

THE U.S. FEDERAL

How Immigration Status Affects Estate and Gift Taxation

By Paula Jones

WITH THE INCREASE IN GLOBALIZATION, more people have a legal connection to more than one country. These connections, such as a client's citizenship, residency, or physical location of assets, can trigger significant estate and gift tax consequences. It is vital that the immigration practitioner identify areas in which tax consequences may be triggered to aid the client in making proper immigration status decisions. The United States bases its taxing authority on four possible grounds—citizenship, residency, U.S. situs assets, and expatriation.

Citizenship

Any U.S. citizen making transfers during life is subject to the federal gift tax. 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. IRC §2031.¹ This means all property located inside and outside the United States.

The philosophy behind the U.S. citizenship basis for taxation is that citizenship offers a kind of insurance policy. U.S. citizens have the protection of the U.S. government wherever they travel, and they can return to the United States at any time.² Taxation is the "payment" for the benefits a U.S. citizen enjoys regardless of where they are.

Legal Residency

The second ground for federal estate and gift taxation is U.S. residency. Any resident of the United States, regardless of citizenship, is subject to the federal gift tax when making transfers during life. At death, any U.S. legal resident is subject to the federal estate tax in the same way a citizen is. A resident's entire estate, "all property wherever situated," is taxable.

For those clients who keep a house in more than one country, determining residency is key.

PRACTICE POINTER: The determination of residency for income tax purposes is not necessarily related to residency for estate tax purposes. The definition of residency is different for both tax systems.³



TAXING AUTHORITY

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).⁴

Now, how does one prove “lack of intent to remove therefrom”? In order to determine the intent of an individual, many factors are considered. Such factors include the individual’s residential location, whether the person owns or rents a home, the size and value of any owned home, and 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 reference to residence on legal documents, passports, visa applications, voter registration, and income tax returns.

To illustrate how the definition of residency is determined, consider the case of *Estate of Paquette v. Commissioner*.⁵ The decedent in the case was a citizen of Canada and he lived in Montreal. During his retirement years, he spent seven summer months in Canada and five winter months at his vacation home in Orlando each year. The decedent died at his home in Florida. Internal Revenue Service (IRS) argued that the decedent was a resident of the United States, and therefore subject to the federal estate tax on his

estate, “wherever situated.” The decedent’s executor argued that the decedent was a resident of Canada. Canada has no estate tax, so only that portion of the decedent’s estate physically located in the United States would be subject to taxation by the United States on the basis of a nonresident foreign national. If the court ruled in IRS’s favor, the U.S. federal estate tax would be levied on all the decedent’s property wherever situated. That result would have caused a large amount of federal estate tax to be due to the United States.

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 *Paquette* was domiciled in Canada and no evidence demonstrated an intention to remain in the United States indefinitely. Even though the decedent sold his home in Montreal and transferred his tangible personal property to furnish his home in Orlando, the court held that 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. Evidence →

showed that he flew to Montreal regularly after the sale of his home there to meet with business and financial advisors, doctors, and his accountant.

The decedent also referred to himself as a resident of Montreal in his last Will and Testament. He filed income tax returns, voted, 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 Canada. The court found the decedent to be a resident of Canada for U.S. federal estate tax purposes and subject only to taxation on his U.S. situs property as a nonresident foreign national.

U.S. Situs Property of Nonresident Foreign Nationals

If the United States cannot base taxing jurisdiction on citizenship or residency, it can claim taxing jurisdiction on any property deemed to be situated in the United States. IRC §2103. Real estate located in the United States is deemed to be situated in the United States for purposes of the estate tax. Treas. Reg. §20.2104-1(a)(1). Similarly, any tangible personal property physically located in the United States generally has a U.S. situs as well. Treas. Reg. §20.2104-1(a)(2). However, the situs of intangible personal property is determined by law and depends on the type of asset. For instance, stock in a U.S. corporation has a U.S. situs (IRC §2104(a)), while insurance

The Tax Man Cometh: A Few Famous Words

Taxes, after all, are dues that we pay for the privileges of membership in an organized society.

—Franklin D. Roosevelt

The taxpayer — that's someone who works for the federal government but doesn't have to take the civil service examination.

—Ronald Reagan

America is a land of taxation that was founded to avoid taxation.

—Laurence J. Peter

I'm proud to pay taxes in the United States; the only thing is, I could be just as proud for half the money.

—Arthur Godfrey

The United States has a system of taxation by confession.

—Hugo Black

Why does a slight tax increase cost you two hundred dollars and a substantial tax cut save you thirty cents?

—Peg Bracken

Unquestionably, there is progress. The average American now pays out twice as much in taxes as he formerly got in wages.

