Advising The Estate Planning Client With International Interests

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Where in the world is your client’s tax bill?

THIS ARTICLE WILL FOCUS on how international issues operate within the context of the federal estate and gift tax system. It will also outline solutions for practitioners in the areas of both estate planning and estate administration in regard to those international issues.

At first, the topic of international estate planning may conjure up notions of shifting assets to tropical locations via offshore trusts. However, international considerations arise in the seemingly average client, as in the following examples:

• A U.S. legal resident lives in Philadelphia, Pennsylvania, and is a citizen of France. He owns no property in France and does not generate any income from outside the United

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States. The beneficiaries of his estate are his four siblings, two of whom live in France.

- A woman dies a resident and a citizen of the United States. She owned an interest in the family home in Scotland.
- A married couple sets up an estate plan. They learn that it is best that they equalize their estates. The spouse with most of the assets is a citizen and must make large transfers to the other spouse, who is a noncitizen.
- A woman is a resident of Barcelona and a citizen of Spain. She travels every winter to her home in California in the United States. In her later years she becomes ill and is unable to travel back to her home in Spain. She remains in her California residence for two years before passing away.
- A U.S. citizen moves to Canada and remains there for 30 years until her death. She has very few ties left to the United States at the time of her death, except for the occasional visit with relatives. She dies at her home in Canada with an estate worth about $16 million.
- A citizen of India has been living in the United States for 35 years. His wife has an untimely death at the age of 58 after a short illness and the couple has no estate plan. The man will inherit about $1.5 million from his wife.

The examples above illustrate the need for practitioners to know about the basis for taxing authority of other countries and how that taxation overlaps with the U.S. system of taxation. How does property located outside the U.S. affect a taxpayer’s estate? Is the unlimited marital deduction for both federal gift and federal estate tax the same for noncitizens? How does the determination of residence affect one’s tax liability? Should a client seek to change citizenship or residency status to reduce tax consequences? The adviser in each of the above examples should know how to identify the international issue in each situation and to advise accordingly.

**TAXING AUTHORITY** • The United States bases its taxing authority on four possible grounds. The first is U.S. citizenship. Any U.S. citizen, wherever located, making transfers during life is subject to the federal gift tax and at death, the estate of a U.S. citizen decedent is subject to the federal estate tax. The gross estate of a citizen includes “all property wherever situated” to the extent of the decedent’s interest. Internal Revenue Code (Code) §2031. This includes all property located outside the United States. (All section references are to the Code unless otherwise indicated.)

Every citizen decedent must file Form 706 if the estate exceeds the federal estate tax exemption amount and the decedent made no taxable gifts during life. For those citizen decedents who had taxable gifts during life, the amount of taxable gifts subtracted from the federal estate tax exemption amount is the new exemption amount. If a citizen’s estate is valued over the new exemption amount, he or she must file Form 706.

Assume a decedent had a gross estate of $1.4 million, made gifts during life of $200,000, and died in 2004. At first glance, a gross estate of $1.4 million with an exemption amount of $1.5 million would appear to mean that the decedent need not file Form 706. However, the amount of taxable gifts ($200,000) subtracted from the federal estate tax exemption amount is the new exemption amount. If a citizen’s estate is valued over the new exemption amount, he or she must file Form 706.

The philosophy behind the U.S. citizenship basis for taxation is that citizenship offers a kind of insurance policy. United States citizens have the protection of the U.S. government wherever they travel and they can return to the United States at any time. Richard L. Doernberg, *International Taxation in a Nutshell* §1.05 (West Group,
Practitioners should note that the federal estate tax reaches all nonresident aliens, not just those with the top one or two percent of wealth, as is the case for U.S. citizens and residents. For instance, if a nonresident alien has a gross worldwide estate of only $300,000, with $100,000 located in the United States, Form 706-NA must be filed and federal estate tax paid. Though the tax in such a case would be minimal (about $5,200) the practitioner must be careful not to overlook the tax needs of a nonresident alien simply because he or she is not wealthy.

