A Guide to International Estate Planning for Cross-Border Families

- U.S. Tax Basics
- International Tax and Inheritance Regimes
- Concepts of Citizenship, Residency, and Domicile
- Situs and its Application
- Tax Treaties and Foreign Tax Credits
- Estate Planning Strategies, Tools and Their Portability
- Non-U.S. Citizen Spouse
- Gifts/Inheritances from Foreigners
- Cross-Border Portfolio Optimization

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INTRODUCTION

A United States expat family, a U.S. person married to a non-citizen spouse, a non-U.S. person investing in the United States, and other cross-border families will need to have an investment plan that is correctly in sync with a tailored cross-border estate plan. Correctly tailoring that cross-border estate plan will require legal and tax experts with a deeper understanding of the relevant estate/succession/gift/generation-skipping transfer (collectively referred to herein as “transfer”) tax laws in each of the relevant countries that may factor in the distribution of property prior to and upon death. These experts should also understand the myriad techniques that can mitigate the punitive effect of transfer taxes. This article, then, is an introduction to the international estate planning and investment techniques that sophisticated international and cross-border families utilize. These topics also include cross-border issues that complicate estate planning: transfer tax rules, treaties, and credits.

WHAT IS A CROSS-BORDER FAMILY?

Thun Financial uses the term “cross-border” broadly to refer to any investment planning circumstance that involves families of mixed nationality and/or whose financial affairs extend across borders. Cross-border families include Americans living abroad, U.S. residents of foreign origin, and non-U.S. residents who are investing within the United States. Such families commonly have a mix of citizenships and/or immigration statuses. Cross-border families typically hold a range of financial assets and business interests that are subject to taxation in more than one national jurisdiction.
Cross-Border Issues that Amplify the Complexity of Estate Tax Planning

U.S. Estate Tax Basics

U.S. taxation – "exceptional" in reach and scope:
America is “special” in many ways, but few aspects of American “exceptionalism” are as tangible as the way the U.S. Treasury levies taxes on its citizens who leave its borders to live and work abroad. While the global income taxation of U.S. citizens gets far greater attention, U.S. transfer taxes apply no matter where a U.S. citizen lives, gifts property, or dies. While expat Americans do enjoy income tax relief in the form of the foreign earned income exclusion, there is no transfer tax corollary for expats. Accordingly, the expat should expect the U.S. Treasury to impose estate tax at his or her death upon all worldwide assets, including proceeds of life insurance policies, retirement assets, personal property (including investments), real estate, and other assets. Additionally, estate tax may be owed on certain assets transferred to others within a fixed time period before death, or where the decedent retained an interest in the property.

Currently, the vast majority of Americans, at home or abroad, have little concern for U.S. federal estate taxes. Recent estate tax law changes have significantly increased the federal estate and gift tax lifetime exclusion amount to very high thresholds:

- Interspousal transfers: gifts and bequests (during your lifetime or upon death) between spouses are unlimited (to citizen spouse).
- Portability of unused exemption to surviving spouse: Beyond that, if the first-to-die spouse’s exemption amount is not fully utilized, an election on that estate tax return will preserve the remaining unused exemption amount for the second-to-die spouse.

Accordingly, with a $22.4 million-per-couple exemption, most Americans feel that the estate tax is something that can be ignored.

That said, the U.S. federal estate tax regime may be described as in a state of flux, with some policymakers calling for its complete abolition, and others seeking to return the exemptions to much lower levels. At present, the recently doubled exemptions are slated to sunset in five years (2023), returning to pre-2017 tax reform levels. Moreover, a laissez-faire attitude to estate planning is far less justified if the U.S. citizen client is married to a non-U.S. citizen. If the non-U.S. citizen is the surviving spouse, the unlimited marital deduction will not be available and the likelihood of estate taxation upon the death of the first spouse increases. Transfers during lifetime to the non-U.S. citizen spouse can reduce the U.S. citizen spouse’s estate, but the annual marital gift tax exclusion is reduced from unlimited to $155,000 (2019). In short, since no one can confidently predict where the estate tax exclusion, marital deduction and tax rate levels will be in the future, ignoring estate planning based on current tax thresholds may be a costly mistake.
**Estate planning challenges for the expat and/or multinational family:** Multi-jurisdictional estate planning issues are actually nothing new for Americans and their financial advisors: A typical affluent American family may have brokerage accounts, savings accounts, and a security deposit box with valuables in New York, a primary residence in Connecticut, a second home in Florida, and possibly even a trust established in Delaware or South Dakota. Accordingly, in addition to the federal estate, gift and generation-skipping transfer (GST) tax regimes, the transfer tax regimes of multiple states may also factor in the distribution of wealth (during lifetime and after death) to the surviving spouse, the children, and future generations. This is already a complex situation, requiring the assistance of legal and financial professionals.

