

# Fact Pattern

- ▶ Jim and Diane have been married for the last twenty-five years. Jim is a successful entrepreneur, who runs a wholly-owned S corporation worth \$50,000,000. Diane is currently the CEO of a large Fortune 500 corporation. Jim is currently 60, and Diane is 58. They have two children, Michael and Ella. Michael is 25 years old, and Ella is 23.
- ▶ Diane's board requires the CEO to retire at the age of 60. Her compensation is mainly in the form of a cash bonus and stock options, paid at the beginning of every calendar year, based on the performance of the preceding calendar year. She currently has stock options worth over \$75,000,000.
- ▶ Jim started the company when he was thirty years old, and he considers it to be his third child. He would consider passing the business on to his children, but also is interested in the possibility of cashing out, and retiring to a beach in Florida.
- ▶ Michael is currently working as a high school math teacher, and has shown no interest in working with, or running his father's company. Michael is engaged to Jackie, who neither of his parents particularly enjoy. Ella recently graduated from college, and would be interested in running the company. Her degree was in Art History. Ella is currently single, but considering adopting a child since she has been unable to find anyone worth dating on any of her fifteen Apps yet.
- ▶ The family is very charitable, and started the Jim and Diane Family Foundation, a private foundation. They usually donate highly appreciated stock to the foundation, and then the board (which is comprised of Jim and Diane), decide at the end of the year which charities to donate too.
- ▶ Jim and Diane have done very little estate planning. Jim is reluctant to plan, since he tends to believe that modern medicine will enable him to live well past 100. Diane has a revocable trust, with a pour-over will. Other than that, no estate planning has been completed for either of them. They both believe that their children should be comfortable after they have passed, but not wealthy. If they have grandchildren one day, they would desire to provide their grandchildren with trusts that provided at an education, and possibly other ventures (starting a business, buying a home, etc.).

# Estate Breakdown

## ▶ Major Assets:

- S-Corporation worth \$50,000,000
- Stock worth \$75,000,000

## ▶ Family:

- Children:
  - Michael (Teacher)
  - Ella (Recent College Graduate)
- No Grandchildren

## ▶ Current Estate Plan:

- Pour-over will with revocable trust
- Non-operating private foundation

▶ Current Estate Value:  
\$125,000,000

▶ 2018 estate exclusion:  
\$11,180,000

▶ Current estate tax rate: 40%

▶ Potential federal estate tax exposure: **\$45,528,000**

# Agenda

- ▶ Comprehensive Example Planning Strategies
  - Gifts that qualify for exclusion
  - Grantor Retained Annuity Trusts (GRAT)
  - Sale to an intentionally defective grantor trust
  - Qualified Personal Residence Trust (QPRT)
  - Family Partnerships
  - Charitable Techniques
    - Charitable Remainder Trusts
    - Charitable Lead trusts
  - Spousal Limited Access Trust (SLAT)
  - Income Tax Strategies
- ▶ International Planning



# Gifts that Qualify for Exclusions

# Annual Exclusion - Background

- ▶ Under Section 2503(b), the first \$15,000 of a gift made by a donor to any person during the calendar year, is not included in the total amount of gifts made during the year to that person.
  - In order to qualify for the annual exclusion, the gift must be of a “present interest” in property.
    - In *Crummey v. Commissioner*, the court held that rather than the existence of the present interest resting on whether the beneficiary actually enjoyed the property, *the focus should be on whether they had the right to enjoy the property.*
    - As such, it enables the donor to give the beneficiary a right to beneficial enjoyment for a set period of time, which then will lapse if the beneficiary does not exercise the right.
- ▶ Under Section 2513, married couples can elect to split gifts, therefore enabling them to give away \$30,000 to each donee during a taxable year.

# Annual Exclusion - Example

- ▶ Diane and Jim decide to make annual exclusion gifts to their two children starting in 2018. Over the next 25 years, they can shift the following assets out of their estate.

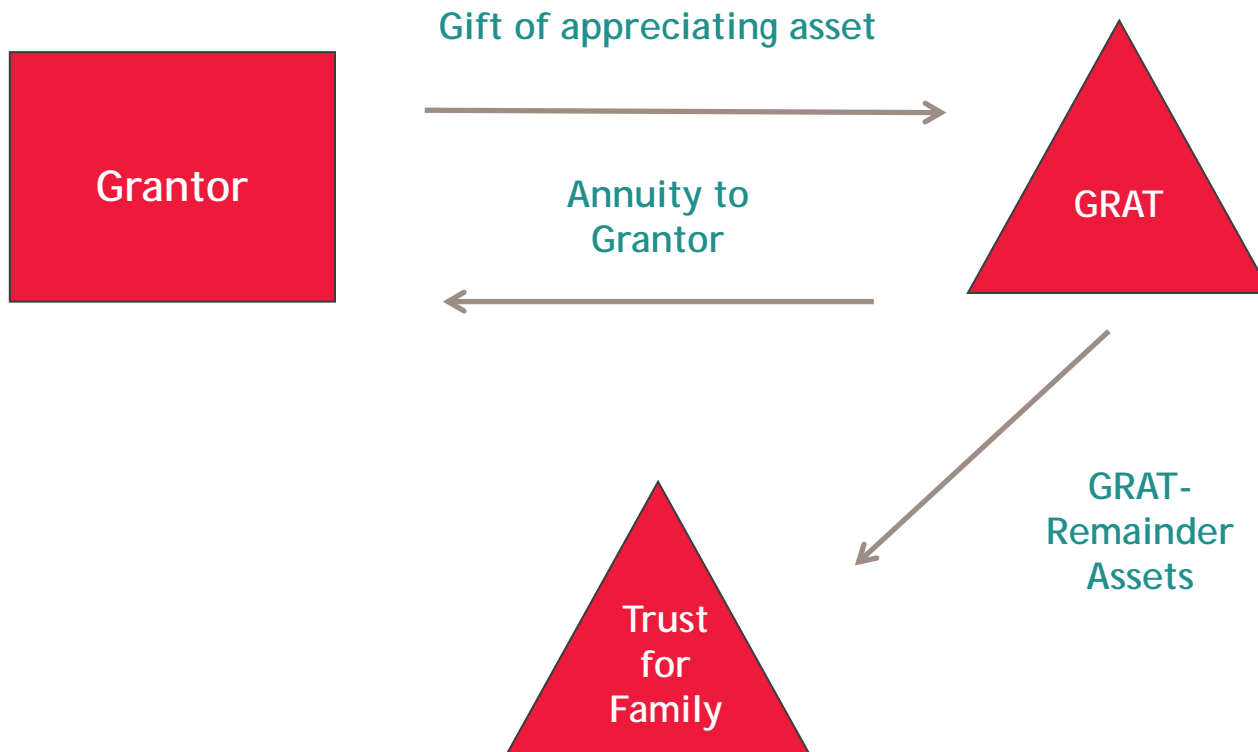
<u>Year</u>	<u>Annual Exclusion</u>	<u>Number of Donees</u>	<u>Value of Gift</u>	<u>Estate Tax Savings</u>	<u>Cumulative Gifts with Growth</u>	<u>Cumulative Estate Tax Savings</u>
2018	\$30,000	2	\$60,000	\$24,000	\$60,000	\$24,000
2019	\$30,000	2	\$60,000	\$24,000	\$121,800	\$48,720
2020	\$30,000	2	\$60,000	\$24,000	\$185,454	\$74,182
2021	\$30,000	2	\$60,000	\$24,000	\$251,018	\$100,407
2022	\$32,000	2	\$64,000	\$25,600	\$322,548	\$129,019
2023	\$32,000	2	\$64,000	\$25,600	\$396,225	\$158,490
2024	\$32,000	2	\$64,000	\$25,600	\$472,111	\$188,845
2025	\$34,000	2	\$68,000	\$27,200	\$554,275	\$221,710
2026	\$34,000	2	\$68,000	\$27,200	\$638,903	\$255,561
2027	\$34,000	2	\$68,000	\$27,200	\$726,070	\$290,428
2028	\$36,000	2	\$72,000	\$28,800	\$819,852	\$327,941
2029	\$36,000	2	\$72,000	\$28,800	\$916,448	\$366,579
2030	\$38,000	2	\$76,000	\$30,400	\$1,019,941	\$407,976
2031	\$38,000	2	\$76,000	\$30,400	\$1,126,539	\$450,616
2032	\$38,000	2	\$76,000	\$30,400	\$1,236,336	\$494,534
2033	\$40,000	2	\$80,000	\$32,000	\$1,353,426	\$541,370
2034	\$40,000	2	\$80,000	\$32,000	\$1,474,028	\$589,611
2035	\$42,000	2	\$84,000	\$33,600	\$1,602,249	\$640,900
2036	\$42,000	2	\$84,000	\$33,600	\$1,734,317	\$693,727
2037	\$42,000	2	\$84,000	\$33,600	\$1,870,346	\$748,138
2038	\$44,000	2	\$88,000	\$35,200	\$2,014,457	\$805,783
2039	\$44,000	2	\$88,000	\$35,200	\$2,162,890	\$865,156
2040	\$46,000	2	\$92,000	\$36,800	\$2,319,777	\$927,911
2041	\$46,000	2	\$92,000	\$36,800	\$2,481,370	\$992,548
2042	\$48,000	2	\$96,000	\$38,400	\$2,651,811	\$1,060,725

