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2024 Estate and Gift Tax Conference

Panel 1: Practical Case Studies for the Multinational Client:
The Lessons We Have Learned

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8:30am - 9:30am

Speakers: Steve Walker and Yulissa Zulaica

Conference Reference Materials

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Practical Case Studies for the Multinational Client: The Lessons We Have Learned

**Estate and Gift Tax Conference
California Lawyer's Association
March 21-22, 2024
UC Law San Francisco**



JOHNSTON, KINNEY
& ZULAICA LLP

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Overview:

- Estate Planning Generally
- What is international estate planning
- Who is a U.S. Person?
- Federal Income Taxation of Non U.S. Persons/Residents
- Comparison of Gift and Estate Tax for Non-Resident Aliens (NRAs) and U.S. Citizen/Domiciliary
- Domicile
- Treatises (Income and Estate)
- Reporting Requirements
- Case studies



What is Estate Planning? What makes it International Planning?

Estate planning is the process of organizing your affairs to provide ease of management in the event of incapacity and on death. This is a global issue, that can be influenced by a number of distinct facts and circumstances, including but not limited to: citizenship, residence, location of assets, value of assets, creditor risk, whether or not jurisdictions recognizes trusts, forced heirship rules, etc. Nowadays, we have a:

- Very Mobile Society – nationally (interstate) and internationally
- Lack of uniformity of laws
- Diversity of families creates complexity- LGBT and non-citizens, unmarried partners



Estate Planning Can ...

- Avoid court intervention in the event of incapacity or death
- Avoid common mistakes (costly)
- Outline wishes: You decide versus the state - beneficiaries, guardians, etc.
- Protect loved ones and clients' assets
- Develop strategies for wealth transfer and wealth preservation
- Address business succession
- Provide for favorite charity or loved ones in a tax efficient manner



Documents Everyone Should Consider

- Health care documents
- Powers of attorney for financial management
- Wills
- Living trusts (at least for sure domestically)

Do we need multiple documents for other jurisdictions, or can we use U.S. documents?



Review:

Will versus Trust

- When do you establish a will versus a trust?
- What is the difference?
- Consider - goals, assets – value and types, family, costs, situs of assets
- Generally, 3 key differences:

Will	Trust
Effective at death	During life and at death
Probate	Avoids probate
Cost of administration	Often less expense (especially in CA but not all states)

Note:

- Not all jurisdictions recognize trusts
- Some jurisdictions recognize trusts as separate and distinct entities (BE CAREFUL!!)



What is International Planning?

- Huge opportunity to add value
- It's more common than you think, it is a...
 - U.S. citizen buying a vacation home in Costa Rica, a time share in Mexico or inheriting a bank account and property in France.
 - U.S. citizen receiving gifts from NRA parents
 - U.S. citizen moving abroad temporarily for work
 - NRA moving for work to the U.S.
 - Should the NRA get a green card? Give it up?
- The first step is often “clean up” (offshore compliance issues)
- Then, the planning.



Why Your Status Matters

Type	Why Status Matters
Income Tax	For example, only US Persons are subject to income tax on world-wide income.
Estate and gift tax differences	The reach of transfer taxes to nonresident non-citizens is limited
Net investment income tax (3.8%)	NIIT does not apply to nonresident non-U.S. citizen individuals
Self-employment tax	Individuals who are neither citizens nor residents of the United States are not subject to self-employment tax



Income Tax

- A United States person generally is taxable on his/her worldwide income regardless of whether the person lives.
- The term “**United States person**” means a citizen or resident of the United States. IRC §7701(a)(30).
- **Green Card Test:** An alien is a resident alien with respect to a calendar year if the individual is a lawful permanent resident at any time during the calendar year. Treas. Reg. §301.7701(b)-1(b).
- **Substantial Presence Test:** An alien individual is a resident alien if the individual meets the substantial presence test. An individual satisfies this test if he or she has been present in the United States on at least 183 days during a three year period that includes the current year. Treas. Reg. §301.7701(b)-1(c).
- Note. A decedent may be a U.S. resident for income tax purposes yet be considered a nonresident for estate and gift tax purposes.



