Hot Topics and Strategies for Cross Border Planning: Danger, Water's Edge Approaching!
(A New Paradigm for Cross Border Clients)

For ACTEC November 2021

PRESENTER
Cynthia D. Brittain, Partner
Karlin & Peebles, LLP
5900 Wilshire Blvd., Suite 500
Los Angeles, CA 90036
cbrittain@karlinpeebles.com
(805) 570 7652

KARLIN & PEEBLES, LLP
ATTORNEYS AT LAW

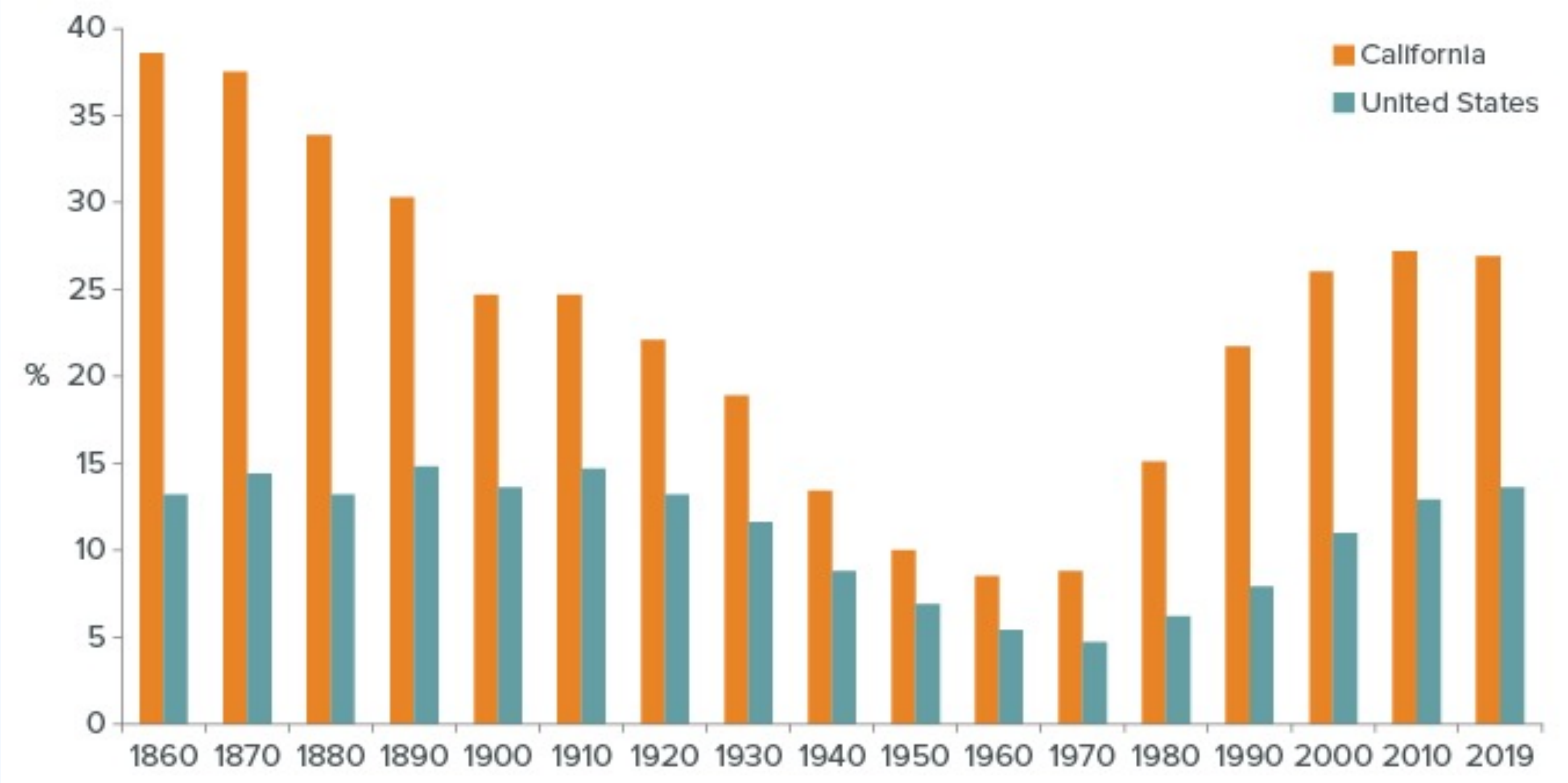
GLOBALIZATION OF PEOPLE….OLD NEWS

FOREIGN SOURCE

- US-Based Children Gifts and Inheritance
- Pre-Immigration
- Direct Investments
- Cross Border Marriages

THE MAJORITY OF RECENT ARRIVALS ARE FROM ASIA.

The vast majority of California's immigrants were born in Latin America (50%) or Asia (39%). California has sizable populations of immigrants from dozens of countries; the leading countries of origin are Mexico (3.9 million), the Philippines (859,000), China (796,000), Vietnam (539,000), and India (513,000). However, among immigrants who arrived between 2010 and 2019, more than half (53%) were born in Asia, while 31% were born in Latin America.



SOURCE: 2019 Census Bureau, decennial censuses, and the American Community

NRAS HAVE UNIQUE NEEDS

Stability:	POLITICAL UNCERTAINTY IN THE CLIENT'S HOME COUNTRY MAY BE CAUSING CURRENCY INSTABILITY.
Safety:	INSTITUTIONS IN THE HOME COUNTRY MAY LACK SUFFICIENT FINANCIAL STRENGTH.
Privacy:	HOME COUNTRY CONDITIONS MAY INCREASE CLIENT DESIRE FOR PRIVACY.
Diversification:	HOME COUNTRY MARKET MAY NOT OFFER SUFFICIENT ASSET DIVERSIFICATION.
Access:	DESIRE ACCESS TO U.S. MARKETS DIRECTLY.

GLOBALIZATION OF TAX LAWS…NEW PARADIGM!

FOREIGN IMPACT

- Foreign Sourced Tax Rules
- Foreign Registration of U.S. Trust
- Foreign Criminal Statutes on U.S. Firms
- Foreign Succession Regulations Driving U.S. Planning

CROSS BORDER FUNDAMENTALS

1. **U.S. TAX RESIDENT** -- CITIZENSHIP, GREEN CARD, SUBSTANTIAL PRESENCE TEST, AND BY ELECTION; (§ 7701(b))

2. **U.S. DOMICILED** -- *ESTATE OF BARKAT KAHN, DECEASED, MOHAMMAD ASLAM KAHN, EXECUTOR V. COMMISSIONER, (75 T.C.B. 1597; T.C. MEMO 1998-22);* (TAKE CARE WITH VISAS)

3. **FOREIGN TRUSTS** – ALL TRUSTS ARE PRESUMED TO BE FOREIGN TRUSTS UNLESS THE U.S. COURT AND U.S. CONTROLS TESTS ARE SATISFIED; (Treas. Reg. § 301.7701-7(c)(3); Treas. Reg. § 301.7701-7(d)(1)(ii)

4. **FOREIGN GRANTOR TRUSTS** – Must satisfy 672(f)(2)(a)(i) and (ii)

5. **TANGIBLE ASSETS** – REAL ESTATE AND CASH* (§ Reg. 25.2511-3(b)(1)) 25.2511-3 25.2511-3 - transfers by nonresidents not citizens

6. **INTANGIBLE ASSETS** – STOCKS, BONDS, CERTAIN ENTITY INTERESTS (§ Reg. 25.2511-3(b)(2)

7. **NON-U.S. DOMICILED EXEMPTION AMOUNT** -- $60,000

(SEE APPENDIX)

INBOUND CASE STUDIES

1. CORE PLANNING SCENARIOS

2. CONSIDERATIONS IN DRAFTING

3. S CORPORATIONS IN A "FOREIGN" TRUST; THAT CAN'T HAPPEN…CAN IT?

PRE-IMMIGRATION AND U.S.-BASED BENEFICIARIES

Income Tax	• Consider accelerating (realize and recognize) any and all income earned by the immigrating taxpayer prior to becoming a U.S. resident. • Possible income to accelerate includes compensation, pension plans, stock options, prepaid rents, royalties, dividends, interest, annuities and capital gains. • Elect out of installment sales treatment; defer recognizing losses; • Review for PFIC or CFC status; • Explore strategies to step up tax basis in assets
Transfer Tax	• Consider transferring assets to an NCND spouse before establishing a U.S. domicile. • Determine if accelerating gift planning would be appropriate – dynasty trusts! • Gifts of tangible personal property located within the U.S. will be subject to U.S. gift tax. • The immigrating NCND can gift any intangible assets either inside or outside the U.S.
Trusts	• Consider a foreign or U.S. trust for estate planning prior to moving to the U.S. • For the NCND who is not immigrating, but who has immigrating children, foreign grantor trusts may be a viable planning strategy. • The NCND parents remain the deemed owners of the underlying trust assets for U.S. income tax purposes. • When the NCND parents pass away, the trust assets remain available for the benefit of the U.S.-based children but will forever escape US estate tax net. • Drop-off Trust Conundrum….other options.

PLANNING WITH DOMESTIC DYNASTY TRUSTS

(USE FOR U.S. REAL ESTATE INVESTMENTS)

CORE PLANNING FOR U.S.-BASED CHILD – DOMESTIC SOLUTION PLANNING OPTION #1.

Mom and Dad
(In China)

Child's Domestic Dynasty Trust
(In United States)

- Mom and Dad do not want U.S. estate tax on what they give to child when they pass away.
- Mom and Dad do not want U.S. gift tax on what they give to child.
- Mom and Dad do not ever want to trigger U.S. estate tax.
- Technique: Mom and Dad set up a domestic dynasty trust. Parents transfer funds as their practitioner directs into the domestic trust.
- (Funding Issue!) -- T-Bill Option – To avoid transfer of a tangible
- This technique should shield future generations from U.S. estate tax and avoid U.S. gift tax currently. Subject to U.S. income tax on trust income and gains.
- **No Basis Step-Up.**

BENEFITS OF CHILD'S DOMESTIC DYNASTY TRUST…

WITH PROPER GIFT AND TRUST DESIGN, IT IS POSSIBLE FOR A FOREIGN PERSON TO ACHIEVE A NUMBER OF WEALTH-PLANNING GOALS WITH AN IRREVOCABLE U.S. DOMESTIC NON-GRANTOR TRUST.