# Education and Medical Exclusion

- ▶ Under Section 2503(e), a donor is permitted to transfer during a tax year unlimited amounts on behalf of a donee of:
  - Tuition to a qualified organization for the education or training of the donee; or
  - To any person who provides medical care with respect to such donee for such medical care.
- ▶ This is a powerful exclusion, as there are no caps on the amount that a donor can pay on behalf of a donee during the year.
  - IRS has contemplated arrangements in which a donor enters into an agreement with an education institution to pre-pay tuition for grandchildren for grades K-12, finding that the gift would qualify for the education exclusion under Section 2503(e), and would not be subject to GST tax.
    - See PLR 200602002.

# Grantor Retained Annuity Trusts

# Grantor Retained Annuity Trust



# Grantor Retained Annuity Trust - Background

- ▶ Grantor transfers appreciated property to a trust.
- ▶ The trust is obligated to pay an annuity back to the grantor for term of years.
- ▶ Section 673 treats the grantor as owner of any portion of a trust in which the grantor has a reversionary interest in either the corpus or income, if the reversionary interest exceeds 5% of the value of the property placed into the trust.
- ▶ Since the trust is a grantor trust under Section 671, all items of income, deduction and credit during the trust term will be reported on the grantor's individual tax returns.
- ▶ Under Revenue Ruling 85-13, any transaction between the grantor, and the grantor's trust, will not be sale or exchange under Section 1001.
- ▶ Section 7520 provides the applicable rates to be used in valuing the annuity.

# Grantor Retained Annuity Trust - Strategy

- ▶ The FMV of the gift is equal to the value of property transferred less value of annuity retained.
  - A gift to a GRAT does not qualify for the use of annual exclusion under Section 2503(b), as it does not qualify as a present interest gift.
  - Walton Case indicates that gifts to GRATs can be zeroed out, resulting in no taxable gift.
    - A zeroed out GRAT reduces the risk to zero. If the GRAT fails, the client has not used up any exclusion. If the GRAT is successful, they have transferred appreciation out of their estate, tax free.



## GRAT - Result

- ▶ Diane creates a two-year GRAT, funded with shares of her company stock with a FMV of \$5,000,000.
- ▶ Diane zeros out the GRAT, resulting in no taxable gift.
- ▶ In order for the GRAT to be successful, the stock needs to appreciate at value greater than the Section 7520 rate (also known as the hurdle rate).

# GRAT - Result

Economic Schedule of GRATs				
Year	Beginning Principal	Growth	Required Payments	Remainder
1.5 Percent Growth				
1	5,000,000	75,000	2,582,778	
2	2,492,222	37,383	2,582,778	-
3 Percent Growth				
1	5,000,000	150,000	2,582,778	
2	2,567,222	77,017	2,582,778	61,461
5 Percent Growth				
1	5,000,000	250,000	2,582,778	
2	2,667,222	133,361	2,582,778	217,805
10 Percent Growth				
1	5,000,000	500,000	2,582,778	
2	2,917,222	291,722	2,582,778	626,166

# GRAT - Result - 2 Year Rolling GRATs

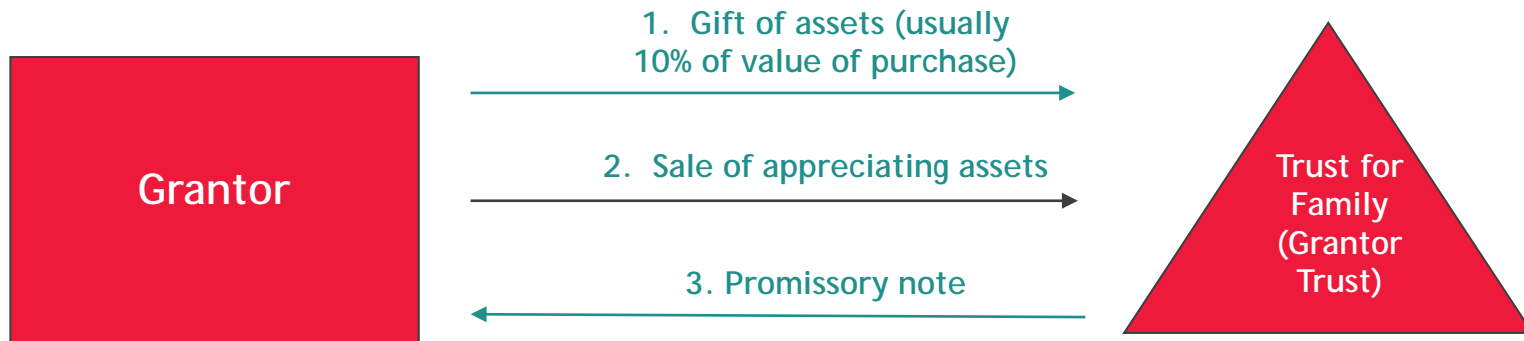
GRAT 1 - Tax Year 2017 (funded)				
Year	Beginning Principal	3.0 Percent Annual Income	Requirement Payments	Remainder
1	5,000,000	150,000	2,582,778	
2	2,567,222	77,017	2,582,778	61,461
GRAT 2 - Tax Year 2018 (funded with first payment from GRAT 1)				
1	2,582,778	77,483	1,334,148	
2	1,326,113	39,783	1,334,148	31,748
GRAT 3 - Tax Year 2019 (funded with second payment from GRAT 1)				
1	2,582,778	77,483	1,334,148	
2	1,326,113	39,783	1,334,148	31,749
GRAT 4 - Tax Year 2019 (funded with first payment from GRAT 2)				
1	1,334,148	40,024	689,162	
2	685,011	20,550	689,162	16,400
GRAT 5 - Tax Year 2020 (funded with second payment from GRAT 2)				
1	1,334,148	40,024	689,162	
2	685,011	20,550	689,162	16,400

