TAXATION

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2024 Estate and Gift Tax Conference

Panel 11: International Estate and Tax Updates

Friday, March 22, 2024

9:30am - 10:45am

Speakers: Jeb Burton, Kurt Kawafuchi, and Luz E. Villegas-Banuelos

Conference Reference Materials

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2024 Estate and Gift Tax Conference
California Lawyers Association
March 22, 2024

Jeb Burton – The Burton Law Firm
Kurt Kawafuchi - Kawafuchi LLLC
Luz E. Villegas – Chamberlain Hrdlicka

Duties for the Worldly U.S. Person

1. Worldwide taxation.
   a) Expatriation tax applies to U.S. citizens and long-term permanent residents ("green card" holders).
2. Strict and complex anti-deferral regimes:
   a) Subpart F (Section 951).
   b) Investment in U.S. property (Section 956).
   c) GILTI (Section 951A).
   d) PFIC (Section 1297).
   e) Throwback tax (Section 666).
3. Information return requirements:
   - Foreign Financial Account – (FinCEN) Form 114 (FBAR)(Title 31).
   - CFC – Form 5471.
   - PFIC – Form 8621.
   - Investment in the U.S. via single-member LLC, 25% foreign-owned US corp. or foreign corporation doing business in U.S. – Form 5472.
   - Foreign partnerships – Form 8865.
   - Foreign trusts – Form 3520A/3520 (including gifts/bequests from foreign persons).
   - Specified foreign financial assets – Form 8938.
   - Expatriation – Form 8854.
   - IRC reporting generally suspend statute of limitations & penalties are at least $10k or sometimes greater such as $25k (Frm5472) or 5.0% of value

U.S. Persons

The following individuals are considered U.S. persons for federal income tax purposes (IRC Section 7701(a)(30)):

1. U.S. citizens, irrespective of their place of residence;

2. U.S. resident aliens:

   a) Lawful permanent residents of the U.S. (i.e., green card holders);
   b) An individual who meets the substantial presence test.
   c) An individual who makes a first-year election for status as a U.S. resident alien, provided that he meets certain additional requirements.

3. U.S. resident aliens through the dual resident tie-breaker rules.
   a) A dual resident is "an individual who is considered a resident of the United States pursuant to the internal laws of the United States and also a resident of a treaty country pursuant to the treaty partner's internal law." Treas. Reg. Section 301.7701(b)-7(a)(1)

Treaty Dual Residency Tie-Breaker Rules

- Virtually all tax treaties include rules for resolving the residence for income tax purposes of dual resident taxpayers; we refer to these rules as "residency tie-breaker rules."

- Under the residency tie-breaker rule, the country of residency of a dual-resident taxpayer is determined by reference to the following facts in order of priority:Permanent home.
  a) Center of vital interest.
  b) Habitual abode.
  c) Nationality.

- Treaty saving clause for U.S. citizens and residents
- Many states including California determine residency if a taxpayer is a resident or domiciled in state

FBARS AND TREATY POSITIONS

- ***Aroeste v. United States***

It is a non-willful FBAR case. The District Court applied the interconnected statutes and regulations of Titles 31 and 26 to help determine who qualifies as a "United States person"; specifically with reference to international law and obligations set forth in the Treaty. The key question in that case remains to be answered is who (specifically Mr. Aroeste and by extension to a pool of millions of green card individuals residing outside the United States who are not citizens*) must file FBARs?

BACKGROUND TO THE DECISION – THE FBAR REQUIREMENT

- The Financial Crimes Enforcement Network (FinCEN) is a unit of the U.S. Treasury Department.
- Under the Bank Secrecy Act, Title 31 U.S. Code, FinCEN requires United States persons to file each year a Report of Foreign Bank and Financial Accounts (known to all as the FBAR) arises from Bank Secrecy Act, Title 31, if the aggregate value of all foreign accounts exceeded $10,000 during the year
  - Includes signatory authority or other authority over accounts
- In 2010, FinCEN promulgated a regulation that defined *who* is subject to the FBAR filing requirement that became effective in 2011. This regulation included United States citizens, residents, and certain entities.
- Before 2011, the term "United States resident" was not defined. The new regulation adopted the tax law definition contained in Title 26 U.S. Code (*i.e.*, the U.S. Internal Revenue Code, or "IRC") section 7701(b), but with a definition of "United States" that included U.S. territories.

