NFP®

Tax Planning for Multinational Clients

INTERNATIONAL

INSIDE

The Global Citizen

In an increasingly global economy, the number of wealthy multinationals exposed to risks such as taxation on worldwide income and wealth transfer has risen dramatically. This is increasing the demand for services and products to help protect foreign nationals. With one of the world's highest standards of living and considered a safe haven for both investment and political stability, the U.S. attracts a significant population of multinationals. Those drawn to the U.S. are investors, foreign business executives running domestic or foreign companies in the U.S., and wealthy individuals purchasing vacation or retirement properties. This document is designed to provide basic information on tax issues pertaining to wealthy foreign nationals as they relate to the United States.

This document focuses primarily on the differences between U.S. income and wealth transfer taxation for resident and nonresident aliens, and provides general information on determining residency status.

Income Taxation of Resident and Nonresident Aliens

In general, an alien will be subject to U.S. income taxation if that individual has elected to become a U.S. citizen or has a substantial presence in the U.S. There are two tests to determine whether an alien is a resident for income tax purposes, only one of which must be met to be considered a resident.

Residency Tests for Income Tax Purposes

Green Card Test

An individual is considered a lawful permanent resident of the United States, at any time, if he or she has been given the privilege, based on the immigration laws, of residing permanently in the United States as an immigrant. In general, this status is given if the U.S. Citizenship and Immigration Services (USCIS) issues an alien registration card, Form I-551, known as a "green card." Under this test, residency begins on the first day of the calendar year in which the individual was present in the U.S. as a lawful permanent resident.[1]

Substantial Presence Test

An individual is considered a U.S. resident if the substantial presence test is met over a three-year period.[2] To meet this test, that individual must be physically present in the United States on at least:

- 31 days during the current year, and
- 183 days during the three-year period that includes the current year and the two years immediately before that, counting:
    - All the days present in the current year (the year for which the return is being filed),
    - 1/3 of the days present in the first year before the current year, and
    - 1/6 of the days present the second year before the current year.

Any portion of a day counts as a day of presence in the U.S.[3]

[1]IRC § 7701(b).
[2]*Ibid.*
[3]*Ibid.*

Income Taxation of Resident Aliens

The worldwide income of an alien who qualifies as a resident of the U.S. is subject to taxation in the same manner that a U.S. citizen's worldwide income would be. Resident aliens can use the same filing statuses available to U.S. citizens, claim personal exemptions for themselves and their dependents that qualify under U.S. dependency rules, and claim the same itemized deductions and tax credits as U.S. citizens.[4]

Non-U.S.-sourced income may also be subject to income tax in the country from which it is sourced. If the sourced country has entered into a tax treaty with the U. S., that income should avoid double taxation both in the U.S. and in the source country. If there is no tax treaty between the U.S. and the source country, then the income could be subject to double income taxes.[5]

Income Taxation of Nonresident Aliens

If an alien is determined to be a nonresident, then the income taxation rules differ. In general, nonresident aliens are subject to U.S. income taxation on income derived from U.S. sources or that is effectively connected with a U.S. trade or business. They are not subject to income tax on their foreign-source income.[6] The rules that apply to determining what constitutes U.S. source income are detailed in the following table.

TYPE OF INCOME	SOURCE DETERMINED BY
Compensation for personal services	Where services are performed
Dividends	Type of corporation (U.S. or foreign)
Interest	Residence of payor
Rents	Situs of property
Royalties – patents, copyrights, etc.	Where property is used
Royalties – natural resources	Situs of property
Pensions due to personal services	Where services were performed while an NRA

Income sourced from a U.S. trade or business is taxed at the ordinary income tax rates applied to U.S. citizens and residents. If, however, the sourced income is not from a U.S. trade or business, then the income is taxed at the lower of 30 percent or the rate set out in the tax treaty.[7]

Not all items of U.S. source income are taxable. Some interest earned on deposits, cash value growth and gains earned from the disposition of personal property are often not subject to U.S. income taxation.[8]

Nonresident aliens may not file as married filing jointly, unless the spouse is a U.S. citizen or they choose to be taxed as U.S. residents. In general, if a nonresident alien is engaged in a trade or business in the U.S., he or she may claim only one personal exemption, unless that individual's spouse or dependent is a resident of Canada or Mexico or is a U.S. citizen. Nonresident aliens cannot claim the standard deduction, nor can they claim deductions related to income that is not effectively connected to their U.S. business activities.[9]

