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CUTTING THROUGH THE CHAOS: OUTBOUND INTERNATIONAL PRIVATE CLIENT PLANNING STRATEGIES IN UNCERTAIN TIMES

TONI ANN KRUSE

MELISSA M. PRICE

MICHAEL SILVA

M. READ MOORE, *MODERATOR*

Thursday, July 23, 2020

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QUESTION SUBMISSIONS

During this webinar you can submit questions through the Zoom Q&A function

- We would like the presentation to be as interactive as possible
- Questions will be visible to the presenters immediately after you submit your question
- The presenters will answer as many questions as possible live

OVERVIEW

- Leaving the US
  - Tax Status of Individuals in the US
  - Non-tax Considerations
  - Tax Considerations
  - Immigration Process
  - US Tax Procedure
- Creating & Moving Trusts Abroad
  - Residency of Trusts
  - US Tax Considerations for Foreign Trusts
  - IRC Section 679
  - IRC Section 684
- Investing Abroad
  - Efficient structuring
  - Reporting

LEAVING THE US

LEAVING THE US: TAX STATUS OF INDIVIDUALS IN THE US

- US Citizen
  - Subject to income, estate and gift tax on worldwide assets, regardless of where the individual lives.
  - US citizen regardless of status and passports in other countries.
  - Double-tax avoided through treaties and foreign tax credits.
  - Subject to annual returns (federal and state) and informational reporting.
- An individual who is not a US citizen is either:
  - US Resident Alien
  - Non-Resident Alien

LEAVING THE US: TAX STATUS OF INDIVIDUALS IN THE US

- US Resident Alien for Income Tax Purposes
  - Lawful Permanent Resident (i.e. Green Card holder) at any time.
  - Substantial Presence Test
    - Weighted 183 day test: present in the US for 31 days in the current year, plus one-third of prior year days, plus one-sixth of second prior year days equal to or greater than 183 days.
    - If current year days are less than 183, and fail substantial presence test, may still be exempt from treatment as a resident alien if meet the “closer connection” exception applies.
- US Resident Alien for Estate and Gift Tax Purposes
  - Taxed as a US citizen if the US resident alien is **domiciled** in the US.
  - Domicile is a facts and circumstances test, with intent being a key factor.
    - Living in the US with no present intention of leaving.
    - Green Card weighs heavily in favor of domicile, but is not determinative.
- Non-Resident Alien
  - Foreign national who is not present in the US for a period of time that would rise to US Resident Alien status.
  - Taxed only on US source income.

LEAVING THE US: TAX STATUS OF INDIVIDUALS IN THE US

US Citizen

- Taxed on worldwide income.
  - Any source
  - Any location
- Estate, gift and generation skipping transfer taxes on worldwide assets.

US Resident Alien

- Taxed on their worldwide income.
  - Any source
  - Any location
- If domiciled in US, subject to estate, gift and generation skipping transfer taxes on worldwide assets.

Non-Resident Alien

- Income derived from US sources.
- US source income is income “effectively connected” with a US trade or business.
- Foreign national, if domiciled in US, subject to estate, gift and generation skipping transfer taxes.

LEAVING THE US: NON-TAX CONSIDERATIONS

- Reed Amendment/ Reed Schumer Amendment – Does it exist?
  - Created under the Immigration Reform and Responsibility Act of 1996 to impose a US entry ban of former US citizens who were deemed to have renounced citizenship for certain purposes (tax avoidance).
- What happens if you expatriate?
  - Irrevocable No future ability to enter the US without a visa or green card (and no entitlement to obtain a visa).
  - No ability to confer citizenship on a spouse or child.
  - If you fall within the excludability provisions, you may never be able to reenter the US.
  - If alternative citizenship is from certain countries, may have difficulty getting visas to enter other countries.
  - Names of expatriating citizens are published in the Federal Register
  - Ability to return to the US is never guaranteed.

LEAVING THE US: NON-TAX CONSIDERATIONS

- Be sure the individual is not "excludable."
- In our current COVID-world: where can you go?
  - Travel restrictions
  - Second passport required
- Planning for future visits, work or residence in US.
  - Timing may be an issues due to coordination of expatriation and issuance of an appropriate visa.
  - If the individual is excludable from the US, may not be able to return in the future.

LEAVING THE US: TAX CONSIDERATIONS

- Current Expatriation Rules
  - Heroes Earnings Assistance and Relief Tax Act (HEART Act) of 2008
    - Internal Revenue Code Section 877A.
    - “Mark-to-market” exit tax.
    - Internal Revenue Code Section 2801 succession/inheritance tax.
- Prior Law
  - Until 2008 alternative tax regime applied to certain income of US expatriates for 10 tax years post expatriation.
    - Alternative tax regime still applied to those subject to prior law.
    - No longer applicable since 2018.

LEAVING THE US: TAX CONSIDERATIONS

- Covered Expatriate
  - An citizen is a "covered expatriate" if they:
    - Have an average annual income tax liability for the previous 5 years in excess of $171,000 or more (for 2020, indexed for inflation); and/or
    - A net worth in excess of $2M;
    - Does not certify tax compliance for 5 prior years.
  - A Green Card holder may be a covered expatriate if they meet the definition above **and** have had a Green Card for **at least 8** of the **last 15 years**.
- Exceptions to the Covered Expatriate, as defined:
  - Certain dual citizens from birth; not a US resident for more than 10 of the last 15 tax years (under the substantial presence test); taxable as a resident of other country of nationality.
  - US citizens under the age of 18 and a half who have not been substantial presence residents for more than 10 years before relinquishing citizenship.