# GRAT - Result - 2-Year Rolling GRATs

GRAT 6 - Tax Year 2020 (funded with first payment from GRAT 3)				
1	1,334,148	40,024	689,162	
2	685,011	20,550	689,162	16,400
GRAT 7 - Tax Year 2021 (funded with Second payment from GRAT 3)				
1	1,334,148	40,024	689,162	
2	685,011	20,550	689,162	16,400
GRAT 8 - Tax Year 2021 (funded with first payment from GRAT 4)				
1	689,162	20,675	355,990	
2	353,846	10,615	355,990	8,472
GRAT 9 - Tax Year 2021 (funded with second payment from GRAT 4)				
1	689,162	20,675	355,990	
2	353,846	8,760	355,990	6,616
GRAT 10 - Tax Year 2021 (funded with first payment from GRAT 5)				
1	689,162	20,675	355,990	
2	353,846	8,760	355,990	6,616
			Remainder	212,261

# Sale to an intentionally defective grantor trust

# Sale to Defective Grantor Trust



# Sale to Defective Grantor Trust - Background

- ▶ Appreciating assets are sold to an intentionally defective grantor trust at fair market value, with consideration returned in the form of a cash down payment, and the balance to be paid with a promissory note.
- ▶ Sections 673 through 677, and Section 679, contain provisions that result in the grantor being treated as the owner of the trust for income tax purposes.
- ▶ Since the trust is grantor, under Section 671, all items of income, deduction and credit during the trust term will be reported on the grantor's individual tax returns.
- ▶ Under Revenue Ruling 85-13, any transaction between the grantor, and the grantor's trust, will not be sale or exchange under section 1001.
- ▶ A promissory note between the trust and the grantor must bear the Section 1274 interest rate.

# Sale to Defective Grantor Trust - Strategy

- ▶ Goal is to transfer future appreciation on certain assets to donees.
- ▶ No gain is recognized under Section 1001 from the sale, because the trust is grantor.
  - Grantor also does not recognize income on the interest payments.
  - Grantor continues to pay the income tax on the assets held by the trust.
- ▶ After creating the trust, but prior to the sale, the grantor gifts “seed” funds to the trust of at least 10% of expected purchase price.
  - This will use a portion of the grantor’s basic exclusion under Section 2010, which during tax year 2018 is \$11,180,000.



# Sale to Defective Grantor Trust - Results

- ▶ Diane creates a trust, which is intentionally defective under Sections 673 through 677.
- ▶ Diane seeds the trust with \$500,000 of cash.
- ▶ Diane then sells \$5,000,000 of her stock to the trust, in exchange for a promissory note to the trust.

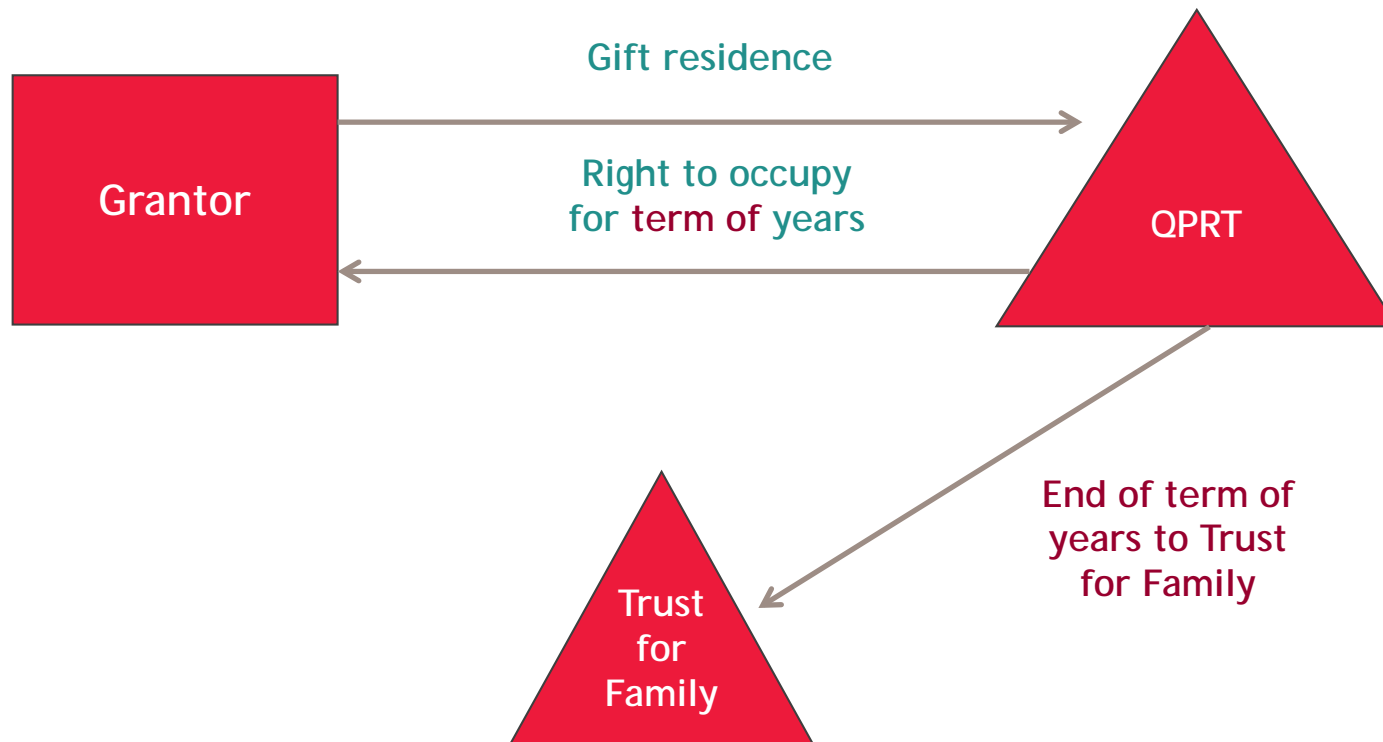
IDIT Installment Sales				
Year	Beginning Principal	Income of Trust at 2.5 Percent	Payment on Note	Ending Principal
1	5,500,000	133,716	605,370	5,028,346
2	5,028,346	121,925	605,370	4,544,901
3	4,544,901	109,839	605,370	4,049,370
4	4,049,370	97,451	605,370	3,541,451
5	3,541,451	84,753	605,370	3,020,834
6	3,020,834	71,737	605,370	2,487,201
7	2,487,201	58,396	605,370	1,940,227
8	1,940,227	44,722	605,370	1,379,579
9	1,379,579	30,706	605,370	804,915

