United States

1. Types of tax

1.1 Estate tax

The United States (US) imposes an estate tax on the transfer of a decedent's taxable estate, also known as the gross estate, at death. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Tax Act) established a top estate tax rate for US citizens and residents of 35% and a $5 million exemption for years 2010 (so long as a carryover basis regime was not elected), 2011 and 2012, with the estate tax exemption indexed for inflation in 2012. Prior to the 2010 Tax Act, the 2001 Economic Growth and Tax Relief Reconciliation Act (2001 Tax Act) provided for fluctuating top rates and exemption amounts and totally repealed the estate tax in year 2010. Because the 2010 Tax Act only governs years 2010, 2011 and 2012, the estate tax will revert to how it existed prior to the passage of the 2001 Tax Act in 2013 and beyond, absent anticipated legislative action. Prior to the 2001 Tax Act, US citizens and residents were entitled to an exemption of $1 million of value transferred at death and subject to a top estate tax rate of 55%. Unlike US citizens and residents, non-resident aliens receive a reduced estate tax exemption. Therefore, estates of non-resident aliens will trigger US estate tax to the extent that the total value of their US *situs* assets exceeds $60,000.

The US estate tax law imposes tax liability on all US citizens and residents. See Section 2.2 for a discussion of who is a US resident and a US non-resident alien for estate tax purposes. The estate tax will ultimately be assessed upon the gross estate, less applicable deductions. For a US person, the gross estate is the fair market value of a decedent's worldwide assets at date of death (the taxpayer may also elect an alternative valuation date six months after date of death). See Section 5.1 for filing procedures.

For an individual who is neither a US citizen nor a resident (i.e., a non-resident alien), the gross estate only includes US *situs* property owned at death. US *situs* property includes real and tangible personal property located in the US, stock or options issued by a US corporation, debt of a US person (except portfolio debt), deferred compensation and pensions paid by US persons, and annuity contracts enforceable against US obligors. It does not include US bank deposits, insurance on the life of a non-resident alien or pensions payable by non-US persons. The US Internal Revenue Code (IRC) determines the *situs* of different types of property, the treatment of which may receive modification by the application of estate and gift tax treaties that the US has concluded with various countries (see list at Section 12).

Retained interests

Due to the retained interest rules, the reach of the estate tax is broader than simply the assets the decedent owned at death. Notwithstanding attempts to make lifetime transfers, some transferred property may be deemed to remain within the decedent's gross estate at his death. This applies to the following retained interests: 1) certain gifts made within three years of death; 2) transfers with a retained life estate; 3) transfers taking effect at death; 4) certain annuities; 5) interests owned jointly; 6) transfers that provide for broad powers of appointment; and 7) revocable transfers. In each case, the IRC applies rules to govern the circumstances in which assets that the decedent attempted to transfer are nevertheless included in the gross estate of the donor. The definition of the gross estate of a non-US domiciliary is "that part of his gross estate … which at the time of his death is situated in the United States." Therefore, the estate will be subject to the same definitions of retained interests or powers as those that apply to the estate of a US citizen or domiciliary — limited by the *situs* rules.

Situs rules provide that property subject to the retained interest transfer rules will be deemed situated in the US if such property was so situated either at the time of transfer or the time of death. This presents a number of issues for estate planning with respect to non-resident aliens. A transferor should therefore remain aware that transferring US property into a foreign entity may not convert the property to foreign *situs* property, even if the foreign entity no longer holds US property at the date of death.

Basis

All property subject to the estate tax receives a step-up in basis to its fair market value on the day of the decedent's death. Each transferee takes the property with full fair market value basis for federal income tax purposes regardless of the transferor's historical cost or basis adjustments. For year 2010 only, an estate could have elected to have a carryover basis regime apply and no federal estate tax, rather than receive a step-up in basis and an estate tax exemption (lifetime exemption) of $5 million.

State estate tax

A minority of states have a state-level estate tax. Where such taxes apply, the state level estate tax is normally significant. Also, state tax rules for determining residence do not necessarily parallel the federal rules. Therefore, any non-US domiciled individual should also seek state tax advice to determine potential estate tax and informational filing requirements for property situated in a given state.

1.2 Gift tax

The US imposes a gift tax on all post-1976 transfers of property by gift made by any US person. See section 2.2 for a discussion who is not deemed a US person. Gift taxes apply to the fair market value of the transferred assets as of the date of the gift. An annual, per donee exclusion (annual exclusion) exists that is indexed for inflation to $13,000 in 2011. In 2011, each US person is also entitled to an exemption against tax in the amount of the tax on the first $5 million of gifts. This exemption (applicable exclusion amount) is further indexed for inflation in 2012. The tax rates on gifts in excess of the exemption range from 18% to 35% in 2011 and 2012. In 2013, the exemption is scheduled to return to $1 million, with a top rate of 55%. See section 5.2 for filing procedures.