AROESTE V. UNITED STATES - BACKGROUND

- The Aroestes were lifelong citizens and residents of Mexico.
- They obtained green cards in the early 1980s.
- Estela Aroeste became a U.S. citizen in 2011.
- They originally filed joint Forms 1040 (U.S. Individual Income Tax Return) for several years. The years at issue in the case are 2012 and 2013.
  - The status "Married Filing Jointly" is only permitted if either (a) both spouses are U.S. citizens or residents or (b) one of the spouses is a U.S. citizen and the two elect to be treated as residents and waive treaty benefits (IRC section 6013(g).
- They were advised to enter into Offshore Voluntary Compliance Program (OVDP) to correct compliance failures relating to non-U.S. income and assets.
- They later opted out of the OVDP. Mr. Aroeste filed a separate return as a nonresident under U.S.-Mexico Income Tax Treaty (filing Forms 1040NR and Forms 8833).

AROESTE V. UNITED STATES - BACKGROUND

- Following their opting out of the OVDP, a Revenue Agent audited the taxpayers for several years.
- The agent "assessed" FBAR penalties on a per-account basis.
- The agent also assessed income tax deficiencies as well as penalties for failure to file international information returns that are required of U.S. persons.
- The case that has been decided at the District Court level concerns FBARs. The income tax case pending before the U.S. Tax Court has not yet been decided.

AROESTE V. UNITED STATES - PROCEDURE

- The U.S. government filed suit to reduce FBAR penalties to judgment in Southern District of Florida.
  - Could never perfect service on Aroestes who reside in Mexico and thus government dropped suit Florida and counterclaimed in California.
- Alberto and Estela filed an illegal exaction claim under the Little Tucker Act in Southern District of California.
- There is also a pending Tax Court case that deals with the Aroestes and the tax treatment of Mr. Aroeste's claim not to be a U.S. resident. No judgment has yet been issued in that case.

THE DISTRICT COURT DECIDES THE CASE

- On November 20, 2023, on motions for summary judgment by both parties, Judge Anthony Battaglia denied the government motion and mostly granted Mr. Aroeste's motion for a discharge of FBAR penalties and a refund of the penalties already paid because treaty nonresident. *Aroeste v. United States*, No. 3:22-CV-00682 (S.D. CA).
- The judge ordered Mr. Aroeste to pay a penalty of $1,000 for each failure to file timely Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) to report his position that he was not a U.S. resident because of the application of the Treaty.
- In January, it was announced that the government had filed a notice of appeal of the judgment to the Ninth Circuit Court of Appeals. The appeal is pending.

AROESTE V. UNITED STATES – COURT’S ANALYSIS

The Court decided on a five-step analysis:

1. Under 26 U.S.C. § 7701(b)(6), anyone allowed to permanently reside within the United States by virtue of US immigration laws is a “lawful permanent resident” for tax purposes *unless* an applicable tax treaty allows that person to be treated as a resident of a foreign country for tax purposes only;
2. Under 26 U.S.C. § 7701(b)(1)(A)(i), any “lawful permanent resident” is a “resident alien”;
3. Under 31 C.F.R. § 1010.350(b)(2), any “resident alien” is a “resident of the United States”;
4. Under 31 C.F.R. § 1010.350(b), any “resident of the United States” is a “United States person” required to file an FBAR;
5. Therefore, any person allowed to permanently reside in the United States by virtue of US immigration laws must file an FBAR unless that person is entitled to be treated as a resident of a foreign country under a tax treaty

WHAT IS THE EFFECT OF A TAX TREATY?