- Unlimited lifetime transfers of <u>foreign</u> assets and <u>intangible</u> U.S. assets for the benefit of U.S. beneficiaries may be made free of U.S. gift and GST taxes – into a dynasty trust.
- No U.S. estate tax going forward if drafted properly
- **U.S. Intangible assets may be removed from a foreign person's U.S. estate, and from the reach of U.S. estate and GST taxes, gift tax free.
- While the trust will be subject to U.S. Federal income tax, it may be established in a state free of state income tax, possibly subject to California's throwback rules….
- **NO FIRPTA RULES TO WORK AROUND**

FOREIGN GRANTOR TRUST STRUCTURE WITH UNDERLYING CORPORATION(S) TO BLOCK U.S. TRANSFER TAX

STRUCTURE ESTABLISHED BY FOREIGN PARENT FOR U.S.- BENEFICIARIES

CORE PLANNING FOR U.S. -BASED CHILD OPTION #2…

Foreign Mom and Dad

Foreign Grantor Trust:
Irrevocable – Lifetime to Parents; or
Revocable – Children can be beneficiaries

ForeignCo
US Assets

ForeignCo
For Assets

ForeignCo
US Assets

ForeignCo
US Assets

- Mom and Dad do not want U.S. estate tax on what they give to child.
- Mom and Dad do not want U.S. gift tax on what they give to child.
- Mom and Dad do not ever want to trigger U.S. estate tax.
- **Mom and Dad would like to minimize U.S. income tax during their lifetimes, if they can. Basis Step-Up!**
- So, Mom and Dad set up a foreign grantor trust. There are a number of scenarios, but child is usually named as one of the beneficiaries along with the parents. Child could participate as the Investment Advisor. Provision for Section 1014(b).

The 2017 Act – May require diamond structure for Foreign Company with U.S. assets.

FOREIGN PARENT – FOREIGN GRANTOR

Corporate Trustee, U.S. TRUSTEE

Foreign Revocable Trust
(Shareholder of Underlying
Foreign Corporation

C

U.S. Beneficiaries
(Possible Foreign
Beneficiaries)

(Parents Assets:
Contributed to
Foreign companies
To avoid any argument
Of Beneficiary Grantor;
§ 2104(b) taint)

Distributions to Beneficiaries made only
From Trust accounts;
Do Not Distribute From Corporate Accounts

ABC, USVI*
Estate Blocker
To Hold U.S.
Assets

ABC USVI*
Estate Blocker
To Hold
Foreign Assets

BVI
Company

BENEFITS OF THE FOREIGN REVOCABLE GRANTOR TRUST

Benefits:

1. Parents' transfer of wealth to U.S.-based children U.S. estate tax free
2. Parents funding of foreign grantor trust is not subject to U.S. gift tax as long as not U.S. situs assets (*i.e.*, intangible ok)
3. With proper investing, U.S. income tax minimized
4. Trust established for efficient tax planning for future generations
5. Some asset protection

Issues to Consider:

1. There may be more than one foreign corporation for U.S. tax efficiency
2. The proposed structure needs a corporate trustee
3. Investment management important to maintain U.S. tax efficiency
4. Draft for a pot trust or separate trusts

DRAFTING CONSIDERATIONS

CONSIDERATIONS:

- Should the trust be a foreign revocable trust designed with separate trusts per U.S. beneficiary or a Pot trust?
- Should the trust be a foreign grantor trust designed under §§ 672(f)(2)(a)(i) or (ii)?
- Must consider the multi-jurisdictional aspects of the assets and beneficiaries, types of assets; whether a company, if any, can be divided, or whether there are different enough assets with equal potential value to equalize between U.S. and non-U.S. beneficiaries;
  - Operating company – (a controlled foreign corporation), then the company may generate Subpart f or GILTI income – Consider de-control….see later for Specified 10% owned foreign corporation
  - Other vehicle or fund – (A passive foreign investment company), then the company will generate PFIC income
  - If the Company can't be divided – then you may want a Pot trust for several reasons:
    - Income is considered distributed first when present, so income could be distributed in year X to foreign beneficiaries and principal distributed to U.S. beneficiaries in year Y (to rid a foreign non-grantor trust of accumulated income – ALTHOUGH THERE ARE DISTRIBUTION METHODS FOR CLEANSING SOLELY FOR U.S. BENEs.)
    - There may be concerns about the separate share rule where income distributed to a non-U.S. beneficiary is still attributable to U.S. beneficiaries, pro rata for U.S. income tax purposes
    - The Separate Share Rule: The Subchapter J, Separate Share Rule found in §663(c) requires that the separate and independent shares of different beneficiaries in the same estate or trust be treated as separate shares or trusts in determining the DNI allocable to the respective beneficiaries. This includes GILTI, Subpart f, and PFIC income.
    - Separate trusts certainly make the separate share rule easier to attribute

THE SEPARATE SHARE RULE

Distributable net income is typically apportioned among multi-beneficiaries proportionately (unless the trust instrument requires differently). Income beneficiaries are treated as receiving proportionate share of each type of income.

Discretionary trusts look to whether a pattern of distribution has occurred; however, that is not the sole determining factor.

CRITICAL CONSIDERATION IN CROSS BORDER WEALTH MANAGEMENT – CURRENCY RISK

- A critical component for cross border clients is a currency management strategy. A risk-adjusted currency return (portfolio) relative to the appropriate base currency for each client must be considered. The added issue for international trusts is that the trust's home country currency may be different from the currency that the beneficiaries will spend. In fact, if the trustees and beneficiaries are situated around the globe, the appropriate reference currency may be quite difficult to determine.

- "…[f]rom the dollar-based perspective of the US beneficiaries, hedging foreign currency exposure against the euro instead of the dollar will make the trust's investment performance significantly more volatile. Indeed, the chance of the trust suffering a 20% peak-to-trough loss during the 30-year period more than quadruples, and a 30% peak-to-trough loss becomes as likely as a coin toss. The reason for the greater volatility is simple: By hedging to the euro, the trustee exposes the US beneficiary not only to the underlying volatility of the trust's stocks and bonds, but also to the US dollar versus euro exchange rate. Currency and International Trusts A Trust Should Be Managed in the Currency of the Beneficiary Hedging to Spending Currency."

BRING IT HOME, (ALLIANCE BERNSTEIN)

Special thanks to Jeanne huang

BASIC THROWBACK

RECEIPT OF A DISTRIBUTION OF ACCUMULATED INCOME INCURS TWO SPECIAL TAXES:

- The so-called throwback tax, which basically subjects a distribution of accumulated income to taxation at ordinary US income tax rates;
    - For all items of income (other than tax-exempt income), the throwback tax entails a loss of the character the income had when originally accumulated in the foreign trust. Thus, an item of capital gain accumulated in the foreign trust will not benefit from the lower tax rates normally allowed capital gains.
- A nondeductible interest charge, which addresses the time value of the delay in US tax payment caused by the offshore accumulation in the foreign trust.

THROWBACK TAX MITIGATION

1. Use a U.S. trust from inception

2. Private placement life insurance

3. Alternate distributions of income to foreign beneficiaries, then principal to U.S. beneficiaries

4. Distribution of current year income annually – to domestic follow-on trust
   • 20 years -- 60% can move into the U.S.; 40 years -- 90% can move into the U.S.*

5. Default Method distributions to U.S. beneficiaries (for faster cleanse, but less wealth transferred)

6. Hedge for currency risk

7. Asset allocation

***Bring it home (alliance Bernstein research)**

FOREIGN SEPARATE SHARE RULES

CONSIDERATIONS:

- Tax Authorities in the foreign country of foreign beneficiaries may also take the position that all the trust's income, not just the amount distributed, is taxable to their resident beneficiary taxpayer.

- Practitioners and fiduciaries should consult with local counsel in the particular jurisdiction; for example:

- Israel will subject a foreign trust with a Israeli resident beneficiary to a 25% tax on trust income whether distributed or not. However, Israel also takes into consideration foreign tax paid, but does not suffer for tax-exempt income such as muni-bonds. (10-year newcomer rule, but four-year tail)

Qualified Revocable Trust (QRT)

CONSIDERATIONS:

- Should the trust be a foreign revocable trust designed with separate trusts per U.S. beneficiary or a Pot trust?
- Should the trust be a foreign grantor trust designed under §§ 672(f)(2)(a)(i) or (ii)? (This becomes important later.)

  In the event the company can be divided or there are only U.S. beneficiaries – then you may want to ensure the initial grantor trust can qualify as a "qualified revocable trust".

  With a QRT, the executor can elect foreign estate tax treatment
  - The separate share rule does not apply during the foreign estate administrative period (§643)
  - The U.S. beneficiaries can decide what restructure is needed (§ 962 Election; restructure; or interpose a domestic company in between);
  - No PFIC, no Subpart f, no GILTI, is applicable during this administrative period
  - Capital gains are taxed to the foreign estate likely with no U.S. capital gains tax
- If CFC income, then the U.S. beneficiaries may wish to elect § 962 tax treatment
- Any such case must be appropriately modeled

“Specified 10% owned foreign company” -- § 245A

CONSIDERATIONS: Available Only to C Corporations

- **Tax Treatment Under 245(a)** -- In the case of any dividend received from a specified 10% owned foreign corporation by a domestic C corporation which is a United States shareholder with respect to such foreign corporation, there shall be allowed as a deduction an amount equal to the foreign-source portion of the dividend.
- **Specified 10-percent Owned Foreign Corporation** -- means any foreign corporation with respect to which any domestic C corporation is a U.S. shareholder with respect to such corporation. (§245(b)(1))
- **Not Applicable to Passive Foreign Investment Companies** -- (§ 245(b)(2))
- **De-Control the Foreign Company CFC** -- It may be possible to de-control for CFC purposes; however, have the company remain a Specified 10-Percent Owned Foreign Corporation.
- **Holding Period** – Section 246(c)(5) provides that § 245A Dividend Received Deduction will not be allowed in respect of any dividend on any share of stock held by a U.S. shareholder for 365 days or less during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to the dividend.
- **Foreign Tax Credit is disallowed** – A foreign tax credit under § 901 for any taxes paid or accrued with respect to any dividend for which a deduction is allowed under § 245A, is disallowed. (§ 245(d)(1))
- **Modeling Critical** – The disallowed foreign tax credit is taken out of the FTC limitation calculation.