US law subjects US citizens and residents to gift tax on transfer of all property, tangible and intangible, regardless of the location of the property. A US citizen or resident remains exempt from gift tax on annual exclusion transfers (other than gifts of future interests in property) and gifts to a US citizen spouse, or up to $134,000 in 2011 (as indexed for inflation), to a non-US citizen spouse.

Unlike US citizens and residents, non-resident alien individuals do not receive a gift tax exemption. Furthermore, every transfer of US *situs* property by a non-resident alien in excess of the gift tax annual exclusion ($13,000 in 2011, as indexed) is subject to gift tax. Non-resident aliens must generally pay gift tax on transfers of real property and tangible property located in the US. Intangible property, including stocks and bonds, is generally exempt. Non-resident aliens, citizens and residents share the same gift tax rates. See section 2.2 for a discussion of who is a US resident and a US non-resident alien for gift tax purposes.

1.3 Real estate transfer tax

Individual states, counties and municipalities may impose a transfer or recordation tax on conveyances of real property. Generally, the transferor (individual or entity) remains liable for any tax due upon transfer; however, local customs vary as to how such costs are allocated among the transferor and transferee. Furthermore, indirect transfers of real estate through the sale or exchange of stock or partnership interests may also result in transfer taxes if the entity itself owns real estate. Although no federal transfer or recordation tax exists upon a transfer of real estate, if the underlying transfer constitutes a sale, the transaction may trigger both state and federal income taxes.

Exceptions to the general rule may apply in situations where no change in the beneficial ownership of the property occurs, e.g., when the transfer occurs for purposes of securing financing or if the owner transfers property to a revocable trust controlled by the original property owner.

1.4 Endowment tax

Currently, no endowment tax laws exist in the United States.

1.5 Transfer tax

A minority of states independently retain inheritance tax regimes. Generally, inheritance tax provisions do not impose taxes on transfers to spouses and descendants. Although, in the limited circumstances where inheritance taxes do apply, the impact can result in significant tax burdens, with rates ranging up to 20%.

1.6 Net wealth tax

US federal law does not impose a net wealth tax, but individual localities may impose such a tax on certain real and personal property interests. If at all, property subject to tax at the state and local level includes real estate, vehicles, boats, aircraft, livestock and intangible personal property. The tax generally only subjects real property or personal property physically situated within the specific taxing locality to this tax. Intangible property, if taxed at all, is generally taxable only to individual taxpayers residing within the locality, whereas personal property used in a trade or business carried on in the state or locality can subject individuals to tax based on their contacts with the taxing jurisdiction instead of on the basis of their residence.

1.7 Expatriation (exit) tax

Before 17 June 2008, the United States did not have an exit tax. However, reporting requirements and potential US income tax liability still burdened former US citizens and former long-term residents under a complex set of rules generally in effect for each expatriate for 10 years following expatriation.

Effective from 17 June 2008, the new US exit tax regime subjects certain individuals known as covered expatriates to immediate taxation on the net unrealized gain in their property exceeding $600,000 (see below). The tax treats covered expatriates as if they sold their worldwide property for fair market value the day before expatriating or terminating their US residency. In general, covered expatriates include US citizens and long-term residents (green card holders for any part of eight tax years during the preceding 15 years) who have a five-year average income tax liability exceeding $124,000 (indexed for inflation; $147,000 for 2011) or a net worth of $2 million or more. As stated above, a taxpayer recognizes net gains to the extent that they exceed $600,000 ($636,000 for 2011, as indexed for inflation). This treatment applies to most types of property interests held by individuals.

The above rules also affect the taxation of certain deferred compensation items (including foreign and US pension plans), interests in and distributions from non-grantor trusts and certain tax-deferred accounts (e.g., 529 plans, Coverdell education savings accounts and health-savings accounts) by accelerating the taxation of these amounts absent certain exceptions.

At the election of the taxpayer and subject to Internal Revenue Service (IRS) approval, the expatriating taxpayer may defer payment of the exit tax upon presentation of adequate security. This tax deferral election remains irrevocable, carries an interest charge and requires the taxpayer to waive any treaty rights with respect to the taxation of the property.

US citizens or residents receiving gifts or bequests of more than $10,000 (indexed for inflation) from covered expatriates are taxed at the highest gift or estate tax rate currently in effect (35% in 2011 and 2012). Under the general US gift tax rules, the IRS assesses the tax on the donor. However, in situations where a covered expatriate makes a gift or bequest to a US citizen or resident, the IRS imposes the gift tax liability on the donee. This rule does not appear to have a time limit either. So, the tax on gifts or bequests from a covered expatriate to a US citizen or resident may be assessed at any time when the receipt of such a gift or bequest occurs after the expatriation of the covered expatriate.