[4]Publication 512 (2012), U.S. Tax Guide for Aliens
[5]*Ibid.*
[6]IRC § 871(b).
[7]IRC § 871(a).
[8]IRC §§ 871(a), 871(h) and 871(i).
[9]Publication 512 (2012), U.S. Tax Guide for Aliens

Estate and Gift Taxation of Resident and Nonresident Aliens

The method used to determine whether an alien is a resident for U.S. estate taxation is more subjective than the method used for income tax purposes. For estate tax purposes, the U.S. includes only the 50 states and the District of Columbia. A non-U.S. citizen may be domiciled in one of the U.S. possessions, such as Puerto Rico, and escape U.S. federal transfer tax, except on transfers of property situsued within the United States.[10] In addition, the rules governing which assets to include in the gross estate are significantly different for resident and nonresident aliens.

Residency Determination for Estate Tax Purposes

When trying to establish residency for estate tax purposes, courts generally rely on multiple factors. Since an individual can only be domiciled in one place, the U.S. determines residency for estate tax purposes with any, or a combination, of the following factors:

- Testimony and statements of intent, like an immigrant visa, U.S. trust, will, etc.
- Green card application and/or U.S. Social Security number
- Driver's license and/or voter registration
- Marital status and residence of individual's family
- Time spent in the U.S. versus other countries
- Location and size of residence and business
- Participation in community affairs and social affiliations

No single factor determines domicile for a resident alien, and this is by no means a comprehensive list of what could determine domicile. Each case is considered individually by a court, and other evidence may be taken into account. However, if it can be shown that an alien illustrates an indefinite intent to stay in the U.S., then they will generally be considered a resident alien for estate tax purposes.[11]

Estate Taxation of Resident and Nonresident Aliens

While the rules of estate taxation differ for resident and nonresident aliens, applicable estate tax rates are the same for both groups.[12]

Resident aliens and U.S. citizens are subject to estate taxes on worldwide assets regardless of the properties' location. The rules pertaining to joint property and the marital deduction are different for resident aliens and U.S. citizens. A federal estate tax credit is allowed, with limitations, for taxes paid to a foreign country on property located in that country.

Nonresident aliens are only taxed on U.S. situs assets. A foreign country may allow a credit against its death taxes for U.S. estate tax paid. [13]

[10]U.S. Treas. Reg. §§ 20.0-1(b) and 25.2501-1(b).
[11]U.S. Treas. Reg. § 25.2501-1(b)
[12]IRC § 2103.
[13]IRC §§ 2102(c)(1), 2102(c)(2)

A nonresident alien is entitled to a credit against estate taxes of $13,000. Effectively, this credit permits the nonresident decedent to pass $60,000 of assets at death without incurring U.S. estate tax, unless provided otherwise in an applicable tax treaty. The estate tax exemption for nonresident aliens is much lower than that of U.S. citizens or resident aliens. The example below illustrates the impact of the U.S. estate tax on an unmarried individual with a $20 million dollar net worth passing away in 2014, based upon whether they are a resident or a nonresident alien.

Example of Single Resident and Nonresident Alien Estate Taxation

Status	U.S. Citizen / Resident Alien	Nonresident Alien
Taxable Estate	$20,000,000	$20,000,000
Gross Estate Taxes	$7,945,800	$7,945,800
Less Estate Tax Applicable Credit	$2,081,800	$13,000
Net Estate Taxes	$5,864,000	$7,932,800
Net to Heirs	$14,136,000	$12,067,200
Estate Shrinkage	29.32%	39.66%

As previously mentioned, asset situs rules are different depending on the type of property being transferred. In general, the gross estate for estate tax purposes for a nonresident alien includes: (a) tangible assets situated in the U.S., like land and buildings; (b) stocks and options issued by a U.S. corporation; (c) compensation paid by U.S. entities; and (d) annuity contracts enforceable against U.S. obligators. Interestingly, items not included in the gross estate include U.S. bank deposits and insurance on the life of the nonresident alien. Similarly, tangible property not considered U.S. situs is omitted from the gross estate valuation for estate tax purposes. Estate tax situs rules for nonresident aliens by property type are summarized in Exhibit II in the Appendix. The U.S. Internal Revenue Code (IRC) determines the situs of asset types and, depending on whether or not there is an estate tax treaty between the U.S. and the country of residence, situs could be modified. See Exhibit I in the Appendix for a list of countries for which the U.S. has an estate and gift tax treaty.[14]

Availability of the Marital Deduction

The Technical and Miscellaneous Revenue Act (TAMRA) of 1988 eliminated the unlimited marital deduction to estates where the surviving spouse is a non-citizen. This was intended to prevent surviving non-citizen spouses from returning to their home countries with assets that would then escape U.S. estate taxes.