LEAVING THE US: TAX CONSIDERATIONS

- Calculating the Mark-to-Market Tax
  - Deemed sale of worldwide assets on the day before the expatriation date at applicable rates on gains in excess of $737,000 (in 2020, indexed for inflation).
    - "Deemed sale": gains reported on final US tax return; rates vary based on asset type.
    - Worldwide assets determine the tax base and include any asset that would be includible in the individual's taxable federal gross estate if they died the day before the expatriation date.
    - Exception to worldwide assets: deferred compensation, interests in non-grantor trusts.
  - It is possible to elect to defer tax on certain assets if security is provided. Deferral applies until expatriate sells, transfers, or dies.

LEAVING THE US: TAX CONSIDERATIONS

- "Covered Gifts/Bequests", Code Section 2801
  - US persons who receive a gift or bequest from a "covered expatriate" will be taxed at the highest applicable gift/estate tax rate, i.e. 40%.
  - Exceptions:
    - annual exclusion gifts;
    - gifts or bequests entitled to marital deduction;
    - gifts or bequests entitled to charitable deduction;
    - amounts shown on timely filed gift or estate tax return.
  - Reduction for any gift or estate tax paid to foreign country on such transfers.
  - Distributions to a US person from a foreign trust funded by a covered expatriate are taxable to the US beneficiary.
  - No time limit on application of Section 2801 after expatriation date.

LEAVING THE US: IMMIGRATION PROCESS

- How do I terminate citizenship?
  - Renunciation at US consular post abroad.
    - Some posts do initial interview on the phone followed by second interview in person.
  - Children under 18 cannot renounce US Citizenship.
- How do I voluntarily give up my US permanent resident status?
  - Mail Form I-407 and permanent resident card to USCIS office in US
  - Submit Form I-407 and permanent resident card to U.S. Customs & Border Protection upon entry to the US – will be admitted as a visitor.
- Loss/Abandonment of permanent resident status
  - US permanent residents can have status revoked by violating the terms of their status:
    - Filing US income tax as a non-resident.
    - Living abroad without reentry to the US for one year or more.
    - Spending little time in the US.
    - Certain criminal convictions or other deportable offenses.

LEAVING THE US: US TAX PROCEDURE

- Reporting Requirements
  - Form 8854 must be timely filed with the expatriate's final US income tax returns.
    - Mark-to-market tax is calculated on the final Form 1040 and payable when due.
  - Annual Form 8854 filing for eligible deferred compensation items, beneficial interests in non-grantor trusts, and expatriates who deferred payment of tax on particular assets.
  - Form W-8CE filed for items excepted from the mark-to-market tax; filed by sooner of first post-expatriation distribution or 30 days after expatriation.
- Compliance
  - Must sign to certify full compliance with all US federal obligations to report all income, pay all tax and submit all required information returns for prior 5 years.
  - If not in compliance, must file all delinquent filings.
    - Streamlined Offshore Procedure: must be non-willful failure to file/pay; must pay tax due plus interest, no penalties.
    - OVDP programs are no longer available.
    - File any delinquent FBARs and informational returns: reasonable cause explanation needed; if not under civil or criminal investigation and no IRS request for delinquent filings, file with reasonable cause statement.

CREATING & MOVING
TRUSTS ABROAD

CREATING & MOVING TRUSTS ABROAD: RESIDENCY OF TRUSTS

- A trust can be a US resident or a non-US resident for US income tax purposes.
- A trust is a US trust if:
  - a court within the United States is able to exercise primary supervision over the administration of the trust (the court test); AND
  - one or more United States persons have the authority to control all substantial decisions of the trust (the control test).
- Any trust that is not a US trust is a foreign trust.
  - This means that any trust that fails either the court test or control test is a foreign trust.

CREATING & MOVING TRUSTS ABROAD: COURT TEST

- A court is "able to exercise" primary supervision if the court would have authority to render orders or judgments concerning the trust.
- A court has "primary supervision" if the court has or would have authority to determine substantially all issues regarding the administration of the entire trust.
- IRS provided safe harbor:
  - The trust instrument does not direct that the trust be administered outside of the United States,
  - The trust is in fact administered exclusively in the United States, and
  - The trust is not subject to an automatic migration provision.

CREATING & MOVING TRUSTS ABROAD: CONTROL TEST

- To evaluate whether a trust meets the control test:
  - Identify whether power holders are US or non-US persons.
  - Determine whether decisions are "substantial."
    - Ministerial decisions are excluded.
  - Determine who has control over decisions.
    - US persons will *control* all substantial decisions if US persons have "the power, by vote or otherwise, to make all of the substantial decisions of the trust, with no other person having the power to veto any of the substantial decisions."
- Consider creating a trust that purposely *fails* the control test to allow the trust to be administered in the United States while a non-US income tax resident.
  - Be careful of IRC § 679

CREATING & MOVING TRUSTS ABROAD: INADVERTENT MIGRATIONS

- The trustees of a trust have one year to fix an inadvertent migration of a trust offshore.
- Treas. Reg. § 301.7701-7(d)(2)(i):
  - Replacement within 12 months. In the event of an inadvertent change in any person that has the power to make a substantial decision of the trust that would cause the domestic or foreign residency of the trust to change, the trust is allowed 12 months from the date of the change to make necessary changes either with respect to the persons who control the substantial decisions or with respect to the residence of such persons to avoid a change in the trust's residency. For purposes of this section, an inadvertent change means the death, incapacity, resignation, change in residency or other change with respect to a person that has a power to make a substantial decision of the trust that would cause a change to the residency of the trust but that was not intended to change the residency of the trust. If the necessary change is made within 12 months, the trust is treated as retaining its pre-change residency during the 12-month period. If the necessary change is not made within 12 months, the trust's residency changes as of the date of the inadvertent change.
- The regulations under IRC § 684 provide that if a trust takes advantage of the cure provisions following an inadvertent migration, the deemed disposition tax will not apply to the migration. Treas. Reg. § 1.684-4(c).

