ABA Section of International Law
Your Gateway to International Practice

NEWSLETTER

INTERNATIONAL PRIVATE CLIENT COMMITTEE (IPCC)

MAY 2016

NOTE FROM THE CO-CHAIR

Agnès Proton, IPCC Co-Chair
Cabinet Proton, Cannes, France

Cabinet d'Avocats
aproton@ap-avocats.fr
+ 33 (0) 4 93 99 27 72
www.ap-avocats.fr

The ABA-SIL International Private Client Committee (IPCC) focuses on Asset Protection, Business Succession Planning, Charitable Organizations, Closely Held Business Counseling, Estate Planning, Fiduciary Services and Tax Minimization in an international context. The IPCC Program organized during the NYC ABA-SIL Spring Meeting on April 14th 2016 could not fit better within this overall scope of work: "*Trusts in Family Wealth and the 3D Problem – Is It Child's Play*"?

Supervised by Markus Zwicky (Chair) and Henrietta Mason (Moderator), it turned out to be – as expected – a very lively and most successful session. Around that topic, all panelists *ie* Caroline Abela, Jean-Louis Collart, Michael Parets and Ziva Robertson have contributed to this Newsletter, along with John R. Strohmeyer. May they all be warmly thanked here, with a special acknowledgement to Annie Jacobs who initiated this publication.

TRUSTS IN FAMILY WEALTH AND THE 3D PROBLEM – IS IT CHILD'S PLAY?

Introduction by the moderator, Henrietta Mason,
Penningtons Manches LLP, England

Penningtons Manches LLP
henrietta.mason@penningtons.co.uk
+ 44 (0) 1256 407298
www.penningtons.co.uk/

The Panama Papers scandal, which broke just a couple of weeks before our panel session in New York, makes it clear that, in times of financial insecurity, who pays what tax matters. The financial crash of 2008 has been followed by a blurring of the line between tax evasion (illegal) and tax minimisation (legal but increasingly morally unacceptable).

And because trusts, particularly in offshore centres, have often formed part of complex tax planning mechanisms, there is a sense that, to the public eye, they have similarly become somewhat tainted over the last few years.

Yet, to use the words of Frenchman Pierre LePaulle, "the trust is the guardian angel of the Anglo-saxon, who accompanies him everywhere, from the cradle to the grave".

Trusts are everywhere in common law jurisdictions. If you co-own property, you are the beneficiary of a trust. If you die intestate, a trust arises for your next of kin. If you misappropriate assets, you hold them on trust for the real owner. Trusts are engrained in the fabric of our society.

Service Hotline
800-285-2221
312-988-5000
Monday-Friday
9:00 AM - 6:00 PM ET

Chicago Headquarters
321 North Clark Street
Chicago, IL 60654
312-988-5000

Washington DC Office
1050 Connecticut Ave. N.W.
Suite 400
Washington, D.C. 20036
202-662-1000

So, as a Brit, and as a trusts litigator, it strikes me that the vulnerability of trusts to attack is highly topical in this political climate.

The session we ran was based on a case scenario involving an international high net worth matriarch who is discovering that 2016 is her annus horribilis! In addressing her difficulties we took a microscope to the three key points of vulnerability in the life of a trust – disputes, divorce, death - and considered whether trusts can be protected from attack on these grounds.

Despite Mr Trump's attempts to evict us from the premises, we had an interesting debate and are very grateful to the attendees for their lively participation.

RESIDENCY AND CONSTITUTION: ATTACKS ON TRUSTS BY THE CANADA REVENUE AGENCY[1]

Caroline Abela, Partner

WeirFoulds LLP
cabela@weirfoulds.com
416-947-5068
www.weirfoulds.com

Two common methods the Canada Revenue Agency ("CRA") can use to tax income that is ostensibly earned by a non-resident trust are to assert that: (1) the trust is resident in Canada (despite the jurisdiction of its formation and the residence of its trustees), and/or (2) the trust was not properly constituted and did not come into existence. Depending on the circumstances, other rules, not discussed herein, can deem a non-resident trust to be a resident of Canada for certain purposes.