SECTION 245A

5% U.S. Shareholder	100,000	Dividend from Foreign Corporation	
	15,000	Foreign Tax Paid (no credit allowed) at 15%	
	85,000	Total Dividend to U.S. Corporation	
	17,850	Tax at U.S. Corporate Level (21%)	
	67,150	Total Dividend to U.S. Shareholder	
	22226.65	Tax at U.S. Shareholder Level; (23.8+9.3)	33.10%
	44,923	**55%** Total in pocket of U.S. Shareholder	
10% U.S. Shareholder	200,000	Dividend from Foreign Corporation	
	15,000	Foreign Tax Paid (no credit allowed)	
	185,000	Total Dividend to U.S. Corporation	
	0	Tax at U.S. Corporate Level (21%)	
	185,000	Total Dividend to U.S. Shareholder	
	61235	Tax at U.S. Shareholder Level at 33.1%	
	123,765	**38%** Total in pocket of U.S. Shareholder	

Power to Revoke (IRC §676) – Qualified Revocable Trust

<u>General Rule</u>: The grantor will be treated as the owner of any part of a trust in which the grantor (or a non-adverse) party has the power to revest title to trust assets in the grantor. In other words, if the grantor (or a non-adverse party) has the power to revoke any part of a trust and reclaim the trust assets, then the grantor will be taxed on the trust income. [IRC §676(a).]

<u>Power to Revoke Held by a Non-adverse Party</u>. The grantor will be taxed as the owner of a trust even if the power of revocation is held by a person other than the grantor unless that person's interest is adverse to that of the grantor. [IRC §676(a).]

<u>Power to Revoke with the Consent of a Non-Adverse Party</u>. Similarly, the grantor will be treated as the owner of a trust if the grantor holds a power of revocation even if that power can only be exercised with the consent of a trustee who has no economic interest in the trust. [IRC §676(a).]

THE 962 SOLUTION

IRC §962

A U.S. shareholder of a CFC who is an individual (including a trust or estate (see Treas. Reg. § 1.962-2(a)) can make a § 962 election, which provides:

- Tax imposed on Subpart F inclusions of said individual, including GILTI inclusions (see § 951A(f)(1)), will be subject to tax as calculated under section 11 (i.e., taxes imposed on corporations).

- A deemed paid credit under § 960 shall be allowed on such amounts.

- Basis step-up under § 961 allowable to the extent of tax paid

IRC § 962 – FOREIGN TAX CREDIT (Treas. Reg. § 1.962-1(b)(2))

- Allowance of foreign tax credit:
  - There shall be allowed a foreign tax credit under § 960(a)(1) for amounts which are the subject of a § 962 election (subject to the applicable limitation of § 904)
    - To the extent the foreign tax credit exceeds the § 904 limitation, the excess can be carried back or carried forward, except can only offset other income for which a 962 election is in place

Individual Holding Stock Indirectly by Constructive Ownership § 958(a)

	Income (Deduction)	Tax
Gross Income – GILTI	$1,000,000	
Foreign Tax (20%)		$200,000
Federal Tax (37%)		$296,000
Distribution from CFC to Trust	$800,000	
PTI	($800,000)	
Foreign withholding tax (15%)	$120,000	$120,000
State Tax (8%)		$64,000
Net Investment Income Tax (3.8%)		$30,400
Total Taxes		$710,100

Effective Tax Rate: 71%

HOLDING STOCK THROUGH U.S. CORPORATION

	Income (Deduction)	Tax (Credit)	
Gross Income – GILTI	$1,000,000		
Foreign Tax (20%)		$200,000	
GILTI Deduction (until 2026) (Sec. 78 gross up)	(200,000)		
Net GILTI	$500,000		
Federal Tax (21%)		$105,000	
Deemed Paid Credit (80%x20% = $160,000)		($105,000)	
Total tax before CFC makes distribution			$200,000
Distribution from CFC to US Corp.	$800,000		
Federal tax ($0 because PTI)		0	
Foreign tax withholding (5%)		$40,000	
State Tax (7%)		$56,000	
Total taxes on distribution from CFC			$96,000
Distribution from US Corp	$704,000		
Federal Tax (20%)		$140,800	
State Tax (8%)		$56,320	
Net investment Income Tax (3.8%)		$26,752	
Total Tax on distribution from C corporation			$223,872
Total taxes at all levels	Effective Tax Rate: 51.9%		$519,872

IRC § 962 – PROCEDURE (Treas. Reg. § 1.962-2)

- Only individuals, trusts or estates may make the election.
- Election made by filing a statement with taxpayer's return:
  - Name, address, and taxable year of each CFC with respect to which the electing shareholder is a U.S. shareholder and all other corporations, partnerships, trusts, or estates in any applicable chain of ownership described in § 958(a)
  - The amounts, on a corporation-by-corporation basis, which are included in such shareholder's gross income for his taxable year under § 951(a)
  - Taxpayer's pro rata share of E&P of such CFC with respect to which the taxpayer as an inclusion under § 951(a) and the foreign taxes with respect to such E&P
  - The amount of distributions received by the taxpayer from each CFC which are (1) excludable § 962 E&P; (2) taxable § 962 E&P; and (3) E&P other than § 962 E&P, showing the source of such amounts by taxable year
- Effect of election
  - A § 962 election when made is applicable to all CFCs owned by the taxpayer and is binding for the taxable year for which the election is made
  - An election may be revoked with the approval of the Commissioner. Approval will not be granted unless a material and substantial change in circumstances occurs which could not have been anticipated.

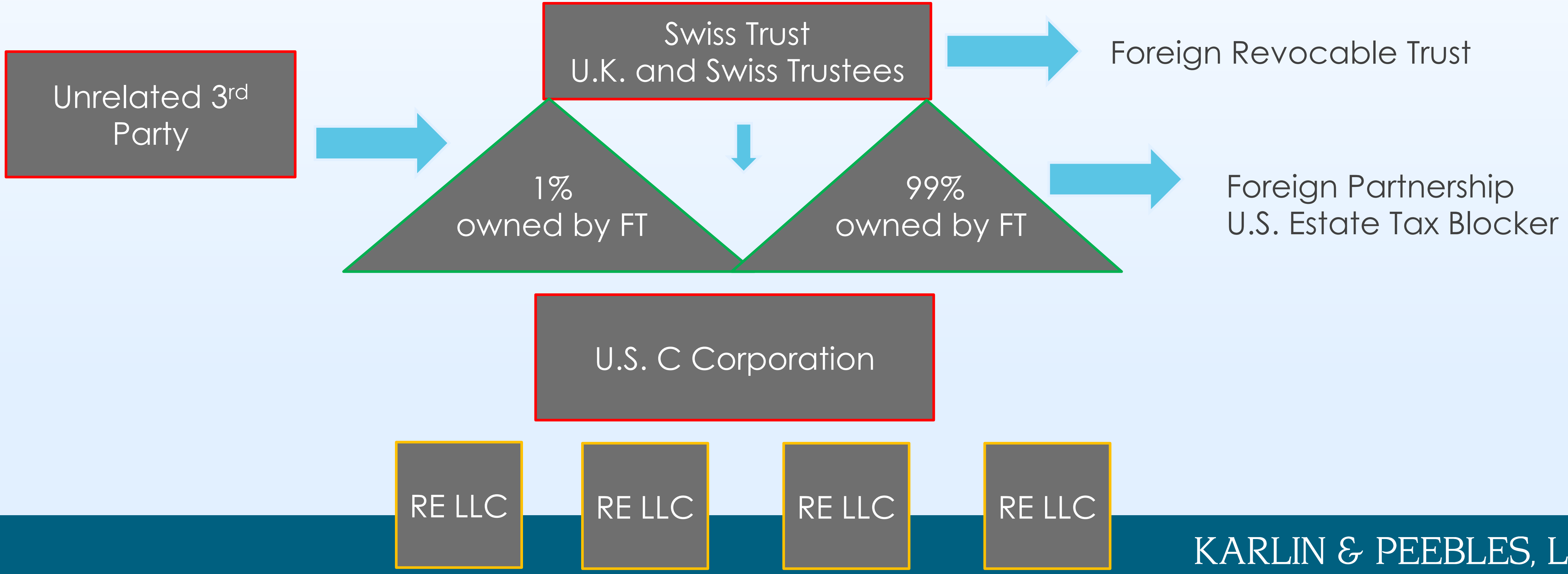
REPORTING FOREIGN ACTIVITY – Attach to Primary Forms

- F 8992 US Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI)
- Form 5471 Information Return of US Persons with respect to Certain Foreign Corporations
- F 8858 Return of US Persons with respect to Foreign disregarded entities
- F 8865 Return of a US persons with respect to Foreign Partnerships.
- F 926 Return by a US Transferor of Property to a Foreign Corporation
- F 8938 Statement of Specified Foreign Assets
- F 5472 Information Return of US a 25% Foreign-owned US Corporation or a Foreign Corporation Engaged in a US Trade or Business
- F 8804, & 8805 Foreign Partner's Information Statement