CREATING & MOVING TRUSTS ABROAD: US TAX RULES APPLYING TO FOREIGN TRUSTS

- Taxation on US source income (FDAP income, effectively connected income, US real estate income).
- 30% withholding tax on FDAP income (unless an income tax treaty applies).
- Application of FIRPTA rules.
- “Distributable net income” calculation includes capital gains and losses.
- Application of throwback tax on distributions of accumulated income to US beneficiaries.
- Certain loans and uncompensated use of trust property are treated as deemed distributions.
- Attribution of ownership of CFCs and PFICs to US beneficiaries.
- Additional reporting requirements.

CREATING & MOVING TRUSTS ABROAD: US TAX RULES APPLYING TO FOREIGN TRUSTS

- US tax consequences of US person *creating* a foreign trust:
  - Grantor trust status under IRC § 679 if there are US beneficiaries.
  - Recognition of gain under IRC § 684 if IRC § 679 does not apply or possibly on US person's death.
- US tax consequences of migrating US trust offshore:
  - Recognition of gain under IRC § 684 if non-grantor trust, or
  - Possible application of IRC § 679.

CREATING & MOVING TRUSTS ABROAD: UNDERSTANDING SECTION 679

- Under IRC § 679, if a US citizen or resident makes a gratuitous transfer to a foreign trust, the trust will be a grantor trust as to the portion attributable to the US settlor, but only if during a given year there is a US beneficiary.
- Grantor trust status applies even if the US person does not retain any strings or control over the trust (i.e., even if the trust would have been a nongrantor trust if the trust had been domestic).
- A trust is treated as having US beneficiaries unless:
  - (A) under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a United States person, and
  - (B) if the trust were terminated at any time during the taxable year, no part of the income or corpus of such trust could be paid to or for the benefit of a United States person.
- A foreign trust is deemed to have a US beneficiary unless no distributions can be made to a US person at any time during the calendar year in question and, if the trust is terminated during that year, no part of the trust's income or principal could be distributed to a US person.

CREATING & MOVING TRUSTS ABROAD: UNDERSTANDING SECTION 684

- Under IRC § 684, if a US person transfers property to a foreign estate or trust, the transfer is treated as a sale or exchange, causing the US person to recognize gain on the excess of (1) the fair market value of the property transferred over (2) the adjusted basis of the property in the hands of the transferor.
  - There is an exception if the property is transferred to a grantor trust for US income tax purposes as to any person.
- If a domestic trust becomes a foreign trust, the migration will trigger a deemed disposition. The disposition is deemed to occur on the same date as the migration but immediately before the migration.
  - If the settlor is still alive and the trust has US beneficiaries, IRC § 679 will prevent the deemed disposition.
  - A deemed disposition could occur when the settlor dies if the trust assets do receive a new basis on the grantor’s death under IRC § 1014(a).
- A non-US citizen who is a US income tax resident should consider IRC § 684 before transferring assets to a foreign trust (e.g., for the benefit of his or her non-US descendants).

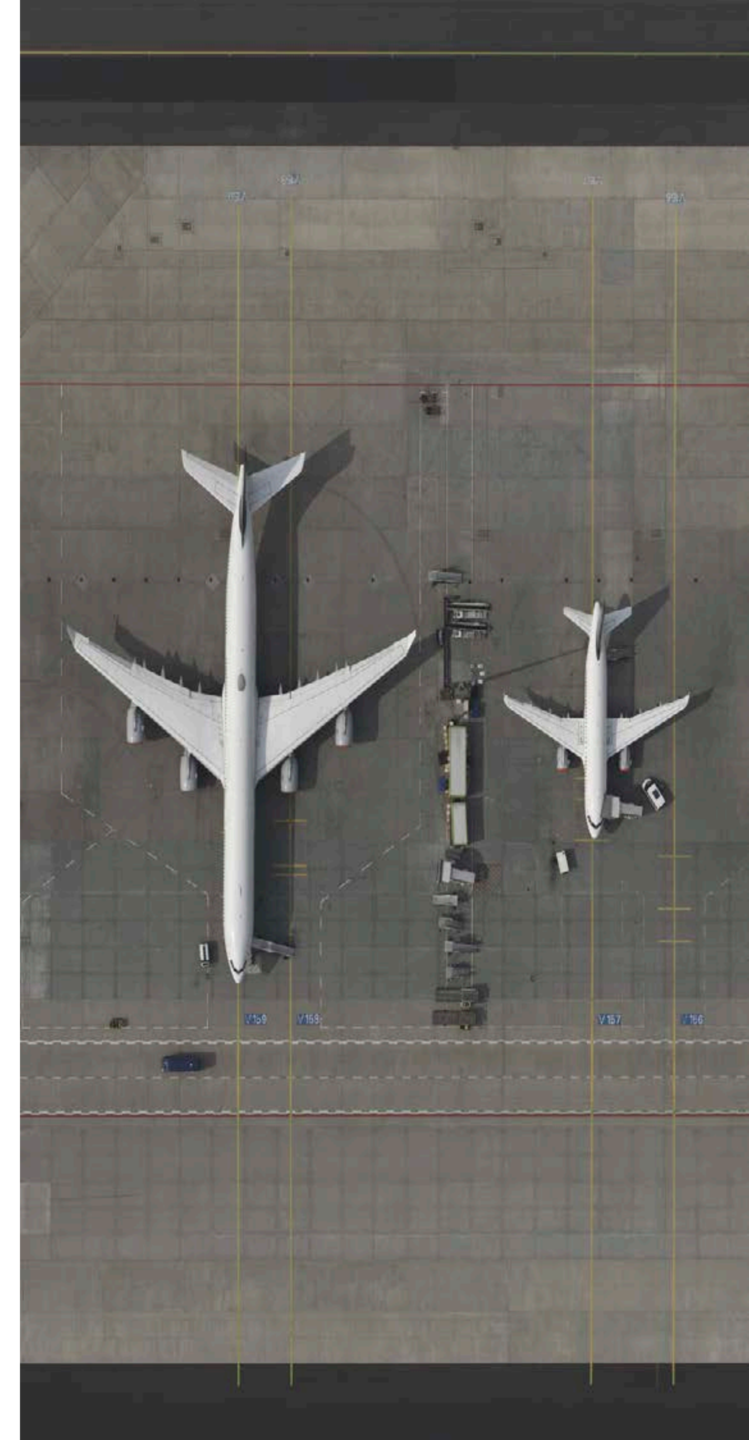
CREATING & MOVING TRUSTS ABROAD: WHERE TO MOVE THE TRUST?