1. Residency

International

In *Garron Family Trust (Trustee of) v. R.*,[2] a trustee disposed of shares of Ontario corporations held by two trusts and the purchaser remitted a sum of $152 million to the CRA as withholding tax. The trustee argued that the trusts were resident in Barbados, and thus not subject to Canadian withholding tax. The CRA took the position that the trusts were resident in Canada. The Supreme Court of Canada held that the principles used in determining the residency of corporations should be applied to trusts. This decision states that, for Canadian tax purposes, a trust will be resident in the jurisdiction in which the substantive decision-making regarding the trust takes place – the "central management and control" test. Prior to this decision, it was generally accepted that a trust was resident in the jurisdiction where the majority of the trustees were resident.

In *Garron Family Trust*, the Supreme Court held that the management and control of the trusts was exercised by the trust's main beneficiaries in Canada, and that the Barbados-resident trustee only provided administrative services. Accordingly, the trust was held to be resident in Canada and thus required to pay taxes in Canada.

Provincial/Territorial

Due to varying provincial income tax rates, the provincial residency of a trust can also have a large impact on a trust's tax liabilities. Generally, trusts are taxed at the top federal rate (currently 33%), but top provincial and territorial rates vary from 11.5% in Nunavut to 25.75% in New Brunswick.[3] However, until 2015, Alberta imposed a flat income tax rate of 10%, resulting in the province being a tax-beneficial and popular jurisdiction to establish a trust's residency.

Canada's first decision involving the provincial residency of a trust was *Discovery Trust v. Minister of National Revenue*,[4] a 2015 case out of the Newfoundland Supreme Court.[5] In Discovery Trust, the trustee argued that it was resident in Alberta during the 2008 tax year and filed its tax return accordingly. The CRA argued that the trust was resident in Newfoundland and subsequently owed $9 million in tax arrears.

In applying the test for trust residency set out in Garron Family Trust, the Newfoundland court held that the trust was resident in Alberta for the 2008 taxation year. In reviewing the actions of the trustee, the Court refuted CRA's assumptions that the beneficiaries directly or indirectly managed or controlled the trust.

2. Constitution

Another method the CRA can use to attack a trust is to illustrate that it was not properly constituted. If the settlor lacks legal title to transfer the property or the legal formalities (certainty of intention, certainty of subject matter and certainty of objects) are not observed, the trust will not be properly constituted and will be deemed to have not come into existence. This can have large tax consequences on the settlor.

[1] Thanks to Ryan L. Morris, Co-Chair of the Tax Group at WeirFoulds LLP, for his input on this article.

[2] 2012 SCC 14.

[3] Provincial/territorial tax rates for 2016.

[4] 2015 NLTD(G) 86.

[5] Another decision, *Boettger c Québec (Agence du revenue)*, 2015 QCCS 7517, also applies the test for trust residency set out in *Garron Family Trust*. However, the application of the test in *Boettger* differs from the test's application in Discovery Trust. In *Boettger*, the Court considered the tax motivated transaction, lack of active business activities, the residency of the legal and tax advisors of the settlor at the time the trust was settled, and the power of the settlor to remove and appoint trustees. The trustee has appealed the decision to the Québec Court of Appeal.

In *Antle v. R.*,[6] the taxpayer used a strategy when selling shares to an arm's length purchaser to shelter the resulting capital gain from tax. This strategy required the taxpayer to settle a Barbados trust in favour of his wife, to convey the shares to the Trust which would then sell the shares to his wife, who in turn would sell the shares to the arm's length purchaser. The Federal Court of Appeal upheld the Tax Court of Canada's decision that the Barbados trust was not properly constituted because it lacked certainty of intention and certainty of subject-matter. As a result, the shares were never transferred to the trust, as required for the taxpayer's strategy.