The non-citizen spouse may gain the unlimited marital deduction by becoming a U.S. citizen before the date for filing the decedent's estate tax return. The surviving spouse must remain a resident of the U.S. between the date of the decedent's death and becoming a U.S. citizen. Alternatively, the estate tax liability may be deferred until the non-citizen spouse's death by having the estate pass to a qualified domestic trust (QDOT). A QDOT may also be set up by a surviving non-citizen spouse with property that passes to him/her outright and must be established before the date for filing the decedent's estate tax return.

[14]IRC § 2105(a), Treas. Reg. § 20.2105-1(g).

Requirements for a QDOT include the following:

- At least one trustee must be a U.S. citizen or domestic corporation.
- Except for income, no distribution may be made from the trust, unless the U.S. trustee has the right to withhold estate tax on the distribution.
- Generally, all income must be paid to the non-citizen spouse annually.
- An election must be made on the decedent's estate tax return.
- The QDOT must comply with regulations to assure the collection of any tax imposed.
- If the trust assets exceed $2 million, the trust must 1) require at least one trustee that is a U.S. bank or trust company, 2) obtain a bond or letter of credit equal to 65 percent of the estate tax value of the trust corpus or 3) if the trust corpus is not more than $2 million, the trust document must prohibit investment of more than 35 percent of the trust's annual fair market value in offshore real estate.

There is an estate tax on the distribution of any principal from a QDOT prior to the death of the surviving non-citizen spouse, unless it is for a hardship situation. The estate tax due on the QDOT's assets, either at the time of a principal distribution or at the surviving spouse's death is based on the amount of the estate tax that would have been paid if the QDOT's assets had been included in the deceased spouse's estate at his/her death.[15]

Jointly Owned Property

Where one member of a married couple is a non-U.S. citizen, the couple's jointly owned property is not treated as though each spouse contributed equally to its cost. Instead, the deceased spouse is presumed to have paid for the entire value of the property and it is included in his/her estate for federal estate tax purposes. An exclusion is allowed, however, for the portion of the property that the non-U.S. citizen spouse can demonstrate represents his/her contribution.

Gift Taxes

U.S. citizens and residents are subject to gift tax on the transfer of worldwide assets. Both citizens and residents have a gift tax annual exclusion ($14,000 per donee in 2014) for present interest gifts. Each also has a lifetime gift tax exemption ($5.34 million in 2014) for transfers to U.S. citizens, or up to a $145,000 annual exclusion gift in 2014 to a non-U.S. citizen spouse, who would have qualified for the marital deduction if they were a U.S. citizen or resident alien.

Nonresident aliens do not have the lifetime gift tax exemption, but they do have the gift tax annual exclusion ($14,000 in 2014) for present interest gifts. Gift splitting is not available, even where the spouse is a U.S. citizen. Gifts to a U.S. citizen spouse qualify for the unlimited gift tax marital deduction, but gifts to a non-U.S. citizen spouse do not. The annual exclusion gift ($145,000 for 2014) to a non-U.S. citizen spouse is available. See Exhibit III in the Appendix for a comparison of the U.S. transfer taxes for resident and nonresident aliens.

Nonresident aliens are subject to gift tax only on gifts of real and tangible personal property that have U.S. situs for the purpose of gift taxes. This means that nonresident aliens may make unlimited gifts to U.S. citizens as long as the property in question has a situs outside the U.S.[16] Intangible property, such as stocks and bonds of U.S. corporations, U.S. business interests (e.g., partnerships), life insurance policies and mutual funds, generally do not have situs and are exempt from U.S. gift tax. Because transfers of intangible personal property are not subject to gift tax, but are subject to the estate tax (except for life insurance death benefits) if located in the U.S., a nonresident alien should take advantage of gifting opportunities during his/her lifetime to transfer intangible personal property.[17]

[15]IRC § 2056A.
[16]IRC §§ 2501(a)(1), 2501(a)(2) and 2511(a); Treas. Reg. § 25.2501-1(a)(1).
[17]Treas. Reg. §§ 25.2511-3(b)(3) and 25.2511-3(b)(4); Priv. Ltr. Rul. 82-10-055 (Dec. 10, 1981).