Now imagine that typical affluent American family in a modern, global setting: A husband that is a United States citizen living in Germany, married to a citizen of France (a “non-U.S. person”), with two children from a prior marriage living in the United States and one from the present marriage living with her parents in Germany. There may be real property in various jurisdictions, separately or jointly titled, personal property also spanning the globe, limited partnership interests (e.g., hedge fund, private equity, or structured products), joint brokerage accounts, individual brokerage accounts, pension funds, defined contribution plans, IRAs, Roth IRAs, and college savings or UTMA/UGMA accounts for the children. There are many factors that will make the transfer tax planning puzzle exponentially more complex for this model global family than for the aforementioned multi-state family.

**A Brief Overview of Contrasting International Transfer Tax Regimes**

**Common law vs. civil law foundations:** While the estate tax laws of different U.S. states may have critical differences (e.g., the recognition and/or treatment of community property), these differences are subtle in comparison to the international landscape. This is partially because all (save Louisiana) states share the same legal foundation: English common law. On the other hand, the majority of European, Latin American, and African nations have civil law systems. Broadly speaking, civil law systems are based on Roman law, and statutes tend to be longer, more-detailed, and leave far less discretion or interpretative influence to the courts. In contrast, common law systems tend to have more concise constitutions and statutes and afford more discretion and interpretive power to the courts when applying the laws to the particular facts and circumstances of particular cases.
**Substantial planning flexibility in common law regimes:** In the estate planning context, common law jurisdictions typically afford much more discretion to the individual (the settlor) to design a scheme of distribution to those people or institutions (heirs) to whom the individual desires to pass on her wealth before or after death. Wills are the common method of establishing a blueprint of specific instructions for passing (bequeathing) wealth to others (spouses, descendants, friends, charities, etc.) through the probate system. Trusts are a primary method of devising a scheme of distribution that may allow some or all of the decedent’s assets to bypass probate, and (sometimes) to defer or avoid estate taxation. In common law jurisdictions, it is usually the estate of the decedent that is taxed prior to distribution of wealth to chosen heirs. If the decedent fails to construct a legally valid will (a situation known as intestacy), trust or other will-substitute scheme (e.g., joint titling all property), the state intestacy laws will direct the distribution of the decedent’s property.

**Succession and forced heirship dominate civil law and other regimes:** Civil law countries tend to follow a succession regime, also known as forced (or Napoleonic) heirship. This is analogous to the intestate succession rules followed in common law when the decedent has otherwise failed to legally direct the distribution of wealth upon death. These regimes are obviously quite different, for the decedent in a civil law country may have little or no say in the distribution of all (or
most) of the wealth accumulated (or previously inherited), during her lifetime. Moreover, civil law succession regimes tend to prefer to impose tax upon inheritance (i.e., upon the heirs) at the time of distribution of the decedent’s estate rather than impose tax upon the estate of the decedent prior to the distribution of the decedent’s estate. Finally, the concept of a trust is likely to be of little or no legal validity in a succession regime.

Given the critical fundamental legal differences in the distribution and taxation regimes around the world, it should come as little surprise that a family’s existing estate plan (designed for one legal system) may quickly become outmoded, ineffective, and even counter-productive once the family relocates overseas (and becomes subject to a completely different legal system).

CONCEPTS OF CITIZENSHIP, RESIDENCY AND DOMICILE

Concepts of citizenship, residency and domicile have crucial significance in determining the exposure of a person to the transfer tax regime of any particular country. An expat should understand the particular definitions and requirements under the laws of the country(ies) in which they live, work, or own property. Naturally, the likelihood that the effectiveness of an American’s existing estate plan will deteriorate will depend not only on where the family relocates, but also on how much the family integrates its wealth/assets/investments into the new country of residence, and for how long the expat family remains (or plans to remain) in the new country of residency. For example, the UK has three residence statuses that impose different rules based on length of residency or election of status: resident, domiciliary, or deemed domiciliary. The particular status of the taxpayer will have significant income and transfer tax consequences, and of course, the particular distinctions vary by country.

In the United States, there is an objective test for determining whether a person is a U.S. resident for income tax purposes (the “substantial presence” test) that measures the days of the tax year that the taxpayer was physically within the United States.