—H.L. Mencken

The nation should have a tax system that looks like someone designed it on purpose.

—William Simon

The expenses of government, having for their object the interest of all, should be borne by everyone, and the more a man enjoys the advantages of society, the more he ought to hold himself honored in contributing to those expenses.

—Anne Robert Jacques Turgot

Be wary of strong drink. It can make you shoot at tax collectors ... and miss.

—Robert Heinlein

The art of taxation consists in so plucking the goose as to get the most feathers with the least hissing.

—Jean Baptist Colbert, attributed

Did you ever notice that when you put the words "The" and "IRS" together, it spells "THEIRS?"

—Author Unknown

We have long had death and taxes as the two standards of inevitability. But there are those who believe that death is the preferable of the two. "At least," as one man said, "there's one advantage about death; it doesn't get worse every time Congress meets."

—Erwin N. Griswold

Income tax returns are the most imaginative fiction being written today.

—Herman Wouk

If the Lord loveth a cheerful giver, he must hate the taxpayer!

—John Andrew Holmes

Of course the truth is that the congresspersons are too busy raising campaign money to read the laws they pass. The laws are written by staff tax nerds who can put pretty much any wording they want in there. I bet that if you actually read the entire vastness of the U.S. Tax Code, you'd find at least one sex scene ("Yes, yes, YES!" moaned Vanessa as Lance, his taut body moist with moisture, again and again depreciated her adjusted gross rate of annualized fiscal debenture").

—Dave Barry

Man is not like other animals in the ways that are really significant: animals have instincts, we have taxes.

—Erving Goffman

Taxes: Of life's two certainties, the only one for which you can get an automatic extension.

—Author Unknown

The purse of the people is the real seat of sensibility. Let it be drawn upon largely, and they will then listen to truths which could not excite them through any other organ.

—Thomas Jefferson


To force a man to pay for the violation of his own liberty is indeed an addition of insult to injury.

—Benjamin Tucker, *Instead of a Book*

policies on the life of a nonresident foreign national have a foreign situs. IRC §2105(a). Also, interests in partnerships conducting a U.S. trade or business have a U.S. situs. Rev. Rule 55-701.

One must look to the situs of the underlying assets to determine if business entities have a U.S. situs.⁶ Interests in trusts are determined by underlying assets as well. Rev. Rul. 55-163, 1955-1 C.B. 674. Any revocable or irrevocable transfer to a trust within three years of a decedent's death shall be deemed to be situated in the United States if the property transferred was situated in the United States at the time of the transfer or at the time of the decedent's death. IRC §2103(b).

Unlike the \$1 million exemption amount for U.S. citizens and residents, the federal estate tax exemption amount is only \$60,000 for nonresident foreign nationals in 2003. IRC §2102(c)(1). Nonresident foreign nationals also are subject to the federal gift tax involving lifetime transfers of U.S. situs property and are subject to the federal estate tax for the transfer at death of U.S. situs property.

 **PRACTICE POINTER:** Practitioners should note that the federal estate tax reaches all nonresident foreign nationals, not just those with the top 1 or 2 percent of wealth, as is the case for U.S. citizens and residents. For instance, if a nonresident foreign national has a gross worldwide estate of only →

The point to remember is that what the government gives it must first take away.

—John S. Coleman, address,
Detroit Chamber of Commerce, 1956

Philosophy teaches a man that he can't take it with him; taxes teach him he can't leave it behind either.

—Mignon McLaughlin,
The Second Neurotic's Notebook, 1966

Death and taxes may be inevitable, but they shouldn't be related.

—J.C. Watts, Jr.

I like to pay taxes. With them I buy civilization. —Oliver Wendell Holmes, Jr.

I shall never use profanity except in discussing house rent and taxes.

—Mark Twain

If, from the more wretched parts of the old world, we look at those which are in an advanced stage of improvement, we still find the greedy hand of government thrusting itself into every corner and crevice of industry, and grasping the spoil of the multitude. Invention is continually exercised, to furnish new pretenses for revenues and taxation. It watches prosperity as its prey and permits none to escape without tribute.

—Thomas Paine

Next to being shot at and missed, nothing is really quite as satisfying as an income tax refund. —F.J. Raymond

There's nothing wrong with the younger generation that becoming taxpayers won't cure.

—Dan Bennett

Pothinus: "Is it possible that Caesar, the conqueror of the world, has time to occupy himself with such a trifle as our taxes?" Caesar: "My friend, taxes are the chief business of a conqueror of the world."

—George Bernard Shaw,
"Caesar and Cleopatra"

There may be liberty and justice for all, but there are tax breaks only for some.