- Income Tax Treaties, and Estate and/or Gift Tax Treaties
- Because FinCEN had adopted the definition of residence in the IRC, the question arose, what if an individual meets the statutory definition, as supplemented by Treasury Regulations, but is nevertheless treated as a resident of another country with which the United States has an income tax treaty and, under the tiebreaker provision of the treaty, the individual is treated as a resident of the other country.
- The FinCEN regulations, the FBAR, and the instructions to the FBAR are all silent on this point. In the preamble to the regulations when they were issued in 2011, FinCEN stated, "[a] legal permanent resident who elects under a tax treaty to be treated as a non-resident for tax purposes must still file the FBAR." Judge Battaglia rejected the government's reliance on this language given the plain language of the regulation itself, which makes no mention of any exception for individuals who are nonresidents under a treaty.

TREATY PROVISIONS ON RESIDENCE

- The U.S.-Mexico Tax Treaty contains a "tie-breaker", based on an OECD model. Almost identical provisions appear in numerous tax treaties. Article 4 provides a series of tests to be applied in order of priority:

  " 2. Where . . . an individual is a resident of both Contracting States, then his residence *shall* be determined as follows:

  a) he *shall* be deemed to be a resident of the State in which he has **a permanent home** available to him; if he has a permanent home available to him in both Contracting States, he *shall* be deemed to be a resident of the State which his personal and economic relations are closer (**center of vital interests**);
  b) if the State in which he has his center of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he *shall* be deemed to be a resident of the State in which he has an **habitual abode** . . . .
  c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
  d) in any other case, the competent authorities of the Contracting States shall settle the question by mutual agreement."

- The Judge held (and the government conceded) that under Article 4, Mr. Aroeste was a resident of Mexico.

FBARS AND TREATY POSITIONS

- ***Kurotaki v. United States (10/10/23)***

This is a willful FBAR case. The U.S. District Court for Hawaii denied the government's motions for summary judgment because the government could not show a lack of a factual dispute, i.e., that Mr. Kurotaki acted reckless, when, among things, even though Mr. Kurotaki had a green card, he resided and worked in Japan, and the Japanese translation of the reporting requirement was different than the U.S. version.

- ***Bittner v. United States***

On February 28th, 2023, the Supreme Court of the United States ("SCOTUS") resolved in *Bittner*, that the applicable non-willful FBAR penalty is not measured by every foreign account of the individual as the Service has argued for years. That case also dealt with non-willful filing of FBARs and the SCOTUS concluded the IRS cannot impose penalties of $10,000 on each and every account held; but rather the penalty is "per report" that was not correctly filed. Hence, the total maximum penalty per year is $10,000.

- ***Moore v. United States (No. 20-36122)***

On June 26, 2023, the Supreme Court of the United States ("SCOTUS") granted certiorari to review the constitutionality of the IRC §965 mandatory repatriation tax. Among other things, the taxpayer contended that the tax violated the 16th Amendment because there was no distribution or realization event. In the lower courts, the taxpayer had argued that the tax was excessively retroactive and violated the 5th Amendment due process guarantee.

- *__Farhy v. Commissioner, 160 T.C. 6 (4/3/23)__*

In a collection due process (CDP) case involving a levy, the U.S. Tax Court held that the Form 5471 penalty against an individual taxpayer is not assessable, and IRS may have to bring suit to recover penalty.

CAVEAT: IRS appealed. Stay tuned!

- *Boechler v. Commissioner, 142 S. Ct. 1493 (2022)*

The Supreme Court of the United States ("SCOTUS") held that the 30 day deadline to file an appeal based upon a collection due process (CDP) notice is directional rather than jurisdictional, and thus, subject to equitable tolling. While it is expected that the taxpayer may not prevail in this case, taxpayers in limited cases may be able to argue equitable tolling, and thus, preserving their right to appeal CDP notices eventually to the U.S. Tax Court. Further, other IRS deadlines may subsequently be held to be directional rather than jurisdictional.

