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Introduction: a note on US tax reform

At the end of 2017, President Trump signed into law the Tax Cuts and Jobs Act (TCJA), which made some significant changes to US federal tax law. The TCJA did not, however, significantly modify the US wealth transfer tax regimes (i.e., estate, gift and generation-skipping transfer tax), other than increasing the estate, gift and generation-skipping transfer tax exemption amounts to $10 million (and retained annual inflation adjustments). The estate tax exemption for US nonresidents remains at $60,000.

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 at death. US citizens and residents dying after 31 December 2012 are subject to a top estate tax rate of 40% and are entitled to a USD10 million estate tax exemption, which is adjusted annually for inflation (USD11.4 million for 2019). Nonresident aliens are also subject to a top estate tax rate of 40%, but their estate tax exemption amount is only USD60,000 and is not indexed for inflation.

The US imposes an estate tax liability on all US citizens and residents. See Section 2.2 for a discussion of who is a US resident and a nonresident alien for estate tax purposes. The estate tax will ultimately be assessed upon the taxable estate (i.e., the gross estate, less applicable deductions). For a US citizen or resident, the gross estate is the fair market value (FMV) 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 US resident (i.e., a nonresident alien), the gross estate includes only US *situs* property owned at death. The Internal Revenue Code (IRC) determines the *situs* of different types of property, the treatment of which may be modified through the application of estate and gift tax treaties that the United States has concluded with various countries (see Section 11). Under the IRC, US *situs* property includes real and tangible personal property located in the United States, 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 nonresident alien, stock issued by non-US corporations, or pensions payable by non-US persons.

Retained interests

Due to retained interest rules, the reach of the estate tax is broader than simply the assets a 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 or her death. The following retained interests may be included in a decedent's gross estate:

- Certain gifts made within three years of death
- Transfers with a retained life estate
- Transfers taking effect at death
- Certain annuities
- Interests owned jointly
- Transfers that provide for broad powers of appointment
- Revocable transfers

The retained interest rules also apply to the estate of a nonresident alien. The definition of the gross estate of a nonresident alien 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 resident alien — 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 nonresident 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 FMV on the day of the decedent's death. Each transferee's basis in property received by a decedent is its FMV for federal income tax purposes, regardless of the transferor's historical cost or basis adjustments.

State estate tax

Many 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 nonresident alien should also seek state tax advice to determine potential estate tax and informational filing requirements for property situated in a given state. A decedent's estate may be permitted an estate tax deduction at the federal level for any state estate taxes paid.

1.2 Gift tax

US citizens and resident aliens are subject to gift tax on transfers of all property, tangible and intangible, regardless of the location of the property. See Section 2.2 for a discussion of who is a US resident and a US nonresident alien for gift tax purposes. Gift tax applies to the FMV of the transferred assets as of the date of the gift.

An annual, per-donee exclusion (annual exclusion) exists that is indexed for inflation (USD15,000 in 2019), which offsets tax on gifts of present interests. Transfers on behalf of a donee directly to a service provider for qualifying medical expenditures or to an educational institution for educational expenditures are entirely exempt from the gift tax.

US citizens and resident aliens are subject to a top gift tax rate of 40% and are entitled to a USD10 million gift tax exemption, which is adjusted annually for inflation (USD11.4 million for 2018). The US gift and estate tax are unified — there is only one exemption for both gift and estate tax purposes. Therefore, gifts made during an individual's lifetime will reduce his or her estate tax exemption.

Gifts by US citizens or resident aliens to a US citizen spouse are entitled to an unlimited marital deduction and, therefore, do not incur gift tax. However, for transfers to a non-US citizen spouse, there is a special increased gift tax annual exclusion (USD155,000 in 2019 as indexed for inflation). This is an annual limitation. See Section 5.2 for filing procedures.