THE S CORPORATION SOLUTION

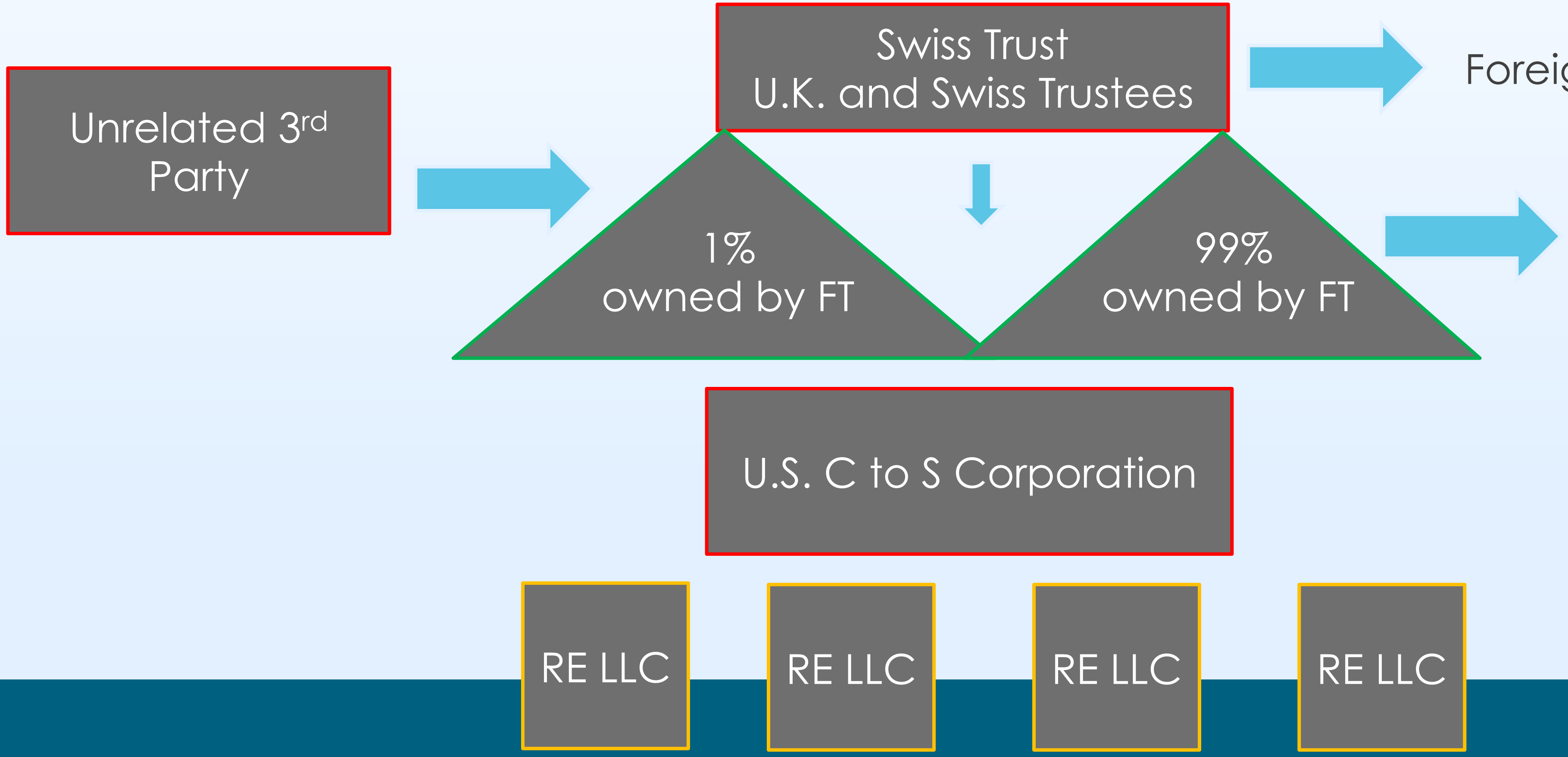
THE 2017 ACT AND S CORPORATION STOCK

Facts: Before moving to the U.S., Robert had invested heavily in U.S. real estate.
Robert's Counsel in Miami set up the following structure: Common for Latin Clients in Miami.
Robert and his Wife, Maria, have 3 children (2 born in Miami; 1 born in Mexico, non-U.S.).



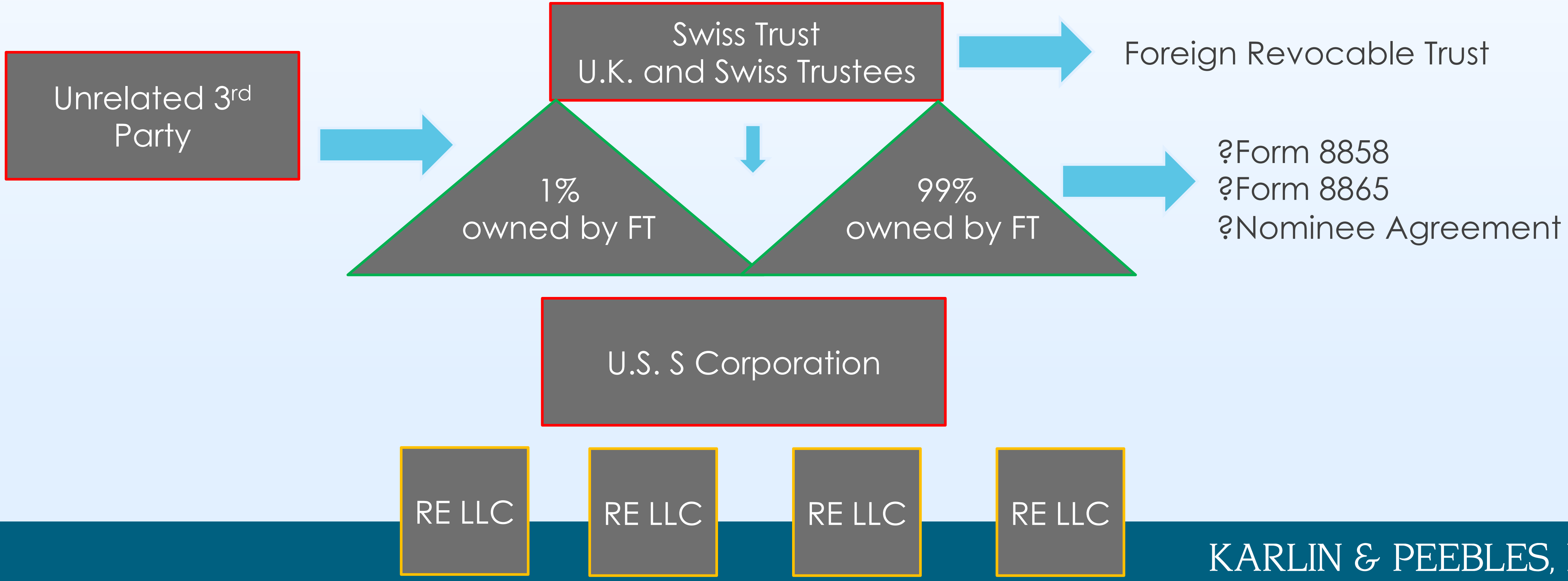
THE 2017 ACT AND S CORPORATION STOCK

Facts: Robert and his wife moved to Miami over 10 years ago.
Likely upon moving to the U.S., someone had Robert make an S election for his C corporation.



THE 2017 ACT AND S CORPORATION STOCK

Problem: Ever since Robert made the S Election, the S Election has been invalid because the entity has been consistently held in a foreign trust. The CPA treated the Swiss Trust as a Grantor trust (which it is), and treated the Foreign Partnership as a disregarded entity, stating that "Unrelated 3rd Party" was serving in a Nominee Capacity. A foreign partnership is also an ineligible entity.



| §1361(B) – THE TERM "SMALL BUSINESS CORPORATION" MEANS A DOMESTIC CORPORATION WHICH IS NOT AN INELIGIBLE CORPORATION AND WHICH DOES NOT –

A. *have more than 100 shareholders,*

B. *have as a shareholder (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual,*

C. *have a nonresident alien as a shareholder, and*

D. *have more than 1 class of stock.*

§1361(C)(2) – CERTAIN TRUSTS PERMITTED AS SHAREHOLDERS (IN RELEVANT PART)

In general, For purposes of subsection (b)(1)(B), the following trusts may be shareholders:

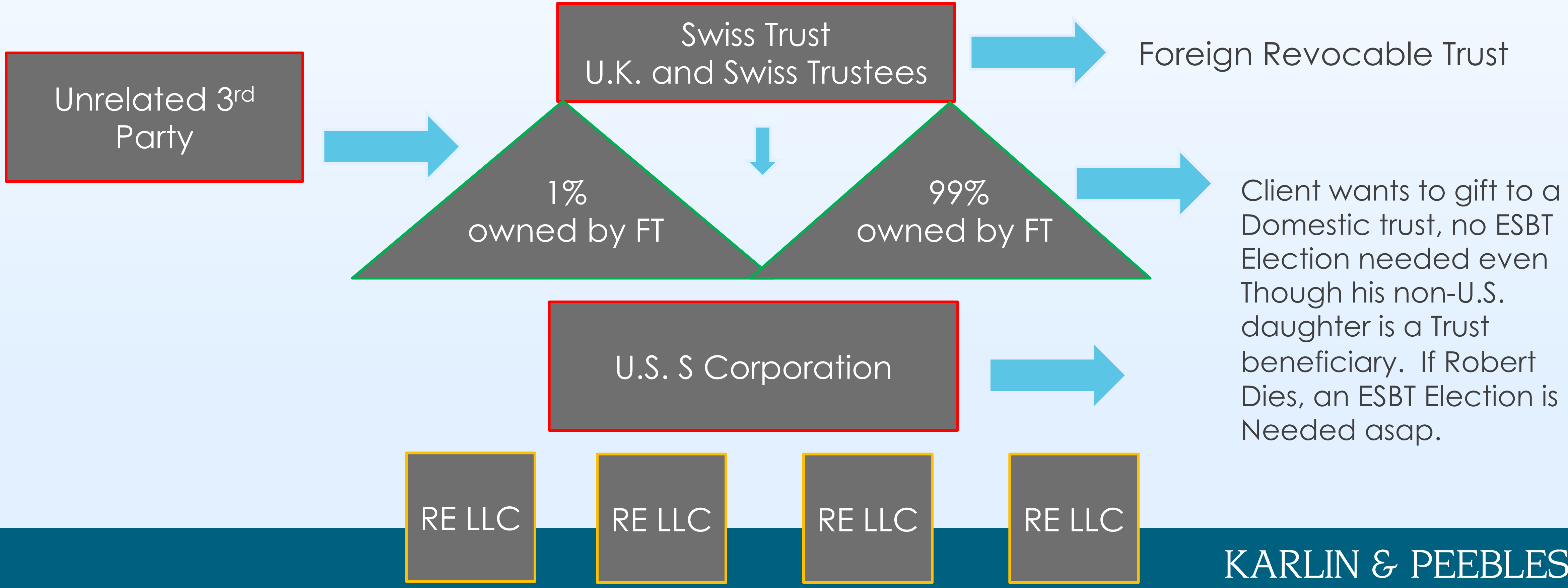
(I) A trust all of which is treated (under Subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States. (*i.e.*, a grantor trust)

However,

<u>THIS SUBPARAGRAPH SHALL NOT APPLY TO ANY FOREIGN TRUST.</u>

THE 2017 ACT AND S CORPORATION STOCK

Next Problem: U.S. Robert wants to make a gift in trust to children, one of his daughters is a non-U.S. Person. That's OK…the S corporate rules allow the grantor trust rules to trump the ESBT election. This is still an Invalid S election….Robert has been filing 1040s. The 2017 Act now allows Non-U.S. resident beneficiaries.