1.8 Generation skipping transfer tax

In 1986, the US Congress enacted a generation-skipping transfer (GST) tax designed to prevent wealthy individuals from transferring property to heirs more than one generation removed from such individuals and thereby allowing that property to pass without any estate or gift tax liability assessed to the generation(s) in between the transferee and transferor. The GST tax is imposed on all direct transfers taxable distributions and taxable terminations to skip persons. The IRC defines a skip person as one who is two or more generations below the transferor or a trust for which all beneficiaries classify as skip persons. In 2010, the GST tax rate was 0%, and for 2011 and 2012, the GST tax rate is 35%. In 2013, the GST tax is scheduled to return to a $1 million per transferor lifetime exemption and a top rate equal to the top estate tax rate, scheduled to be 55%. See Section 5.2 for filing procedures.

General

The GST tax potentially applies to all transfers of a US person's worldwide assets. See section 2.2 for an analysis of who is deemed a US person. As stated above, the GST applies to any transfer from one taxpayer to a skip person or any donee assigned to a generation two or more generations below the transferor. For taxable terminations and taxable distributions, the distributee is liable for a tax on the fair market value of the property received, allowing the distributee to pay the tax out of the property received. Similar to the estate tax, this is a tax-inclusive result. For direct skips, the law imposes a tax on the transferor with respect to the fair market value of the transfer at the time of the transfer — a tax-exclusive result like the gift tax. More specifically, primary responsibility for GST taxes rests with the transferee on payments of taxable distributions, rests with the trustee on taxable termination payments and rests with the transferor on direct skip transfers.

Property subject to GST tax

GST tax applies to all transfers by US persons to skip persons. For GST purposes, a non-resident alien can transfer non-US *situs* property without the transfer triggering GST tax, but transfers of US *situs* property do trigger the GST tax regime — whether covered by applicable exclusions or exemptions or taxable in nature. The definition of US *situs* property depends upon whether the transfer constitutes a gift or bequest. Lifetime gift transfers use the same *situs* rules as the gift tax, and bequests use the same *situs* rules as the estate tax. In addition to the application of general *situs* rules, estate and gift tax treaties the US has concluded with various countries may also modify the *situs* and treatment of an asset (see list at Section 12). Additionally, the GST tax also excludes property exempt from taxation by the gift tax annual exclusion or the qualified educational and medical expenses exclusion.

GST exemption

In 2011, US citizens, US residents and non-resident aliens have a GST exemption in the amount of $5 million — indexed for inflation in 2012. This GST exemption is scheduled to return to $1 million in 2013. A taxpayer may irrevocably allocate GST exemption to any property transferred during life or at death. The individual or the individual's executor can make the election on a timely filed gift or estate tax return. The law automatically allocates GST exemption to direct skip transfers up to the total amount of the transferor's remaining GST exemption, without further action by the transferor to affirmatively alter this allocation. Whether voluntarily elected or automatically imposed, the GST allocation applies to the pro-rata exempt amount, which always remains exempt from the GST tax — notwithstanding the amount of future appreciation. Non-resident aliens can elect to allocate GST exemption to US *situs* assets they transfer and, in some instances, forever shielding the assets from GST tax. If the initial transfer of property is non-US *situs* property, subsequent events that make the property US *situs* assets will not later trigger US tax.

2. Who is liable for US estate, gift and generation skipping transfer tax?

2.1 Residency

General

US law imposes income taxes on US persons — defined as US citizens and US residents — with respect to their worldwide income and imposes transfer taxes on their worldwide assets. However, income tax law determines residence differently than the US transfer tax law determines residence.

Income tax residence

US income taxation based on residence applies to US citizens and US residents. US residence is determined under two separate tests — substantial presence test and green card test. The substantial presence test calculates residence based on the number of days an individual spends in the US over a three-year period. An individual who is in the US 183 or more days over a three-year period meets this test for residency. The test determines the sum of the total number of days of presence by adding the total number of days of presence in the current year, plus one-third of the number of days in the previous year, plus one-sixth of the number of the days in the year prior to that. Any day, or portion of a day, counts as a day of presence in the US. Second, the green card test is based on an individual's US immigration status and treats a person as a resident for US income tax purposes if the individual obtains lawful permanent resident visa status. A person who fails to meet the citizenship inquiry and both tests for residence is considered a US non-resident alien. In addition to these regulatory tests under US law, income tax treaties entered into between the US and other jurisdictions can alter the residence inquiries. Each treaty should be analyzed separately for residence impact.