Life Insurance

Life insurance is a unique asset in that it provides an income-tax-free death benefit when paid out to beneficiaries at the insured's death. Life insurance also offers tax advantages to the policy owner during the insured's lifetime. Any earnings or cash accumulation within the policy is accumulated on a tax-deferred basis, and in some cases these earnings can be accessed by the policy owner income-tax-free. The income tax benefits and rules are exactly the same for U.S. citizens, resident aliens and nonresident aliens.

Life Insurance for Foreign Nationals

In addition to supplemental retirement income, college funding, debt reduction, emergencies and unexpected events, foreign nationals may be interested in purchasing life insurance for reasons a U.S. citizen or resident alien may not. For example, a foreign national may simply want a contract based in the U.S. because they believe that U.S. companies are more stable than those of their home country or because the policy type simply isn't available in their home country. A foreign national may wish to invest some of their wealth in U.S. corporations or mutual funds, in a tax-favored manner through the use of a U.S. variable life insurance policy that utilizes a variety of separate accounts in order to meet investment objectives.

Life insurance issued by a U.S. carrier on the life on a nonresident alien can provide the liquidity to pay estate taxes on U.S. situs property. Due to its income-tax-free death benefit, life insurance can be an extremely useful tool in mitigating the costs of estate taxes and maximizing inheritance to heirs. Resident aliens may consider having an irrevocable life insurance trust own the life insurance policy in order to keep the death benefit value outside of their taxable estate while still maintaining the ability to use the death benefit to pay estate taxes, as well as for additional layers of asset protection.

For estate tax purposes, life insurance death benefits in the estate of a nonresident alien insured policy owner are deemed to have a foreign situs and are therefore exempt from U.S. estate taxes. Since a nonresident alien can own the life insurance policy without income, gift or estate tax consequences, outright ownership is a popular model for nonresident aliens. However, a nonresident alien may wish to use an irrevocable trust if: (a) he or she is considering relocating to the U.S.; (b) he or she wishes to take advantage of the asset protection function an irrevocable trust offers; or (c) he or she would like the policy proceeds to pass through more than one generation free of estate or generation skipping transfer (GST) tax. The GST tax applies only where the transfer was subject to either U.S. gift or estate tax and was made to a "skip person" (e.g., grandchild, or a person two or more generations younger than the transferor).

The value of a policy issued by a U.S. company owned by a nonresident alien on the life of another (includes survivorship, where the policyowner was the first-to-die) has U.S. situs, making its fair market value includable in the taxable estate of the policyowner.

Life Insurance Sales to Nonresident Aliens

U.S. carriers generally have certain parameters surrounding the sale of life insurance on nonresident aliens. These parameters include, but are not limited to:

- Solicitation, application, negotiation and policy delivery must occur in the U.S.
- The owner (individual or entity) must have a U.S. domicile and billing address.
- The owner must have a U.S. tax identification number (TIN) or Social Security number.
- The medical examination and labs must be done in the U.S.
- Premium payments must be drawn on a U.S. bank account in U.S. dollars.

Appendix

Exhibit I – List of Countries with Estate and Gift Tax Treaty

It's outside of the scope of this document to detail how a treaty can affect the estate taxation of a nonresident alien's estate. The list below, however, outlines the countries with which the U.S. has an estate and gift tax treaty.[18]

Australia	Canada	France	Ireland	Netherlands	Switzerland
Austria	Denmark	Germany	Italy	Norway	United Kingdom
	Finland	Greece	Japan	South Africa	