Unlike US citizens and residents, nonresident alien individuals do not receive a lifetime gift tax exemption, but are entitled to use of the annual exclusion amount. Thus, every transfer of US *situs* property by a nonresident alien in excess of the gift tax annual exclusion (USD15,000 in 2019) is subject to gift tax. Nonresident 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. Nonresident 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 nonresident alien for gift tax purposes.

Basis

Generally, the donee takes the gifted property at the same income tax basis as it had in the hands of the donor (i.e., "carryover" basis). However, if the FMV of the property at the time of the gift is lower than the donor's adjusted basis, the donee must use the FMV at the time of gift as the basis for computing loss on a subsequent sale of the property. Additionally, the donee's basis may be increased by all or part of the gift tax actually paid by the donor.

State gift tax

Currently, only Connecticut imposes a state-level gift tax, at rates ranging up to 12%.

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 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

No endowment tax laws exist in the US.

1.5 Inheritance tax

The US does not impose an inheritance tax at the federal level. However, 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 16%.

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 applies to real property or personal property physically situated within the specific taxing locality. 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 a 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 since 17 June 2008, the US exit tax regime subjects certain individuals known as "covered expatriates" to immediate taxation on the net unrealized gain on their property exceeding USD600,000 (indexed for inflation; USD725,000 for 2019). The tax treats covered expatriates as if they sold their worldwide property for FMV 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 8 tax years during the preceding 15 years) who have a five-year average income tax liability exceeding USD124,000 (indexed for inflation; USD168,000 for 2019) or a net worth of USD2 million or more. This treatment applies to most types of property interests held by individuals.

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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.

Additionally, US citizens or resident aliens receiving gifts or bequests on or after 17 June 2008 of more than the gift tax annual exclusion (USD15,000 in 2019) from covered expatriates are taxed at the highest gift or estate tax rate currently in effect (40% in 2019) (the "Section 2801 tax"). Note, though, that application of the Section 2801 tax is deferred until the IRS issues final regulations. Under the general US estate and gift tax rules, the IRS assesses the tax on the donor. However, the IRS imposes the Section 2801 tax liability on the donee. Thus, the Section 2801 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 to "skip persons" and on "taxable distributions" and "taxable terminations" by trusts that have skip persons as beneficiaries. The GST tax is in addition to any gift or estate tax that may be assessed on a transfer. The IRC defines a skip person as someone who is two or more generations below the transferor or a trust for which all beneficiaries are skip persons. Generation-skipping transfers that are subject to GST tax are taxed at a rate of 40%. There is a GST exemption of USD10 million that is adjusted annually for inflation (USD11.4 million for 2019) available to US citizens, US residents and non-US residents. The GST exemption is in addition to the gift and estate tax exemption.

General

The GST tax potentially applies to all transfers of a US person's worldwide assets. See Section 2.1 for an analysis of who is deemed a US person. As stated above, the GST tax 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, a trust is liable for the GST tax on the FMV of the assets in the trust at the time of the taxable termination. For taxable distributions, the beneficiary is liable for the GST tax on the FMV of the property received. For direct skips, the transferor is liable for the GST tax on the FMV of the property transferred at the time of the transfer.

A nonresident alien can transfer non-US *situs* property without the transfer triggering GST tax, but transfers of US *situs* property do trigger GST tax — 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 the 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 Section 11. 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 tax exemption

A taxpayer may irrevocably allocate GST tax 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. GST tax exemption is automatically allocated to direct skip transfers and indirect skip transfers (a transfer to a trust in which skip persons are beneficiaries) up to the total amount of the transferor's remaining GST tax exemption, without further action by the transferor to affirmatively alter this allocation.

2. Who is liable?

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 from the way that the US transfer tax (gift, estate and GST 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 tests — substantial presence test (SPT) and green-card test. The SPT 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 in the current year or for 183 days or more during a three-year period, calculated using a weighted-average formula, is a US resident for income tax purposes.