# Comparing GRATs and Sales to IDGTs

- ▶ GRATs and IDGTs are very similar planning techniques. They both save estate and gift tax to the extent that the rate of return is in excess of the hurdle rate.
- ▶ Sales to an IDGT are usually more successful, since the Section 1274 interest rate, is less than the Section 7520 rate (120% of the AFR).
- ▶ Sales to IDGTs also allow for the immediate allocation of generation-skipping transfer tax exemption.
  - A GRAT cannot allocate GST exemption until the GRAT term ends, as the grantor is receiving annuity payments (considered to be estate tax inclusion period (ETIP)).

# Qualified Personal Residence Trust

# Gift to QPRT



# Gift to QPRT - Background

- ▶ The Internal Revenue Code specifically authorizes QPRTs under Section 2702(a)(3), as an exception to the general rule of valuing retained interests as being zero.
- ▶ Grantor creates an intentionally defective grantor trust under Sections 673-677.
- ▶ Grantor will make a completed gift to the trust of a residence, which will be discounted for gift tax purposes.
  - The Section 7520 rate is used for QPRTs.
- ▶ During the term of the trust, the grantor retains the exclusive right to enjoy the possession and enjoyment of the residence, rent free.
  - Grantor will be responsible for all ordinary expenses of the residence.
- ▶ Once the term expires, the residence is removed from the grantor's estate.
  - If the grantor wishes to remain in the residence, they will need to pay rent to the beneficiaries of the trust.
- ▶ In order for the QPRT to be successful, the grantor needs to survive the term of the trust.

# Gift to QPRT- Results

- ▶ Diane and Jim own a summer lake house worth \$2,000,000. Their family loves to spend summer weekends on the lake and they would desire that the residence stay in the family.
- ▶ Since they are still relatively young, they decide to make a gift of the residence to a Qualified Personal Residence Trust for a term of 10 years.
- ▶ The real estate on the lake has been appreciating at a value of 2 percent per year.

Qualified Personal Residence Trust					
Grantor's Age	Term of Trust	Principal Value of Residence	Section 7520 Rate	Taxable Gift (Present Value of Remainder Interest)	Value of Nontaxable Transfer (Retained Interest by Grantor)
60		\$ 102,000,000	2.2%	\$ 1,579,440	\$ 420,560

- ▶ In addition to the discount received on the gift, the grantor also has potential death tax savings based on the future appreciation of the property.

Potential Death Tax Savings			
Death Tax Bracket	Value of Property at end of QPRT Term	Taxable Gift	Potential Death Tax Savings
40%	\$ 2,437,989	\$ 1,579,440	\$ 343,420

# Gift to QPRT - Advantages and Disadvantages

## Advantages:

- ▶ Grantor receives a discount for the gift, and doesn't have to make any annual interest payments for the right to live in the house (this is captured in the retained right to live in the home by the grantor).
- ▶ Grantor shifts any future appreciation on the residence outside of their estate.

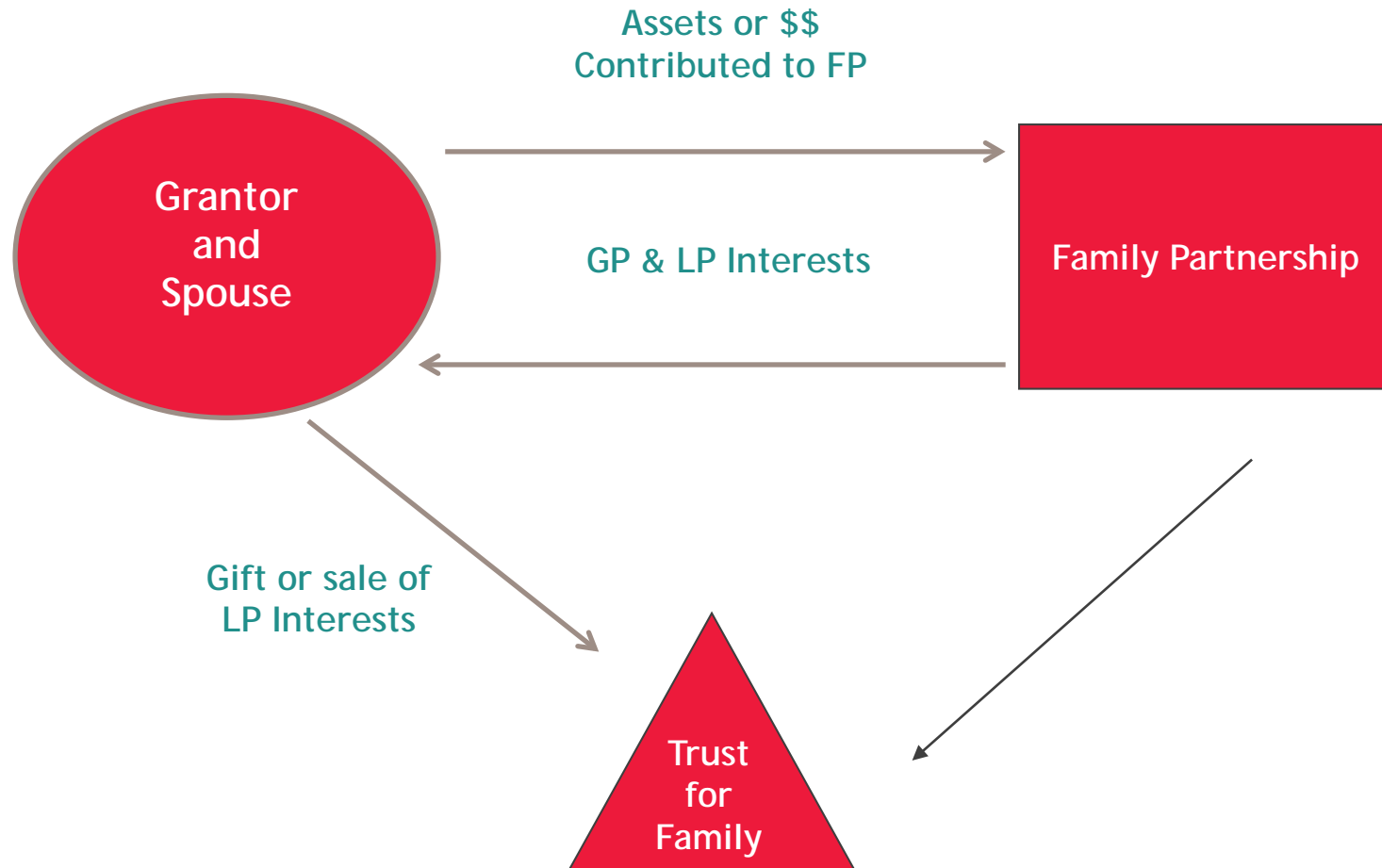
## Disadvantages:

- ▶ If grantor survives the term and grantor desires to stay in the residence, they must pay FMV rent.
- ▶ The beneficiaries of the QPRT do not receive a step-up in basis on the residence at the death of the grantor(s).
- ▶ If the grantor dies during the trust term, the QPRT is includable in their estate under Section 2036.