Transfer taxes are more closely tied to the concept of domicile rather than residency. Domicile is acquired by living in a jurisdiction without the present intention of leaving at some later time. Residency, without the requisite intention to remain, will not create domicile, but domicile, once created, will likely require an actual move outside the country (with intention to remain outside) to sever it. Accordingly, for an immigrant to attain estate tax residency in the U.S., the person must move to the United States with no objective intention of later leaving. Permanent resident (green card) status would in most (but not necessarily all) cases establish domicile. In practice, there is no bright-line test for non citizens to establish domicile. U.S. Courts have looked at a number of factors in determining the domicile of a decedent.
Transfer Tax Situs Rules, Treaties and Foreign Tax Credits

The transfer tax implications for the expat’s (or non-U.S. person’s) property will depend upon the interplay of:

- The nature or character of the assets;
- The assets’ physical locations;
- The applicability of an estate (and/or gift) tax treaty between the U.S. and the country of residence, domicile and/or citizenship; and
- The availability of tax credits in the relevant jurisdictions where overlapping taxes are levied.

Understanding the Role of Situs in International Transfer Taxation

What is “Situs”?

Situs is Latin for “position” or “site.” In the law, it is a term that refers to the location of the property for legal purposes.

While U.S. citizens and residents are subject to federal estate tax on worldwide assets, the non-resident alien’s estate is subject to federal estate tax only on U.S. situs assets, consequently “situs” has an important role to play in estate planning for many cross-border families.

Expats Living in Europe and E.U. Directive 650/2012:

As of August 17, 2015, U.S. citizens living in the E.U. can elect the probate/succession laws of either their country of residency or their country of citizenship to govern the distribution of all of their wealth.

- Provides greater clarity – one country’s courts will have jurisdiction and its laws will apply to the transfer of assets.
- Creates a European Certificate of Succession which is recognized in all participating EU countries to clearly demonstrate the heirs, legatees, executors of the will or the administrators of the estate.
- Avoids the Napoleonic “heirship” system for those living in countries (e.g., France) where the law mandates a majority of assets passing to children.
- Must update your Will and specify the election. Have an official notary in residence country confirm the Will complies.
- Denmark, Ireland and the UK opted out of this arrangement. Applies to U.S. citizens residing in other Eurozone countries.
- Warning: Does not alter the path or nature of transfer (estate/inheritance) taxes upon your death (in U.S. and E.U. country of residence) nor does it cover trusts.

For more information see: the New EU Succession Rules
**Situs generally:** The general situs rule is that tangible assets physically located in the U.S. are subject to federal estate tax, but the situs rules for intangible property are somewhat involved and complicated. For instance, an asset can be non-U.S. situs for gift tax purposes but U.S. situs for estate tax purposes. Here are the general situs guidelines for non-resident aliens and their U.S. estate tax exposure:

- **Real Property** – Land, structures, fixtures and renovations/improvements located in U.S. are U.S. situs.

- **Tangible Personal Property** – property physically inside the U.S. is U.S. situs. This includes physical dollars or other currency.

- **Intangible Personal Property** – U.S. situs will depend on the character of the investment:
  - *Business Investment Funds* – funds used in conjunction with a U.S. trade or business and held in bank or brokerage (including domestic branches of foreign banks), are U.S. situs.
  - *Personal Investment Funds*, including:
    - *Checking or Savings* – demand deposits in U.S. banks are non-U.S. situs, while money market funds or cash in a brokerage account are U.S. situs.
    - *Qualified Retirement Plans* – if funded through U.S. employment are U.S. situs.
    - *Stock* – if issued by a U.S. corporation, are U.S. situs, even if stock certificates are held abroad. (Stock/ADRs in non-U.S. corporations are non-U.S. situs assets, even if purchased and/or held in the U.S.)
    - *Bonds* – The U.S. passed a law in 1989 that created a “portfolio exemption” for publicly traded bonds, including treasuries, so they will not be considered U.S. situs. Privately offered debt instruments issued by U.S. organizations may still be considered U.S. situs.
  - *Life Insurance* – if issued by a U.S. licensed insurance company, the cash value of a life insurance policy is considered a U.S. situs asset, while the death benefit is a non-U.S. situs asset.
  - *Annuities* – if issued by a U.S. licensed insurance company will be considered U.S. situs assets (Policies issued by foreign-licensed insurance companies abroad will not be U.S. situs assets).