Income Taxation of Nonresident Aliens

A nonresident alien's income that is subject to U.S. income tax must generally be divided into two categories:

- Income that is **Effectively Connected** with a trade or business in the United States
- U.S. source income that is **Fixed, Determinable, Annual, or Periodical (FDAP)**

Examples of FDAP income

- Compensation for personal services (such as commissions and gross proceeds from performances)
 - Dividends and dividend equivalent payments
 - Interest
 - Original issue discount
 - Pensions and annuities
- Tax at a 30% (or lower treaty) rate applies to FDAP income or gains from U.S. sources, but only if they are not effectively connected with your U.S. trade or business.
- File Form 1040-NR, U.S. Nonresident Alien Income Tax Return.



Estate Tax Imposed on Citizens or Residents of the United States

- A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or **resident of the United States**. IRC 2001(a).
- The term "**resident**" in the transfer tax context is different from the definition of "resident" in the income tax context. Residence in the transfer tax context is based on the individual's "**domicile**." Domicile is defined as living within a country with no definite present intent of leaving. Determining domicile for estate and gift tax purposes is fact specific. Treas. Reg. 20.0-1(b)(1); Treas. Reg. 25.2501-1(b); IRM 4.25.4.2.1 (07-31-2020) (Domicile).



Is Your Client a Nonresident Not a Citizen?

- Location and duration of current residence;
- Location of medical providers, civic organizations, and employment;
- Driver's license, voter registration, and vehicle registration;
- Place of business;
- Green card or visa;
- Declarations of intent;
- Bank accounts;
- Motives of changing residence; and
- Renting versus owning a home.



Estate Tax Imposed on Nonresidents Not Citizens

- For estates of decedent nonresidents not citizens of the United States, the Estate Tax is a tax on the transfer of **U.S.-situated property**, which may include both tangible and intangible assets owned at the decedent's date of death. IRC §§2010, 2103.
- **Situs rules** control but may be modified by treaty. IRC §§2104, 2105.
- If the date of death value of the decedent's U.S.-situated assets, together with the gift tax specific exemption and the amount of the adjusted taxable gifts, **exceeds the filing threshold of \$60,000** [indexed for inflation], the executor must file a **Form 706-NA** for the decedent's estate
- The amount of **unified credit** available to the estate of a nonresident who is not a citizen is dependent on the presence or absence of an **applicable treaty**.



List of Countries with Death Tax Conventions in Effect with the United States

Country	Country
Australia	Italy
Austria	Japan
Canada	Netherlands
Denmark	Norway
France	Switzerland
Germany	Union of South Africa
Greece	United Kingdom
Ireland	



Gross Estate of a Nonresident, Not a Citizen

- What is included in estate? What are U.S. situated assets for estate tax purposes?
- See IRC §§ 2101-2108 and related regulations
- U.S. tangible and intangible property –
 - Real property
 - Interest in corporation
 - Shares in U.S. corporation
 - What if stock certificate at NRA's home abroad, still U.S. situated?
 - What if it's an interest in a partnership – a see-through entity for tax purposes, still U.S. situated?
- Exceptions:
 - Art on loan at museum
 - Deposits in U.S. bank accounts
 - Life insurance IRC §2105(a)



Gift Tax for Nonresidents not Citizens of the United States

- For nonresidents not citizens of the U.S., transfers subject to gift tax include real and tangible personal property that is **situated in the U.S.**
- However, gifts of U.S.-situated **intangible property** are not subject to gift tax. See IRC § 2501(a)(2). Such intangibles include, for example, stock of U.S. corporations.
- Annual exclusion applies (\$18,000 in 2024)
- A person is considered a nonresident not a citizen of the United States if he or she, at the time the gift is made, (1) was **not a citizen** of the United States and did not **reside** there, or (2) was domiciled in a United States possession and acquired citizenship solely by reason of birth or residence in the possession.