Under the SPT, the sum of the total number of days of presence is determined by adding the total number of days of presence in the current year, plus one-third of the number of days in the first preceding year, plus one-sixth of the number of days in the second preceding year. Any day, or portion of a day, counts as a day of presence in the US. Exceptions and special rules are provided for individuals in the US due to a medical condition, students, teachers, commuters from Mexico and Canada, professional athletes and foreign government officials. There is also an exception to the SPT for foreign individuals who are US residents under the SPT but are present in the US for fewer than 183 days in the current year, have a tax home in a foreign country and have a closer connection to that home country than to the US. A closer connection is established if the individual maintains more significant contacts with a foreign country than with the US.

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 status. A person who is not a US citizen and fails the SPT and the green-card test is considered a US nonresident alien for income tax purposes. 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 upon which test the individual satisfies for US resident status (e.g., SPT or green-card test). Under the SPT, 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 in 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 SPT or the first day as a lawful permanent resident.

2.2 Domicile

In contrast to income tax residence, the US transfer tax laws determine an individual's residence with a subjective inquiry into the individual's "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.

Nonresident aliens

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

3. Rates

A unified tax rate schedule applies to gift and estate 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 estate tax rate schedule applies to transfers of property by gift for US citizens and residents and transfers of US *situs* property by gift for nonresidents occurring in 2019. For US citizens and US residents, a USD11.4 million gift and estate exemption amount exists in 2019. Nonresident aliens are limited to a USD60,000 estate tax exemption and a USD0 gift tax exemption, other than the gift tax annual exclusion. The same rate schedule applies.

Column A (USD)	Column B (USD)	Column C (USD)	Column D (USD)
Taxable amount over	Taxable amount not over	Tax on amount in column A	Rate of tax on excess over amount in column A
USD0	USD10,000	USD0	18%
USD10,000	USD20,000	USD1,800	20%
USD20,000	USD40,000	USD3,800	22%
USD40,000	USD60,000	USD8,200	24%
USD60,000	USD80,000	USD13,000	26%
USD80,000	USD100,000	USD18,200	28%
USD100,000	USD150,000	USD23,800	30%
USD150,000	USD250,000	USD38,800	32%
USD250,000	USD500,000	USD70,800	34%
USD500,000	USD750,000	USD155,800	37%
USD750,000	USD1,000,000	USD248,300	39%
USD1,000,000	No upper limit	USD345,800	40%

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 nonresident aliens. A nonresident 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 citizen or resident as the denominator (i.e., the decedent's worldwide gross estate). Calculation of the nonresident 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 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, 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. Nonresident aliens are also entitled to a similar charitable deduction for gifts to a qualifying charity. To receive this deduction, a nonresident alien decedent must disclose the full value of all worldwide assets. The deduction for nonresident aliens differs from the deduction for US citizens and residents. First, the deduction is only applied to the nonresident alien's US gross assets. Second, nonresident aliens only receive a charitable deduction for property passing to a US-based charity.

Marital deduction for bequests to US spouse

US citizens, US residents and nonresident aliens 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 non-US citizen spouse.

The estate tax allows portability of the estate tax exemption of a deceased US citizen or US resident to a US citizen or US resident surviving spouse. The availability of a portability election on behalf of a non-US citizen, non-US resident surviving spouse is limited to certain circumstances, including application of certain treaties. 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 utilizes his or her 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, because these rules are not applicable to non-citizens and nonresidents, traditional estate tax planning minimization techniques should be considered for such persons. The portability election is made on the decedent spouse's estate tax return.

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 surviving spouse or on earlier distributions of principal from the QDOT. The US has estate and gift tax treaties with some countries that allow an increased marital deduction for transfers to a non-citizen spouse without requiring that the assets be placed in a QDOT.