- Consider US income tax consequences in the new governing jurisdiction.
- Consider reporting requirements in the new governing jurisdiction.
  - E.g., France has burdensome reporting requirements for trusts with a nexus to France.
- Consider KYC requirements when engaging a non-US trustee, opening a non-US bank account for the trust or investing trust assets.
  - We have clients who opt for US structures and possibly greater US taxes to avoid the need to disclose certain information to non-US banks and governments.

INVESTING ABROAD

OVERVIEW

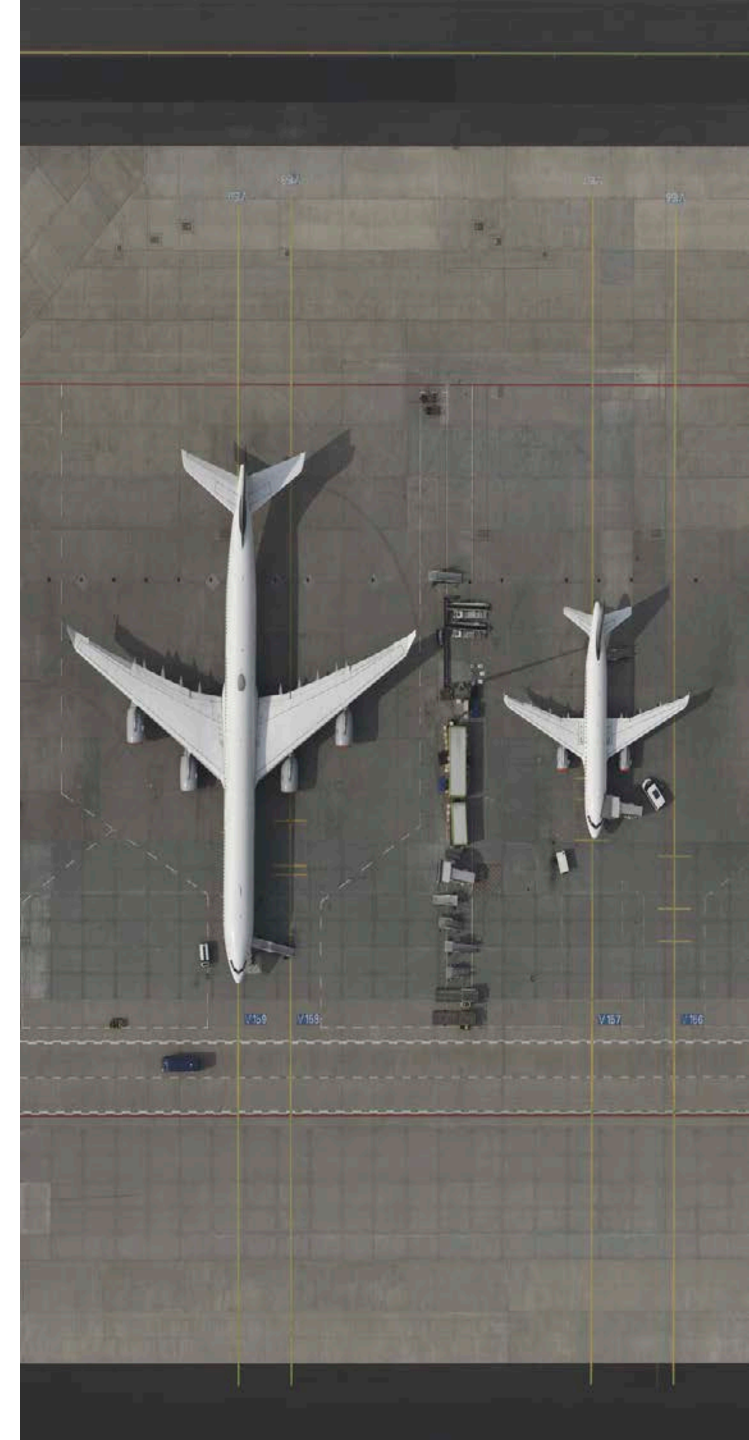
- Focus on individuals, trusts, and partnerships investing overseas.
- Increasingly complex rules and increased reporting.
- Classification of companies may not match across jurisdictions.
- Tax rules seek to prevent deferring payment of tax by use of foreign structures.
- Two anti-deferral regimes to impose tax on current basis:
  - CFC
  - PFIC
- Expanded by TCJA of 2017.
- Impacts family offices and closely held businesses operating overseas.
- Post-mortem estate planning techniques.



