

Foreign Nationals in the U.S. – Estate Tax, Wills & Guardianship

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Foreign nationals arriving in the United States as investors or on business generally have a lot on their mind, but all too often - although quite understandably - U.S. estate planning and its co-ordination with home-country arrangements do not make the list!

Crucial to understand in this increasingly global world is a fundamental and long-standing legal concept that governs a person's status, capacity and rights – *lex domicilii*, now known as the law of domicile.

This notion of domicile embodies the idea as to where one considers one's permanent home to be, and has a bearing on the application of law in multiple areas, including marriage, guardianship, inheritance, tort and contract law. While a domicile of origin is acquired at birth, a domicile of choice may be acquired at a later point in life.

In the United States, the concept of domicile operates at the State level and, for the purposes of this discussion, governs a number of important issues.

In general, an individual is considered domiciled in the U.S. (and, therefore, resident for estate and gift tax purposes) if he or she lives here, for even a brief period of time, with no definite present intention of leaving the United States.

The courts and the Internal Revenue Service (IRS) look to various factors to assist in establishing the intent of the individual in connection with a determination of domicile, including the following:

- Place of residence/business
- Length of time at residence
- Location and extent of social and community contacts
- Declarations of intent
- Existence of a green card or visa
- Location of bank accounts
- Location of physicians
- Motives for changing residence
- Renting versus owning a home

Estate Taxation

The United States subjects both its Citizens and “residents” to estate and gift tax on worldwide assets. Unlike the objective tests applied to U.S. federal income tax, however, the estate and gift tax definition of the term “resident” is not predicated upon days of presence in the country but, rather, is driven by this notion of domicile.

U.S. residents are subject to estate tax on the value of world- wide assets, subject to certain exemptions. If an individual is a non-resident, however, a different set of rules

applies. The United States taxes non-residents only on U.S. "situs" property. U.S. situs property for estate tax purposes includes, but is not limited to, real estate located in the U.S., tangible personal property located in the U.S. and stock of a U.S. domestic corporation. The highest marginal rate of estate tax is 45% in 2009.

Exclusion Amount

In the case of residents, the limit on the amount that can be transferred tax-free at death in 2009 is \$3,500,000 per individual.

However, this rule does not apply to non-residents for U.S. estate tax purposes. Instead, non-residents are entitled to a much smaller exclusion amount — only \$60,000 in assets is exempt!

Deductions for Mortgage Debt

For U.S. residents, certain deductions are available to reduce the value of the gross estate before estate tax rates are applied to the resultant taxable estate. One of these deductions is for unpaid mortgages or other indebtedness outstanding on the decedent's date of death. For non-residents, however, the deduction for general debts (e.g., full-recourse mortgages) is limited to a pro-rata share of the outstanding liability based on the ratio of U.S.-situs assets to world-wide assets.

Even this pro-rata amount is only permitted if the non-resident's estate is willing to disclose the existence of and information about the decedent's worldwide assets. As many non-residents estates are unwilling to make such disclosure, the estate tax may be assessed without the benefit of this deduction at all.

Marital Deduction

Both residents and non-residents may make unlimited transfers of property at death to a U.S. Citizen surviving spouse free of estate tax by utilizing the estate tax marital deduction.

However, bequests to a non-U.S. Citizen spouse (even if a U.S. resident) do not qualify for the unlimited marital deduction.

Two limited exceptions apply:

- The surviving spouse becomes a U.S. citizen before the U.S. estate tax return is filed, and was resident in the U.S. between the date of the decedent's death and the surviving spouse's naturalization, or
- The property passes to a Qualified Domestic Trust (QDOT) or similar contractual arrangement for the benefit of the surviving spouse.

A full discussion of the QDOT and U.S. marital deduction is beyond the scope of this article. In brief, a QDOT defers estate taxation until the death of the surviving spouse. It can be funded either pursuant to the terms of the deceased spouse's Will or the surviving spouse can establish the trust prior to the due date of the estate tax return.

The trust is to be solely for the benefit of the surviving spouse during the lifetime of the surviving spouse and must have a U.S. trustee. Income from the trust is required to be distributed to the surviving spouse on at least an annual basis. The trustee may make distributions from the principal of the trust to the surviving spouse, but generally, distributions of principal are subject to estate tax. Estate tax will also become due upon the death of the surviving non-citizen spouse or the cessation of qualification of a trust as a QDOT.