The U.S. situs rules are particularly instructive for expat families that include non-U.S. persons (e.g., an American abroad married to a foreign spouse), or to non-U.S. persons with investments in the United States. Moreover, while each sovereign has their own rules and interpretations of situs rules, the U.S. regime can be somewhat instructive for other countries’ situs rules. While a country-by-country discussion of the situs rules is beyond the scope of this article, many jurisdictions employ situs rules similar to the U.S.

**The Interplay of Tax Treaties and Foreign Tax Credits on Cross-border Estates**

Currently, the United States has estate and/or gift tax treaties with sixteen sovereign nations (see Appendix A). These treaties serve several important roles in determining the transfer tax consequences of assets held within the cross-border estate, and may provide a meaningful reduction in the estate taxes by mitigating double taxation and discriminatory tax treatment while allowing for reciprocal administration. The treaty will control which treaty country can assess transfer taxes by either:
• Determining which country is the decedent/donor’s domicile for transfer tax purposes;
• Determining in which country the property is deemed to be located.

Certain estate tax treaties relieve some of the burden that occurs when a surviving spouse is a non-resident upon the death of the U.S. spouse by increasing the marital deduction for non-resident spouses. Moreover, where both countries have a claim and assess taxes, a tax credit regime may operate to eliminate or at least reduce double taxation.

These treaties among the pertinent jurisdictions will alter the path of estate planning. The estate planning team must evaluate the interplay of the relevant transfer tax regimes and the pertinent treaty to determine the transfer tax outcome in consideration of not only the nature of the property and its location, but also the impact of citizenship and domicile on net tax outcomes. It is extremely important to remember that the filer must specify any specific benefit under the treaty that is being claimed in the actual tax filings; otherwise, the presumed benefit is lost.

**Estate tax treaty “tiebreakers” and the new/old situs rules:** Another key effect of tax treaties is that they establish tie-breaker rules. How those tiebreaker rules operate will depend on whether the treaty follows the newer or the older situs rules in U.S. estate tax treaties.

Generally, more recently ratified U.S. estate tax treaties follow the “new” rules based upon a domicile-based approach. These include the treaties between the United States and Austria, Denmark, France, Germany, the Netherlands, and the United Kingdom. The treaty rules establish taxation priority by first determining which jurisdiction was the domicile of the decedent. The domiciliary country may tax all transfers of property within the entire estate, while the non-domiciliary country may only tax real property and business property with situs in that country. The domiciliary country will then provide foreign transfer tax credits for taxes paid to the non-domiciliary country.

The older treaties (including Australia, Finland, Greece, Ireland, Italy, Japan, Norway, South Africa and Switzerland) follow the more elaborate nature/character situs rules described above for non-resident alien property in the United States. Conversely, the situs rules of the foreign jurisdiction will apply to that portion of the U.S. person’s estate that is deemed to have situs in that foreign jurisdiction. These treaties are far from uniform, and some treaties eliminate double taxation better than others. Generally, these older treaties provide for primary and secondary credits to be applied to reduce double taxation: the non-situs country (where the property is not located) will grant a credit against the amount of tax imposed by the country where the property is located. Additionally, the countries may provide secondary credits where both countries impose tax because their individual situs laws determine that the property has situs in both (or even in neither) country.
Foreign tax credits in the absence of an estate tax treaty: In the absence of a treaty (the majority of jurisdictions), the potential for double taxation increases, but foreign transfer tax credits may still provide some relief from double taxation. The availability of a U.S. foreign tax credit will hinge upon:

- Whether the property is situated in the foreign country;
- Whether the property is subjected to transfer/death taxes; and
- Whether the property is properly included in the gross estate.

There is also the potential that a foreign transfer tax credit could be unavailable because of a Presidential proclamation based on the foreign country’s failure to provide a reciprocal tax credit to U.S. citizens. (For more information, please see the relevant portions of the U.S. Tax Code including 26 U.S. Code § 2014 “Credit for foreign death taxes”).

Estate Tax Planning Strategies: Cross-Border Pitfalls and Considerations

Traditional Estate Planning Tools

The solutions or tools of estate planning and wealth management that could be utilized in any given situation may include (but by no means are limited to):

- Wills (either a U.S. Will, or a U.S. Will accompanied by a “situs Will” where the expat has accumulated property);
- Trusts (living or testamentary, grantor or non-grantor, revocable or irrevocable, QDOT);
- Life Insurance (whole, universal, second-to-die, using irrevocable life insurance trust (ILIT) for business planning, retirement, estate preservation);
- Gifting Strategies (charitable, inter-spousal and trans-generational gifting);
- College Savings Plans (a 529 gifting strategy can be an extremely effective estate tax planning tool, particularly for grandparents and great-grandparents);
- Personal Investment Companies (PICs); and
- Cross-portfolio investment optimization (the right investment in the right type of account and in the right owner’s account).

