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Mapping your future: Global estate planning*

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If you live and work outside your country of citizenship, the rules regarding estate and gift taxes can be confusing—but a little knowledge can go a long way toward effective wealth transfer.

In today's mobile and global economy, as people and assets rapidly circle the world, issues like estate and gift tax planning may not always be a high priority. But for those US citizens living and/or working abroad and for foreign citizens living and/or working in the US, understanding the laws and regulations that govern this area is instrumental to sound financial planning.

Several elements—including gifting policies, the amount of property involved, resident or domicile status, the availability of deductions, and exclusions and credits—play important roles in estate and gift tax planning. And while each individual's strategy depends on a number of personal circumstances and objectives, keeping a few guidelines in mind can make a big impact in the efficacy of your wealth transfer plan. It's important to understand US federal rules in this area; proper planning should also include a review of the rules in the state of residence, as those rules may also influence planning.

Citizen, domicile or resident?

"At the heart of international estate and gift tax planning is the distinction between people who are either US citizens or domiciliaries and people who are either resident or nonresident aliens of the US," according to Andrew Martone, a director in PricewaterhouseCoopers' Personal Financial Services practice. While this distinction is relatively straightforward for determining income tax liability, "it's a much more subjective process when it comes to estate and gift taxes," said Martone.

"Resident and nonresident aliens fall under substantially different US estate and gift tax rules than do US citizens and domiciliaries. The key differences lie in the amount of property that is subject to tax and in the allowable deductions, exclusions and credits," said Martone.

While US citizens and domiciliaries are subject to US estate and gift taxes regardless of where in the world they or their property is located, non-US citizens living in the

US (on long-term work assignments, for example) should be aware of the factors that determine how the US views their domicile status. The first step is to understand how the definitions are applied: Individuals are generally considered US "domiciles" if they live in the US and have no definite intention of leaving. Individuals are considered "residents" for this purpose if they live in the US but are not considered US domiciles.

The resident or domicile distinction is a frequent point of confusion for non-US citizens living in the US. Determining domicile is a subjective process that considers several factors seen as demon-strating intent, such as the country in which the person's family resides; if on work assignment, the length of the assignment and whether a definitive end date has been set; green card status; the country in which the person owns substantial property; and the country where the individual maintains social, business, and professional contacts.

What is subject to US estate tax

US citizens and US domiciles are subject to US estate tax on their worldwide assets regardless of where they reside at the time of death. (While the exemption amount varies slightly from year to year, US citizens and domiciles who die in 2009 are entitled to an estate tax exemption that shields the first $3.5 million of property from estate tax.)

Individuals who are resident aliens (neither US citizens nor US domiciles) are typically subject to US estate tax only on property located in the US. The common types of property deemed to be located in the US include real estate, shares of stock in US corporations, bonds and notes issued by US people or US entities, pension amounts under a US employer, and tangible personal property. The exemption amount varies slightly from year to year in this instance as well; non-US citizens and domiciles who die in 2009 are entitled to an estate tax exemption that shields the first $60,000 of property from estate tax.

What is subject to US gift tax

The same general rule applies for US gift tax purposes: US citizens and domiciles are subject to US gift tax on their worldwide assets, and non-US citizens and nondomiciles are subject to US gift tax only on their US property. There is, however, an important exception that applies to intangible property (such as stocks and bonds) owned by non-US citizens and domiciles. Under this exception, non-US citizens and domiciles are not subject to US gift tax on gifts of intangible property. In other words, non-US citizens and domiciles can give away shares of US stock without being subject to US gift tax, even though they would be subject to US estate tax on such shares if they held them until they died.

All individuals are generally entitled to give $13,000 (as of 2009) per year to as many different people as they want without incurring a US gift tax. For gifts in excess of this amount, US citizens and domiciles are exempt from US gift tax on cumulative lifetime gifts of $1 million. No such exemption is available to non-US citizens and domiciles.

Marital deductions and joint property

A spouse's citizenship can drastically impact US estate and gift tax planning. For example, if a US citizen's spouse is not a US citizen, the citizen may be limited in the amount of property he or she can transfer to the spouse without an estate or gift tax liability, unless the citizen leaves that property in a special type of trust.

There is a US estate tax marital deduction that allows all individuals to leave unlimited amounts of property—estate tax free—to a surviving spouse. However, this estate tax marital deduction is available only if the surviving spouse is a US citizen. "What this means for estate and gift tax marital transfer planning," says Martone, "is that the citizenship of the surviving spouse is more of a factor than is the citizenship of the deceased spouse." If the surviving spouse is not a US citizen, the estate tax marital deduction is not available unless the property is left to the surviving spouse in a special type of trust known as a qualified domestic trust (QDOT).