Estate and Gift Tax Comparison

	Nonresident Alien	Citizen/Domiciliary
	Only taxed on U.S. situated assets	Taxed on assets worldwide
Estate Tax Exemption	\$60,000 (subject to treaty)	\$13.61 million
Gift Tax Exemption	\$0 (subject to treaty)	Included in above
GST Tax Exemption	\$0	Included in above
Annual Exclusion amount	\$18,000 (for year 2024) (but gift splitting with spouse is not allowed); medical and education gifts under IRC 2503(e) \$185,000 for non-citizen spouse gifts	\$18,000 (gift splitting with spouse allowed)



Estate and Gift Tax Comparison

	NRA	Citizen/Domiciliary
Marital Deduction	None for transfer to <i>non-citizen</i> spouse – just annual exclusion – or via QDOT [<u>but</u> , non-citizen can transfer to U.S. spouse unlimited]	Available to all U.S. citizens



Treatises

- Treaties are very important! They can change and/or influence an outcome or decision.
- U.S. has income tax treaties with over 60 countries
- <https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z>
- U.S. has estate and/or gift tax treaties with 15 countries
- <https://www.irs.gov/businesses/small-businesses-self-employed/estate-gift-tax-treaties-international>



Foreign Trusts

- A foreign trust is a trust that fails to satisfy the court and control test (Treas. Reg. 7701(a)(30)(E))
 - Court Test – U.S. court has to have primary jurisdiction (ok for another country to have jurisdiction)
 - Control Test – a U.S. person has to have complete control of all substantial trust decisions



Expatriation

- Expatriation refers to the process of renouncing U.S. citizenship or long term residency (green card holder for 8 years)
 - Must renounce with immigration **and**
 - IRS Form 8854 if IRC 877A applies
- You are a “covered expatriate” under IRC 877A if....
 - U.S. Citizen or Long Term Resident (“LTR”)
 - Your average annual net income tax for the 5 years ending before the date of expatriation or termination of residency is more than a specified amount that is adjusted for inflation:

\$172,000 for 2021	\$190,000 for 2023
\$178,000 for 2022	\$201,000 for 2024
 - Your net worth is \$2 million or more on the date of your expatriation or termination of residency.



Expatriation

- Fail to certify on Form 8854 that you have complied with all U.S. federal tax obligations for the 5 years preceding the date of your expatriation or termination of residency.
- Exit tax – all property deemed sold
- Gifts during life and death to U.S. citizens from a covered expatriate are taxable – NRA rules do not apply.
- For short term green card holders who are only here temporarily, please make sure they know they must expatriate **before** they become a long-term resident for these purposes
- If LTR leaves the U.S. without formal expatriation, they can be deemed to have renounced
 - Careful with minor children as well



U.S. Person Reporting Requirements

- A U.S. person is required to file certain reports with the IRS. Penalties for failures to do so can be substantial. Such forms may include...
 - Form 3520 – reports gifts from NRAs if > \$100,000 or foreign corporations if > \$19,570, transactions with foreign trusts (transfer to and from)
 - Form 3520-A – foreign trust with U.S. owner
 - “FBAR” – financial interest or signatory authority, foreign accounts with \$10,000 at any point in calendar year (substantial penalties but recent Supreme Court case mitigates exposure)
 - Form 8938 – foreign account reporting
 - Form 5471 – controlled foreign corporation
 - Form 8865 – certain foreign partnerships



Case Study #1 (Canadian Client)



- Bob, an unmarried man, is a Canadian citizen with a Green Card. He has been your client for 20 years since he first moved here for work but has only had his green card for 10 years.
- He has an existing revocable trust. His beneficiaries are charities and family members. He intends to keep his home in San Francisco and rent it. He bought his home 10 years ago and it has gone up in value quite a bit. But he may also want to split his time between the U.S. and Canada.
- He comes to you to let you know he is moving back to Canada but wants to keep all his assets with a U.S. based financial advisor. What red flags do you see?