Most of these tools are very familiar and frequently utilized by domestic financial planners and estate planning attorneys to assist single and multi-state U.S. families. The utilization of offshore PICs is generally no longer utilized for U.S. clients, because Passive Foreign Investment Company (PFIC) rules and the Foreign Account Tax Compliance Act (FATCA) create income tax problems that vastly outweigh any estate planning benefits. (for more information see Thun Research’s article on PFICs).
However, PFICs may be instrumental in the financial plan of a non-U.S. person investing within, or outside of, the United States.

**Examples of Estate Planning Tools that May Not Travel Well**

Perhaps one of the more dangerous routes that an expat family could take would be to rely upon the estate planning that was done before leaving the United States. It is generally advisable to review an existing estate plan (and the broader financial plan) when major events (divorce, remarriage, etc.) have resulted in changed circumstances, but the importance increases with a relocation overseas, or a move from one foreign country to another. **U.S. expats need to be aware that standard U.S. estate planning techniques will likely fail to protect wealth in cross-border situations and may even produce unintended, counter-productive results.**

These are issues that extend beyond the scope of this guide, but certain issues can be discussed to illustrate the nuances involved in cross-border estate planning. As the fact patterns (citizenship, domicile residency, marital history, assets, etc.) of the global family change, so will the tax implications and the available solutions.

**Utilizing wills in international estate planning:**

Naturally, the will is one of the more common and widely utilized estate planning tools in the United States. A traditional will provides written directions on how the individual (the “testator” of the will) wishes to distribute her assets upon her death. While different states have specific legal requirements for executing a will with legal effect, generally the requirements are straightforward:

- That the testator be legally competent and not under undue influence;
- That the will describe the property to be distributed; and
- That the will be witnessed by the requisite number of witnesses.

In addition to testamentary wills, living wills (powers of attorney) are also utilized to direct who can make decisions for the individual in the event of physical or mental incapacity. The complexity and sophistication of traditional and living wills varies greatly, and any individuals with estates that may approach the levels that trigger any transfer taxes (which may be substantially lower in many foreign countries), or anyone who wants to make sure that their wishes are given legal effect, would be well advised to seek legal counsel regarding the drafting and execution of their will.

Within the cross-border context, individuals would be wise to seek legal counsel with a specialized focus on estate planning in the relevant jurisdictions. Some experts on the subject of international estate planning suggest multiple “situs” wills, with each will governing the distribution of property in the country for which the will is executed. There seems to be some risk in a strategy of multiple wills, as the traditional rule holds that the legal execution of a will extinguishes the validity of any prior will. Other experts suggest one “geographic will,” which would incorporate the laws of the relevant jurisdictions involved in the distribution of the testator’s assets. The propriety or effectiveness
of the geographic will is likely to depend on the particular laws of the relevant jurisdictions and the particular expertise of the legal advice that went into the design and execution of the will.

**Caution when moving overseas with trust structures:** If your estate plan includes trusts, it is particularly dangerous to move overseas with your old domestic estate plan in tow as it may not travel well at all. For example, consider a U.S. citizen who established a revocable grantor trust in favor of his children and grandchildren, but who thereafter moves to live and work overseas. There may be extremely negative consequences (e.g., the trust may be separately taxed upon the grantor obtaining residency in the new country), and those consequences will vary depending on where the expat relocates and how long the expat and his or her family remain in their new country of residence.

In civil law/forced heirship regimes, a fundamental problem exists when examining distributions to heirs through such a trust: the beneficiary is receiving the property from the trust, rather than a lineal relative (parent, grandparent, etc.). Accordingly, if the expat grantor moves to Germany with her family, the children-beneficiaries will be German residents and the intended consequences of the grantor trust will conflict with German gift and inheritance tax laws. This exposes distributions from the trust to potentially higher German transfer taxes. The magnitude of unintended tax consequences might intensify over time. If the grantor and his beneficiaries remain in Germany over ten years, the tax relief offered by the U.S.-Germany Estate and Gift Tax Treaty phases out and distributions from the trust could be exposed to the highest German transfer tax rate of fifty percent. Similar results may occur in France, which has a relatively new tax regime applicable to any trust with French situs assets or a French domiciled settlor or beneficiary. There have been recent reforms in several civil law jurisdictions designed to better accommodate immigrants’ trusts, but uncertainties and complications remain.