Certainty of intention requires proof that the settlor intends to create a trust, whereas certainty of subject-matter requires that the trust property is clearly defined and identified. In *Antle*, the court held that the taxpayer simply signed documents on the advice of his professional advisors with the expectation that the result would avoid tax in Canada and never intended to lose control of the shares or the money resulting from the sale. In addition, the trust's paperwork was not properly completed. The Barbados-resident trustee signed the trust deed a month and a half before it was dated, and another trustee did not sign the deed until ten days after its purported settlement. Also, the trustee resolutions relating to other steps in the transaction were not signed until after the steps purportedly occurred.[7] The settlor therefore faced a taxable capital gain in the amount of $1.3 million.

Conclusion

To assist in avoiding unexpected tax consequences, a trust's settlors and trustees should ensure that the trust is legally resident in the jurisdiction it claims to be resident in, and has observed all legal formalities to be properly constituted. Among other considerations, the management activities of the trust should occur in the jurisdiction in which it is resident, the settlor should exhibit the proper intention to settle the trust, and all paperwork should be properly executed.

THE SWISS LEGAL ENVIRONMENT – SOME ISSUES RELATED TO TRUSTS AND 3D THAT HAVE BEEN RAISED DURING THE ABA SIL 2016 SPRING MEETING

Jean-Louis Collart, Partner
Mentha Avocats

MENTHA
jl.collart@mentha.ch
+41 (0) 22 311 22 23
www.mentha.ch

Some History

Historically, trusts were considered by civil law countries and, notably Switzerland, as strange animals. The concept of trust was not known by Swiss law.

Today, the trust remains a foreign legal institution and is not included in Swiss substantive law subject to The Hague Convention on the Law Applicable to Trusts of 1st July 1985. It is therefore not possible to set up a trust under Swiss law. A trust can only be set up under the laws of jurisdictions which know this institution; a foreign trust is however recognized in Switzerland as such, provided it fulfils the minimum requirements of the Convention and the law applicable to the trust is clearly decided upon by said Convention.

In Switzerland, and this is the case in most civil law countries, some frictions remain, mainly under succession matters and divorce litigations.

Succession issues

As to succession issues, the existence of a trust may lead to some questions:

1. As to forced heirship, is it possible not to respect the requirements of Swiss law aiming at protecting forced heirs in setting up a trust?

2. Is it possible to organize a succession by the way of a trust?

3. Is it possible to set up a trust with the purpose of financial support of a family on a perpetual basis despite the prohibition of Swiss law of the so-called "substitution fidéicommissaire" provided for in article 335 paragraph 2 of the Swiss Civil Code?

[6] 2010 CAF 280.

[7] *Antle v R*, 2009 TCC 465 at paras 47, 54, 57.

Marital property law

Under Swiss law, in case of divorce disputes a spouse has a claim in the liquidation of the matrimonial regime.

1. How is this claim calculated?

2. Are there assets that do not have to be shared upon divorce?

3. Could the value of dispositions made without consideration by one spouse without the other's consent during the marital property regime, in particular in favor of a trust, be added to the claim of the spouse whose rights have been infringed?

4. Can the claim be made against the trustees?

To illustrate those issues we presented and discussed the famous decision rendered by the Federal Supreme Court on 26 April 2012 in the *Rybolovlev v. Rybolovleva* case. According to it, an injunction from the Geneva Courts has been considered as legally appropriate where it has, as a provisional measure, ordered the attachment of various assets, worldwide, held by the husband directly or indirectly and notably through foreign trusts. Interestingly, the Geneva Court ordered the attachment not only with regard to assets located in Switzerland but also with regard to assets located abroad and extended the prohibition made to the husband from disposing of the assets to in particular the foreign (Cyprus) trusts and to the trustees.

The decision of the Court was mainly based on the abuse of law rules and the theory of piercing the corporate veil. The attachment was justified by the need of the wife to guarantee her share in the matrimonial property according to article 208 of the Swiss Civil Code, as the majority of the assets of the husband had been transferred into irrevocable Cypriot discretionary trusts shortly before the wife filed a divorce proceeding.