—Martin A. Sullivan

The income tax created more criminals than any other single act of government.

—Barry Goldwater

I don't know if I can live on my income or not—the government won't let me try it.

—Bob Thaves, "Frank & Ernest"

Any tax is a discouragement and therefore a regulation so far as it goes.

—Oliver Wendell Holmes, Jr.

Count the day won when, turning on its axis, this earth imposes no additional taxes.

—Franklin P. Adams

Taxation, for example, is eternally lively; it concerns nine-tenths of us more directly than either smallpox or golf, and has just as much drama in it; moreover, it has been mellowed and made gay by as many gaudy, preposterous theories.

—H.L. Mencken

Collecting more taxes than is absolutely necessary is legalized robbery.

—Calvin Coolidge

It's about ten times the size of the Bible — and unlike the Bible, contains no good news.

—Don Nickles,
about the Internal Revenue Code

The payment of taxes gives a right to protection.

—James M. Wayne

If we don't do something to simplify the tax system, we're going to end up with a national police force of internal revenue agents.

—Leon Panetta

There is an ancient belief that the gods love the obscure and hate the obvious. Without benefit of divinity, modern men of similar persuasion draft provisions of the Internal Revenue Code. Section 341 is their triumph.

—Martin D. Ginsburg

All the Congress, all the accountants and tax lawyers, all the judges, and a convention of wizards all cannot tell for sure what the income tax law says.

—Walter B. Wriston

The more you earn, the less you keep, And now I lay me down to sleep. I pray the Lord my soul to take, If the tax— collector hasn't got it before I wake.

—Ogden Nash

I can give you 1040 good reasons why I hate the government.

—Terri Guillemets, *The Quote Garden*

SOURCE: www.quotegarden.com

\$300,000 with \$100,000 located in the United States, federal estate tax must be paid. Though the tax in such a case would be minimal (about \$5,200), the practitioner must be careful not to overlook the federal estate and gift tax issues of a nonresident foreign national 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 in the past 10 years.

Roughly 220,000 legal resident Americans decide to permanently leave the United States each year.⁷ And 48,000 native-born Americans choose to permanently leave each year. Yet it is still possible for the United States to tax these individuals even if they have no property located in the United States. How? The U.S. estate tax is applied against the estate of an expatriate of the United States who is no longer a long-term resident or citizen. IRC §2107. The estate tax is imposed on those nonresident foreign nationals if,

within 10 years of the date of death, they relinquished citizenship or long-term residency, and if their principal purpose for leaving was to avoid taxation.

An individual is treated as having a principal purpose of avoiding taxation if the annual net income for the five taxable years prior to the loss of citizenship exceeded \$100,000 (indexed after 1996), or the net worth as of the date of the loss of citizenship is greater than \$500,000 (indexed after 1996). IRC §877(a)(2).

It appears the United States wants to make sure it gets a fair chance to maintain taxing authority over the wealthy—even after they permanently sever all ties to the United States.

In order to avoid the “principal purpose of avoiding taxes” requirement, an individual taxpayer may secure an IRS ruling confirming that the expatriation is not motivated by a desire to avoid taxes. Otherwise, an expatriate must simply survive for more than 10 years after permanently leaving the United States to avoid taxation.

Emigration actually may be used as an estate planning tool for some clients. Consider the wealthy woman who is a citizen of the United States. Her total estate is about \$16 million. She moves to Canada and has lived there for close to 30 years. She has no intention of moving back to the United States. However, since she is a citizen of the United States, her estate will be taxed at the rate of about 49 percent at her death. Emigration is a smart option for her in order to avoid an estate tax bill of approximately \$7 million.

However, once she renounces her U.S. citizenship, she still will be presumed to be emigrating for tax avoidance purposes—which is precisely her reason for leaving. If she survives another 10 years, this presumption is moot and she avoids federal estate tax on all assets except those physically located in the United States. Remember, Canada has no estate tax, so she saves \$7 million.

Conclusion

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. The immigration practitioner should be able to identify those areas in which tax consequences may sway his or her client's immigration status preference.

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Notes

¹ All references are to 26 USC §877 *et seq.*

² Doernberg, Richard L., *International Taxation*, 2001 West Group. Section 1.05.

³ 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.

⁴ All references are to 26 CFR §20 *et seq.*

⁵ *Estate of Paquette v. Commissioner*, 46 TCM (CCH) 1400 (Tax Ct. 1983-571).

⁶ *Sanchez vs. Bowers*, 70 F.2d 715 (2d Cir. 1934).

⁷ U.S. Census Bureau, 1995–97.