The dangers are not limited to the expat who relocates to a civil law jurisdiction. If a U.S. citizen arrives in the U.K. (a common law jurisdiction) with an existing U.S. trust, the government may not recognize this trust structure, or, worse, consider the trust a UK resident and subject the trust assets to immediate income taxation on the unrealized gains within the trust. Moreover, if the trust provides for a successor U.S. trustee, then a settlement (triggering UK capital gains taxes) could also be declared on the death of the UK resident trustee (the grantor). Additionally, in Canada, which shares the British common law heritage, a special capital gains tax will be periodically assessed on trusts holding Canadian real property.
**Gifting strategies (e.g. 529s) to reduce your taxable estate:** Lifetime gifting strategies are a common method for reducing a taxable estate in the United States. Section 529 college savings plans (see Thun Financial's research article on 529 Plans for ex-pats) have grown substantially in popularity over recent years, as parents begin to realize the tremendous long-term advantages to saving larger amounts for college in earlier years for their children, and 529 accounts allow substantial deposits (as much as $150,000 in a one-time gift from joint filers covering a five-year period) and provide Roth IRA-style tax-free growth of the investment account, provided that the 529 plan assets are withdrawn for qualified educational expenses. Moreover, grandparents and great-grandparents can employ a 529-plan gifting strategy to shrink the taxable estate and to pass on wealth to grandchildren and great grandchildren (otherwise “skip classes” that would trigger generation skipping transfer (GST) taxes in addition to estate or gift taxes). In short, Section 529 college savings accounts provide tremendous income and transfer tax-advantaged gifting opportunities to accomplish multigenerational wealth transfer. They also provide the donor with control over the use of the gifted proceeds and flexibility regarding the designation of account beneficiaries.

However, while U.S. expats are free to open and fund 529 college savings accounts, they must be aware of the local country rules in their country of residence regarding the gains that will eventually accumulate within these accounts. From an income tax perspective, it is worth mentioning here that there are no treaties between the United States and any foreign jurisdiction that recognizes the tax-free growth of investments in 529 accounts (or Coverdell ESAs – another type of U.S. savings vehicle for education expenses allowing much smaller annual contributions). Therefore, it is quite possible that the expat individual will find that gifting through a 529 plan could create detrimental tax consequences, as the donor may potentially incur tax liability on any investment gains in the portfolio going forward (recognized or unrecognized gains, depending on the local tax rules). Alternative college savings or generational gifting strategies (including having U.S. based relatives open the 529 account) may work better for expats.
Estate Planning For Families That Include a Non-U.S.-Citizen Spouse

Americans living abroad may accumulate more than income and assets while living and working abroad, they may also find love! Unfortunately, the tax complications and challenges facing American expats also extend to the circumstance of marrying a foreigner. Even if an expat’s spouse obtains U.S. permanent resident (“green card”) status, gifts and bequests to the non-citizen spouse are not eligible for the unlimited marital deduction. On the other hand, the $11.4 million (2019) lifetime exclusion applies to bequests left to anyone, including a non-citizen spouse. For estates larger than the lifetime exclusion limit, alternative estate planning strategies may be required, two of which are discussed below.

**Lifetime gifting to the non-citizen spouse:** First, although a citizen can give unlimited assets to a fellow citizen spouse during her lifetime, there is a special limit allowed for tax-free gifts to non-citizen spouses of $155,000 annually (2019). Accordingly, a gifting strategy can be implemented to shift non-U.S. situs assets from the citizen spouse to the non-citizen spouse over time, thereby shrinking the taxable estate of the citizen spouse. The nature, timing, and documentation of the gifts should be done with the assistance of a knowledgeable tax and/or legal professional.

**Qualified domestic trust (QDOT) – an important tool for marriages between a U.S. citizen and a non-citizen spouse:** A QDOT is a type of trust designed to afford the surviving spouse the ability to claim use of and income from the decedent spouse’s estate during the lifetime of the surviving spouse, but then the QDOT assets will pass to the original decedent’s heirs upon the death of the surviving spouse. With a QDOT, only distributions from principal during the surviving spouse’s life and at the surviving spouse’s death are subject to estate tax (insofar as they exceed the original decedent spouse’s exclusion). Accordingly, the QDOT can be a critical wealth planning tool for deferring the estate tax until distribution to eventual U.S. citizen heirs when the surviving spouse is a non-U.S. citizen.