Case Study #1 – Things to Consider

- Subject to expatriation rules?
 - LTR– what is he planning on doing?
- If he keeps assets in U.S. and expatriates, he will be considered a NRA and only have \$60K exemption.
- What if his beneficiaries were all US charities? Canadian charities? Still an estate tax concern?
- Should he become a U.S. citizen? What if he has 3 U.S. citizen children and will continue to come back and forth between Canada and the U.S.? Different advice?
- But wait! We forgot to look at the treaty! What changes?



Case Study #1 – Possible Planning

STEP 1: Obtain Counsel in Canada (province important)

STEP 2: Unwind Trust

- Possible Options:
 - Use Canadian Will and California Will under Probate Code section 6380 et seq.
 - Powers of Attorney in both Jurisdiction
 - Medical Directives (??)
 - Count your days!



Case Study #2 (Australian Clients)

- Bob is a citizen and resident of Australia and June, his wife, is a U.S. citizen but resident in Australia. They are referred to you as potential new clients.
- As part of your intake and request for estate planning documents, they send you their estate planning documents, which include their existing joint **U.S. revocable family trust** which holds June's rental real estate in San Diego.
- Bob and June are grantors and trustees. Everything goes to the survivor via the trust, and there is no QDOT. What issues do you see and/or steps to take?



Case Study #2 – Things to Consider

- Do they have an accountant? Inquire about offshore compliance issues such as FBARs, Form 8938 (specified foreign financial assets), Form 5471 (foreign corp.), and Form 3520, Form 3520A (foreign trust and receipt of foreign gifts)
- Foreign trust issues? If so, reporting obligations?
- QDOT?
- Trust recognized as entity; likely an Australian tax resident from their perspective; revocation/rescission, and potential tax issues.



Case Study #3 – Possible Planning

- Step 1: Local Counsel
- Step 2:
 - Gift NRA interest in RE to US citizen spouse
 - Rescind trust in court
 - Compliance reporting – do nothing or disclose?



Case Study #3 (Costa Rica)



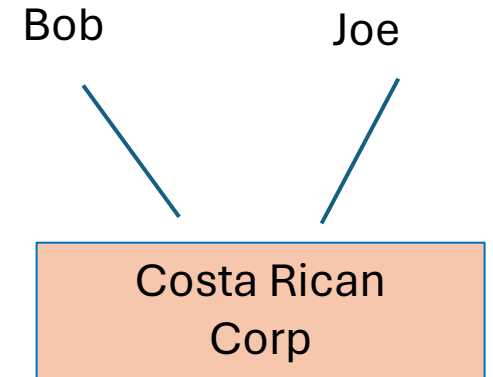
- Bob and Joe are a same-sex couple living in San Francisco and the majority of their assets are in the Bay Area. During your quarterly meeting they mention they are looking to purchase a vacation home in Costa Rica.
- You say, “How exciting, this is what you have been saving for, see you next quarter!” The attorneys in Costa Rica recommend they use a **Costa Rican corporation** to purchase the property because they are U.S. citizens.
- At your next meeting, they let you know of their recent exciting Costa Rican investments. They now own a Costa Rican corporation that holds the Costa Rica property and **2 bank accounts** in Costa Rica, one in the name of the corporation and the other in their individual names.



Case Study #3 (Costa Rica) – Things to Consider



- What could you have done better during your first meeting?
- What issue should you be able to highlight and what do you see during your second meeting?
 - Ask re FBARs and other foreign reporting and who accountant is?
 - Signatory authority over corporate bank accounts? Individual account? CFC reporting?
 - Use will to dispose of corporate interest?
 - Income tax issues of holding? Benefit?
 - Lose step up in basis?
 - Does Costa Rica recognize same-sex marriage?



- Vacation Home
- Bank account held individual names
- Bank account held in the company's name



Case Study #4 – Possible Planning

- Step 1....? Local counsel
- US compliance “clean up”
- What is property in Costa Rica being used for?
 - Rental: consider LLC? Viable? Practical?
 - Personal: trust? LLC?



