TEN KEY PRINCIPLES TO KEEP IN MIND WHEN PLANNING FOR U.S. CLIENTS WITH NON-U.S. FAMILY OR PROPERTY, AND NON-U.S. CLIENTS WITH U.S. FAMILY OR PROPERTY

(1) ***All citizens of the United States and U.S. residents are subject to U.S. federal transfer taxes on their worldwide assets.***

(2) Non-Resident Aliens (NRAs) ***may make unlimited gifts of U.S. financial assets (other than cash) completely free of U.S. federal gift and generation-skipping transfer taxes.***

Gifts NRAs make of all U.S. assets other than real and tangible property located in the United States are completely free of federal gift tax. The Internal Revenue Service considers gifts of cash from a U.S. bank account to be gifts of U.S. tangible properly subject to gift tax. By contributing intangible U.S. or foreign assets to a dynasty trust for the benefit of U.S. beneficiaries, the property can be available to the families of U.S. beneficiaries for generations to come, while being completely insulated from federal gift, estate and generation skipping transfer taxes.

(3) ***Estates of NRAs are subject to federal estate and gift tax only on U.S. property they directly own, not on property they own through foreign corporations.***

Estates of foreign persons who die owning U.S. assets are subject to U.S. estate tax on these assets, but with an estate tax exemption of only $60,000. But NRAs enjoy an exemption on proceeds of life insurance on the life of a foreign decedent, almost all U.S. bank deposits and accounts, and on virtually all U.S. debt instruments issued since July 1984.

(4) ***Gifts and bequests to non-U.S. citizen spouses that are subject to federal transfer taxes are not eligible for the gift and estate tax marital deductions.***

As a partial offset, the annual gift tax exclusion for gifts to a non-citizen spouse is increased tenfold (in 2006, $120,000), with adjustments for inflation. A marital deduction is available if the recipient of a bequest upon death is a qualified domestic trust (QDOT) for the non-citizen spouse's benefit. The most significant practical difference between a QDOT and a QTIP trust is that distributions of QDOT principal to the surviving spouse are generally subject to additional estate tax payable on April 15 of the subsequent calendar year.

(5) ***Direct contributions by U.S. individuals to foreign charities are generally eligible for the federal gift and estate tax charitable deductions, even though they are not eligible for the federal income tax charitable deduction.***

One exception is a charitable remainder trust (CRT) for which the named charities must be domestic.

(6) ***The United States imposes special tax regimes and reporting requirements on U.S. persons who own foreign assets through foreign corporations, partnerships and trusts.***

(7) ***Trusts can very easily become foreign trusts for U.S. federal income tax purposes, with substantial disadvantages for U.S. grantors and beneficiaries.***

To be a U.S. trust, a trust must be (i) subject to the primary supervision of a U.S. court (the "court test"), and (2) U.S. persons alone must exercise control over all substantial decisions affecting the trust (the "control test"). The control test is a trap for the unwary because the range of decisions that must be subject to the control of U.S. persons includes not only decisions made by formally designated trustees and trust protectors, but also by anyone else who has a power over the trust. Such powers include the power to appoint trust property (whether general or limited), to remove trustees or to appoint successor trustees, and, in some cases, to make investment decisions. Thus, for example, if a U.S. person establishes a lifetime domestic trust for the exclusive benefit of U.S. persons, but gives a Canadian relative the unrestricted authority to appoint a successor trustee, the trust would be a foreign~ trust for U.S. income tax purposes and these consequences would follow: (1) the trust would become a grantor trust with the U.S. grantor treated as the owner of the trust property and taxed during the grantor's lifetime as if the grantor still owned it; (2) if the grantor died and the assets of the trust were not eligible for a step-up in basis, gains tax would be due on the unrealized appreciation of the trust's assets; and (3) if the trust were not repatriated (by ending the unrestricted authority of the Canadian relative), the U.S. beneficiaries would be subject to the throwback tax on deferred distributions of income earned after the trust became a non-grantor trust, with capital gains for this purpose being converted to ordinary income and the imposition of an interest charge on the tax at the tax underpayment rate.

(8) ***U.S. persons living abroad or owning property abroad often must contend with "heirship" regimes and property regimes that may be inconsistent with their estate-planning goals.***

This is especially so in civil law countries such as France or Spain where children must receive outright a portion of a deceased parent's estate, statutory heirs (whether spouse or issue) cannot easily waive inheritance rights, and trusts are often not recognized.

(9) ***A U.S. citizen domiciled in a foreign country with estate or inheritance taxes may be subject to double transfer taxation—unless that person lives in, or owns property in a jurisdiction with, a favorable U.S. transfer tax treaty.***

U.S. citizens who reside in countries that have estate taxes but with whom the United States does not have estate tax treaties, such as Belgium, Spain, and the former Eastern bloc countries are subject to a serious risk of double taxation and are especially in need of careful planning.

(10) ***Most U.S. citizens owning assets outside the United States should consider a U.S. limited liability company (LLC) to hold foreign assets in order to reduce exposure to foreign inheritance law and taxes.***

This might be done by transferring legal title in foreign property to U.S. entities that foreign countries will not look through to apply their inheritance and property rules or impose their transfer taxes when interests in the U.S. entities are transferred or when the U.S. owner dies. It is critical to review the law of each non-U.S. jurisdiction in which property is located to determine the degree of protection this technique will afford.