The QDOT can be created by the will of the decedent or the QDOT can be elected within 27 months after the decedent’s death by either the surviving spouse or the executor of the decedent’s estate. If the QDOT is created after decedent’s death, the surviving spouse is treated as the grantor for income and transfer tax purposes. Certain transfer tax treaties provide spousal relief that may lessen the need for a QDOT, and, if the treaty benefit is claimed, the QDOT may no longer be utilized.

It should also be noted that, while the QDOT trust can certainly be a useful tool for arranging for the eventual transition of the U.S. estate to U.S. citizen heirs while providing maintenance for the surviving non-citizen spouse, the tax and maintenance consequences may pose considerable negatives that outweigh the benefits of setting up the trust arrangement. The cross-border family may have alternative solutions for providing for the heirs and for the maintenance of the non-citizen spouse.
that are more practical or even more tax efficient (such as a lifetime gifting strategy, discussed above). The personal and financial merits of the QDOT and alternative planning tools must be analyzed on a case-by-case basis.

**Gifts/Inheritances from Foreigners**

In contrast with many succession/heirship-based transfer tax systems abroad, gifts and inheritances in the United States are not taxed to the beneficiary of the gift or bequest, because we have a transfer tax system that taxes these transfers at the source of transfer (i.e., the donor, grantor, or the estate). For transfers on death, in addition to receiving the distribution tax free, the beneficiary of a bequest will receive what is known as a “step-up in basis” to the fair market value of the asset on the date of death (or the alternative valuation date, 6 months after the date of death). For gifts, the recipient takes the donor’s original cost basis.

For the American taxpayer (citizen or resident) inheriting or receiving a gift from a foreign person, the general rule still applies: no income or transfer tax will be due at the time of receiving the gift or inheritance, and the beneficiary receives the donor’s basis in a gift or receives a full step-up in basis in a bequest. However, the American taxpayer needs to be mindful that special disclosure rules apply to gifts or bequests received from foreign persons (or entities). If the American taxpayer receives annual aggregate (can be from multiple donors/grantors/testators) gifts above $16,388 (2019) from a foreign corporation or partnership, or aggregate gifts or bequests from a non-resident alien or foreign estate exceeding $100,000, the taxpayer must report the amounts and sources of these foreign gifts and bequests on IRS Form 3520, which must be filed at the time that the income tax is due, including extensions. Not unlike the FBAR, this disclosure requirement is designed to help the
IRS flag substantial income that may have been mischaracterized by the taxpayer so that the IRS may further investigate and verify the nature and character of the transactions.

**Non-U.S. Persons Investing in the United States**

*Even modest foreign investments in the U.S. may raise transfer tax issues:* When non-U.S. persons own U.S. situs assets, including real estate, U.S. corporation stocks, and tangible personal property (e.g., collectibles) that remain in the United States, they are generating a U.S. estate – one with a considerably miniscule exemption of only $60,000. If the investor resides in 1 of the 16 estate tax treaty countries, there may be significant relief, however.

Accordingly, and perhaps ironically, non-Americans are more likely to trigger federal transfer tax liability than a similarly situated U.S. citizen. While the foreign investor in the U.S. may become very aware of the federal (and possibly state) income tax regime, she might be well served by learning the particulars of the federal (and possibly state) estate tax regimes that could impact the distribution of those investments to her heirs. More sophisticated estate planning tools become necessary at more modest estate levels whenever the assets of a non-U.S. person are concerned.

*Non-resident foreign (NRA) investors in U.S. real estate:* The United States can provide a very attractive market for investing in securities. For example, the situs rules discussed earlier illustrate that investments in U.S. publicly traded fixed-income (bonds) will not subject the foreign investor to estate taxes (nor income taxes). However, the United States has not extended the investor-friendly income and estate tax rules to foreign investment in U.S. real estate. As mentioned previously, foreign direct ownership of U.S. real estate will subject the non-resident’s estate to U.S. estate tax. Frequently, it will make sense to own U.S. Real Estate through an offshore corporate or trust structure (for a foreign, non-resident investor only, as U.S. persons should certainly avoid offshore corporate or trust structures) to avoid U.S. estate tax, and possibly reduce U.S. income tax as well.