Withersworldwide
micheal.parets@withersworldwide.com
+41 (0) 44 488 88 03
www.withersworldwide.com/

THE US TAX AND LEGAL ISSUES TO BE DISCUSSED AT THE ABA SIL 2016 SPRING MEETING

Michael Parets, Partner
Withers LLP

US Tax System

A person born in the United States is automatically treated as a citizen of the US, and under US federal tax law, a US citizen is treated as a US tax resident regardless of where the US citizen actually resides. This means that all of their income, regardless of its source, is subject to US federal income taxation. US citizens are also subject to the US transfer tax system on their worldwide assets. US transfer taxes include an estate tax and a gift tax and an additional tax—the generation-skipping transfer tax—on certain gratuitous transfers that skip a generation. US citizens are also subject to information reporting on non-US financial assets including financial interests in, or signature authority over, financial accounts, and interests in non-US trusts, corporations and partnerships. Taxation and reporting based on citizenship alone, regardless of where the individual resides, has proven to be a costly trap for many unwary US citizens residing abroad.

US authorities face an uphill battle to enforce claims on unsatisfied federal tax obligations if it does not have jurisdiction over that assets or the parties involved. They may need to rely on tax information exchange agreements and mutual legal assistance treaties.

US Succession Law

In the US, succession law is not governed by federal law, but by applicable state law. All states provide the spouse of a decedent a right to elect against the estate if the amount they receive pursuant to the decedent's will and other transfers is less than the share to which they are entitled under applicable state law. The size of this share varies from state to state. Only in Louisiana are children of a decedent protected against disinheritance.

Asset Protection Planning

Individuals can use various techniques to protect assets against attack by potential future creditors in the US, including irrevocable transfers in trust. The settlor of a trust intended to provide protection against creditors needs to take various considerations into account, including:

- whether the transfer will leave the settlor with enough assets to satisfy existing and foreseeable creditors;
- whether the settlor will be a discretionary beneficiary of the trust;
- whether the settlor will maintain a continued role in the trust, such as protector or trustee;
- the jurisdiction of the governing law for the trust;
- physical location or custody of the trust assets;
- residence and physical location of trustees, protectors and other parties involved; and
- whether to include a "flight clause."

McDermott Will & Emery
zrobertson@mwe.com
+44 20 7577 3460
www.mwe.com

DIVORCE, DISPUTES AND DEATH: THE "3DS" AND THE ENGLISH DIMENSION

Ziva Robertson
Partner, McDermott Will & Emery

It has been said that there are two certainties in this world: death and taxes. With recent legislative developments, as well as public opinion, bringing about ever-tighter fiscal controls and transparency measures, that saying has never been more resonant than it is today. Add to the mix the prevalence of divorce rate and other beneficiary disputes, and you start to appreciate the increasingly difficult environment that the "3Ds" present for trustees.

Some of the issues experienced by trustees of English (and offshore) trusts can be summarised as follows:

1. Fiscal transparency and administrative control

The "Panama Papers" scandal is, on one view, the culmination of a number of measures, adopted globally, to maximise taxation and minimise both tax avoidance and tax evasion. Public pressure has made tax minimisation by large organisations such as Amazon, Google and Facebook, unacceptable. In addition, following on from the FATCA example, by late 2015 approximately 130 countries outside the USA indicated their intention to give legislative effect the OECD's Common Reporting Standards (CRS), by which financial institutions are obliged to carry out due diligence on the beneficial owners and/or deemed controllers of assets under management, and report their assets to the country in which they are liable to tax. The effect of CRS, which imposes more onerous obligations than FATCA, is that Revenue Authorities will be receiving a large amount of information from different sources, which will enable them to cross-reference the information provided by the taxpayer and ensure that tax is fully paid.