GREEN VALLEY INVESTORS, LLC V. COMMISSIONER

- Found that, "Legislative rules impose new rights or duties and change the legal status of regulated parties."
- These require Notice-and-Comment under the APA.
- Most of IRS listed transactions were not APA-compliant.
  - The IRS has already amended its approach, the proposed regulations for Maltese pension plans are in direct response to *Green Valley Investors*.
- All IRS material other than regulations that impose new duties are vulnerable under this case.

CHRISTENSEN V. U.S.

- At issue, was whether the Net Investment Income Tax (NIIT) was included in the tax treaty between the US and France.
  - If so, the foreign tax credit could be used against the NIIT.
- Deference to a tax treaty interpretation by the government requires both governments to hold this interpretation.
  - This is particularly so because the foreign government was not officially notified of the NIIT.
- Taxpayer prevailed: The foreign tax credit under the U.S.-France Tax Treaty is distinct from the IRC § 901 foreign tax credit.
- This Court of Federal Claims case is on appeal with the Federal Circuit.

ROST V. U.S.

- “[T]he IRS is not obligated to promulgate a regulation listing all foreign entities that are or may be classified as a foreign trust.”
- A generic facts and circumstances test is sufficient.
- A Stiftungen under Liechtenstein law was a foreign trust because a legal titleholder held the assets with a fiduciary relationship toward beneficiaries under a prohibition to engage in commerce.

Gift & Estate Tax – Domicile

- U.S. transfer taxes are imposed on the FMV of the worldwide assets of U.S. citizens or residents (See IRC Section 2031, defining the decedent's gross estate to include the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated).

- Treasury Regulations provide that a resident decedent "… is a decedent who, at the time of his death, had his domicile in the United States." Treas. Reg. § 20.0-1(a)(1).

- A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.
- Separate analysis independent of an individual's status for state income, estate, inheritance and gift tax purposes.

Gift & Estate Tax – Domicile

- Revenue Ruling 80-209.
  1. Person will be presumed domiciled in the U.S. if he/she:
     a) has the legal capacity to form intent necessary to establish domicile;
     b) must have expressed and displayed intent to make the U.S. his home without the intent to leave; and
     c) Person must be physically present in the United States.

  2. Presumption of domicile can be rebutted in the U.S.
  3. Rev. Rul. 80-209 applied to a decedent who entered the U.S. without a visa.

- Revenue Ruling 85-70. Deals with persons who are temporary visitors present in the U.S. at the time of death (found not domiciled).

U.S. Estate Tax – Gross Estate

Estates of Citizens or Residents
(U.S. Domiciled)

26 U.S. Code § 2031

(a)General
The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated.

U.S. ESTATE TAX – GROSS ESTATE

Estates of Non-Citizens,
(Not Domiciled)

26 U.S. Code § 2031

For the purpose of the tax imposed by section 2101, the value of the gross estate of every decedent nonresident not a citizen of the United States shall be that part of his gross estate (determined as provided in section 2031) which at the time of his death is situated in the United States.

Different tax consequences for different taxes. For example, U.S. corporate stocks and bonds are intangibles for U.S. gift taxes, but generally U.S. situs for U.S. estate taxes.

Nonrecourse liability: Estate of Hon Hing Fung, (2001) 117 TC 247, aff'd (2003, CA9) 91 AFTR 2d 2003-1228, 58 Fed Appx 328 (unpublished)(Estate argued loan was essentially nonrecourse but Court held that it was recourse liability and estate only entitled to proportionate share of liability).
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Back-to-back to transactions, e.g., loans, gifts, exchanges, etc., --- taxpayers sometimes mischaracterize transactions.