Case Study #4 (Mexico)



José is a Mexican citizen and resident who bought a vacation home in San Diego. His daughter, who is a dual US and Mexican citizen, is attending UCSD and she is living in the home. He purchased the property in his name. He is also moving some of his financial investments to U.S. based accounts.



Case Study #4 – Things to Consider

- Estate tax issues
- What is the plan for the property?
- Does daughter pay rent?
 - Gifts from NRA for daughter? Reporting for her?
- Use a Foreign Corporation for US Investments?
- Transfer real estate to LLC and to revocable trust?
- Life insurance?
- Obtain non-recourse debt
- Sell deal with FIRPTA



Case Study #4 – Sample Planning

- Step 1: Local Counsel in Mexico
- Step 2, think through options:
 - Obtaining life insurance (easy “fix”)
 - Nonrecourse debt on property
 - Use trust or will for property
 - For US investments use a foreign corporation or invest in non-US situated assets and specific platforms.



Case Study #5 (Dual Citizen – France and US)

- Joan is a professor at UC Law. She is a dual French and U.S. citizen.
- She plans to retire in France which is where she grew up.
- All of her beneficiaries are in France.
- She has an existing estate plan, including a revocable trust, and lets you know that she will retire in 5 years and move back to France.



Case Study #5 (Dual Citizen – France and US)

- Revocable trust may be an issue when she moves back to France.
- No estate tax issue if non-taxable estate because she is a U.S. citizen
- French foreign reporting requirements for beneficiaries of trusts starting immediately (?)
- Forced heirship in France
- Inheritance and wealth tax in France
- How does the treaty affect this?
- EU Regulation No. 650/2012



Case Study #5 – Sample Planning

- Step 1: Local Counsel
- Step 2:
 - Unwind trust
 - DPOA in US
 - CA Will
 - Reporting obligations on French beneficiaries
 - Beneficiary designations for accounts
 - Any forced heirship concerns?



Case Study #6 (Tech Client/Green Card Holder)

- David is a permanent resident working in tech for a successful company and expects it will IPO. He is married to a U.S. citizen and has 2 kids.
- David's parents, who are NRAs, are very wealthy and have decided to gift him and his family \$30 million from non-U.S. situated assets.
- His parents may also buy them a nice house.
- He expects he will inherit at least \$100 million more.



Case Study #6 (Tech Client)

- Does David have a taxable estate already? Creditor issues? Divorce protection?
- Directed to an irrevocable dynastic type trust for David's benefit – South Dakota, Delaware, Nevada (estate tax and GST tax free in perpetuity!)
- If home purchased – subject to gift tax?
- Report gift(s)
- Qualified small business stock?
- Expatriate – now or later?



Case Study #6 – Sample Planning

- Gift QSBS stock to an irrevocable domestic dynastic trust
- Have parent make us domestic trust beneficiary of their estate instead of David directly
- US kids not expatriating
- Or if he does consider doing so earlier on



Case Study #7 (UK Tech Client)

- John is here on a work visa from the UK, working with a start-up that may go public. He has purchased a home and has amassed quite a built of wealth as an Apple executive.
- He has several million in stock and stock options.
- While he has purchased a home in the Bay Area, he still has substantial assets in the UK, which he visits at least 3 to 4 times a year. He is not sure if he will stay in the U.S. or return to the UK.



Case Study #7 (UK Tech Client)

- Suggest they talk to their planner for a trust? Wait! UK domiciliary issues
- Contact UK counsel
- Multiple wills or U.S. will can control, if latter have UK counsel review
- Expat issues? 8-year rule
- NRA no capital gains....move?!



Case Study #8: (Client Moving to CA)

Yulissa and Julio are spouses and live in Germany. They are both Green Card Holders. Julio founded a company that just got bought out by Google and netted Julio over \$40 million while residents in Pennsylvania. Yulissa is a schoolteacher. Julio gets a job offer in Silicon Valley. They decide to move to California from Pennsylvania and will at some point in the future consider becoming US citizens. They just had a baby and want to do some gifting.