Exhibit II – Estate Tax Situs for Nonresident Aliens

Type of Property	**U.S. Situs Property** Subject to U.S. Estate Tax	**Non-U.S. Situs Property** Exempt from U.S. Estate Tax
Real Property	Real Property (e.g., land, buildings, fixtures and improvements, condos and time-shares, growing crops, timber cutting rights and mineral rights) situated in U.S.	Real property located outside the U.S.
Tangible Personal Property	Property (e.g., cash/foreign currency, jewelry, paintings and automobiles) physically located in the U.S., except for certain works of art on loan for exhibition. Cash/currency is considered tangible personal property (although most forms of monetary instruments are not).	Tangible property in the possession of the foreign national if only temporarily visiting the U.S.
Bank, Brokerage and Fiduciary Accounts	Funds held by U.S. banks or other financial institutions, if used in conjunction with a U.S. trade or business and funds held in brokerage accounts. Deposits with domestic branches of foreign banks are also subject to trade or business requirement.	Savings accounts, checking accounts or certificates of deposit issued by a U.S. bank if not used in conjunction with a U.S. trade or business; funds held in a U.S. bank custody account; funds deposited in a foreign branch of a U.S. bank.
Qualified Retirement Plans	Assets held by plan administrators representing service for a U.S. company.	Pensions payable by non-U.S. persons.
Stocks	Shares issued by a U.S. corporation, irrespective of the situs of the certificates.	Shares issued by a foreign corporation even if the certificates are located in the U.S.
Debt Obligations	Debts held from U.S. persons, or of the United States, any state, any state political subdivision or the District of Columbia.	Exempt from U.S. estate tax where exempt from U.S. income tax or the interest is treated as sourced from outside the U.S.
Life Insurance	The value of a policy on the life of another (i.e., the interpolated terminal reserve or PERC value), issued by a U.S.-licensed insurance company and owned by the decedent.	The proceeds from an insurance policy on the life of a nonresident alien, owned by the nonresident alien, regardless of the insurance company's country of origin.
Annuities	The value of any commercial annuity issued by a U.S. insurance company on the life of another.	Annuities issued by foreign insurance companies.

[18]IRS. "Estate and Gift Tax Treaties (International). March 2013. www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estate-&-Gift-Tax-Treaties-(International).

Exhibit III – Comparison of U.S. Transfer Tax Application for Resident and Nonresident Aliens

	Resident Aliens	Nonresident Aliens
Assets Subject to U.S. Gift Tax	Worldwide Assets	Real and Tangible Personal Property Located in the U.S.
U.S. Gift Tax Annual Exclusion	$14,000*	$14,000*
U.S. Gift Tax Marital Deduction	Gift to U.S. Citizen Spouse: Unlimited Otherwise: $145,000,* Annually	Gift to U.S. Citizen Spouse: Unlimited Otherwise: $145,000,* Annually
U.S. Lifetime Gift Tax Exemption	$5,340,000*	None
Gift Splitting	Yes (with U.S. Citizen/Resident Spouse)	No
Assets Subject to U.S. Estate Tax	Worldwide Assets	U.S. Situs Assets
U.S. Estate Tax Exemption	$5,340,000* (Less Lifetime Taxable Gifts)	$60,000 (Approximately)
U.S. Estate Tax Marital Deduction	Gift to U.S. Citizen Spouse: Unlimited Otherwise: Need a QDOT	Gift to U.S. Citizen Spouse: Unlimited Otherwise: Need a QDOT

*2014 amount. Subject to annual adjustments for inflation.

Exhibit IV – Gift Versus Estate Tax Situs for Nonresident Aliens

Type of Property	Gift Tax	Estate Tax
Real Property in the U.S.	Yes	Yes
Tangible Personal Property in the U.S.	Yes	Yes*
Cash, Cash or Property in a U.S. Safety Deposit Box	Yes	Yes
Custodial/Brokerage Accounts	Yes	Yes
Debt Obligations of U.S. Government	No	No
Debt Obligations of U.S. Persons	Yes	Yes
Deposits in U.S. or Foreign Banks	No	No
Life Insurance on the Life of the Nonresident Alien	No	No
Life Insurance Policy on Life of Another Person	No	Yes
Shares of a U.S. Mutual Fund	No	Yes
Stock in Foreign Corporations	No	No
Stock in U.S. Corporations	No	Yes
U.S. Business Interests (Includes Partnerships)	No	Yes

*Except for certain works of art on loan for exhibition and tangible property in the possession of the foreign national if only temporarily visiting the U.S.

About International

NFP International was designed to ensure that multinational individuals, families and businesses are protected today, tomorrow and in the future. As an experienced team of experts in wealth transfer, accounting, tax planning, financing and wealth protection, NFP International can design and implement a strategy uniquely suited to your multinational clients' needs. As a part of NFP – a national organization that extends to you capabilities that go far beyond the scope of any one firm – you maintain your local presence and gain worldwide reach: the service, excellence and integrity of an established local firm, backed by the reputation, strength and resources of a national organization.

143527 05/15 (LIF-16155-13)