# Family Partnerships



# Family Partnerships - Structure



# Family Partnerships - Background

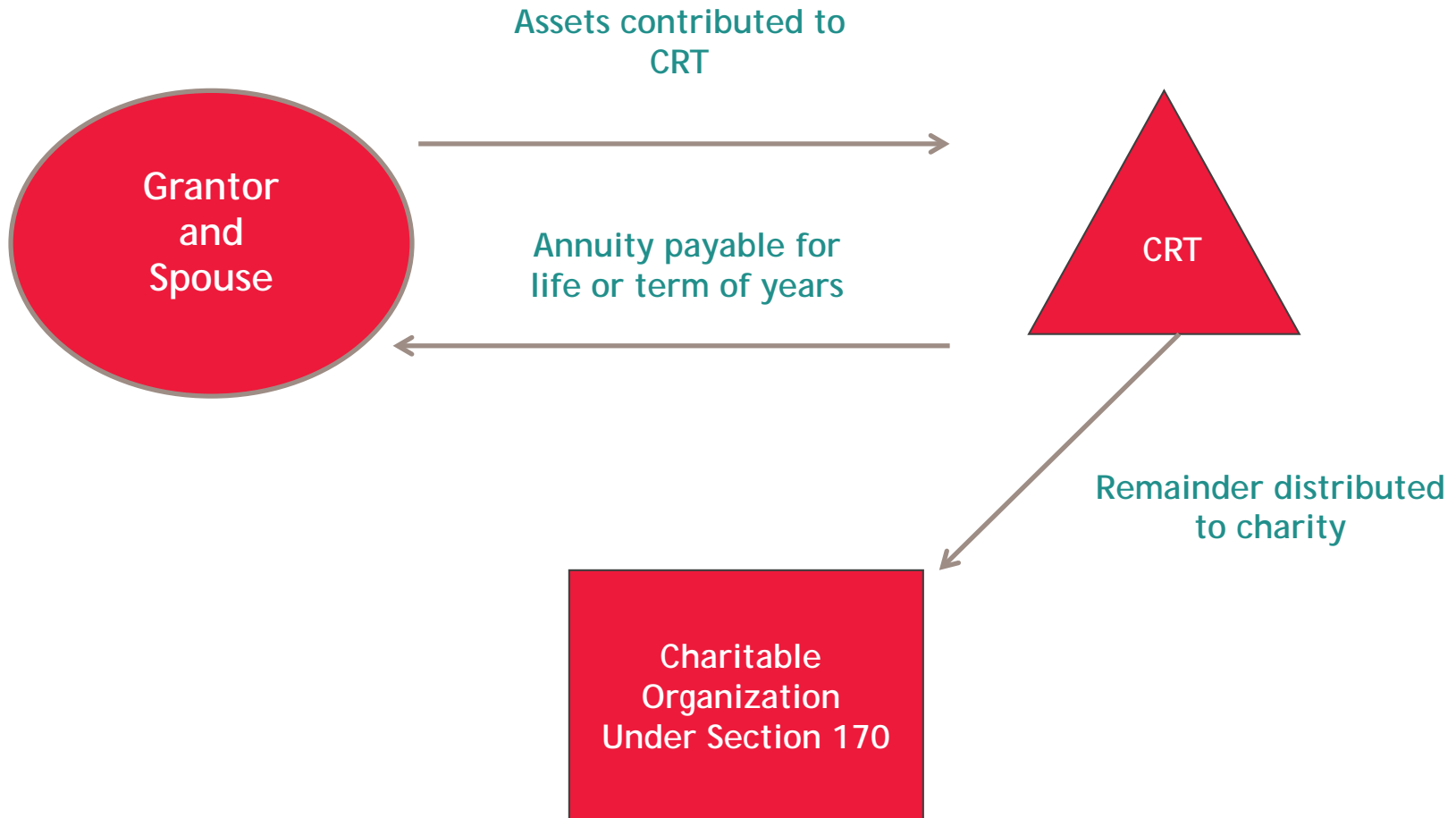
- ▶ A family partnership (FP) is an investment vehicle, formed pursuant to a partnership agreement, which enables the family to control, distribute and protect assets.
- ▶ The structure of the Family Partnership enables a donor to transfer fractional interests in the partnership that are eligible for marketability and minority discounts.
  - This enables the donor to transfer more value to the donee, using less of their unified credit.
- ▶ If the gift of the limited partnership interest is structured correctly, it may qualify for the annual gift tax exclusion.
  - In order to qualify, the donee needs to have a right to immediate use, possession, and enjoyment of the partnership interest (i.e. a present interest).
    - After decisions in Hackl, Price and Wimmer, donor should provide that the donee can make a transfer of the partnership interest to anyone, and the transferee will be admitted as a substituted limited partner; however the transfer would be subject to a right of first refusal by the partnership.

## Family Partnerships - Result

- ▶ Diane and Jim decide to create a family limited partnership, and fund it with \$15,000,000 of stock. They take back all of the limited partnership interests.
- ▶ During tax year 2018, Diane and Jim decide to use their split-gift annual exclusion amounts to gift fractional interests of the partnership to their children.
  - Conceivably, Diane and Jim could give away a partnership interest that is worth \$60,000 for the split-gift annual exclusion amounts. Consider discount for marketability and a minority discount on the partnership interest.

# Charitable Tax Planning

# CRTs- Structure



# Charitable Planning - CRTs - Background

- ▶ Under Section 664, a grantor can create a charitable remainder trust, in either a annuity form (fixed payment based on FMV at creation), or unitrust form (fixed payment based on FMV of assets determined on yearly basis).
- ▶ Section 664(d)(1) and (2) defines a CRT as:
  - (1) A sum certain (not less than 5%, not more than 50% of initial FMV)
  - (2) paid at least annually
  - (3) to one or more persons (one of whom is not a charity)
  - (4) for a term of years (not to exceed 20), or life
  - (5) At termination of the trust, the assets have to be distributed to a charity under Section 170
  - (6) the remainder interest has to be at least 10% of the initial FMV of the assets placed into the trust.