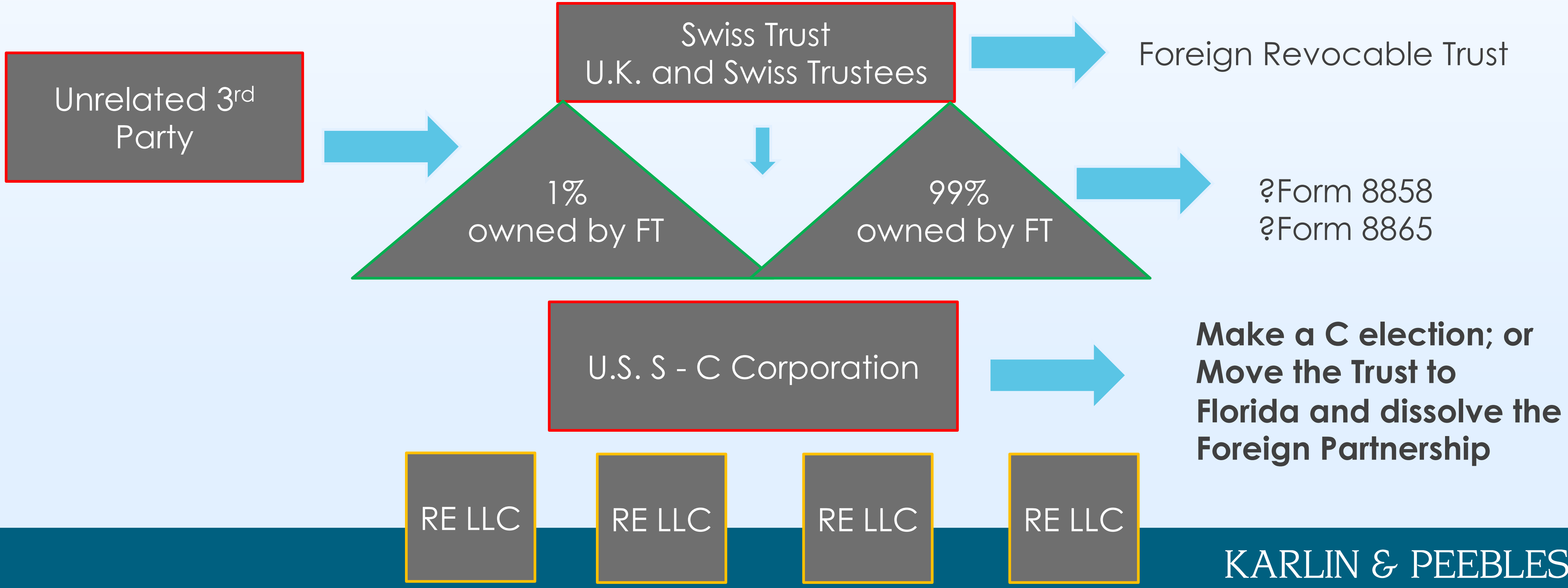


As amended, §1361(c)(2)(B)(v) – provides that an Nonresident alien potential current beneficiary will not be taken into account for purposes of the S corporation shareholder eligibility requirement that otherwise prohibits nonresident alien shareholders.

The Invalid S Election

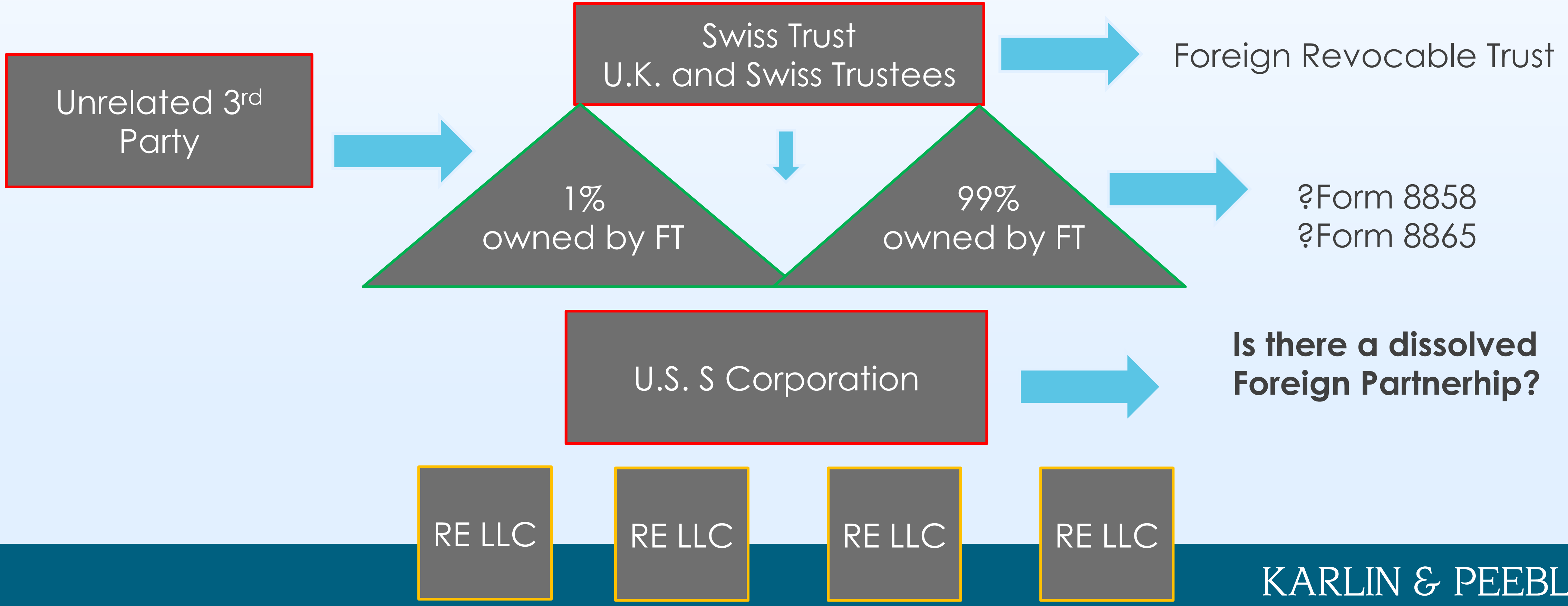
Invalid S – Possible Mitigation: Make a C election; Move the Trust to Florida and dissolve FP

The above does pose two possible options Robert could take to protect himself, although he will remain vulnerable for a time.