- ***<u>Estate of William A.V. Cecil v. Cmm’r, T.C. Memo. 2023-24, Code Sec 2512</u>***

In Cecil v. Commissioner (TC Memo 2023-24), the US Tax Court upheld the use of ‘tax affecting’ to determine the value of S corporation shares for Federal gift tax purposes. ‘Tax affecting’ is a valuation approach that applies a hypothetical entity-level tax to a pass-through entity’s taxable income, which reduces the value of the business.

ESTATE OF WILLIAM A.V. CECIL V. CMM'R, T.C. MEMO. 2023-24, CODE SEC 2512

- In November 2010, Mr. William Cecil Sr. and Ms. Mary Cecil (both since deceased) transferred voting and nonvoting stock in The Biltmore Company ("TBC") to their children and grandchildren. The IRS determined a $13-million combined gift tax deficiency in March 2014.
- The Biltmore Company, a Delaware S corporation, owns the Biltmore House, built by George W. Vanderbilt, and the surrounding acreage in Asheville, North Carolina. The house was inherited by his only daughter (William's mother) and remains the largest privately owned house in the United States. TBC offers tours of the house and gardens and also operates hotels, restaurants, retail stores, and various outdoor activities.
- The two biggest valuation issues to be decided dealt with whether TBC should be valued using an income approach or an asset approach (yielding drastically different value conclusions) and whether the earnings under the income approach should be tax affected.

OTHER ESTATE & GIFT TAX ISSUES -

- **2026 ISSUES IN PRE-IMMIGRATION PURPOSES**
- Draw back into a decedent's gross estate the value of any property that the decedent transferred during his lifetime for less than adequate and full consideration where the decedent retains the possession or enjoyment or the right to income from the property, or the right to designate persons who shall possess or enjoy the property. IRC § 2036(a)(1) & (a)(2).
- **Section 1014 issues of foreign-owned assets**
- **Estate and/or Gift Tax Treaties**
  - Issues may include domicile/residence, marital deduction, proportionate amount of U.S. estate and gift tax exemption, etc.

Tax Considerations: Maze
Federal income taxes, subchapter J. Subtitle A&B (Income & Transfer Taxes?)
Federal gift taxes IRC §2501 et seq. (subtitle B)
Federal estate taxes IRC §2101 et seq. (subtitle B)
Federal generation skipping §2601 et seq. (subtitle B)
California income taxes – CA Rev. & Taxation code §17731 et seq.

Relevant questions
Who is the Taxpayer?
Who is the Settlor/Grantor? Where is their residency?
Who is the Trustee? Where is their residency?
Who are the beneficiaries? Where is their residency?

The Structure

Our trust settlor is a Mexican national who does not have a U.S. passport. He has legal-source funds but is not anxious to level with his home government. He forms a U.S. trust (a directed trust under Delaware or South Dakota law) with a U.S. trustee and a U.S. bank custodian for assets that include U.S.-issued securities, treasuries, and foreign assets. The trust is a grantor trust because it is revocable (section 676). U.S. law does not see a completed gift. A trust need not be revocable to be a grantor trust (section 672(f)(2)(A)).

The trust has a foreign trust protector that has the power to remove the trustee or terminate the trust. U.S. law would consider the trust foreign because it has a foreign trust protector. Under some circumstances, a trust can be a foreign person for U.S. tax purposes even if it has a U.S. trustee, such as by giving a foreign person the right to terminate the trust or replace the trustee (section 7701(a)(31)(B) and (30)(E), reg. section 301.7701-7). Only U.S. tax resident trusts are required to file Form 8938, the tax analogue of a foreign bank account report.

PLR-101747-15

Under the terms of Trust, during the joint lifetimes of Settlors, each Settlor retains the absolute power to revest title in him or herself to any community property and any separate property that he or she contributed to Trust. Accordingly, based solely upon the information submitted and the representations made, we conclude that under § 676(a), during their joint lifetimes, each Settlor will be treated as the owner of that portion of Trust constituted of his or her interest in community property, if any, and the separate property that he or she contributed. Furthermore, we conclude that § 672(f)(1) will not prevent each Settlor from being treated under § 676(a) as the owner of that portion of Trust.