# CRTs - Results

- ▶ Diane and Jim decide to fund a CRUT for a term of 10 years, with \$5,000,000 of stock from Diane’s company, with the remainder interest flowing to their private foundation

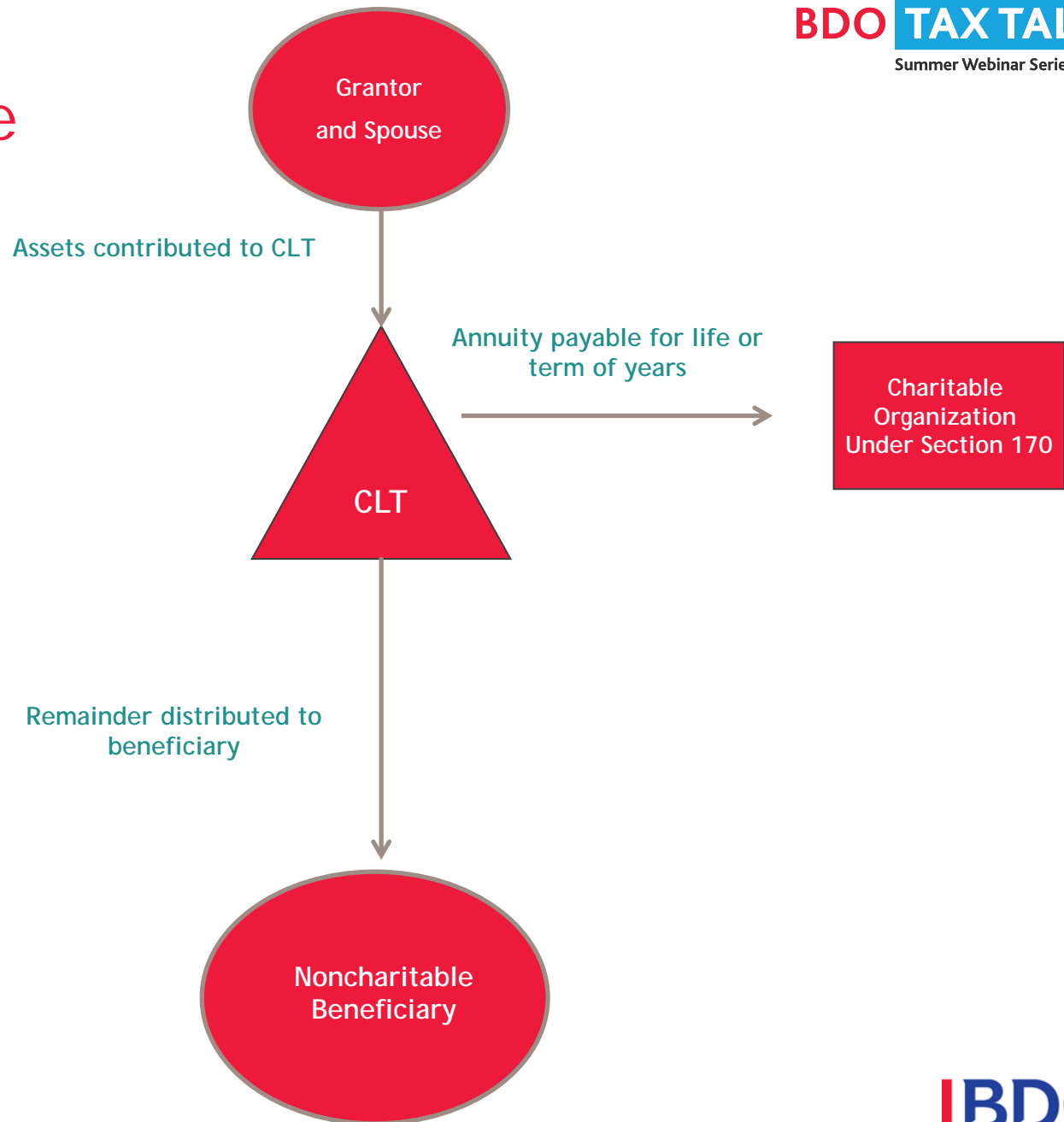
Charitable Remainder Unitrust					
Year	Principal	Growth (at 2 percent)	Income (at 4 percent)	Distribution	Remainder
1	5,000,000	84,491	170,750	1,033,950	4,221,291
2	4,221,291	71,332	144,157	872,921	3,563,859
3	3,563,859	60,223	121,706	736,971	3,008,818
4	3,008,818	50,843	102,751	622,193	2,540,219
5	2,540,219	42,925	86,749	525,292	2,144,601
6	2,144,601	36,240	73,238	443,482	1,810,597
7	1,810,597	30,596	61,832	374,413	1,528,611
8	1,528,611	25,831	52,202	316,101	1,290,542
9	1,290,542	21,808	44,072	266,871	1,089,551
10	1,089,551	18,411	37,208	225,308	919,862
				10% of Initial FMV to Charity as Remainder	
				500,035	

# CRTs - Considerations

- ▶ CRTs are not as effective in low interest environments.
  - CRTs are subject to exhaustion, see Revenue Procedure 2016-42.
- ▶ CRTs are exempt from income taxes under Section 664(c) (they are subject to UBTI).
  - This means that a taxpayer can gift assets with low-basis to the CRT, and they will not be taxed on the capital gains from the sale of the assets within the CRT (although the recipient of the trust may receive it from DNI).
- ▶ The ultimate beneficiary of a CRT can be a private foundation.



# CLTs- Structure



# Charitable Planning - CLTs - Background

- ▶ Designed to pay fixed sum to a charitable beneficiary, at least annually, for a fixed term of years, or lives of one or more individuals. At termination, the remainder is distributed to one or more noncharitable beneficiaries.
- ▶ Interestingly, the CLTs are not found anywhere in the Internal Revenue Code or Treasury Regulations.
  - They have been discussed in letter rulings.
- ▶ There is no minimum required annuity payment amount (unlike CRTs). There is also no maximum term.

# CLTs - Results

- ▶ Diane and Jim decide to fund a CLUT for a term of 10 years, with \$5,000,000 of stock from Diane’s company. The income interest is paid to their private family foundation, with the remainder interest flowing to their children.