CRS and tax compliance are not the only reasons why trustees need to take administrative control of the assets of the trust. Although many trust instruments allow the trustee to leave the management of companies in the hands of their directors without interference, the case of *Appleby Corporate Services BVI Ltd v Citco Trustees BVI Ltd* demonstrates that such clauses will be narrowly construed. Trustees who fail to supervise the directors of underlying companies or investment advisers, and ensure the trust assets are both clean and safe, may be in breach of trust despite the protections afforded by the trust instrument. They may also be subject to criminal sanctions under legislation such as the Proceeds of Crime Act, if they turn a blind eye to tax evasion.

2. Divorce

There is no "community of property" regime in England & Wales. The English matrimonial courts have historically been seen as sympathetic to the plight of the financially weaker spouse, leading such spouses to favour England as a jurisdiction in their divorce. The English courts will accept jurisdiction, *inter alia*, if the petitioner is domiciled in England & Wales and has been habitually resident there for at least 6 months prior to the issuing of the divorce petition. Once it has seized of a matter, the court has extensive powers to make financial orders for the benefit of the parties and children of the family, including the power to vary "nuptial" trusts, whether they are governed by domestic or foreign law, and regardless of the location of the trustees. If a foreign trustee does not submit to the jurisdiction of the court, the judge may make such orders against the parties that take into account the assets in the trust, thereby bringing "judicious encouragement" to bear upon the trustee to give effect to the court's order.

English law does not automatically recognise the validity of prenuptial agreements, but following the Supreme Court decision in *Radmacher v Granatino* in 2010, the court may do so if it satisfied that the parties entered into the agreement following appropriate disclosure, with the benefit of advice, and without pressure being brought to bear upon the financially weaker party.

3. Testamentary freedom

Under English law, a testator has full testamentary freedom and is not obliged to leave any legacy to his (or her) surviving spouse or children. However, a surviving spouse or a dependent child (including an adult child) who does not receive a sufficient share of the estate to meet their needs may apply to the court under the Inheritance (Provisions for Family and Dependants) Act 1975 for an order varying the disposition of the estate. The court will take into consideration factors such as the size of the estate; the needs and resources of the applicant and other interested parties; the obligations assumed by the deceased towards them; the duration of the marriage and so on. The court may also set aside any disposition at an undervalue, including a transfer of assets into a trust, which took place less than 6 years before the date of death, with the intention of defeating an application for financial provision out of the estate.

In face of these challenges, trustees' duty to protect and uphold the integrity of their trust has never been more challenging than it is today. As families become more international and as jurisdictions take greater notice of the decisions of foreign courts, it is likely that the impact of decisions in one country will have greater effect on those of other countries than ever before. The need for global knowledge and cooperation in this legal sphere has never been more acute than it is today.

A BRIEF INTRODUCTION TO PRE-IMMIGRATION TAX PLANNING

John R. Strohmeyer

Crady, Jewett & McCulley, LLP
jstrohmeyer@cjmlaw.com
713-739-7007
www.cjmlaw.com

The digital economy makes it easy for people and money to move across international borders. Most of the time, this movement will not have an impact on a person's tax situation, and a nonresident of the United States would have few, if any, interactions with the Internal Revenue Service ("IRS"). But upon becoming a "resident" of the U.S. for tax purposes, the rules change dramatically, and if not planned for, the tax consequences can be severe.

For this article, I'll briefly outline the two tax systems that an individual considering spending more time in the United States should plan for: the federal income tax and the federal "wealth transfer" taxes—the estate tax, the gift tax, and the generation-skipping transfer tax. And although U.S. law provides rules for non-residents, a treaty may change those rules, such as reducing the rate of tax on certain types of income. Because of the complexity involved in planning for any one of these taxes, it is not possible to provide anything more than a cursory introduction to the concepts involved in pre-immigration tax planning. For that reason, many concepts have been abbreviated or left out entirely to provide a brief overview.

Federal Income Tax

The U.S. uses as a worldwide taxation system, which means that U.S. citizens and residents are subject to U.S. income tax on their worldwide income. This is dramatically different than most countries, which use a territorial system to impose income tax only on the income generated within that country's own borders. To offset potential double taxation, the U.S. allows taxpayers to use worldwide expenses to reduce worldwide income, and grants a foreign tax credit for foreign income taxes paid on income generated outside of the United States.