During the first year of US residency, special rules apply to determine the exact start date of US residency. If an individual is considered a US resident during a specific year, but was not a US resident at any time during the preceding calendar year, that individual is only a US resident for a portion of the year in question. The determination of the start date of residency depends under which test the individual obtains US resident status (e.g., substantial presence or green card). Under the substantial presence test, residency generally begins on the first day of presence in the US for the year, but up to 10 days of actual presence can be ignored if the individual had a closer connection to a foreign country and maintained a tax home in a foreign country. Under the green card test, residency begins on the first day of the calendar year on which the individual was present in the US as a lawful permanent resident. If a person meets both residency tests, residency begins on the earlier of the first day of presence under the substantial presence test or the first day as a lawful permanent resident.

2.2 Domicile

In contrast to income tax residence, the US transfer tax laws determine domicile in a more subjective manner. A person acquires a domicile by living at a location — even for a brief period — while possessing no definite, present intention of later removing therefrom. Domicile depends on the facts and circumstances of each particular case. An individual has exactly one domicile — no more, no less—and once established, the individual must explicitly exhibit the intent to leave the old domicile in favor of a new one. Courts in the US have relied on several distinct factors when attempting to discern an individual's domicile. These include written statements of intention, such as those included in wills, visa applications, trust agreements and deeds, the time spent in the US in comparison to other countries, the location and size of the individual's residences, as well as business, family, social and religious attachments. No single factor is determinative, and each case will depend upon the totality of the circumstances.

Non-resident aliens

A non-resident alien is defined as any individual who is not a US resident. For transfer tax purposes, residence is defined by domicile, so a person is a non-resident alien when the person is not domiciled in the US. Non-resident aliens are not considered US persons for estate, gift and GST purposes. Non-resident aliens for estate and gift tax purposes do not receive the same unified credit as US residents. Non-resident aliens are not subject to taxation on worldwide assets; instead their US estates include only those assets deemed situated in the US.

3. Rates

A unified tax rate schedule applies to estate, gift and GST tax (together, transfer taxes). The estate tax directs the application of this unified schedule for computation of tax to lifetime transfers and transfers at death, cumulatively, and then subtracting the amounts previously subject to gift tax on lifetime transfers. In doing so, the unified rate schedule attempts to subject all property transfers to tax liability under the gift tax or estate tax, and in return, each individual receives the benefit of a single unified credit.

The following gift and generation-skipping transfer tax rate schedule applies to transfers of property by gift for US citizens and residents and transfers of US *situs* property by gift for non-resident alien individuals occurring in 2011 and 2012. This same schedule also reflects the estate tax rates, which apply to the estate of US citizens and US residents. For US citizens and US residents, a $5 million lifetime exemption amount exists in 2011 and 2012. The US estate tax limits non-resident aliens to a $60,000 estate tax exemption and a $0 gift tax exemption, other than the gift tax annual exclusion, and the same rate schedule applies.

Column A	Column B	Column C	Column D
Taxable amount over	Taxable amount not over	Tax on amount in column A	Rate of tax on excess over amount in column A in %
$0	$10,000	$0	18
$10,000	$20,000	$1,800	20
$20,000	$40,000	$3,800	22
$40,000	$60,000	$8,200	24
$60,000	$80,000	$13,000	26
$80,000	$100,000	$18,200	28
$100,000	$150,000	$23,800	30
$150,000	$250,000	$38,800	32
$250,000	$500,000	$70,800	34
$500,000	No upper limit	$155,800	35

4. Exemptions and reliefs

4.1 Estate tax deductions

Administrative expenses, debts, taxes and losses

Deductions for funeral and administrative expenses, debts and losses may reduce the gross estate of a US person. However, the estate tax law limits these deductions for most non-resident aliens. A non-resident alien determines the deductible portion of these expenses by a fraction — the total US *situs* property as the numerator and the estate determined as if the decedent were a US domiciliary as the denominator (i.e., the decedent's worldwide gross estate). Calculation of the non-resident alien's total deductible expenses occurs by multiplying the deductible expenses by this fraction. A case where a decedent owns US real property subject to a recourse mortgage illustrates this limitation on deductions. The estate must include the real property in the estate at its full date of death value, but the estate may only deduct the percentage of the mortgage represented by the US property's value in relation to the decedent's worldwide assets at death. Additionally, the estate must substantiate this deduction by providing the US taxing authorities with a certified copy of the foreign inheritance tax returns reflecting the worldwide assets. In some special situations though, the provisions of US estate and gift tax treaties may allow full deductibility.

Charitable deduction

US citizens and residents receive a charitable deduction for the entire value of any property donated to a qualifying charitable organization located anywhere in the world upon death. Non-resident aliens are also entitled to a similar charitable deduction for gifts to a qualifying charity. To receive this deduction, a non-resident alien decedent must disclose the full value of all worldwide assets. The deduction for non-resident aliens differs from the deduction for US citizens and residents. First, the deduction is only applied to the non-resident alien's US gross assets. Second, non-resident aliens only receive a charitable deduction for property passing to a US-based charity.