Exemption

In 2019, estates of US citizens and residents receive a credit against the estate tax that exempts the first USD11.4 million (as adjusted for inflation) in assets from taxation. This estate tax exemption unifies with the gift tax exemption in the sense that lifetime transfers of property in excess of the statutory annual exclusion amounts reduce the estate tax exemption. The estate of a nonresident alien receives an estate tax exemption of USD60,000, although some US estate tax treaties allow a higher amount. Effectively, this means that US estate tax will capture many estates of nonresident aliens who die owning US *situs* assets.

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 property is distributed by the estate. 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 nonresident 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 resident is Form 706. For nonresident aliens, it is Form 706-NA. All Forms 706-NA are filed with the Internal Revenue Service Center in Cincinnati, Ohio. The location for filing Form 706 will vary with the US citizen's or resident's domicile at death. The original due date for estate tax returns for all estates is nine months following the 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.

Consistent-basis reporting requirements, effective for estate tax returns filed after 31 July 2015, ensure beneficiaries use the same basis for inherited property as was reported on the decedent's estate tax return. In order to curb perceived abuses, the rules state that a beneficiary may not utilize a higher basis on a subsequent disposition of inherited property than was finally determined for estate tax purposes (unless, of course, the beneficiary has taken action to increase the basis of the property, such as by making permanent improvements to inherited real property). When an estate must file Form 706, the executor must report on Form 8971 the basis of each asset to the IRS and the beneficiary who received the asset. Form 8971 must be filed within 30 days of the due date for filing Form 706.

5.2 Gift and GST tax

The reporting of gifts and generation-skipping transfers made during life occurs on Form 709. In general, 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 per-donee annual exclusion (even if no tax is due after application of the gift tax exemption) that does not meet the requirements of a qualified education or qualified medical expense; or (2) of any future interest. Tax is imposed on the FMV of property at graduated rates determined by the individual's cumulative lifetime transfers on the date of the gift.

In addition to GST tax, taxpayers should also report allocations of GST exemption on a timely filed Form 709. 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. Gifts received in 2019 from foreign corporations or foreign partnerships in excess of USD16,388 (adjusted for inflation), in the aggregate, are reported on Form 3520, Part IV. The IRS also requires gifts from foreign individuals or foreign estates to be reported once the aggregate gifts exceed USD100,000 on Form 3520, Part IV. The IRS can impose substantial penalties for failure to report such gifts or bequests.

The primary 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 10 years on the transferred property. The donor of property must pay the gift tax at the time and place for filing 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 events and rests with the transferor on direct skip transfers. Secondary liability is determined in the same manner as secondary liability for gift taxes.

5.3 The Section 2801 tax

Unlike the estate, gift and GST taxes, the Section 2801 tax is paid by the donee of a gift or bequest from a covered expatriate. The donee must file Form 708 to report gifts and bequests from covered expatriates in excess of the gift tax annual exclusion amount (USD15,000 in 2019). The requirements to file Form 708 and pay the Section 2801 tax are suspended until the IRS issues final regulations.

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6. Assessments and valuations

The value of a US citizen's or resident'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, contain extensive valuation rules. These valuation rules are accompanied by prescribed actuarial and interest rate tables.

The general rule for determining value for estate and gift tax purposes is to determine an asset's FMV. FMV 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 FMV 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.

Also, the FMV 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 US, 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.

7. Trusts, foundations and private purpose funds

7.1 In general

As a practical matter, US succession planners use trusts when a donor wishes to place certain constraints on the access of the proposed donee to the trust property. If succession serves as the objective of the transfer in trust, the donor must retain neither influence nor control over the trustees or the property placed in trust to avoid having the property placed in trust being brought back into the donor's estate and subject to estate tax.

