Stonehage Fleming Law US

BEWARE THE US FEDERAL ESTATE TAX

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NOW AND FOR FUTURE GENERATIONS

Professional advisors to wealthy clients who are not citizens or residents of the United States ("US") must be aware of how the US Federal estate tax can impact their clients. Failure to understand this tax and to properly advise a client can eliminate years of investment returns for the client and can pose a risk for advisors.

The US Federal estate tax applies to a non-citizen non-resident of the US to the extent he or she dies owning certain types of property deemed to be "situated" in the US. The most common examples of US-situs property for purposes of this tax are:

- Real estate located in the US
- Shares of stock of a US corporation or other US business entity
- Debt obligations of a US citizen or resident, US corporation, US trust

The tax is assessed against the fair market value of the property using date-of-death values. A small exemption shields the first $60,000 of value and everything above that amount is subject to the tax. From $60,000 to $1,000,000 the tax rates are graduated from 26% to 39% and all value above $1,000,000 is taxed at 40%. For example, the tax liability for an estate with $1,000,000 of US-situs property would be $332,800. It is not enough to examine only a client's personal portfolio for US-situs property because the US employs a complicated set of look-through rules that may sweep trust assets into the taxable estate. It is very common for non-US trusts to contain powers or provisions that cause the US to look through the trust and treat it as if the client owned the trust assets personally. Provisions that can cause this result include:

- A settlor/funder of the trust being included as a beneficiary
- The settlor/funder (or a beneficiary) having any of the following powers (individually, as trustee, or as protector):
  - The power to remove and replace a trustee
  - The power to add or remove beneficiaries
  - The power to terminate the trust
  - The power to participate in decisions to distribute income or capital

It is not uncommon for non-US clients to shrug off the risk when it comes to US securities in their investment portfolio on the theory that the US will never find out and even if they do, they cannot enforce the tax. Don't let a client get caught in this tax trap. The US Internal Revenue Service is employing increasingly sophisticated big-data techniques to identify taxable estates, and long-existing law makes the non-US executor personally liable for the unpaid tax. A well advised executor will pay the tax out of the estate rather than take on the liability personally. That being the case, the best course of action is to avoid the tax in the first instance, and it is easily avoided with proper planning.

Key questions for advisors to ask:

- Does my client own any US-situs property personally?
- Does my client have any trust that owns US-situs property?

If the answer to either of these questions is yes, there is important work to be done.

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