From an income tax perspective, direct ownership of investment real estate will subject the foreign, non-resident investor to preparing the annual federal income tax (U.S. 1040-NR) and state income tax return. More concerning, it will also subject the foreign, non-resident to a more complicated tax regime – the Foreign Investment in Real Property Tax Act (FIRPTA) – which creates a myriad of tax headaches that are well beyond the scope of this article. This example merely highlights that certain classes of investments may be subject to more draconian reporting and taxation rules than other investments. Ultimately, competent financial planning and investment management must recognize and design an investment plan that takes full consideration of the cross-border tax issues.
CROSS-PORTRFOLIO INVESTMENT OPTIMIZATION

While non-U.S. investors and non-citizen spouses present obstacles for certain common traditional estate planning tools (e.g., joint ownership), knowledge of U.S. situs rules can be utilized to construct family portfolios that are particularly U.S. income tax and U.S. estate tax efficient. Despite its importance, cross-portfolio investment optimization is something that is seldom discussed in a meaningful way, much less implemented effectively.

In addition to optimizing after-tax returns, a holistic approach involving all of the various accounts available to cross-border investors (brokerage, IRA, etc.) can also help with transfer taxes. For example, to return to the aforementioned global family from earlier (U.S. husband, French wife, and child living in Germany, with two U.S. children from husband’s prior marriage living in the U.S.), the tax-conscious financial plan can go beyond the routine suggestion of a QDOT, and actually design investment portfolios that will minimize potential income and transfer taxes in a comprehensive wealth management strategy. The U.S. husband’s portfolios might be over-weighted in certain asset classes including U.S. stocks or ETFs, while his wife’s portfolio might be overweight bonds, international equities, or non-U.S. ETFs).

This approach can allow for superior after-tax returns to help achieve important lifetime goals and greater wealth transfer to heirs. Solutions can even be modified with sophisticated ownership structuring (e.g., the wife might own securities through a trust or offshore company), all designed with the assistance of legal and tax advice from competent consultants in the relevant jurisdictions. Indirect ownership can be a particularly effective means for non-U.S. persons to own U.S. real property, too.
**CONCLUSION**

Cross-border families and multinational asset portfolios add substantial complexity to the financial planning needs of global families. Citizenship/domicile/residency, location and character of investments (situs of assets), applicable tax treaties and/or the availability of foreign tax credits, and the existing or proposed estate plan are some of the critical variables that must be factored into a financial plan and in the design of a comprehensive portfolio that is optimized for income as well as transfer tax efficiency. The savvy expat or multinational investor also needs to understand that the standard U.S. estate plan may no longer protects wealth as intended. A new team of expert trusted advisors is going to be required. This new team of expert trusted advisors should possess a combination of cross-border legal, tax, and financial planning expertise in order to tailor a financial plan, an estate plan, and an investment strategy that is harmonious with the multijurisdictional taxation regimes to which the expat or multinational investor’s wealth is now subject.

**Thun Financial Advisors Research** is the leading provider of financial planning research for cross-border and American expatriate investors. Based in Madison, Wisconsin, David Kuenzi and Thun Financial Advisors’ Research have been featured in the *Wall Street Journal, Emerging Money, Investment News, International Advisor, Financial Planning Magazine* and *Wealth Management* among other publications.

Please visit our [website](http://www.thunfinancial.com) for the most up-to-date articles and press or email us with any additional questions.
Appendix A: List of U.S. Bilateral Tax Treaties

- Armenia
- Australia*
- Austria*
- Azerbaijan
- Bangladesh
- Barbados
- Belarus
- Belgium
- Bulgaria
- Canada*
- China
- Cyprus
- Czech Republic
- Denmark*
- Egypt
- Estonia
- Finland*
- France*
- Georgia
- Germany*
- Greece*
- Hungary
- Iceland
- India
- Indonesia
- Ireland*
- Israel
- Italy*
- Jamaica
- Japan*
- Kazakhstan
- Korea
- Kyrgyzstan
- Latvia
- Lithuania
- Luxembourg
- Mexico
- Moldova
- Morocco
- Netherlands*
- New Zealand
- Norway*
- Pakistan
- Philippines
- Poland
- Portugal
- Romania
- Russia
- Slovak Republic
- Slovenia
- South Africa*
- Spain
- Sri Lanka
- Sweden
- Switzerland*
- Tajikistan
- Thailand
- Trinidad
- Tunisia
- Turkey
- Turkmenistan
- Ukraine
- Union of Soviet Socialist Republics (USSR)
- United Kingdom*
- Uzbekistan
- Venezuela

*Indicates a bilateral estate and/or gift tax treaty or protocol

As of the 2018 edition of this report, this was the most current information available on the irs.gov website. Visit the IRS’s website for the most current and up-to-date official information available.
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