Marital deduction for bequests to US spouse

US citizens, but not US residents, receive an unlimited marital deduction for all bequests to US citizen spouses. The law limits the applicability of the marital deduction allowance to transfers to a US resident or non-resident alien spouse.

A provision of the 2010 Tax Act introduced a new provision for 2011 and 2012, which allows portability of the estate tax exemption among US persons. Portability of the estate tax exemption permits a surviving spouse to utilize any remaining unused estate tax exemption of the predeceased spouse. A major focus of US estate tax planning for married couples is to make certain that each spouse fully uses his or her own estate tax exemption, because full utilization of both exemptions allows a married couple to double the amount that they pass free of estate tax. Portability allows for this full use of the estate tax exemption without the need to utilize tax savings trusts or other tax planning techniques on the first spouse's death. However, since portability of the estate tax exemption only exists for years 2011 and 2012, married couples should continue planning to maximize their estate tax exemptions in future years. In addition, because these rules are not applicable to non-citizens, traditional estate tax planning minimization techniques should be considered for such persons.

Marital deduction for bequests to non-US spouse

The law prohibits a marital deduction for a transfer to a non-US citizen spouse, even by a US citizen decedent. Instead, a special marital trust called a qualified domestic trust (QDOT) allows for the deferral of the tax at the first death. This trust must have at least one US trustee possessing the obligation to withhold US estate tax from principal distributions from the trust. The deferred tax (at the rate applicable to the first decedent's estate, but applied on the current asset value) becomes payable at the death of the spouse or on earlier distributions of principal from the QDOT trust.

Credits

In 2010 (as long as the carryover basis regime was not elected), 2011 and 2012, estates of US citizens and residents receive a credit against the estate tax that exempts the first $5 million in assets from taxation. This estate tax credit unifies with the gift tax credit in the sense that lifetime transfers of property in excess of the statutory annual exclusion amounts reduce the estate tax credit. However, in 2013, the estate tax credit will only exempt the first $1 million in assets from taxation. The estate of a non-resident alien receives an applicable credit of $13,000 for amounts that pass tax free at death for the decedent, as calculated from the unified rate schedule on the first $60,000 of the taxable estate. Effectively, this means that US estate tax will capture many estates of non-resident aliens who die owning US *situs* assets. Audits of non-resident alien US estate tax returns conducted by the IRS corroborate this fact.

5. Filing procedures

5.1 Estate tax

The decedent's estate — a separate legal entity and taxpayer — comes into existence on the date of the decedent's death and continues to exist until the personal representative (also referred to as an executor or administrator) has distributed all of the decedent's property from the estate and properly taken action to close the estate. Therefore, the estate may have US income tax filing obligations during the years between the date of death and the date all the property is distributed. The naming of the personal representative may occur through nomination in the decedent's will or by appointment in court if the decedent dies intestate (without a will). For estates of non-resident aliens, if no qualified US personal representative is appointed, then every person in possession of the decedent's property is required to file an estate tax return and may be liable for any US estate tax due.

The estate tax return for a US citizen or US-domiciled individual is Form 706. For non-domiciled individuals it is Form 706-NA. All Forms 706-NA are filed with the Internal Revenue Service Center in Philadelphia, PA. The location for filing Form 706 will vary with the decedent's domicile at death. The original due date for estate tax returns for all estates is nine months following date of death. An estate can request an extension of an additional six months to file the return, but the tax must be paid by the original due date to avoid interest and potential penalties. Note that although the IRS does permit filing extension requests for executors outside the US, extensions for Form 706 are automatic, while those for Form 706-NA are only discretionary.

5.2. Gift and GST

The reporting of gifts and generation-skipping transfers occurs on Form 709. A taxpayer must file this return for any calendar year that the taxpayer makes a transfer by gift to a person, other than the donor's US citizen spouse, either: 1) of a present interest at a value in excess of the annual exclusion (even if no tax is due after application of the lifetime exemption) that does not meet the requirements of a qualified education nor qualified medical expense or 2) of any future interest. Tax is imposed on the fair market value of property at graduated rates determined by the individual's cumulative lifetime transfers on the date of the gift.

In addition to GST tax itself, taxpayers should also report allocations of GST exemption on a timely filed Form 709, the gift tax and GST tax return. Timely filed returns result in allocations effective as of the day of the transfer; late filed allocations result in allocations effective on the date of the filing. In the year of death, the decedent's executor may make an allocation election on a timely filed estate tax return.

