

Transfer Tax Considerations for Foreign Nationals

By Claire Durand



With today's growing global economy and increasing number of foreign nationals owning U.S. assets, life insurance agents should have a good understanding of international tax planning issues. So, what are some of the issues that are often overlooked when it comes to U.S. estate and gift taxes for non-U.S. citizens, otherwise known as foreign nationals?

Things to Consider for Foreign Nationals:

- The difference between a resident alien (RA) and a nonresident alien (NRA),
- One spouse is a foreign national, and
- The location (or situs) of property.

1) Residency: RA versus NRA

Planning can help minimize the impact of U.S. transfer taxes (gift and estate taxes) for foreign nationals. The first step is to determine whether or not an individual is a foreign national. Foreign nationals are either resident aliens (RAs) or nonresident aliens (NRAs). The difference is based on residency status and the individual's domicile.

For transfer tax purposes, an individual's domicile is defined as the location at which the person lives, even if for a brief time, and also intends to remain indefinitely. This is a subjective test, based on one's intent. However, there are some factors that can help determine an individual's domicile, such as location of the primary residence, family, the principal place of business and business interests, official documents such as visas, personal possessions and duration of stay, among others. If one's domicile is outside the U.S., then he or she will be classified as a NRA for U.S. gift and estate tax purposes.

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Resident Aliens

RAs are taxed similarly to U.S. citizens: all property transfers are subject to U.S. transfer taxes. Individuals considered RAs for transfer tax purposes (which can be inadvertent) may be shocked to find out that they will be subject to U.S. transfer taxes on assets owned worldwide, not just those located within the United States.¹

Nonresident Aliens

NRAs are taxed only on property deemed to be located in the U.S., and the rules differ for gift taxes versus estate taxes. For gift taxes, the lifetime gift tax exemption of \$1 million in 2009 is not available for taxable gifts made by an NRA. Although the U.S. estate tax rate is the same for NRAs, the estate tax credit is only \$13,000 and is not indexed for inflation. This allows only the first \$60,000 of an NRA's estate to be shielded from estate taxes, compared to \$3.5 million for U.S. citizens and RAs in 2009.

Cesar Lopez, a nonresident alien, passed away this year with an estate worth \$7 million. Cesar's estate included \$5 million worth of assets, considered to be situated within the U.S. Only those assets with a situs in the U.S. would be subject to U.S. estate taxation.

Gross US Assets	\$5,000,000
Gross Estate Taxes	(\$2,250,000) (\$5 million x 45%)
Less Credit	-_____13,000
Net Estate Taxes	(\$2,237,000)
Net Assets	\$2,763,000
U.S. Estate Shrinkage	[44.74%]

¹Some countries have tax treaties with the U.S. and their tax laws will take precedence in defining residence for individuals with assets in those countries. Other countries may offer tax deductions or credits to offset the double taxation.

2) U.S. Citizen or RA Married to a Foreign National

Other planning considerations occur when a U.S. citizen or RA is married to a foreign national. The unlimited marital deduction is generally disallowed if a spouse is a foreign national. Instead, a “super” annual gift exclusion (equal to \$133,000 in 2009, and indexed for inflation) is provided for present interest gifts to a non-U.S. citizen spouse.

RAs who are married to a U.S. citizen are able to use the unlimited marital deduction and the applicable annual gift exclusion (\$13,000 in 2009), as well as the lifetime gift and estate tax exemptions for transfers to their citizen spouse.

Gift splitting takes advantage of each spouse’s annual exclusion amount by allowing one-half of the total gift to be treated as being made by each spouse. Gift splitting is available only if each spouse is either a U.S. citizen or RA. Although NRAs can take advantage of the annual gift tax exclusion, NRAs are prohibited from splitting gifts.

Assets owned jointly by spouses (i.e., joint tenants with rights of survivorship or tenants by the entirety) are generally presumed to be owned one-half by each spouse. However, a U.S. citizen or RA who owns jointly-held property with a foreign national spouse will have its entire value includable in his or her estate at death if the surviving spouse is not a U.S. citizen. To exclude any portion of an asset from the estate, the executor must prove that the non-citizen spouse furnished consideration in acquiring the asset.

	RA	NRA
Unlimited marital deduction	No	No
Gift splitting	Yes	No
Annual gift tax exclusion	Yes	Yes
\$3.5 M Estate tax exemption	Yes	No (limited to \$60,000)

Andreas and Anna have \$10 million in assets titled as tenants by the entirety. If Andreas, a U.S. citizen, gifts \$200,000 in 2009 to his wife Anna, a Swedish national and NRA, then \$67,000 (\$200,000 - \$133,000) would be a taxable gift to his wife. Also, if Andreas is the first to pass away, then the entire \$10 million in jointly-held assets would be includable in his estate.

3) The Location of Property

Another consideration is the determination of where the property is located, its situs. Tax rules differ for estate and gift taxes depending on the property's situs.²

NRAs are subject to U.S. gift and estate taxes for property deemed to be situated in the U.S. In addition, situs rules differ depending on the type of property being transferred. Gifts of intangible property (such as U.S. bank deposits, stock in a U.S. corporation or life insurance policy ownership interest) are generally not subject to U.S. gift taxes, but may be subject to U.S. estate taxes. NRAs are only subject to gift taxes when gifting real property or tangible personal property located within the U.S. at the time of the gift.

Life Insurance

An NRA can own life insurance on his or her life, and the death benefit will not be subject to estate or income taxes. Income, such as withdrawals of gains, received by NRAs from a U.S. carrier-issued life insurance policy is subject to a 30% tax and withholding.³ Withholding generally occurs only if there's income and is not caused by withdrawing up to basis or by taking a loan from a policy that isn't a modified endowment contract (MEC).

Life insurance owned by NRAs

Gift taxes	No
Estate Taxes	No

Since NRAs have a low estate tax credit of \$13,000, life insurance can be a great option for providing liquidity to pay estate taxes on U.S. situated property.

In Conclusion

A solid understanding of the U.S. transfer taxation of resident and nonresident aliens will help you to assist financial advisors in preparing an appropriate gift and estate tax plan for clients who are foreign nationals or are married to foreign nationals. Transamerica has a dedicated international underwriting team as well as marketing materials for support on international cases.

²Some countries that have tax treaties with the U.S., so those country's tax laws will take precedence in defining residence and situs for individuals with assets in U.S. or that country. Other countries may offer tax deductions or credits to offset the double taxation.

³Revenue Ruling 2004-75.