The rule is generally the same for US gift tax purposes: one can give unlimited amounts to one's spouse as long as the spouse receiving the gift is a US citizen. Gifts to a non-US citizen spouse do not qualify for the unlimited US gift tax marital deduction. The QDOT, which allows transfers made at death to a non-US citizen spouse to qualify for the US estate tax marital deduction, is not available for gifts made to a non-US citizen spouse. However, in order to partially compensate for this denial of

the gift tax marital deduction, gifts of $133,000 (as of 2009) per year may be made to a non-US citizen spouse without incurring US gift tax.

Recent changes to US expatriation rules

New rules have recently been enacted that can affect the US estate and gift tax treatment of certain individuals who give up their US citizen or long-term US residency status (covered expatriates). Under the new rules, a US inheritance tax is imposed on gifts or bequests received by a US citizen. This inheritance tax generally applies to any property acquired (directly or indirectly) by a US citizen from an individual who was a covered expatriate on either the date of the gift or the date of death. The gift or bequest is subject to US inheritance tax at the highest US gift or estate tax rate.

This is an important consideration for former US citizens and long-term US residents. Under the rules discussed earlier, such individuals could transfer non-US property without being subject to US gift or estate tax. Under the new rules, transfers from covered expatriates to US people may be subject to US inheritance tax.

Considerations under the Obama Administration

Due to rules enacted several years ago, the US estate and gift tax system is currently in a state of flux. As mentioned previously, US citizens and domiciles dying in 2009 are currently entitled to an estate tax exemption of $3.5 million. The highest estate tax rate applicable to individuals dying in 2009 is 45%. US citizens and domiciles are also currently entitled to a gift tax exemption of $1 million, and the highest gift tax rate is also 45%.

Under current US law, the US estate tax is scheduled to be repealed for one year for persons dying in 2010, and scheduled to be reinstated in 2011. The US gift tax is not scheduled to be repealed, and the highest gift tax rate is scheduled to be 35% in 2010. For 2011 and thereafter, the estate tax exemption is scheduled to be $1 million; the gift tax exemption is scheduled to remain at $1 million; and the highest tax rate for both estate and gift tax purposes is scheduled to be 55%.

Although it is not currently possible to know how the uncertainty caused by this scheduled one-year repeal of the estate tax will be resolved, the general consensus is that some action will be taken before the temporary estate tax repeal takes effect.

The administration and both houses of Congress currently have proposals that focus on the available exemption and the highest tax rate. The proposal that currently appears to have the most support would freeze the exemptions and tax rates at 2009 amounts. “In other words, the estate tax would not be repealed for 2010. It would still apply in 2010 and years going forward, with an estate tax exemption of $3.5 million and a highest estate and gift tax rate of 45%,” said Martone.

Other proposals being discussed are increasing the gift tax exemption to $3.5 million (so that it would be equal to the estate tax exemption) and allowing for portability of the estate tax exemption between spouses (i.e., allowing a surviving spouse to use the unutilized estate tax exemption of the deceased spouse).

While these guidelines can direct both US citizens living abroad and non-US citizens living in the US toward estate and gift tax planning, each individual’s circumstances can impact how US rules and regulations are applied. Questions or concerns about estate and gift tax planning subject to US tax law should be discussed with a professional adviser. For US citizens with property abroad, another planning step is to consult with an adviser in the country where the property is located in order to address potential issues that may arise in establishing estate and gift tax plans.

Definitions for the purposes of US estate and gift tax planning

US domicile: generally, a person who lives in the US and has no current intention of leaving

US resident alien: A person who lives in the US but is not a US domicile

Nonresident alien: A person who is not a US domicile and does not live in the US

Steps you can take in estate and gift tax planning

In addition to the larger issues outlined here, the following are key concepts you may want to consider in your estate and gift tax planning.

Treaties

- Be aware that certain treaties with other countries affect deduction amounts and domicile rules. Research any treaty existing between the US and your home country, as each treaty has different rules (depending on your citizenship, residence location, and other factors), some of which may protect you from exposure to double estate and gift taxes.
- In the absence of a treaty, you may also have the option of applying foreign tax credits to lessen your double taxation exposure.

Wills and asset titling

- Having a US will helps ensure your property will be distributed according to your wishes and with minimal administrative cost and burden.
- Have a durable power of attorney and health-care proxy, and make sure these representatives are aware of your wishes in the event of your incapacity.
- Pay attention to how your property is titled. This can help in achieving the desired deemed asset location and enable you to fully utilize any available exemptions and deductions.

Residency status

- Since the determination of domicile status is subjective, make sure your estate plan covers both scenarios of being a US domicile and being a non-US domicile.
- Structure your living situation, activities, and other factors to influence your desired domicile status.
- Leave property to your spouse in a form designed to qualify for the US estate tax marital deduction.
- Take maximum advantage of the available US estate and gift tax exemptions and deductions as applicable to your citizenship or domicile status.
- Make transfers prior to becoming a US domicile in order to take advantage of the exclusion of intangible property gifts from US gift tax.
- To the extent possible, structure your activities to avoid being subject to US expatriation rules when leaving the US.

Want to know more about estate and gift tax planning for US citizens abroad and non-US citizens in the US? Please contact:

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