US citizens or residents (as defined for income tax purposes) must report gifts or bequests from foreign sources in excess of $14,375 (adjusted for inflation), in the aggregate, on Form 3520. However, the IRS has not actually required gifts from foreign individuals or foreign estates to be reported unless the aggregate gifts exceed $100,000. The IRS can impose substantial penalties for failure to report such gifts or bequests.

The primarily liability for the gift tax due to the IRS falls on the donor of the gift. This liability transfers to the executor or administrator of the estate of the decedent as a liability of the estate, if the tax remains unpaid at the time of death. In the event gift tax remains unpaid, gift tax liability can also be enforced on the donee or through the imposition of a gift tax lien for up to ten years on the transferred property. The donor of property must pay the gift tax at the time and place for filling the gift tax return — as determined without regard to filing extensions. Furthermore, if a donor dies before filing any required gift tax returns, the executor or administrator of the estate of the decedent must file such returns.

The primary liability for GST tax rests with the transferee on payments of taxable distributions, rests with the trustee on taxable termination payments and rests with the transferor on direct skip transfers. Secondary liability is determined in the same manner as secondary liability for gift taxes (see above).

6. Assessments and valuations

The value of a US client's gross estate is the value at the time of his or her death of all property, real or personal, tangible or intangible, wherever situated. The IRC does not prescribe how this value is to be determined. The estate and gift tax regulations, however, prescribe extensive valuation rules. Those valuation rules are accompanied by prescribed actuarial and interest rate tables.

A general rule is prescribed in the US Treasury Regulations for determining value for estate and gift tax purposes: "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts." The fair market value of a particular item of property includable in the decedent's gross estate, or for purposes of computing the value of a taxable gift, is not to be determined by a forced sale price, and the fair market value of an item of property is not to be determined by the sale price of the item in a market other than that in which the item is most commonly sold to the public, taking into account the location of the item wherever appropriate. The latter rule contemplates that when property of a US taxpayer (perhaps resident in a foreign jurisdiction) is outside the United States, the valuation should occur in the relevant foreign market, rather than by reference to values for that or similar property existing in a US market.

In many instances, taxpayers will assert and be successful in seeking significant discounts based on various arguments. These could include discounts because the holding is a minority interest, illiquidity or blockage. The argument might also be made that the discount should be available for the federal income tax liability to be incurred on the disposition of the item, such as when appreciated assets are held through an entity classified as a corporation for US federal income tax purposes.

7. Trusts, foundations and private purpose funds

7.1. In general

As a practical matter, US succession planners use trusts where the donor wishes to place certain constraints on the access of the proposed donee to the trust property. A lifetime gift that uses the annual exclusions or a US citizen/domiciliary donor's exemption can serve a useful way of transferring property out of the donor's estate, especially property likely to appreciate in value. If succession serves as the objective of the transfer in trust, the donor must retain neither influence nor control over the trustees to avoid any inference of an incomplete gift and, hence, estate tax ineffective gift.

7.2. Types of trusts

Various types of trusts exist in the US, but most fit the classification of either simple or complex trusts, for US tax purposes. Simple trusts require trustees to distribute all of the trust's current income to one or more beneficiaries annually, whereas the trustees of complex trusts have discretion to determine the timing, amount and type of property used to make distributions from income or principal (e.g., the power to accumulate income). Absent specific powers vested in a beneficiary, the law does not require estate inclusion of the underlying trust assets in the beneficiaries' estates.

Trusts work extensively in conjunction with probate avoidance and estate planning for non-US citizens; specifically, a common practice is to use a QDOT trust created by will to benefit a non-US citizen spouse (see discussion under deductions and credits above) or a qualified terminable interest property (QTIP) trust for US citizen spouses.

7.3. Trust location

Non-US persons who obtain US residence who are settlors or beneficiaries of trusts that have been created for estate or gift tax planning in other jurisdictions may encounter unexpected US tax results if they do not seek advice before establishing US residence. This occurs because the US rules that apply to foreign trusts with US beneficiaries and settlors may apply once they become US residents. We outline these onerous rules briefly below, but non-US persons who subsequently acquire US tax residence while retaining an interest in a non-US trust should seek advice of a US tax professional.

7.4. Outbound transfers by US person or domestic trust

Trusts with US beneficiaries

A US citizen or resident who creates a foreign trust over which he or she has no control or power may nevertheless be subject to tax on the income under the US grantor trust rules. These rules provide that, in a year where the trust has a beneficiary who is a US person, any transfer made by a US resident or citizen to a foreign trust will cause grantor trust treatment, at least as to the portion attributable to that transfer to the US resident beneficiary. The grantor trust rules presume foreign trusts to have US beneficiaries, unless the transferor can establish that no part of the income or principal of the trust benefits or could benefit a US person. Grantor trust treatment may also extend to transfers made to foreign trusts by foreign individuals who later become US residents within five years of the transfer (for further discussion under inbound transfers, see below). The US tax law treats any transfers made within that five-year period as though the transfer was made on the date the settlor's US residence begins.