WHY EVEN HAVE A "FOREIGN TRUST"?

- Global world with global assets
  - Global family members (Residency in different countries)
  - **Taxpayers often don't know they have foreign trust and/or are subject to foreign trust reporting requirements (including 3520A and 3520), e.g., foreign retirement accounts including Superannuation Funds (e.g., Australia), foreign educational funds, fails definition of U.S. trust, etc.**
- Global estate planning needs
  - Necessities of planning with foreign assets
- Avoiding conflicts of law questions
  - Which law prevails (when assets and/or people are located in multiple jurisdictions?
  - Choosing the best forum; avoiding or minimizing disputes among beneficiaries residing in different countries.
  - Minimizing the cost of administration.

WHAT IS A "FOREIGN TRUST"?

- There is no clear and concise definition of a "trust" in the Internal Revenue Code and in the United States, trust creation is governed by state law.
- "…In general, the term "trust" as used in the [Code] refers to an arrangement created either by a will or by an *inter vivos* declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts."
- *"Generally speaking, an arrangement will be treated as a trust under the IRC if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit."*
- Treas. Reg. § 301.7701-4(a).

WHAT IS A "FOREIGN TRUST"?

- A foreign trust is any trust which is not a "United States person" ("USP") as defined in IRC § 7701(a)(30)(E). *See* IRC § 7701(a)(31)
  - Under IRC § 7701(a)(30)(E), a trust is a USP when the trust satisfies two objective tests - the *Court Test,* and the *Control Test.*
  - The *Court Test* requires a court in the United States to be able to exercise primary jurisdiction over the administration of the trust. Treas. Reg. § 301.7701-7(a)(1)(i).
  - The *Control Test* is satisfied when one or more USPs have the authority to control all substantial decisions of the trust. Treas. Reg. § 301.7701-7(a)(1)(ii).
  - The terms of the trust instrument and applicable law are applied to determine whether the Court Test and Control Test are satisfied. Treas. Reg. § 301.7701-7(b).

WHAT IS A "FOREIGN TRUST"?

United States Person

- The person exercising substantial control over the trust must be a United States Person as defined in Code § 7701(a)(30). Treas. Reg. § 301.7701-7(d)(1)(i).
- A Qualified Domestic Trust (QDOT) may be a foreign trust (US bank was co-trustee with foreign surviving spouse as other co-trustee). PLR 199918039.

Substantial Decisions

- Control is defined as "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." Treas. Reg. § 301.7701-7(d)(1)(iii).
- In analyzing who has "control" over a trust, "…it is necessary to consider all persons who have authority to make a substantial decision of the trust, not only the trust fiduciaries." *Id.*
- For ease of reference, we are referring to the positions of trustee, trust protector, and any power which gives a person control over a trust or its principal as a "*Control Position*".
- Substantial decisions are not ministerial decisions such as bookkeeping, collecting rents (or, presumably, other types of income), or carrying out investment decisions. Treas. Reg. § 301.7701-7(d)(1)(ii).

WHAT IS A "FOREIGN TRUST"?