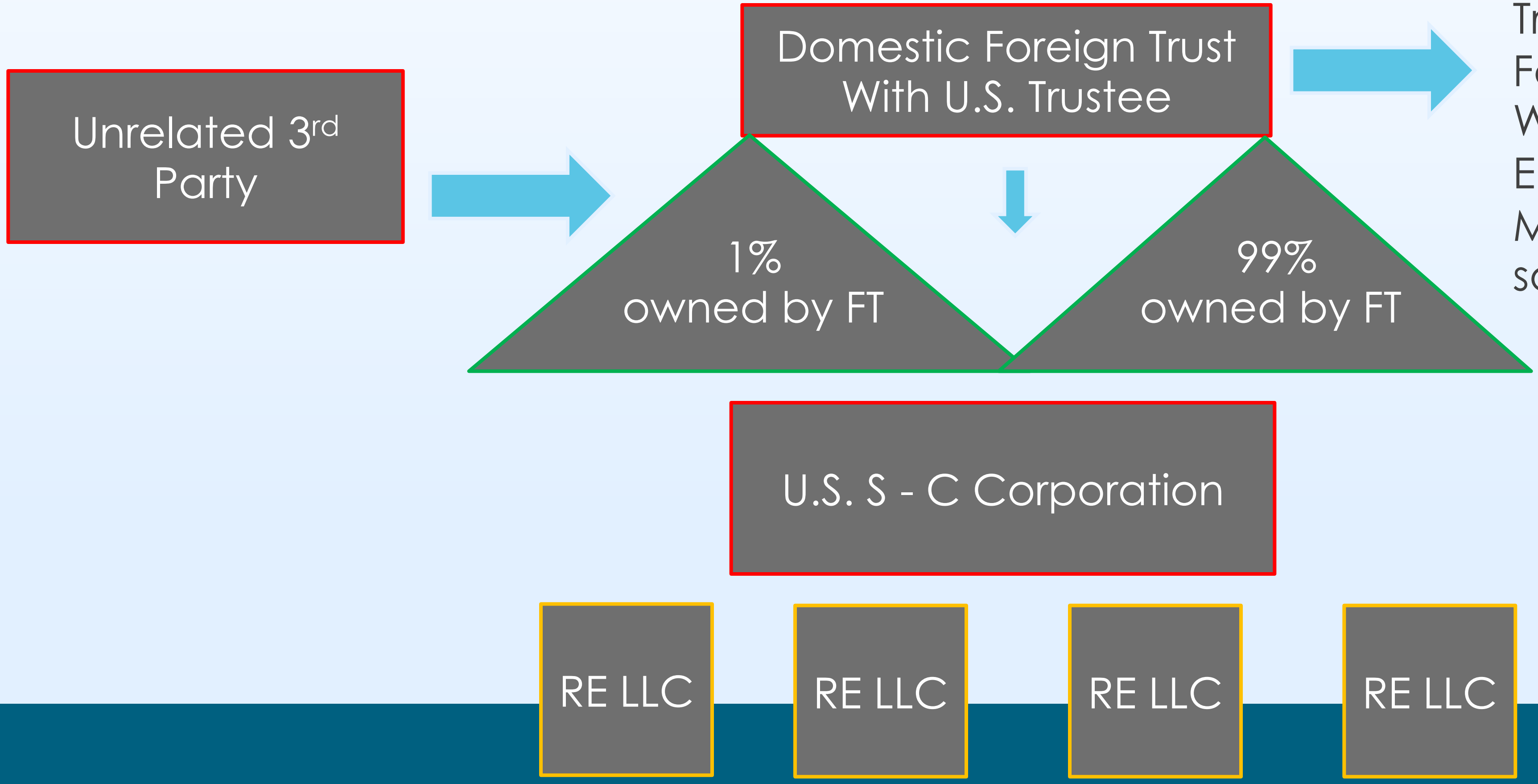
THE 2017 ACT AND S STOCK

But Robert also wants to leave the U.S. to become non-U.S. domiciled. In that case, Robert will need the foreign partnership for his U.S. estate tax blocker, if it works. Leaving will not resolve the invalid S Election. (foreign partnership) Getting back into a foreign blocker entity could be difficult.



THE 2017 ACT REGULATIONS

Restate the Swiss Trust to be a foreign grantor trust under § 672(f)(2)(A)(ii). The Trust will need a non-U.S. person who has authority over at least 1 substantial decision; the trust must be relocated to a U.S. jurisdiction.



Foreign Irrevocable Grantor Trust; a valid S but for the Foreign Partnership.
We'll likely need to make a C Election, anyway. Better to Make a C election when leaving so, no gain is triggered.

AS PROVIDED UNDER §1.641(c)-1(b)(ii):

Nonresident alien deemed owner. If pursuant to section 672(f)(2)(A)(ii), the deemed owner of a grantor portion of the ESBT is a nonresident alien, as defined in section 7701(b)(1)B)(NRA), the items of income, deduction, and credit from that grantor portion must be reallocated from the grantor portion to the S portion, as defined in paragraph (b)(2) of this section, of the ESBT.

Example 6: NRA as potential current beneficiary. Domestic Trust (DT) has a valid ESBT election effect. DT owns S corporation stock. The S corporation owns U.S. and foreign assets. The foreign assets produce foreign source income. B, an NRA, is the grantor and the only trust beneficiary and potential current beneficiary of DT. B is not a resident of the country with which the United States has an income tax treaty. Under section 677(a), B is treated as the owner of DT because, under the trust document, income and corpus may be distribution only to B during B's lifetime. Paragraph (b)(2)(ii) of this section requires that the S corporation income of the ESBT that otherwise would have been allocated to B under the grantor trust rules must be reallocated from B's grantor portion to the S portion of DT. In this example, the S portion of DT is treated as including the grantor portion of the ESBT, and thus all of DT's income from the S corporation is taxable to DT.

Remember: 672(f)(2)(A)(ii) is a grantor trust if all income and principal go to grantor and grantor's spouse, during grantor's lifetime.

THE WATER'S EDGE HAS ARRIVED!!!

(A NEW PARADIGM FOR DOMESTIC PLANNERS)

KARLIN & PEEBLES, LLP
ATTORNEYS AT LAW

ENABLERS ACT

A new law introduced by a bipartisan group that would require trust companies, lawyers, art dealers, to investigate clients seeking to move assets into the United States.

This law amends the 51-year-old Bank Secrecy Act.

The Treasury Department will create basic due diligence for American Gatekeepers.

Consider -- WorldCheck and OFAC:

JANUARY 1, 2021
Congress passed the National Defense Authorization Act for Fiscal Year 2021 (NDAA)

This was taunted as the most sweeping legislation since the USA Patriot Act of 2001.

This law introduces enhanced due diligence and reporting of owners of U.S. companies. The NDAA introduced The Anti-Money Laundering Act.

Under the AMLA, Certain corporations and limited liability companies must disclosure their beneficial owners to the Financial Crimes Enforcement Network (FinCen).

DOMESTIC PLANNERS MUST THINK BEYOND THE WATER'S EDGE (OR OUR NORTHERN EDGE…WITH CANADA) – SIMPLE EXAMPLE

THERE ARE COMPETING COUNTRY CONCEPTS

- Client in Santa Barbara purchased a home in Hope Ranch 20 years ago.
- The client is domiciled and resident in the U.K.
- 5 years ago….
- An attorney said the home should be contributed to a California revocable trust to avoid probate…
- Now the client is in your office:
  - Conflicting tax implications for trusts…20% entry charge for the Trust Contribution
    - Unless the California Trust can qualify as a "bare trust"
  - Conflicting application of attorney-client privilege
    - Many exceptions but something to keep in mind when seeking advice

COMPETING CROSS BORDER CONCEPTS… UK EXAMPLE

ARE LIVING TRUSTS = "SETTLEMENTS" FOR UK IHT?

- S43(2) IHTA 1984 includes property *"held in trust for persons in succession…"*
- Assets in a bare trust are held in the name of a trustee. However, the beneficiary has the right to all of the capital and income of the trust at any time if they're 18 or over (in England and Wales), or 16 or over (in Scotland). This means the assets set aside by the settlor will always go directly to the intended beneficiary. Technical argument used with HMRC is that no "trust" exists for English law purposes where there is no duty owed to beneficiaries
- Very much like our CA revocable trust (with same grantor-beneficiary)
- But what happens when the Grantor Beneficiary dies?
- In general, we use a Will/Trust scenario in such cases.
- What happens if the Grantor Beneficiary loses capacity? You need someone who has a continuing broad power for the Grantor Beneficiary…likely broader than what we draft

INBOUND WEALTH TRANSFERS INCREASING

- COMMON REPORTING STANDARD – ANNUAL TAX AND FINANCIAL INFORMATION EXCHANGE WITH OVER 100 PARTICIPATING COUNTRIES – DIFFERENT FROM FATCA
  - Legitimate planning for each Planning Scenario:
    - Caution:
    - Careful not to set up structures in the U.S. that may violate certain home country laws or require onerous disclosures!
    - Our partnership: Attorneys, Accountants, and Fiduciaries…with any client, there is always clever planning that can be done, but who will administer it!
    - And, we are seeing significant erosion to our non-participation

FOREIGN PARENT – FOREIGN GRANTOR

Corporate Trustee, U.S. TRUSTEE

(Parents Assets:
Contributed to
Foreign companies)

Foreign Revocable Trust
(Shareholder of Underlying
Foreign Corporation

C

U.S. Beneficiaries
(Possible Foreign Beneficiaries)

Distributions to Beneficiaries made only
From Trust accounts;
Do Not Distribute From Corporate Accounts

U.S. Investment Funds

ABC, USVI
Estate Blocker
To Hold U.S.
Assets

ABC USVI
Estate Blocker
To Hold
Foreign Assets

C

BVI
Company

MICRO EROSION --

U.S.-Based Investment Funds –

- Although the United States has decided not to participate, U.S. fund managers may wish to advise their clients about potential CRS compliance requirements triggered when utilizing non-U.S. alternative investment vehicles and special-purpose vehicles.
- Depending on local law, CRS requires financial institutions in a CRS participating country to report detailed information about account holders which are tax resident in another CRS participating country, regardless if the investment is made through a U.S. investment account offered by a U.S. financial institution.
- Investment funds generally must obtain a self-certification form stating the tax residence of the investor to avoid being required to treat the investor as a reportable account.
- When filling out the self-certification form (for CRS purposes) the definition section is specific to CRS, which can get confusing with similar SEC or FATCA definitions. Therefore, this form is fraught with opportunity to circumvent the integrity of the request.
- Fund managers must consider the sanctions applicable under local law for undocumented investors.

MICRO EROSION – LET THE GAMES BEGIN!

U.S.-Based Investment Funds – CRS Reporting Requirements – Definitions

- Controlling Person (Defined under CRS as the Account Holder)
    - A Natural Person who –

      ✓Owns more than a threshold percentage of the relevant investor entity (e.g., 25%) (beneficial or legal owner?)

      ✓This may be different for certain trusts

      ✓What about a foreign company with a U.S. investment advisor?

      ✓Absent significant equity ownership, the controlling person is who exercises control over such entity.

      ✓If control is not established, is in charge of the effective manage of such underlying entity (ignoring any nominee directors)

MICRO EROSION --

For the U.S. Financial Institution or Representing a Foreign Client –

- Considerations

  ✓Confirm what CRS registration requirement applies under the investment’s local law;

  ✓THE FATCA GIIN NUMBER MAY EXEMPT THE INVESTMENT FROM CRS REGISTRATION…(FGT with underlying foreign company with a GIIN)

  ✓Consider the self-certification that permits recording of tax residence carefully

  ✓If you are a fund, require self-certification or proof of exemption

  ✓Implement a CRS reporting manager

  ✓Ethics related to CRS…and other Criminal Statutory Crimes…..

GLOBALIZATION OF ENFORCEMENT…TRENDING

- UK Criminal Finances Act 2017
- EU Trust Registration Requirements
- Aggressive Transaction Disclosure
- Core Income Generating Activities (“CIGA”)
- EU Succession Regulations (“Brussels IV”)

THE UK CRIMINAL FINANCES ACT 2017

A criminal measure makes companies criminally liable for failing to prevent their employees from engaging in tax evasion.