Foreign beneficiary becomes US resident

These rules may also trigger immediate taxation on all of the trust's undistributed net income at the end of the year immediately preceding the year in which the trust acquired the US beneficiary, when a US resident settlor transfers assets to a foreign trust with a US beneficiary. The provisions can also cause problems in the year that the grantor ceases to be treated as a US person if the trust becomes a non-grantor trust after the individual ends his or her residence in the US (see further discussion on transfers of appreciated assets to foreign trusts below).

7.5. Reporting

In addition to the required annual information return on Form 3520-A, the creation of, and transfers to or distributions from, foreign trusts are reportable for US citizens and residents on Form 3520. Penalties of up to 35% of the amount transferred may be applied for failure to report or late reporting.

7.6. Inbound transfers for foreign trusts with US beneficiaries

A non-resident alien who becomes a US resident who has created a trust within five years of establishing US residency may be treated as the grantor of the portion of the trust that the individual funded, if the trust can benefit a US beneficiary. This result does not change due to the fact that the beneficiaries of the trust were not US persons upon trust creation. If such a trust benefits the settlor or any of the settlor's family members who have become US residents, he or she will be taxed on an arising basis on the trust income and have US filing requirements on Forms 3520 and 3520-A. The penalty for failure to file Form 3520-A reaches 5% of the value of the trust corpus.

7.7. Transfers of appreciated assets by US persons to foreign trusts

The Taxpayer Relief Act of 1997 repealed the prior law applicable to transfers to foreign trusts before 4 August 1997 and substituted a taxable gain recognition rule on transfers of appreciated property by US persons to foreign trusts. Therefore, gain must be recognized for income tax purposes on the difference between the cost basis and the fair market value of the appreciated assets transferred to a foreign trust. However, an exception from gain recognition for transfers to a grantor trust exists. Care needs to be taken, however, in the case of certain trusts, which are only considered grantor trusts because they have a US beneficiary under the rules described above, since they may become non-grantor trusts when the beneficiary ceases to be a US resident or dies. This can cause the appreciated assets in the trust to be treated as though if transferred to a foreign trust triggering gain recognition. For trusts that may become non-grantor trusts when the settlor ceases US residency, the settlor should seek US tax advice before ending his or her residence in the US.

8. Grants

With regard to estate taxes, there are no specific rules in the United States.

9. Life insurance

Life insurance can serve as an important asset on the life of a decedent in the United States. A person with an insurable interest — an articulable interest in the continued life of a person — can choose one or more varieties of policies, including: whole life, term life, accidental death, joint life, universal life and variable life. The person or entity that retains incidents of ownership (e.g., power to change a beneficiary, assign the policy, use the policy as collateral for loans, reversionary interest, settlement options or surrender the policy) over the policy garners treatment as the owner for United States tax purposes. The concept of incidents of ownership is intentionally broader than the technical definition and concept of ownership in other areas of the law.

Life insurance ownership can provide many benefits to an estate and survivors of a deceased individual. First, life insurance proceeds can provide enough cash without having to monetize assets within the estate to pay debts that survive a decedent and any tax bills arising as a result of death. Second, the death benefit can create a larger pool of assets for more modest estates to assure adequate security and funds for survivors. Third, amounts paid from a life insurance policy can assist business colleagues of the decedent to accumulate funds sufficient to purchase ownership interests left for their procurement.

While life insurance can provide many benefits to a broad group of individuals surviving a decedent, it does not come without limitations. First, if the owner of a life insurance policy is also the person insured by the policy, the death benefit paid is included in his or her estate without regard to the identity of the recipient. This creates the potential for transfer tax implications (e.g., a generation skipping transfer tax liability may arise if a payment is made to a skip person or an estate tax liability could arise if the value of the policy included in the gross estate calculation takes the value of the estate over the estate tax exemption amount in the year of death). A possible solution to the transfer tax implications is to have a person (other than the insured) or an irrevocable life insurance trust own a policy on the life of the insured. When properly structured and implemented, an irrevocable life insurance trust can purchase the policy on the life of an individual without the insured having any incidents of ownership with respect to the policy; however, if the insured already owns a policy on his or her own life, it can either be transferred to the trust more than three years before death or purchased by the trust for full and adequate consideration in money or money's worth.

The method of permissible beneficiary designation on life insurance policies differs from that of other most other assets a decedent owns at death. An individual cannot name a beneficiary of a life insurance policy in a will or other at-death declaration; instead the owner must make explicit recognition of the identity of the beneficiary of a policy prior to the death of the insured to the issuing company in the manner it requires.