INVESTING ABROAD

TCJA introduced several key changes to the CFC rules:

- Expanded definition of US shareholder.
- Expanded attribution rules.
- Transition tax on deferred foreign income of certain foreign corporations.
- New GILTI tax regime, which expanded types of CFC income includable in a US shareholder's gross income.
- Eliminated "30-day rule" which formerly required 30 consecutive days of CFC status each year before US shareholders were subject to phantom income inclusions.



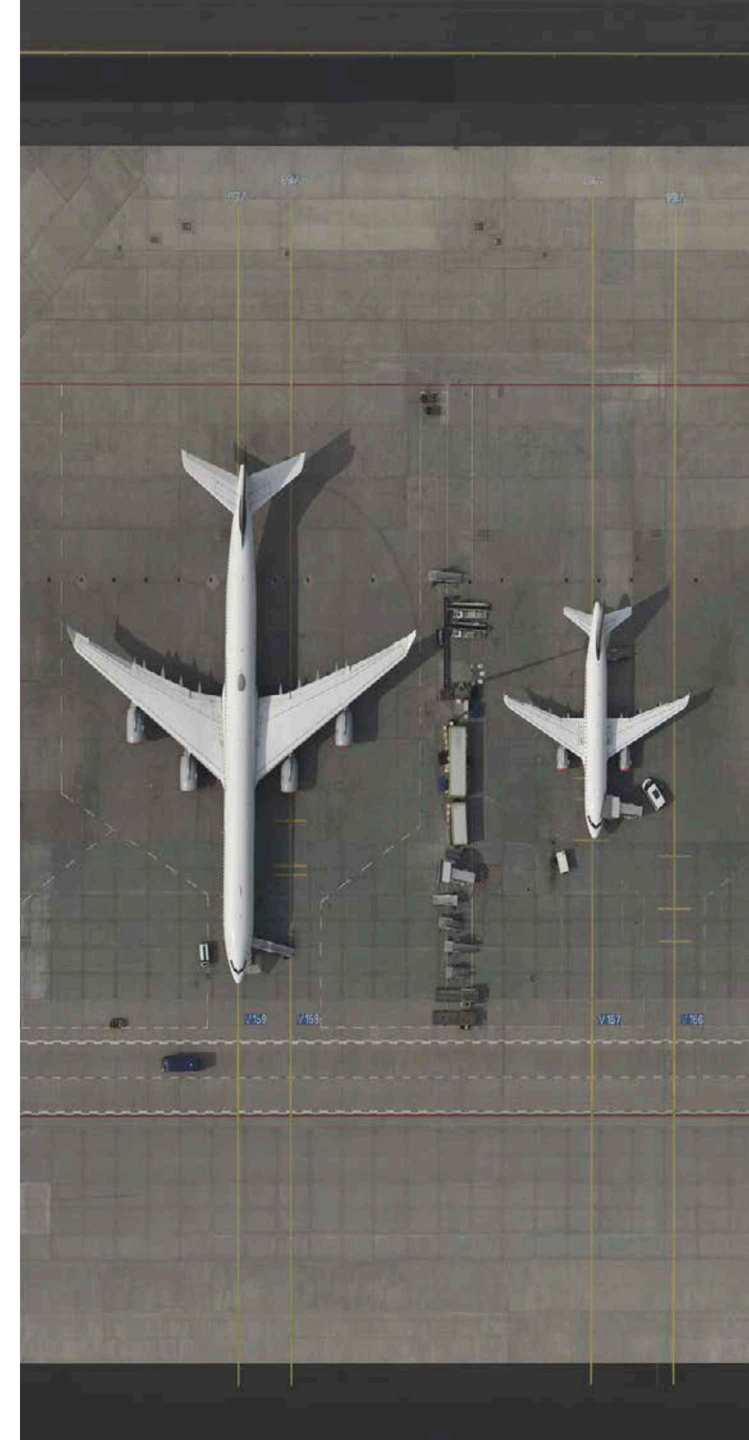
INVESTING ABROAD

Expansion of Definition of "US Shareholder" to Include Value

- Before 2018, family owned businesses avoided CFC status by putting their voting stock in the hands of non-US family members, while US family members held non-voting stock (value in non-voting stock).
- TCJA expanded "US Shareholder" definition to include persons holding voting or non-voting stock ≥ 10% of value of all classes of stock of corporation.

Downward Attribution

TCJA allows "downward" attribution from non-US shareholders, partners and beneficiaries to US corporations, partnerships and trusts. So ownership of US and foreign subsidiaries by a common foreign parent that is not itself a CFC can cause the foreign subsidiaries to become CFCs to its sister US corporations due to attribution of ownership from the foreign parent down to the US subsidiaries. This exposes such sister US companies, and potentially their US owners of the foreign parent to phantom income inclusions from the foreign subsidiaries. This also impacts foreign investment funds where US and non-US companies are held under the same fund umbrella. Exceptions apply in certain situations.