Because of the dramatic differences between worldwide taxation for U.S. purposes, and the territorial taxation system that a nonresident may be accustomed to, nonresidents must know how and when they will be treated as residents for U.S. tax purposes. For income tax purposes, non-citizens are divided into two groups: residents and nonresidents. An income tax resident is a person who satisfies one of two tests: the legal permanent resident test and the substantial presence test.

- The legal permanent resident test (also known as the "green card test") is satisfied if a person is a lawful permanent resident of the United States (because they have been granted a "green card," and with it, the right to legally reside in the United States) at any point during the tax year.

- The substantial presence test, although more complicated, is satisfied if a person is present in the United States for at least 31 days during the calendar year, and for 183 or more total days during the current year and the previous two years (with only a fraction of each day from the prior two tax years being counted). A person who can demonstrate a closer connection to another country can qualify for an exemption to the substantial presence test.

Both of these objective tests produce a clear result based on bright-line rules. Once determined to be a resident under either test, residents must file income tax returns to report and pay tax on their worldwide income.

Unlike citizens and residents, nonresidents are only subject to income tax on income derived from sources within the U.S. Instead of a single set of tax rules applicable to all income, the income derived by a nonresident is subject to four broad categories of taxation.

- *Effectively Connected Income ("ECI")* — Income from U.S. sources that is "effectively connected" with a U.S. trade or business is taxed at graduated rates on a net basis. Income is generally treated as effectively connected with a U.S. trade or business if the taxpayer is engaged in a business located in the U.S., and the "effectively connected" income is generated by that business.

- *Fixed, Determinable, Annual, or Periodical Income ("FDAP" Income)* — FDAP Income is generally defined as all income other than gains derived from the sale of real or personal property, and certain items excluded from gross income. But any FDAP Income that is not "effectively connected" with a U.S. trade or business (e.g., dividends, interest, and royalties) is taxed at a flat 30% rate. A significant drawback to being taxed at a flat rate is that a taxpayer is taxed on the gross amount received, and is not allowed deductions for the expenses of producing such income.

- *Sales of U.S. Real Property and the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA" Income)* — A nonresident's disposition of a U.S. real property interest is treated as effectively connected with a U.S. trade or business, and is subject to mandatory tax withholding at 10% or 15% rates, depending on the taxpayer.

- *Income Not Subject to Income Tax* — A few types of income, such as interest generated by assets held in a bank account, escape income tax entirely.

One of the biggest changes for a nonresident considering immigration to the U.S. is the foreign asset reporting requirements. While nonresidents are not subject to these requirements, U.S. taxpayers must disclose their ownership of certain foreign assets to the IRS. While it is not possible to list all of the reporting obligations in this article, here are just a few of the information returns that may need to be filed.

- FinCEN 114—Foreign Bank Account Report (the "FBAR")

- IRS Form 926—Return by a U.S. Transferor of Property to a Foreign Corporation

- IRS Form 3520—Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts

- IRS Form 3520-A—Annual Information Return of Foreign Trust With a U.S. Owner

- IRS Form 8621—Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

- IRS Form 8858—Information Return of U.S. Persons With Respect to Foreign Disregarded Entities

- IRS Form 8865—Return of U.S. Persons With Respect to Certain Foreign Partnerships

- IRS Form 8938—Statement of Foreign Financial Assets

These forms do not require the payment of any additional tax, but significant penalties can be imposed for failing to file them. Additionally, the failure to file these returns may allow the taxpayer's return to remain open to inspection by the IRS until the information returns have been filed. A potential immigrant must consider these additional reporting requirements that will be imposed after immigrating to the U.S.

Wealth Transfer Taxation

As with the income tax, U.S. citizens and residents are subject to worldwide taxation by the three wealth transfer taxes: the estate tax, the gift tax, and the generation-skipping transfer tax. Nonresidents are only subject to wealth transfer taxation on their U.S. situs assets. So, while these taxes are different from the income tax, the principle that nonresidents are taxed only on assets that are located in the U.S. is similar to the principal in income taxation that the U.S. only taxes income that is connected with the U.S.