What should they think about? What should we advise them are potential issues?

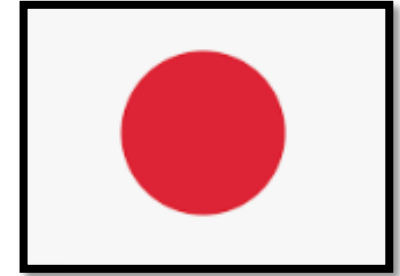


Case Study #8 – Things to Consider

- California is a community property state
- Gifting between spouses to equalize estates and maximize exemptions
- Treaty could apply and extend application of German law to gifts and inheritances
- Prenups?



Case Study #10 (Japanese client)



Akio is a nonresident, not a U.S. citizen, and resides in Japan. He owns a single-family home in Saratoga, California and would like to gift the home to his daughter, Yua. Is the transfer subject to estate or gift tax?

- A) Yes, due to \$60,000 exemption
- B) No, due to \$13.6M exemption
- C) Check the treaty

The U.S. has entered into a treaty with Japan that covers the U.S. estate and gift taxes. The treaty allows a \$12.92 million deduction or unified credit for purposes of the federal estate tax on U.S. property owned by Japanese nationals in the United States.



Takeaways ...

- Be cautious when planning for individuals with an international component...
- Make sure you work with an attorney in the jurisdiction in which there is an overlap – just doing a google search is not good enough
- Citizenship vs. residency
- Characterization of property maybe different
- Prenuptial Agreements may not be effective
- Assets are different – example: Australian superannuation funds
- How one takes title/owns assets is important
- Just because it does not make a difference in U.S. does not mean it does not matter in the other country
- It's complicated! And it's not always based on the size of the estate



Cheat Sheet – Questions for Clients

- Dual citizenship/residency?
- Do you have an estate plan?
- Are you a dual citizen or green card holder:
 - How long have they been a green card holder?
 - How long have they lived in the U.S.?
 - When did they last file a tax return in another jurisdiction?
 - Are they doing their foreign reporting?
 - Often, they think they are compliant, and they are not!
 - Where are the beneficiaries?
- Do you own property in another country?
- Prenup?
- Inheritances from abroad?
 - Value, types of assets
- Where do the following reside: Intended beneficiaries? Your intended trustees? Guardians for minor children? Healthcare and financial decision makers?
- How long do you intend to stay in the U.S.?





Yulissa Zulaica, Esq., LLM

Yulissa Zulaica is a partner in the law firm of Johnston, Kinney & Zulaica LLP. Her estate planning practice includes representing high net worth clients and clients with cross-border issues. She has also served as an expert witness in matters relating to international planning. In addition, Yulissa has extensive experience with probate and trust administration and litigation, and is often in court on contested and uncontested matters. Yulissa is a frequent speaker on topics related to estate and probate matters, including wealth transfer strategies and tax planning.

Yulissa is a Certified Specialist in Estate Planning, Trust and Probate Law. Yulissa has worked on various publications for Continuing Education of the Bar (CEB). She is a member of the State Bar of California and the Trusts and Estates Section of the Bar Association of San Francisco. She has been selected as a Northern California Super Lawyers Rising Star from 2017-2021 and Super Lawyer 2022-2024. She earned a B.A. in Japanese and a B.A. in Political Science from the University of California, Berkeley, and her J.D. and L.L.M. in Tax from Golden Gate University.

Yulissa currently lives in the East Bay with her husband and two children. She is proficient in Spanish and English and speaks conversational Japanese and Basque.





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Steven L. Walker is a tax attorney in San Jose, California. He advises clients on tax controversies and litigation with the Internal Revenue Service, Franchise Tax Board, and state and local taxing agencies. Steven represents clients in civil and criminal tax matters, including individual international tax, voluntary disclosures, offshore matters, audits, appeals, litigation, and collection. Steven also handles trusts and estate matters for clients in Silicon Valley, including estate planning, trust and probate administration, and probate and trust litigation.

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