INVESTING ABROAD

Transition Tax

- Generally required US shareholders to include their share of CFC's previously untaxed earnings (generally prior to January 1, 2018) as Subpart F income to transition to participation exemption regime.
- Applies to US shareholders of "specified foreign corporations."
- All post-1986 earnings not previously subject to tax in the US and accrued while it was a specified foreign corporation are taxed to US individuals.
- The transition tax applies to corporate ***and non-corporate*** US shareholders, although a DRD only applies to corporations (or others with a certain election).
- Participation exemption introduced 100% DRD available to US corporations receiving foreign source dividends from foreign subsidiaries if certain ownership/holding period requirements are met.

Taxable to US shareholders as Subpart F income under Section 951(a), but with a partially offsetting deduction under Section 965(c) designed to reduce the effective tax rate to a range of 8-15.5% (based on amount of foreign cash held in the foreign corporation), but US shareholders could be taxed on earnings accrued by the corporation *before* they became shareholders of the CFC.

- Could elect to pay tax over 8 years but watch defaults like expatriation.
- For foreign corporations held by S-corporations, US S-corporation shareholders can elect to maintain deferral of foreign income.

INVESTING ABROAD

GILTI Tax

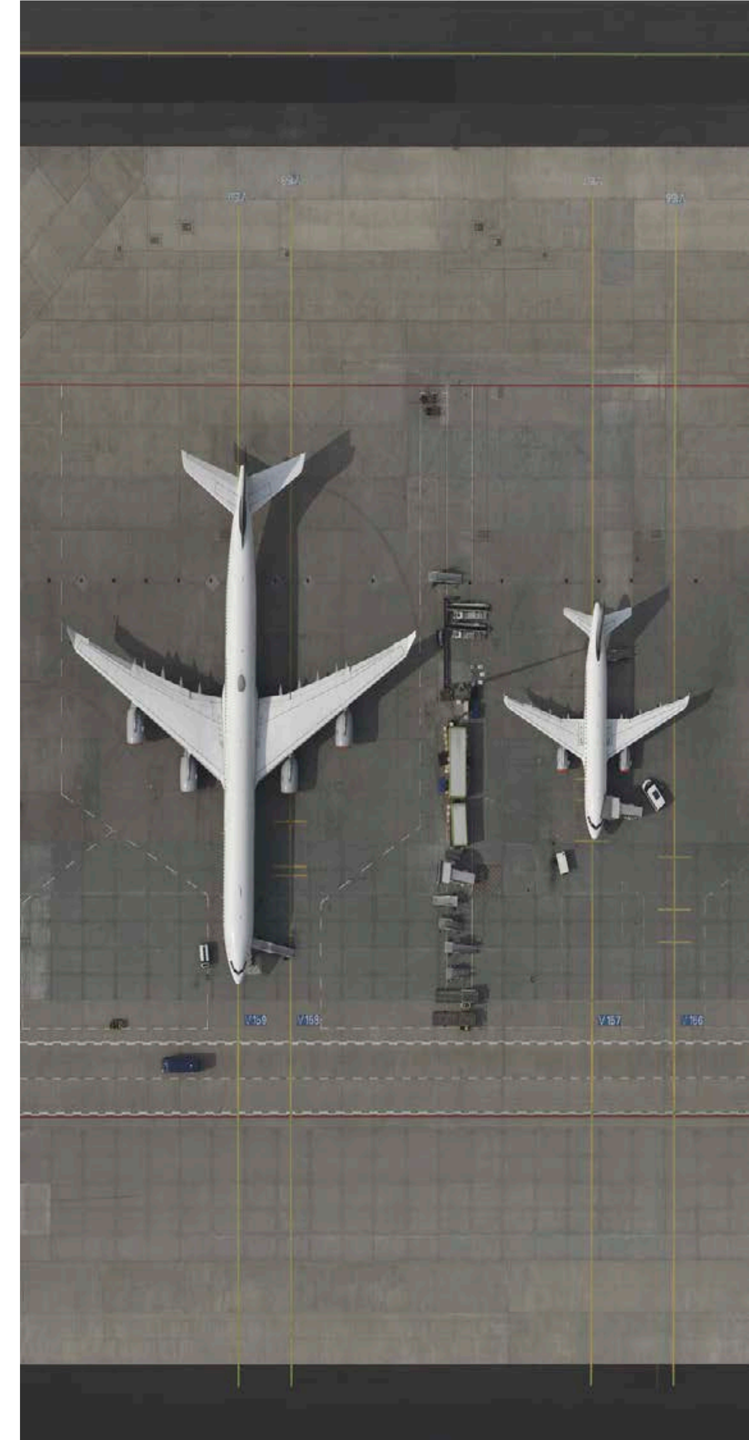
- Before 2018, the CFC rules did not tax active business income of a CFC on a look-through basis (other than certain related party sales/services income and certain insurance income).
- The GILTI tax targets income from intangibles held in low-tax jurisdictions without a clear business nexus and is defined broadly enough to pick up most operating income. If a CFC's modified gross income (excluding certain items such as Subpart F income and income that is effectively connected with a US trade or business) exceeds a benchmark return of 10% of CFC's adjusted basis in depreciable tangible property used in a trade or business (with adjustments for interest expense), then the excess is taxable to the US shareholder as ordinary income just like Subpart F income.
- For Corporations, no US tax if foreign tax was greater than or equal to 13.125% (10.5% after 50% deduction and 80% FTC).
- For Individuals taxed at 37% (no 50% deduction and no 80% FTC), so file "962 election" to be treated as a corporation.
- For individuals taxed at 37%, there is no 50% deduction or 80% FTC. Consider "962 election" to treat the individual as a corporation for GILTI and Subpart F purposes. The 962 election applies with respect to all CFCs in which the individual has an interest, so careful consideration of the individual's worldwide structure is necessary before making the election.
- IRS issued proposed and final regs under 951A and 954 on treatment of income subject to high rate of foreign tax, including new proposed regulations on July 21, 2020.