Treas. Reg. § 301.7701-7(d)(1)(ii) - Substantial Decision

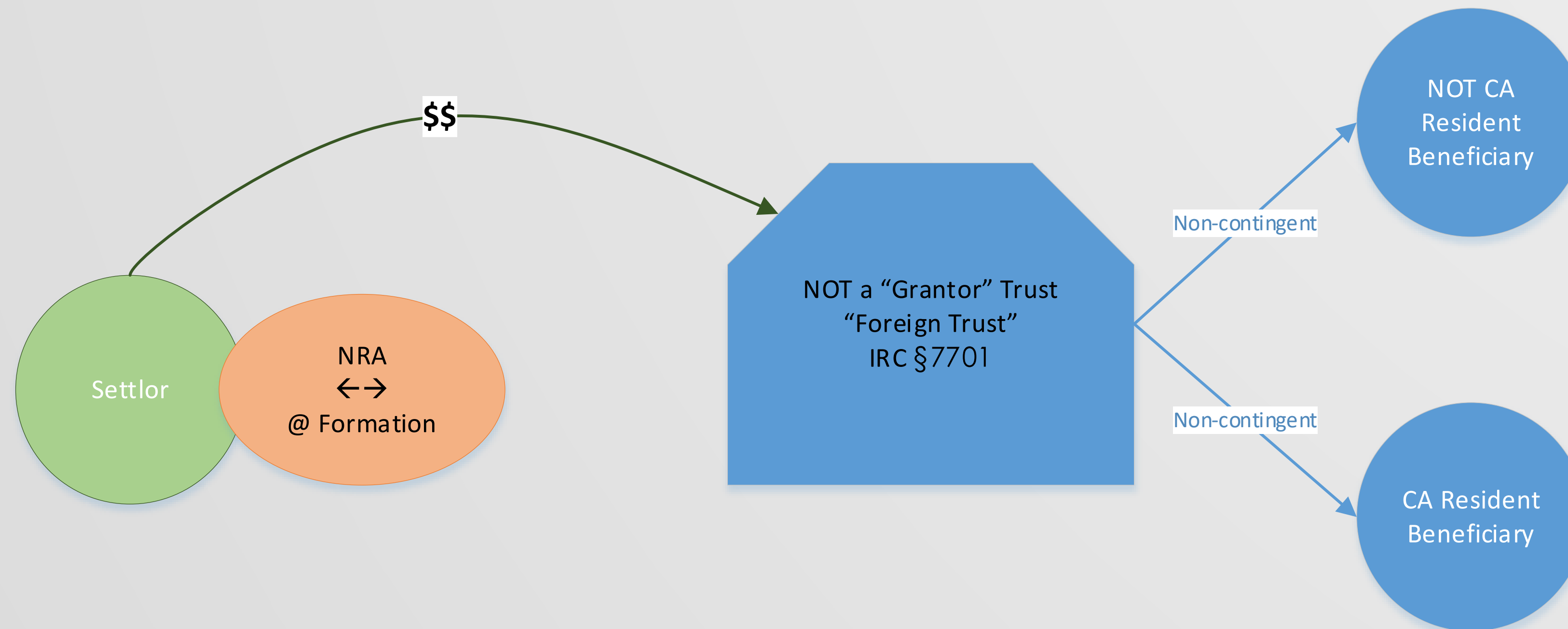
- Examples include:
  - Whether and when to distribute income or principal,
  - The amount of any distributions,
  - Deciding which beneficiaries should receive distributions
  - Allocating trust revenue between income and principal,
  - Deciding to terminate the trust,
  - Dealing with claims by or against the trust,
  - Determining whether to remove, replace, or add a trustee,
  - Exercising a power to replace a trustee who is unable or unwilling to continue to serve as trustee, and
  - Making investment decisions or exercising control over any investment advisors.

NOW THAT YOU HAVE A "FOREIGN TRUST" . . .

- What are the U.S. federal (and California, if applicable) tax consequences?
  - Information reporting requirements under U.S. law
  - Maybe the biggest "economic exposure item" for a foreign trustee and/or U.S. beneficiaries – e.g. of the trust assets.
- Necessity of foreign advice – foreign advisors
  - Foreign assets, non-U.S. resident beneficiaries, necessity for competent foreign legal advice.

See, Justin T. Miller & Richard S. Kinyon, When Should a Trust Be Subject to California Income Tax?, 2014 State Tax Today 98-6 (May 19, 2014).

BASIC EXAMPLE OF FOREIGN TRUST



FOREIGN TRUSTS – "TRAPS FOR THE UNWARY"

- U.S. Estate tax considerations.
- Transfer as part of pre-immigration planning.
- Information reporting requirements.
- California Income Tax Issues.
  - "Foreign Trust" status is not relevant.
- Throwback taxes.
- Tax returns & international information return.
  - Forms 3520 and 3520-A.
  - IRS Form 1040NR for Foreign Trusts.
  - IRS Form 1040NR for Grantor Trusts with NRA Settlor/Trustor.