Unlike the objective tests for income tax residence, the test for estate and gift tax residence is subjective, and is satisfied if a person is domiciled in the U.S. at the time of his or her death or transfer by gift, as applicable. A person acquires U.S. domicile by residing in the U.S. for any period of time with no definite present intention of leaving. Absent that intention, a person will not acquire domicile for the purposes of wealth transfer taxation. As a result, the determination of residence for wealth transfer tax purposes requires a determination of an individual's state of mind at the requisite moment. Once determined to be a resident under this subjective test, a resident is required to file returns to report gifts or to have an estate tax return filed if the resident's estate is required to file a return. Because this test is different than the residence test for the income tax, it is possible for an individual to be a resident for income tax purposes without being a resident for wealth transfer tax purposes, and vice versa.

Nonresidents are subject to wealth transfer taxation only on assets that are sitused in the U.S. For example, a nonresident will be subject to estate tax only on U.S. situs property owned at death, which includes U.S. real property and stock in U.S. corporations. Cash deposits in a U.S. bank, insurance on the life of a nonresident, or stock in a non-U.S. corporation are generally not treated as U.S. situs assets, though they would be subject to estate tax in a resident's estate.

Nonresidents are entitled to only limited deductions and exemptions for estate tax purposes. The unlimited marital deduction for assets that pass to a surviving spouse is not available for transfers to spouses who are not U.S. citizens. General expenses of administration, debts, taxes, funeral expenses, and losses of the worldwide estate are only deductible from the U.S. estate in the proportion that the U.S. estate bears to the worldwide estate. So, if a nonresident decedent has a worldwide gross estate valued at $1,000,000, of which the U.S. gross estate is valued at $100,000, only 10% of their debts, taxes, and funeral and administration expenses would be deductible, regardless of whether they are directly attributable to the administration of the U.S. estate. But to obtain these deductions, the nonresident's estate must disclosure the decedent's worldwide estate on the estate tax return. And a nonresident is only allowed a $13,000 estate tax credit (effectively a $60,000 exemption amount), as opposed to the $5,450,000 estate tax exclusion amount available for U.S. citizens in 2016. Because the exemption amount available to nonresident is so low, even nonresidents with few U.S. assets can face a significant estate tax burden.

Like the estate tax, the gift tax only applies to a nonresident's gifts of U.S. situs real estate and tangible property, and not worldwide transfers. A nonresident's gifts of intangible property are not subject to U.S. gift tax. A nonresident is also granted the same annual $14,000 exclusion per donee exemption that is granted to U.S. citizens and residents on transfers of U.S. situs assets. But a nonresident is not granted the same $5,450,000 lifetime exemption from gift tax that is granted to U.S. citizens and residents.

In addition to the estate tax and the gift tax, nonresidents are subject to the generation-skipping transfer tax ("GST"). The GST serves as a backstop to the estate tax and the gift tax by taxing transfers that "skip" a generation (e.g., a gift from a grandparent to a grandchild) if the transfer is subject to either the estate tax or gift tax. A nonresident is granted an exemption from GST, but it is not clear if the exemption amount is $1,000,000 or if it is $5,450,000, the amount granted to U.S. citizens and residents.

Even this brief introduction to the U.S. income tax and the wealth transfer taxes shows the varied rules, exceptions, requirements, and exemptions that apply to both U.S. residents and nonresidents. These rules are complicated, and present many traps for the unwary. But the increased amount of investment in the U.S. by foreign citizens looking for a safe haven for their investments presents opportunities for these tax traps to be sprung. The tax planning needed to avoid these tax traps will take on a greater importance in the coming years as it becomes easier to transfer the money and property to move into the United States.

Please contact Caroline Abela and/or Agnès Proton if you are interested in participating in the IPCC and/or membership in the IPCC.