INVESTING ABROAD

Elimination of the 30-Day Rule

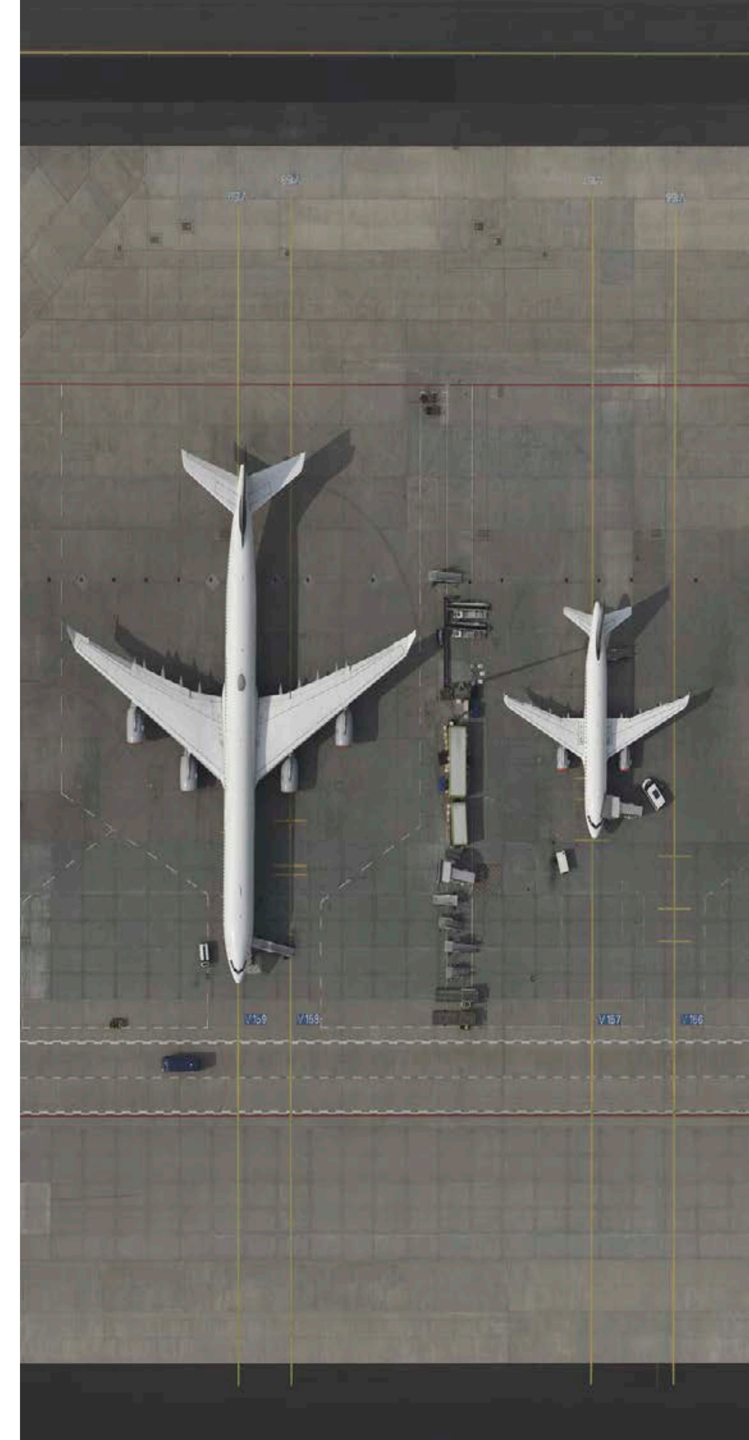
Until 2018, a CFC would not arise unless held for an uninterrupted period of ≥ 30 days during a taxable year. This rule was very useful in situations where a non-US individual needed a foreign blocker to invest in US situs assets but ultimately wanted to pass ownership to a US beneficiary. The 30-day rule provided a 29-day window after the death of the non-US owner during which the foreign blocker could “check the box” to be disregarded for US federal tax purposes, thereby stepping up the basis of the underlying assets and preventing Subpart F income inclusions for the US owners under the CFC rules. The elimination of the 30-day rule means it is more difficult to unwind these structures after the non-US person’s death without some tax leakage.

- File 5471 for each CFC or civil/criminal penalties apply.