EXPATRIATION, I.E., EXIT TAX (IRC §877A AND §877)

IRC §§877A and 877 (Form 8854)

- Deemed sale
- Applies to Covered Expatriate
  - U.S. Citizens
  - Long-term permanent resident aliens (green card holders) in 8 of 15 prior years
  - Meet tax liability, net worth or cannot certify compliance with IRS for prior 5 years
    - >$201k average net income tax liability for prior 5 years (2024)
    - $2 million or more in net worth
  - Exception for certain dual citizens
  - Exemption - $821k (2023)
  - Deferral on certain types of income or gains
  - Form 8854 – may be > one time and even annual filing. $10k penalty per each Form 8854
- Accidental expatriation
  - Example: Long-term U.S. permanent resident alien that could not travel to U.S. during pandemic including because of burdensome quarantine periods, e.g., 21 days, upon return to other country

IRC §2801 PROPOSED REGULATIONS

IRC §2801 Regulations – First proposed in 2015 (Form 708)

- Imposes 2801 on U.S. person receiving “covered gifts or bequests” from a “covered expatriate”
- Covered gifts include non-U.S. situs assets, intangible assets including U.S. stocks and bonds and stock in foreign corporations, and regardless of when acquired by covered expatriate
- Covered bequests apply to U.S. recipient/beneficiary from the gross estate of a covered expatriate if he/she had remained a U.S. citizen or resident
- Tax at highest rate-40%
- Liability for tax is upon U.S. person who receives the covered gift or bequest in addition to Form 3520 reporting requirement
- Deductions for marital and charitable deductions (Cont’d)

IRC §2801 PROPOSED REGULATIONS

IRC §2801 Regulations – First proposed in 2015 (Form 708) (Cont'd)

- Gift tax exclusions may *not* include annual exclusion, direct gifts for tuition and qualified medical expenses, political organizations, and waiver of pension rights but covered gifts and bequests must exceed annual exclusion amount
- Exceptions if "covered expatriate" timely filed U.S. gift or estate returns and timely paid U.S. gift or estate tax
- Applies to covered gifts or bequests on or after 6/17/08
- Return due 15th day of 18th month after close of year of gift or inheritance.
- U.S. trusts liable for gift or inheritance tax
- U.S. beneficiaries of foreign trusts liable for tax to extent attributable to covered gifts or bequests to the foreign trust. Potential income tax deduction.
- Rebuttable presumption of "covered expatriate" but may ask IRS to confirm with consent of "covered expatriate"

FOREIGN TAXPAYERS – "EXAMPLES OF OTHER TRAPS FOR THE UNWARY"

- IRS Denies Expenses and Credits for Foreign Taxpayers (Individuals, Corporations, etc.) Who Don't File or File Late
  - If foreign taxpayer doesn't file for 16 months after filing deadline (18 months for foreign corporations), the IRS can disallow all deductions and credits. See e.g., 1.874-1(b).
  - If foreign taxpayer doesn't file for at least 2 consecutive years by filing deadline, IRS can immediately disallow all expenses and credits for 2 years
  - Possible defense if taxpayer acted reasonably and in good faith
  - Very challenging to argue that taxpayer acted reasonably and in good faith if taxpayer provided certain withholding certifications, e.g., Form W-8ECI because it states at top that taxpayer must file U.S. income tax returns each year.

Kurt Kawafuchi

Law Offices of Kurt Kawafuchi LLLC
(808) 688-8986
kurtkkawafuchi@icloud.com

Jeb U. Burton

The Burton Law Firm
916.822.8700
jburton@lawburton.com

LUZ E. VILLEGAS

Chamberlain Hrdlicka
210.278.5837
luz.villegas-banuelos@chamberlainlaw.com