7.2 Types of trusts

Various types of trusts exist in the US, but most fit the classification of either grantor, simple or complex. Grantor trusts are ignored for US income tax purposes as separate taxable entities from the grantor as a consequence of the grantor's retention of certain powers over the property in the trust. In the case of a grantor trust, the grantor is treated as owning the property held by the trust for US income tax purposes (although not necessarily for estate tax purposes). Simple trusts are non-grantor trusts that require trustees to distribute all of the trust's current income to one or more beneficiaries annually. Trusts that are not grantor or simple are complex. 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 "Marital deduction for bequests to non-US spouse" in Section 4.1) or a qualified terminable interest property (QTIP) trust for US citizen spouses.

7.3 Trust location

Non-US persons who obtain US residence and 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 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, see Section 7.6). The US tax law treats any transfers made within that five-year period as though the foreign settlor made the transfer on the date the settlor's US residence begins.

Foreign beneficiary becomes US resident

The taxation of a foreign beneficiary who becomes a US income tax resident will be impacted by the classification of the trust as a foreign grantor trust or as a foreign non-grantor trust. First, if the settlor of the trust was not a US person, then under very limited circumstances will the trust be classified as a grantor trust, causing the beneficiary to receive a gift, rather than a taxable distribution. Next, if the trust was created by a US person and is classified as a grantor trust, then the income tax ramifications flow to the settlor. The more complex case is where a trust is or has become a foreign non-grantor trust; a US beneficiary is subject to tax on distributions from a foreign non-grantor trust and it is possible that an additional throwback tax on accumulated income and interest charge could apply.

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 nonresident alien who becomes a US income tax resident and 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 has 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 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

US persons who transfer assets to a foreign trust must recognize gain for income tax purposes on the difference between the cost basis and the FMV of the appreciated assets. However, an exception from gain recognition for transfers to a grantor trust exists. Care is necessary, 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 they were 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 residency in the US.

8. Grants

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

9. Life insurance

Life insurance can serve as an important asset on the life of a decedent in the US. 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 US 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 liquidate 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 GST 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, thus allowing policy proceeds to escape US estate tax in the estate of the insured. Where the insured already owns a policy on his or her own life, in order to keep the proceeds of the policy out of the estate of the insured, the policy can either be purchased by an irrevocable life insurance trust for full and adequate consideration in money or money's worth or transferred to the irrevocable life insurance trust, but such transfer must be made more than three years before death because of the retained interest rule that brings assets transferred within three years of death back into an estate.

The method of permissible beneficiary designation on life insurance policies differs from that of 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 nonresident, 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.

Note that the term "life insurance" has a technical definition under the IRC, which can result in some foreign policies failing to meet that definition and being subject to taxation in different ways than described above.

10. Civil law on succession

The US does not follow a civil law system.

10.1 Intestacy rules

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. The provisions of the Uniform Probate Code are briefly described below. US legal advice should be sought regarding the intestacy statutes of any particular state as many states do not follow these rules in their entirety:

- Jurisdictions:
  1. Community property: one-half of the property belonging to the decedent passes to the surviving spouse as the intestate share.
  2. Separate property: share of the decedent's surviving spouse depends on the circumstances as follows:
     a. No children or parent of decedent survives decedent: entire intestate estate
     b. Spouse has same children as decedent: entire intestate estate
     c. No descendants of decedent but a parent survives decedent: first USD200,000 plus three-fourths of balance of intestate estate
     d. Decedent's children are also those of spouse, but spouse has other children: first USD150,000 plus half of balance of intestate estate
     e. One or more of decedent's children are not those of spouse: first USD100,000 plus half of balance of intestate estate
- Order of priority if no surviving spouse:
  1. To the decedent's descendants by representation
  2. If no surviving descendants, to the decedent's parents equally if both survive, or to the surviving parent
  3. If no surviving descendant or parent, to the descendants of the decedent's parents, or either of them, by representation
  4. 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. The other half goes 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 tax treaties

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

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*	
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 (ended 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 US real estate and business property.*

*** The 1995 Canada-US Protocol had retroactive effect to the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). Claims for refund based upon the treaty had to be filed by 9 November 1996.*

**** "PR-UC" in the 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.)*