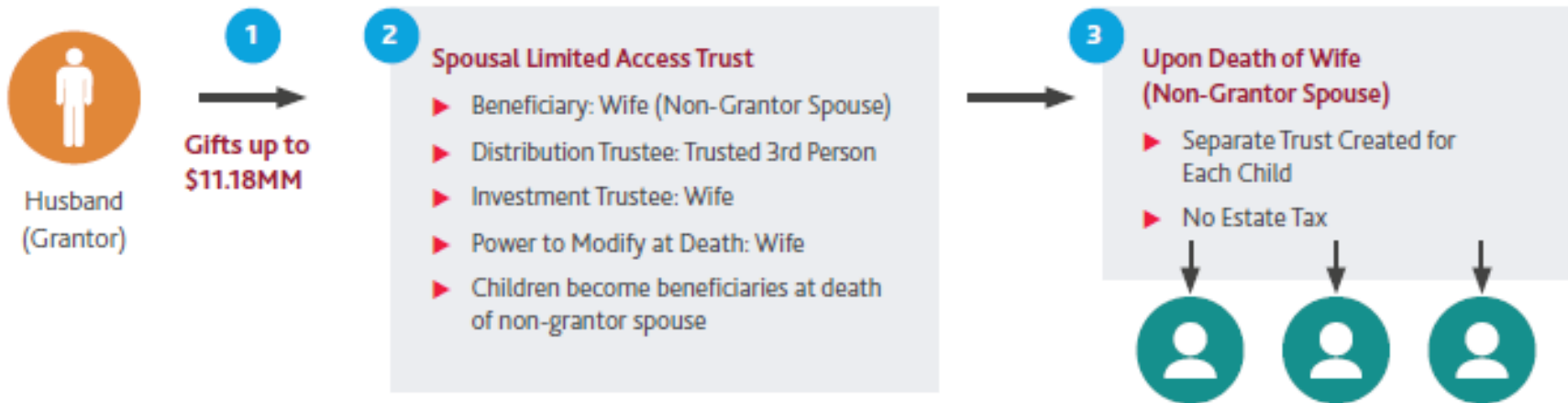
Charitable Lead Unitrust - 5 Year Term				
Year	Principal	Growth (at 2 percent)	Payment	Remainder
1	5,000,000	94,750	350,000	4,744,750
2	4,744,750	89,913	332,136	4,502,527
3	4,502,527	85,323	315,177	4,272,673
4	4,272,673	80,967	299,087	4,054,554
5	4,054,554	76,834	283,819	3,847,568
6	3,847,568	72,912	269,330	3,651,150
7	3,651,150	69,189	255,581	3,464,759
8	3,464,759	65,657	242,533	3,287,883
9	3,287,883	62,305	230,152	3,120,036
10	3,120,036	59,125	218,403	2,960,758
			Charitable Deduction of Income Interest	\$ 2,570,105
			Remainder Interest	\$ 2,429,895

# Other Planning Considerations

# Other Planning Considerations

- ▶ Other Planning Strategies to Consider.
  - Spousal Limited Access Trusts (SLATs)
  - Income Tax Strategies

# Spousal Limited Access Trust



# International Planning

# U.S. Citizens

- ▶ Gift Tax - worldwide gifts are subject to tax.
- ▶ Estate Tax - worldwide estate is subject to estate tax.
- ▶ Generation Skipping Tax - applies to worldwide GST transfers.

Domicile or residence is irrelevant



# Non-U.S. Citizen

- ▶ The application of the U.S. gift and estate tax to a non-citizen depends on:
  - Domicile
  - Situs of assets
  - Application of Treaty

## Domicile: What does it mean?

- ▶ Physical presence + Intent to remain indefinitely.
- ▶ Subjective test.
- ▶ Different than the federal income test of substantial presence.

## Domicile: Treas. Reg. 20.0-1(b)(1)

A person acquires a domicile in a place by living there, even for a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.

# Domicile: Factors

- ▶ Place of residence
- ▶ Length of time at residence
- ▶ Social and community contacts
- ▶ Declarations of intent
- ▶ Green card or visa

# Domicile: Factors

- ▶ Bank accounts
- ▶ Physicians
- ▶ Motives of changing residence
- ▶ Rent vs. own a home
- ▶ Place of business

# Non-U.S. Citizen Domiciled in U.S.

## Non-U.S. Citizen Domiciled in U.S.

- ▶ Gifts-taxed on worldwide gifts
- ▶ Estate-taxed on worldwide estate
- ▶ Same unified credit as U.S. citizen
- ▶ No marital deduction for gifts or bequests to non-U.S. citizen spouses

# Non-U.S. Citizen Domiciled in U.S.

- ▶ Qualified Domestic Trust (QDOT) for estate tax purposes will qualify bequests to spouse for marital deduction.
- ▶ Section 2040(b) dealing with qualified joint interests between spouses will not apply if surviving spouse is not a U.S. Citizen. IRC Section 2056(d)(1)(B).
- ▶ Gifts to non-citizen spouse eligible for \$100,000 (indexed to \$152,000 for 2018) annual exclusion.
  - Must be a present interest.
  - Would qualify for the marital deduction if made to U.S. spouse.



## Non-U.S. Citizen Domiciled in U.S.

- ▶ Foreign death tax credit allowed for foreign death taxes paid to other countries for property situated in that country.
- ▶ Property for which the marital or charitable deduction is allowed is not eligible for foreign death tax credit.

# Non-U.S. Citizen Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, has her green card and has been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. She gives \$20 million of cash to her son and \$20 million to her husband via foreign bank accounts.

# Non-U.S. Citizen Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, has her green card and has been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. She gives \$20 million of cash to her son and \$20 million to her husband via foreign bank accounts.

## Answer:

Ms. Executive would be domiciled in the U.S. The gift to her U.S. Citizen husband would be eligible for the marital deduction. She would need to file a gift tax return and pay gift tax on the transfer to the son since she is taxed on worldwide gifts.

# Non-U.S. Citizen Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, has her green card and has been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. Her husband makes a \$20 million cash gift to her using offshore bank accounts.

## Non-U.S. Citizen Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, has her green card and has been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. Her husband makes a \$10 million cash gift to her using offshore bank accounts.

### Answer:

Husband is a U.S. Citizen and is subject to gift tax on his worldwide gifts. The gift would not be eligible for the marital deduction since Ms. Executive is not a U.S. Citizen. An outright gift should qualify for the \$152,000 annual exclusion.

# Non-U.S. Citizen Domiciled in U.S. Example-Estate Tax

Ms. Executive, who is not a U.S. citizen, had her green card and had been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. On her death, she left her entire \$20 million estate to her Husband.

# Non-U.S. Citizen Domiciled in U.S. Example-Estate Tax

Ms. Executive, who is not a U.S. citizen, had her green card and had been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. On her death, she left her entire \$10 million estate to her Husband.

## Answer:

Since Ms. Executive is domiciled in the U.S. at the time of her death she would subject to estate tax on her worldwide estate. The bequest to her U.S. Citizen husband is eligible for the unlimited marital deduction and no estate tax would be due.

# Non-U.S. Citizen Domiciled in U.S. Example-Estate Tax

Ms. Executive, was not a U.S. citizen, had her green card and had been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. On her death, she left her entire \$20 million estate to her son.



# Non-U.S. Citizen Domiciled in U.S. Example-Estate Tax

Ms. Executive, was not a U.S. citizen, had her green card and had been living in the United States for 20 years with her U.S. Citizen husband, Mr. Executive. On her death, she left her entire \$10 million estate to her son.

## Answer:

Since Ms. Executive was domiciled in the U.S. at the time of her death her worldwide estate would be subject to U.S. estate tax. Her estate would be entitled to the \$11,180,000 applicable exclusion amount (unified credit).