Expatriates
The United States exerts its taxing authority over certain former U.S. citizens who have renounced citizenship and left the United States in the past 10 years. It also claims taxing authority over certain long-term residents of the United States who have renounced their residency.

Citizenship, residency, U.S. situs assets, and expatriation are the four bases on which the United States justifies the taxing authority for the federal estate and gift tax. Many foreign countries, however, use only residency as a basis for taxation. This difference will often result in the taxation by two different countries on the same transfer during life or at death. Doernberg, supra, at §2.04. Double taxation is not an uncommon occurrence and the tax adviser must know the options for minimizing this risk.

UNITED STATES DEFINITION OF RESIDENCY • The increase in international travel has made the possibility of dual residences more common. It is possible that individuals with more than one residence fit the definition of residency for more than one country and unknowingly subject themselves to each country’s taxing jurisdiction as a result. There may be a tax benefit to establishing residency in one
country over another in order to avoid paying more tax than is needed.

For those clients who keep a house in more than one country, determining residency is key. (Practitioners should note that the determination of residency for income tax purposes does not necessarily translate to residency for estate tax purposes. The definition of residency is different for both tax systems. Joint Committee on Taxation, Review of the Present-Law Tax and Immigration Treatment of Relinquishment of Citizenship and Termination of Long-Term Residency (JCS-2-03, February 2003).) The definition of residency for U.S. federal estate tax purposes is “a decedent, who at the time of death, had domicile in the United States.” A person acquires domicile, according to the law, by living in a particular location “for even a brief period of time, with no definite present intention of later removing therefrom.” Treas. Reg. §20.0-1(b)(1).

How does one prove “lack of intent to remove therefrom”? To determine the intent of an individual, many factors are considered. Such factors include the individual’s residential location, whether or not he or she owns or rents a home, the size and value of any owned home, personal ties to the location (such as club membership), personal possessions, and even a chosen burial site. Other factors used to determine residence include the residence listed on legal documents, passports, visa applications, voter registration, and income tax returns. Estate of Paquette v. Commissioner, 146 T.C.M. (CCH) 1400 (1983).

To illustrate how the definition of residency is determined by a number of factors, consider the Paquette case. The decedent was a citizen of Canada and he lived in Montreal. In his retirement each year he would spend seven summer months in Canada and five winter months at his vacation home in Florida. The decedent died at his home in Florida. The IRS argued that the decedent was a resident of the United States, and therefore subject to estate tax on his estate, “wherever situated.” The decedent’s Executor argued that the decedent was both a citizen and a resident of Canada. Canada has no estate tax and so the decedent’s estate would be subject to taxation by the United States on the basis of his being a nonresident alien. Therefore, the U.S. federal estate tax would extend to only that property situated in the United States, such as his home and tangibles in Orlando, Florida. If the court ruled in the IRS’s favor, however, the U.S. federal estate tax would be levied on all of the decedent’s property wherever situated. The result of the case would have made a large difference in the amount of estate tax due.

The U.S. Tax Court determined that a “resident” decedent is a decedent who at the time of death had domicile in the United States. A domicile, once acquired, is presumed to continue until it is shown to have been changed. To establish a new domicile, a decedent must do two things: reside in the United States and have the intention to remain here indefinitely.

The decedent in this case was domiciled in Canada and had not demonstrated an intention to remain in the United States indefinitely. Even though the decedent sold his home in Montreal, Canada and transferred his tangible personal property to furnish his home in Orlando, this did not rise to the level of intention to change domicile, because he did so due to illness. The decedent had repeatedly reiterated his intent to purchase a new apartment in Montreal when his health improved. He flew to Montreal regularly after the sale of his home there to meet with business and financial advisers, doctors, and his accountant. The decedent referred to himself as a resident of Montreal in his last Will. He filed income tax returns, voted, and maintained a driver’s license in Canada and maintained his valid Canadian passport. His automobile was purchased, registered, and insured in Canada and most of his assets were in