Relevance: U.S. Attorneys, CPAs, financial institutions worldwide who may have the slightest nexus (gossamer thread) with the UK

Suffice to say, since we seems incapable of regulating ourselves, the European Union has decided they will do it for us….with harsh criminal penalties…

Domestic Tax Evasion

Foreign Tax Evasion

Effective September 30, 2017 –
Two Corporate Criminal Offenses

- An associated person (employee or agent or referral partner)
- Of a relevant body (a company with even the slightest nexus to the UK)
- Fails to prevent the facilitation of tax evasion.
- Legal Tax avoidance will not trigger liability.
- Affirmative Defense: Adoption of reasonable prevention procedures.
- Definitions are broadly defined
- **CRS avoidance will trigger**

FRANCE TRUST REGISTRATION REQUIREMENT

- **The French Government published, on 12 February 2020, Ordinance No. 2020-115 (the Ordinance) regarding the strengthening of French Anti-Money Laundering and Financing Terrorism (AML/FT) framework.**
- ***Extension of the scope: a new French nexus that triggers a trust reporting requirement***
- Prior to the Ordinance, Trustees had reporting obligations towards the French Tax Administration in the following two situations:
- where the Trustee, the settlor, one of the beneficiaries* or beneficiaries deemed settlor of the trust is tax resident in France for the year of the declaration; and / or
- one or more of the assets or rights placed in the trust are located in France.
- The Ordinance introduces a third situation that triggers French nexus and then a reporting obligation by the trustee according to Article 1649 AB of Code Général des Impôts (CGI): this happens when (a) the trustee is established or resident outside the EU and (b) it acquires real estate or enters into a business relationship in France.
- ***New sets of data to be filed in the trusts returns (annual and monthly returns) – Filed by Trustee at the latest on June 15th of each year***
- The protector(s) as well as any other natural person exercising effective control over the trust or performing equivalent or similar functions
- The nationality of each member of the trust (administrator, settlor, beneficiary, protector or any other natural person exercising effective control)
- The French tax authority will notify the trustee of any discrepancies between the information collected in the trust register and the information on beneficial owners available to the tax administration.
- There are two outcomes with respect to the notification:
    - The trustee agrees on the finding/discrepancy or provides a sufficient answer: in this case, the French tax authority will amend or complete both registers (French trust register and beneficial owners register).
    - The trustee does not answer or does not provide a sufficient answer: the French tax authority may apply the €20,000 penalty as already provided by Article 1736 IV bis of the CGI.

***This includes a remainder beneficiary. Does not matter if revocable trust. The penalty is for each violation.**

U.K. TRUST REGISTRATION REQUIREMENT

Starting OCTOBER 6, 2020, (Portal ready late 2021)

- Now, all UK trusts (both express and implied) and "complex estates" must be registered.

Which Trusts Must Be Registered?

- Now, all implied trusts with a tax liability and UK resident express (i.e., those in writing) must be registered. This includes common forms of trusts, such as discretionary trusts, interest in possession trusts and bare trusts.
- Non-UK trusts must also register in certain circumstances, such as the following:
- Bare trusts, where the beneficial and legal owner are not the same, must register, including the common instances where a parent holds property on trust for the benefit of a child, or where one spouse holds a property for the benefit of themselves and their spouse.
- Non-resident trusts that pay Stamp Duty Reserve Duty on the sale of UK securities will also apparently be caught by the new regulations

Exceptions

- Non-UK trusts, which have already been required to register with a similar scheme abroad (i.e., an EU Member State).

Privacy

- There is a vast amount of personal information which must be provided when registering a trust or complex estate. Trusts which are chargeable to UK tax will have to divulge even greater detail than those trusts which are not liable.

DISCLOSURE OF AGGRESSIVE TRANSACTIONS

The EU's mandated Disclosure of Aggressive Transactions applies to any transaction that seeks to minimize tax.

Compare:

U.S. persons have the absolute right to use any legal structure to minimize tax and have the right to privacy with regard to their structures.

All enterprises and investors with any EU nexus should be aware, that the disclosure requirements will apply to all "intermediaries" and possibly their clients involved in cross border tax arrangements. This could range from third-party service providers, tax advisors, in-house tax counsel, local directors, and other in-house representatives involved in any such arrangement.

Intermediaries (EU and those with an EU nexus…possible includes your client) will have to report any cross-border tax planning arrangement that they design or promote if it bears ***any of the features or hallmarks listed in the Directive.***

HALLMARKS

Category A

Generic tax planning hallmarks: (i) confidentiality agreements imposed on clients; (ii) contingent fee arrangements; (iii) the use of standardized documentation.

Category B

Specific hallmarks related to the nature of the transaction: (i) planning the use of losses; (ii) conversion of income into an item that benefits from more favorable (or no) taxation; and (iii) circular transactions resulting in the round-tripping of funds which yield a net tax benefits…no real purposes other than tax…step transaction.

Category C

Transactions (i) involving payments to stateless entities, to low/no tax jurisdictions, to non-cooperative jurisdictions and to taxpayers benefiting from exemptions or preferential regimes (the U.S.?); and (ii) a wide range of hybrid/dual deduction/double relief transactions.

Category D

Transactions that are by their nature intended to circumvent transparency rules (e.g., frustrating application of CRS rules).

Category E

Transfer pricing/restructuring with 50% decline in revenues.

CIGA – HARSH PENALTIES FOR EU NEXUS HOLDERS

- Is investment fund activity included? Cayman and the BVI have taken the position that such activity is outside the economic substance requirements.

- Harsh penalties…up to forfeiture

- Disclosure of Activity with relevant tax authorities

- BEPS initiative….

EU SUCCESSION REGULATION

- Lived in Switzerland and moved to California
- Continue to have property in Switzerland
- One Child, Charity, Fiancé
  - *Habitual Place of Abode is now California*
  - *Born in Switzerland*
- Switzerland has strict forced heirship….
- EU Succession Regulation allows California to govern
  - Must elect in a specified way in a California Will……
- Don’t forget about The Hague Convention…
  - You may not elect under Brussel IV, but an older trust can record with countries that have adopted The Hague Convention (i.e., Italy)

AND THE MORAL OF THE STORY IS…

Scenarios to demonstrate the difference between Inbound and Outbound Planning and the treatment of trusts in different jurisdictions: The "why" of understanding trusts in the cross-border context.

Outbound

- The California Revocable Trust Migration Story.
- Gifting to UK-based children through U.S. gift trusts.
- Trust planning with California community property.
- Gifting to Israeli-based children through U.S. gift trusts
- Relying on Heggstad for U.K. domiciled individuals

DEFINITION OF TRUST IN THE WORLD OF GLOBAL RELATIONSHIPS

INITIAL CLASSIFICATIONS AND WHY DO WE CARE?

What is a Trust for U.S. tax purposes?

- Lichtenstein Foundation
- Stiftung
- Usufruct
- Treuhand

INITIAL CLASSIFICATIONS

Ordinary Trusts -- 301.7701-4(a)

In general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually the beneficiaries of such a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under the Internal Revenue Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. **Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries** who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

INITIAL CLASSIFICATIONS

Business Trusts -- 301.7701-4(b)

There are other arrangements which are known as trusts because the legal title to property is conveyed to trustees for the benefit of beneficiaries, but which are not classified as trusts for purposes of the Internal Revenue Code because they are not simply arrangements to protect or conserve the property for the beneficiaries. **These trusts, which are often known as business or commercial trusts, generally are created by the beneficiaries simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships under the Internal Revenue Code**. However, the fact that the corpus of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association or partnership. The fact that any organization is technically cast in the trust form, by conveying title to property to trustees for the benefit of persons designated as beneficiaries, will not change the real character of the organization if the organization is more properly classified as a business entity under Section 301.7701-2.

INITIAL CLASSIFICATIONS

Investment Trusts -- 301.7701-4(c)(1)

An "investment" trust will not be classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders. See *Commissioner v. North American Bond Trust*, 122 F. 2d 545 (2d Cir. 1941), cert. denied, 314 U.S. 701 (1942). An investment trust with a single class of ownership interests, representing undivided beneficial interests in the assets of the trust, will be classified as a trust if there is no power under the trust agreement to vary the investment of the certificate holders. An investment trust with multiple classes of ownership interests ordinarily will be classified as a business entity under Section 301.7701-2; however, an investment trust with multiple classes of ownership interests, in which there is no power under the trust agreement to vary the investment of the certificate holders, will be classified as a trust if the trust is formed to facilitate direct investment in the assets of the trust and the existence of multiple classes of ownership interests is incidental to that purpose.

INITIAL CLASSIFICATIONS

301.7701-4(c)(2), Example 4. Business Interest versus Trust Classification.

Corporation N purchases a portfolio of bonds and transfers the bonds to a bank under a trust agreement. At the same time, the trustee delivers to N certificates evidencing interests in the bonds. These certificates are sold to public investors. Each certificate represents the right to receive a particular payment with respect to a specific bond. Under section 1286, stripped coupons and stripped bonds are treated as separate bonds for federal income tax purposes. Although the interest of each certificate holder is different from that of each other certificate holder, and the trust thus has multiple classes of ownership, the multiple classes simply provide each certificate holder with a direct interest in what is treated under section 1286 as a separate bond. Given the similarity of the interests acquired by the certificate holders to the interests that could be acquired by direct investment, the multiple classes of trust interests merely facilitate direct investment in the assets held by the trust. **Accordingly, the trust is classified as a trust.**

WHY IS TRUST CLASSIFICATION IMPORTANT?

Stiftung -- Great Analysis of trust factors…In Estate of O.T. Swan, 24 T.C. 803 (1981, acq. 1981-2 C.B. 1., the Tax Court determined that *stiftungs* should be treated as trusts for U.S. tax purposes.

In PLR 9121035, a citizen of Germany died and left her son a life estate in certain property in Germany – a usufruct interest. Upon the son's death the assets were to pass to his children who were U.S. citizens. In this case, the parties wanted the interest to be classified as a trust so that upon the death of the son, his U.S. children would simply become U.S. beneficiaries and the interest would not pass into the U.S. estates for U.S. estate tax purposes.

This became a very fact sensitive case which turned on the rights the children had and the duties of their father vis a vis his children as a trustee.

But, what about when there is undistributed net income!