Because life insurance is not considered a US *situs* asset to a non-resident, it can be an efficient mechanism for mitigating US estate tax exposure on US *situs* assets such as real property and the equity securities of US issuers.

10. Civil law on succession

The US does not follow a civil law system.

10.1. Intestacy rules

Intestacy means the part of a decedent's estate that is not effectively disposed of by will is governed by the intestacy rules of the decedent's state of residence at death, or the rules of the state where immovable property owned by the decedent is situated. Therefore, an attorney in that state should be contacted to determine the specific rules that apply to the property.

10.2 Probate

The Uniform Probate Code provides a model of provisions that states consider when drafting their legislation. By way of example, the intestacy provision of the Uniform Probate Code has been adopted in full by certain states, modified by others and not adopted by others:

1. Jurisdictions:
   a. Community property: One-half of the property belonging to the decedent passes to the surviving spouse as the intestate share.
   b. Separate property: Share of the decedent's surviving spouse depends on the circumstances as follows:
      I. No children or parent of decedent survives decedent: Entire intestate estate.
      II. Spouse has same children as decedent: Entire intestate estate.
      III. No descendants of decedent but a parent survives decedent: First $200,000 plus ¾ of balance of intestate estate.
      IV. Decedent's children are also those of spouse, but spouse has other children: First $150,000 plus ½ of balance of intestate estate.
      V. One or more of decedent's children are not those of his spouse: First $100,000 plus ½ of balance of intestate estate.
2. Order of priority if no surviving spouse:
   a. To the decedent's descendants by representation.
   b. If no surviving descendants, to the decedent's parents equally if both survive, or to the surviving parent.
   c. If no surviving descendant or parent, to the descendants of the decedent's parents, or either of them by representation.
   d. If no surviving descendant, parent or descendant of a parent, one-half of the estate to the decedent's paternal grandparents equally if both survive, or to their descendants by representation if they predecease the decedent; and the other half to the decedent's maternal grandparents in the same manner as the paternal grandparents. If there are no surviving grandparents or their descendants on either the maternal or paternal side, then the entire estate will pass to the decedent's relatives on the surviving side, in the same manner as the other half.

11. Estate and gift tax treaties

The following table provides details on the US estate tax, gift tax and combined estate and gift tax treaties currently in effect.

Table 1: US estate tax treaties, gift tax treaties and combined estate and gift tax treaties

Country	Separate estate tax treaty	Separate gift tax treaty	Combined estate and gift tax treaty	Other	Signed	Transfers made on or after	Comments	
Australia	No	Yes	No	No	May 1953	14 December 1953		PR-UC***
Australia	Yes	No	No	No	May 1953	7 January 1954	Old *	PR-UC
Austria	No	No	Yes	No	June 1982	1 July 1954	New *	
Belgium	Yes	No	No	No	May 1954	Not yet	Old	No effect
Canada	No	No	No	1995 Protocol	March 1995	**9 November 1995	Estate tax only	PR-UC
Denmark	No	No	Yes	No	April 1983	7 November 1984	New	
Finland	Yes	No	No	No	March 1952	18 December 1952	Old	PR-UC
France	No	No	Yes	No	November 1978	1 October 1980	New	PR-UC (Protocol)
Germany	No	No	Yes	No	December 1980	1 January 1979	New	PR-UC (Protocol)
Greece	Yes	No	No	No	February 1950	30 December 1953	Old	PR-UC
Ireland	Yes	No	No	No	September 1949	20 December 1951	Old	
Italy	Yes	No	No	No	March 1955	26 October 1956	Old	PR-UC
Japan	No	No	Yes	No	April 1954	1 April 1955	Old	PR-UC
Netherlands	Yes	No	No	No	July 1969	3 February 1971	New	
Norway	Yes	No	No	No	June 1949	11 December 1951	Old	PR-UC
South Africa	Yes	No	No	No	April 1947	15 July 1952	Old	
Sweden	No	No	Yes	No	June 1983	5 September 1984 (through 31 December 2007	New (terminated 1 January 2008)	
Switzerland	Yes	No	No	No	July 1951	17 September 1952	Old	PR-UC
UK	No	No	Yes	No	October 1978	11 November 1979	New	

** Old or new refers to whether the treaty has the old situs rules, or the new provisions that generally restrict the US to taxing non-resident aliens' US real estate and business property.*

*** The 1995 Protocol had retroactive effect to TAMRA. Claims for refund based upon the treaty had to be filed by 9 November 1996.*

**** "PR-UC" in comments section above refers to a pro-rata unified credit provision. (The pro-rata unified credit provisions in the German and French treaties apply only to estate tax, not to gift tax.)*

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Additional reading materials

Spielman, Michael (2011) *US International Estate Planning*. Thomson Reuters/WG&L.