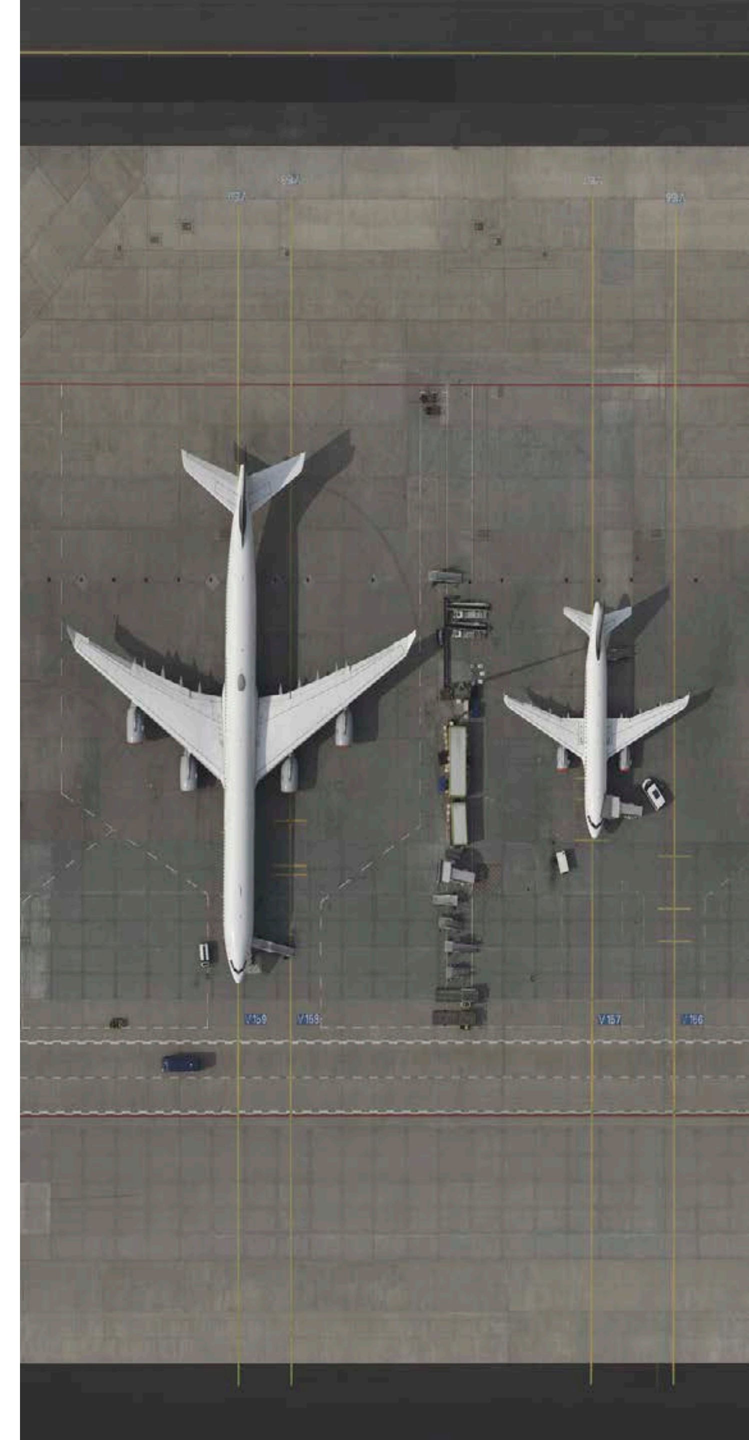
PFIC

- 75% of income is passive, or
- 50% of assets produce passive income (quarterly test, cash is considered passive).
- US person holding any interest is subject to PFIC reporting.
- Most foreign mutual funds are PFICs (even tax-deferred accounts: UK ISAs or Canadian TFSAs).
- Form 8621, no penalty for not filing but SOL open.
- Coordination rules if both PFIC and CFC rules apply.



PFIC PUNITIVE RATES & REPORTING

- "Once a PFIC, always a PFIC" rule; PFIC taint can be "purged" with certain elections.
- Distribution from or sale of PFIC is taxed at highest marginal tax rates on individuals (even if capital gain rates normally apply).
- Non-deductible interest charge penalty compounds while holding PFIC.
- PFIC losses cannot be used to offset non-PFIC gains, and PFIC gains (*see Toso v. Comm'r*, 151 T.C. No. 4).
- FATCA is producing mass of info including foreign mutual funds earned by expats, which can lead to audit.
- QEF Election – Annual Inclusion of net ordinary income and STCG at ordinary tax rates; LTCG taxed at preferential LTCG rates.
  - No current inclusion of losses.
  - Foreign tax credits do not flow-through.
- Mark-to-Market Election – Annual Inclusion of Appreciation in PFIC stock value as ordinary income.



THANK YOU

Toni Ann Kruse
Partner
+1 212 547 5766
tkruse@mwe.com

Toni Ann has a broad-based estate and wealth transfer planning practice in New York. She advises ultra-high net worth individuals and families on estate, gift and generation-skipping transfer tax issues, trust and estate administration, state fiduciary income tax planning, and charitable gifting, as well as contested trust and estate matters. She has significant experience working with multinational clients on structuring efficient ways to benefit US persons as well as inbound and outbound planning opportunities.

Melissa M. Price
Partner
+1 305 3476535
mmprice@mwe.com

Melissa focuses her practice on domestic and international tax and estate planning matters. She advises clients on estate, gift, generation-skipping transfer and income tax issues, trust and estate administration, wealth transfer techniques and charitable planning. Melissa has significant experience with international tax and estate planning. She advises trustees of foreign trusts with US beneficiaries, individuals moving to and from the US, and families with members residing in multiple jurisdictions.

Michael Silva
Partner
+1 305 329 4494
masilva@mwe.com

Michael focuses his practice on international tax law, with an emphasis on US investment structures, cross-border transactions, tax treaty planning and US activities of foreign banks. He has significant experience forming investment funds and advising family offices. Michael regularly advises families on trusts and private trusts companies and other techniques to transfer wealth and business assets. Michael advises foreign clients on the US income, estate and gift tax consequences of alternative inbound investment structures while utilizing income, estate and gift tax treaties to minimize tax and regulatory burdens.

M. Read Moore, Moderator
Partner
San Francisco: +1 628 218 3881
Chicago: +1 312 984 7576
mmoore@mwe.com

Read provides legal counsel on all aspects of estate planning, estate and trust administration, tax controversy, and privately owned business governance and succession planning. He has considerable experience in the international aspects of the private client practice, including inbound investment and wealth transfers to the United States, the US tax and legal aspects of non-US private company and wealth management structures, and US tax compliance for clients with global investments and assets.

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