Other Solution Strategies

There are further planning techniques available that should be reviewed carefully, including, but not limited to, structuring the ownership of U.S. assets through bona fide offshore entities, securing non-recourse financing on U.S. real estate assets, and arranging tax effective life insurance for the replenishment of a foreign estate's U.S. estate tax exposure.

Impact of Estate & Gift Tax Treaties

The U.S. has a number of estate, gift, and inheritance tax treaties in effect with other countries. In certain instances, the exemption amount may be increased by an applicable Estate Tax Treaty provision, but very few such Estate Tax Treaties exist.

Gift Taxation

Further complications – and opportunities – arise in the area of gift taxation imposed on non-residents that may be subject to tax on the gifting of U.S. situs assets. Gift taxation shares the same tax rate structure as estate taxation although the rules differ and professional advice should be sought.

The Importance of U.S. Will Provisions

A Will is a document that disposes of an individual's assets at his or her death. If an individual dies without a Will, known as intestacy, generally the local law of the decedent's domicile governs the ultimate division and distribution of the decedent's assets to his or her heirs, as defined by such local law. Such division of assets may not be the individual's intent. A Will provides the Testator of the Will with the opportunity to modify such default provisions in order to reflect specific intent.

For inbound foreign nationals, in certain cases a U.S. Will may govern the disposition of U.S.-situs assets. If a non-domiciliary holds U.S.-situs real property, shares in a co-operative apartment or tangible personal property, a U.S. Executor of the Will may dispose of those assets under the U.S. Will provisions.

Whether or not a foreign national not domiciled in the United States needs a United States Will depends on many factors, but is often recommended when such a person (1) holds U.S.-situs assets, particularly U.S. real estate, (2) has minor children, or (3) has no other Will and is domiciled in a common law jurisdiction. There may also be concerns about the validity of any existing foreign Will as viewed under U.S. law, or more practically, issues of probating (or "proving") a foreign Will in a foreign language in the appropriate U.S. state jurisdiction.

The Will may be restricted to the disposition of U.S. assets only. It is critical that any U.S. Will is appropriately coordinated with any existing Will if a dual Will scenario is chosen and that individual circumstances are discussed with legal counsel.

Guardianship Issues

A surviving spouse is the natural Guardian of any minor children. However, in the event of a common accident, a United States Will would contain nomination provisions of Guardians for the minor children of persons not domiciled in the United States. U.S. law recognizes these nominations and upon the non-residents' death, the U.S. Court would appoint the Guardian nominated under the Will to be the Guardian of the person of the minor child.

Without a Will Provision appointing a Guardian of the minor children, however, the local courts in the U.S. will typically require that an application be made to have a Guardian appointed for the person and/or property of the minor children. Without a United States Will, another requirement of many local courts in the U.S. is to require the Guardian of the child's property to obtain local court approval of the investment plan and the situs of the assets.

A United States Will (or, when appropriate, a Will substitute) avoids any court involvement in the investment and management decisions of the Guardian. It would contain trust provisions for minor children along with Trustee nominations for each child's trust. The nomination of a Trustee would obviate the need to obtain post mortem court approval of a Guardian of the minor child's property. The Trustee of the minor child's assets would then be in charge of making all investment decisions without court involvement.

Guardian Trap

It is, of course, common for foreign nationals to wish to appoint similarly U.S. non-domiciled Guardians under their Wills in the event of a common accident. However, this may not be effective. In order to qualify as a Guardian, a person may also be required to be eligible to qualify as a Fiduciary (i.e., as an Executor or Trustee).

Under New York law, for example, persons ineligible to serve as Fiduciaries include (1) an infant, (2) an incompetent, (3) a *non-domiciliary alien*, (4) a felon or (5) one who does not possess the qualifications required of a fiduciary by reason of substance abuse, dishonesty, improvidence and want of understanding or who is otherwise unfit for the execution of the office.

Consequently, a non-domiciliary with children located in the U.S. who dies and is not survived by a spouse cannot name, for example, his or her alien sibling or parent as Guardian. One solution to this problem is to name the alien Guardian as first choice and also a *default* U.S. Guardian, who can then act in the best interests of the child. Further guidance on this point should be sought from legal counsel.

Conclusion

It is hardly surprising that foreign nationals in the United States do not regard estate planning as their most pressing concern. This article highlights some of the reasons why

addressing such issues at an early stage, however, can help to pre-empt potentially significant problems.

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