APPENDIX

TRUST USES FOR OTHER PURPOSES….

- In certain Muslim countries, the forced heirship rules may be applicable. Sharia Law may apply which means that the inheritance rules under that country's specific interpretation of Sharia Law will apply to inheritance. The application of Sharia Law may differ from country to country.

- The benefit of a trust (that is Sharia law approved): In some Sharia Law countries, lifetime transfers into trust may assist to bypass the strict forced inheritance laws of the specific country.

- Certain transfers may depend on under what regime a couple were married…..

ESTATE OF BARKAT A. KHAN, MOHAMMED ASLAM KHAN V. COMMISSIONER, TAX COURT 1998

Issue Presented: Was Mr. Khan domiciled for U.S. estate tax purposes to avail himself of the higher U.S. estate exemption amount in 1998?

Facts Presented:

- Mr. Khan moved to the U.S. in 1971, at age 61, and his wife and two daughters remained in Pakistan.
- His son had come to the U.S. earlier and had married.
- Mr. Khan continued to extend his temporary U.S. visa.
- Mr. Khan returned to Pakistan where he attempted to obtain a permanent visa.
- Mr. Khan owned substantial property in California which was an operating ranch.
- He was told he could get his permanent visa when his son became a U.S. citizen.
- Mr. Khan was granted a permanent visa based on his status as the parent of a U.S. citizen.
- Mr. Khan came back to the U.S. in 1985 and lived with his son in California.
- Mr. Khan obtained a social security number.
- Mr. Khan filed form 1040s.
- Before leaving for Pakistan, for a visit, in 1986, Mr. Khan applied for a permit to re-enter the U.S.
- However, his accountant filed a return in 1986, stating that Mr. Khan had left the U.S. permanently and the accountant filed a Form 1040NR.
- Soon after his arrival into Pakistan, Mr. Khan fell ill.
- The petition provides that decedent wanted to return to the U.S., but his health failed. His accountant continued to file 1040NRs for tax years 1987 through 1990.
- Mr. Khan died in Pakistan in 1991.

ESTATE OF BARKAT A. KHAN (CONT'D)

FACTORS:

- Mr. Khan's business interests were in the U.S.
- Mr. Khan owned substantial land.
- Mr. Khan's family had a long history of immigrating to the U.S. (Brothers and sons)
- Mr. Khan's eldest son was a U.S. naturalized citizen.
- Mr. Khan's second son moved to the U.S.
- That he had no library card or driver's license was not weighed heavily.
- He didn't join social clubs, but he didn't speak English.
- That his wife did not move to the U.S. was not weighed heavily.
- Mr. Khan had a bank account in the U.S. as early as 1976.

ESTATE OF BARKAT A. KHAN (CONT'D)

FACTORS CONT.:

- Mr. Khan was a citizen of Pakistan at his death.
- Presumption: Once a domiciled is acquired, it is presumed to continue until it is shown to have been changed
- If there is doubt, the presumption is that it has not changed.
- A person acquires a domicile by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intent to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.
- Must haves: (1) lived in the U.S. and (2) had the intent to remain indefinitely.

VISAS!

- EB5 – Green card status
- E2 – Must have a treaty to get this one!
- O – Coming to U.S. for job opportunity within 1 year
- L – Intracompany transfers for persons with specialized knowledge
- H – Coming to U.S. job opportunity within six months
- Green card

Each of these designations carries with it its own tax implications….

You need to consult with an immigration attorney in some instances because you can jeopardize someone's visa status with certain tax planning decisions…

U.S. ESTATE TAX ON U.S. SITUS ASSETS OF NON-U.S. DOMICILE

Non-U.S. domicile: Taxed on U.S. Assets

- Applicable exclusion amount shields only $60,000 from tax, a unified credit amount of only $13,000
- An applicable treaty may increase that amount if it includes a pro rata formula which we will see shortly.
  - The United States has estate and gift tax treaties with a number of countries including Australia, Austria, Canada (*note – this is an income tax Treaty but addresses some estate/gifting issues*), Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, South Africa, Sweden, Switzerland, United Kingdom.

THE NON-U.S. DOMICILED INDIVIDUAL'S U.S. TAXABLE ESTATE (CONT'D)

The value of the gross estate shall not include certain property, even though physically in the U.S.

Examples:

- U.S. bank accounts, as defined, good option to start moving assets over…..unless large amounts….
- Works of art on loan in the U.S.
- Life insurance
- Qualified debt obligations
- By treaty, sometimes shares of domestic companies
- Beware of U.S. real estate with no foreign blocker!

THE NON-U.S. DOMICILED INDIVIDUAL'S U.S. TAXABLE ESTATE

- **Deductions**: The value of the gross estate may be reduced by applicable deductions; however, the use of such deductions is subject to a formula which requires disclosure of the NRNC's worldwide assets. This may not be something the NRA family wishes to do.

- **Tainted Property**: The value of the gross estate shall also include property deemed situated in the U.S. if it was situated in the U.S. either at the time of the gift or at the time of the death of the donor/decedent. **Section 2104(b). The sequence of purchase and subsequent planning makes a difference.**

- Additionally, the United States has estate and gift tax treaties with various countries.

- **GILTI and the Ability of Individuals to Make IRC § 962 Elections:**
- GILTI is the income earned by controlled foreign corporations ("CFCs") from intangible assets. It requires a 10% U.S. shareholder (by vote and value) of a CFC to include in its current income the shareholder's prorated share of the GILTI income of the CFC. U.S. corporate shareholders and individual shareholders are taxed differently on GILTI. Subject to certain limitations, a U.S. corporate shareholder is allowed a 50% deduction against GILTI (the "IRC § 250 deduction"), and is entitled to a credit for 80% of the CFC's foreign tax allocable to GILTI. Individual shareholders are not allowed the 50% deduction or the 80% tax credit and are subject to a marginal tax rate of 37%. IRC § 962 is an election that allows an individual to be taxed on subpart F income and GILTI at corporate tax rates. The final regulations permit individuals making an IRC § 962 election to take into account the 50% deduction for GILTI under IRC § 250. The preamble to the regulations notes uncertainty regarding when an individual may make an IRC § 962 election on an amended return.

- **Example:**
- During 2021, a U.S. individual wholly owns a foreign corporation that is a CFC. The CFC has $1 million of net active earnings before foreign income tax. The CFC does not have income characterized as subpart F income during the year. Further, the CFC does not have any qualified business asset investments. The CFC pays a foreign income tax of $180,000 on the earnings.
- If the U.S. individual does not own any other CFCs, the total net tested income (the GILTI inclusion) is $820,000 [$1 million-$180,000]. The individual will owe a U.S. tax of $303,400 applying the maximum individual tax rate of 37% on the GILTI inclusion. No deemed paid foreign tax credit pursuant to IRC Sec. 960 is allowed. This is the default outcome without the IRC § 962 election.
- If an IRC § 962 election is made, the U.S. individual will recognized GILTI income of $820,000 plus the IRC § 78 gross-up of $180,000. Therefore, the total deemed inclusion is $1 million. An IRC § 250 deduction will be allowed on 50% of the $1 million, or $500,000. Therefore, the U.S. taxable income on the inclusion is $500,000. The U.S. corporate tax rate of 21% will apply resulting in a tax liability before foreign tax credit of $105,000. The amount is further reduced by the deemed paid foreign tax credit. 80% of the deemed paid foreign tax credit attributable to tested income is allowed, or $144,000 [80% of $180,000]. The foreign tax credit is more than sufficient to offset the entire U.S. tax liability of $105,000, resulting in a zero tax.
- When the CFC later distributes the $820,000 of earnings and profits of the CFC, the individual shareholder will be taxed on the dividend. If the dividend is paid by a CFC organized in a country that has a comprehensive tax treaty with the U.S., it will be a qualified dividend and be eligible for the 20% preferential tax rates on qualified dividends (plus net investments tax and state and local taxes). If it is from a CFC in a country that does not have a comprehensive income tax treaty with the U.S., it will be taxed at marginal rates of up to 37% (plus net investment income tax and state and local taxes).

- **Effective Date of Final Regulation:**
- The final regulations are generally applicable to tax years beginning on or after January 1, 2021, giving taxpayers additional time to develop systems and procedures for complying with the regulations. The proposed regulations were proposed to apply to taxable years ending on or after March 4, 2019.
- Taxpayers may choose to apply the final regulations to tax years beginning before January 1, 2021, provided that they apply the final regulations in their entirety (with the exception of certain substantiation requirements). Alternatively, taxpayers may rely on the proposed regulations in their entirety for tax years beginning on or after January 1, 2018, except that taxpayers relying on the proposed regulations may rely on the transition rule for documentation for all taxable years beginning before January 1, 2021 (rather than only for taxable years beginning on or before March 4, 2019).

CYNTHIA D. BRITTAIN

Cindy Brittain focuses her practice on high net worth, multinational families and individuals who themselves and their global companies require expertise in sophisticated cross-border income and estate tax planning strategies. Working closely with family members, Cindy obtains a comprehensive understanding of their values and dynamics, ensuring that unique personal and business goals are achieved. Cindy's extensive experience includes advising families on the complex issues relevant to pre-immigration planning, international corporate tax, and both international and domestic wealth and asset transfer strategies. Cindy also has extensive experience with cross-border regulatory laws that affect U.S. domestic planning as well as with U.S. tax compliance under the several voluntary disclosure regimes.

Cindy previously worked at a major accounting firm within its international mergers and acquisitions group, and has continued to advise clients on the effective integration of their global business operations into the U.S. tax regime. Over the course of her career, she has worked with clients in Brazil, Saudi Arabia, Dubai, London, Hong Kong, Mainland China, India, and the United States to develop overall income and estate planning strategies on behalf of large global families.

Practice focus

- Advanced domestic and international estate and tax planning; Transactional tax and corporate cross-border design
- Pre-immigration strategies for corporate assets; Multi-generational succession and entity planning
- Trust and legacy design; Multi-state trust strategies to mitigate California state income tax
- Charitable planning for effective tax and philanthropic goals; Family governance and family retreats for NextGen Education