# Non-U.S. Citizen Not Domiciled in U.S.

## Non-U.S. Citizen Not Domiciled in U.S.

- ▶ Generally will be subject to U.S. estate tax only on assets of the decedent that have a situs in the U.S.
- ▶ Generally will be subject to U.S. gift tax only on gifts of tangible assets with situs in the U.S.
- ▶ U.S. Person receiving gift in excess of \$100,000 must report the gift (Form 3520).
- ▶ Note the distinction between gift tax and estate tax as to what is subject to the tax.
- ▶ Treaty may cause a different result.
- ▶ Former U.S. citizens and former long-term green card holders will be subject to different rules depending on when expatriation occurred.

# Non-U.S. Citizen Not Domiciled in U.S. Gift Tax

- ▶ Generally only tangible personal property and real property located in the U.S. will be subject to U.S. for gift tax.
- ▶ Intangible personal property will not be subject to US gift tax. IRC Section 2501(a)(2).
- ▶ Thus, for example, a gift of U.S. Corporation stock will not be subject to the U.S. gift tax.

# Non-U.S. Citizen Not Domiciled in U.S. Gift Tax

- ▶ Cash as a tangible asset?
- ▶ Gift of U.S. Real Property would clearly be subject to U.S. gift tax.
- ▶ Gifts are eligible for the gift tax annual exclusion and the tuition and medical exclusion.
- ▶ Gifts to Non U.S. Citizen spouses are subject to tax but are eligible for \$152,000 annual exclusion.

# Non-U.S. Citizen Not Domiciled in U.S. Gift Tax

- ▶ Beware, there is no exemption or unified credit amount to apply against the gift in excess of the annual exclusion. In other words, the exemption for gift tax is zero!
- ▶ Do you ask every estate planning client if they are a U.S. Citizen?

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

- ▶ U.S. Estate Tax is imposed on assets situated in the United States. IRC Section 2103.
- ▶ Stock in a United States corporation is situated in the United States. IRC Section 2104.
- ▶ Debt obligations of a U.S. person or gov't entity are situated in the United States IRC Section 2104(c) (but there are significant exceptions).

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

- ▶ Life insurance proceeds on the life of an individual who is not a U.S. Citizen and is not domiciled here is deemed not situated in the U.S. IRC Section 2105(a).
- ▶ Bank deposits in the U.S. are not situated in the United States as long as not effectively connected with U.S. trade or business IRC Section 2105(b).



# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

- ▶ Bank deposit with foreign branch of U.S. Corp. or U.S. partnership if branch is in commercial banking business is not considered situated in the United States.
- ▶ Debt obligations generating portfolio interest are not considered situated in the U.S. Generally, registered debt obligations will qualify.

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

- ▶ Partnership interests? Rev Rul 55-701 situated where the predominant business of partnership is done. But isn't a partnership interest an intangible asset?
- ▶ Revocable type transfers subject to inclusion due to IRC Sections 2035-2038 will be included in gross estate if property transferred is situated within U.S. at death or at the time of the transfer! IRC Section 2104(b).

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax

- ▶ What if you are a beneficiary of an irrevocable trust that was created and funded by another?
  - Beneficial interests in a trust-must first have general power of appointment. Then determination would depend on situs of trust assets. Commissioner v. Nevius 76 F.2d 109 (2d Cir.).

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax-Computation

- ▶ Marital deduction again depends on U.S. Citizenship or Qualified Domestic Trust (QDOT).
- ▶ Charitable deduction only available for bequests to U.S. charities. IRC Section 2106(a)(2). Estate must report the value at the time of death of the assets not situated in the U.S. IRC Section 2106(b).
- ▶ Administrative expenses and debts are only deductible based on ratio of U.S. situs assets to worldwide assets. Thus, disclosure of worldwide assets would be required to take deduction.

# Non-U.S. Citizen Not Domiciled in U.S. Estate Tax- Computation

- ▶ Non-recourse mortgage may be deducted in full.
- ▶ Unified credit amount is \$13,000 or exemption equivalent of \$60,000.
- ▶ Credit for foreign estate tax is NOT available to Non-U.S. Citizen Not Domiciled in the U.S.

# Non-U.S. Citizen Not Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, is living in the U.S. on temporary assignment for a multi-national corporation on an L-1 Visa. She has been in the U.S. two years and expects to return to Australia at the end of her four year assignment. She rents her home in the U.S. and has a residence in Australia. She gave \$20 million of Microsoft stock to her son.

# Non-U.S. Citizen Not Domiciled in U.S. Example-Gift Tax

Ms. Executive, who is not a U.S. citizen, is living in the U.S. on temporary assignment for a multi-national corporation on an L-1 Visa. She has been in the U.S. two years and expects to return to Australia at the end of her four year assignment. She rents her home in the U.S. and has a residence in Australia. She gave \$20 million of Microsoft stock to her son.

## Answer:

There is no U.S. gift tax because she is not domiciled in the U.S. and she gave an intangible asset.

# Non-U.S. Citizen Not Domiciled in U.S. Example-Gift Tax

- ▶ Foreign parent wires \$5 million to US child as a gift. Child is a citizen of the US. Parent is not a citizen and is not domiciled in the US. Parent is an Australian. Child plans to purchase US real estate with the \$5 million.
- ▶ What are the issues?



# Non-U.S. Citizen Not Domiciled in U.S. Example-Gift Tax

## Issues:

- ▶ Did parent make a taxable gift?
- ▶ Is parent a covered expatriate?
- ▶ Is gift of cash a gift of a tangible asset in the US?
- ▶ If funds were wired to an escrow account to buy US real estate for child, is this an issue?
- ▶ What are taxable consequences to child?
  - Income tax?
  - Gross income?
  - Tax basis?
  - Gift tax?
- ▶ Is parent a covered expatriate? Section 2801.
- ▶ Does child have reporting requirements?

# Non-U.S. Citizen Not Domiciled in U.S. Example-Estate Tax

Ms. Executive, was not a U.S. citizen, and was living in the U.S. on temporary assignment for a multi-national corporation on an L-1 Visa. She had been in the U.S. two years and had expected to return to Australia at the end of her four year assignment. She was renting her home in the U.S. and had a residence in Australia. Ms. Executive died in a boating accident. Her estate consisted of the Australia real estate worth \$500,000, cash on deposit in U.S. banks, \$100,000, life insurance of \$5 million and Microsoft stock of \$20 Million. She left the entire estate to her husband, a Australian citizen, also living in the U.S.

## Non-U.S. Citizen Not Domiciled in U.S. Example-Estate Tax

- ▶ Since Ms. Executive was not domiciled in the U.S. her estate would only be subject to estate tax on her U.S. situs assets
- ▶ Real Estate in Australia - clearly an Australian asset
- ▶ Cash Deposit in U.S. Bank, interest is not effectively connected with a U.S. trade or business-no U.S. situs
- ▶ Life Insurance proceeds-no U.S. situs
- ▶ Microsoft stock-U.S. domestic stock has a situs in U.S.

# Non-U.S. Citizen Not Domiciled in U.S. Example-Estate Tax

## ► Computation:

- No marital deduction unless QDOT.
- Unified Credit is limited to \$13,000 (\$60,000 exemption equivalent).
- Tax rates same as U.S. Citizen.
- Treaty?

Thank You!

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