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Worldly Wealth: Tax and Estate Planning for U.S. Persons with Global Investments

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International Planning

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Michelle Graham is a Shareholder in the San Diego office of Greenberg Traurig, LLP, where she leads a sophisticated practice focused on domestic and international estate and tax planning. With a global client base, Michelle advises high-net-worth individuals, families, and closely held businesses on strategies to preserve wealth, ensure compliance, and navigate complex cross-border tax issues.

Her work spans multiple jurisdictions, including Latin America, Europe, Asia, Canada, Australia, and the Middle East. Michelle is particularly adept at guiding international families with U.S. connections through the intricacies of U.S. tax law, foreign reporting obligations, and succession planning. She regularly counsels clients on inbound investments, pre-immigration planning, and the acquisition of U.S. real estate, especially in California, and outbound investments and expatriation.

Michelle also works closely with family-owned enterprises on business succession, intra-family transactions, and governance structures that support long-term sustainability. Her approach integrates legal precision with a deep understanding of family dynamics and international considerations.

Recognized by Chambers High Net Worth Guide for Private Wealth Law in Southern California since 2020, Michelle is a frequent speaker at leading industry forums, including the Heckerling Institute on Estate Planning, the American College of Trust and Estate Counsel (ACTEC), STEP, and the USC Gould School of Law Tax Institute.

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In our increasingly global society, estate planning is important, if not essential, for United States (U.S.) persons with ties to non-U.S. countries or international assets, especially during certain critical junctures and life altering events (i.e., immigration to the U.S., marriage, health issues, etc.) – belying each major life decision, a critical estate tax ramification. In the U.S., estate planning is relatively commonplace, in part, owing to the complex tax system and adversarial legal system (as compared with bureaucratic legal systems abroad), and in other part, owing to the desire to have certainty, finality, and stability in the ultimate disposition of one's estate.

Indeed, even individuals with modest estates will have "estate plans," generally consisting of a will, health care directive, power of attorney, and possibly a revocable living trust depending on the magnitude of an individual's estate and jurisdiction in the U.S. in which he or she resides.[1] For example, revocable trusts (also known as "living trusts") are commonly used in states such as California, a jurisdiction in which it is desirable to avoid probate due to the added time and expense (in addition to emotional distress) incurred in a probate proceeding.

In common law countries such as the U.S., Canada, and the United Kingdom of Great Britain and Northern Ireland ("U.K."), there is considerable control over how one may plan for the disposition of his or her estate, with few restrictions. Particularly for the high net worth taxpayer, it is not uncommon for bequests to a surviving spouse and children to have "strings" attached to the bequests. For example, a trust agreement may grant the trustee discretion to withhold distributions to a particular beneficiary, such as a child, if the child has drug or alcohol problems or perhaps because the child is not a productive member of society. Trust distribution schemes can often become quite complicated, often tailored to a client's objectives and desires, requiring distributions at various intervals, or when the beneficiary has met certain age or other achievement milestones, such as graduating from college or university.

In comparison, civil law countries often have in place laws that designate classes of beneficiaries who are entitled to benefit from a decedent's estate by default. The proportion of inheritance distribution invariably depends on the composition of heirs, with children often required to receive a substantial portion of the decedent's estate. It is perhaps for this reason that estate planning is not as commonplace in civil law countries as it is in common law countries like the U.S.; there is less incentive to plan when distributions to certain beneficiaries (e.g., descendants) is mandatory.

Yet another reason that estate planning may not be as commonplace in some countries is because there simply is no death, estate, or inheritance tax (i.e., Australia, Israel, Mexico, New Zealand, Sweden, Hungry, and Norway to name a few). In such countries, the burden of the U.S. estate tax system may seem onerous – even draconian – as the current gift and estate tax rate is forty percent (40%) – considered a historical low.

Importantly, for countries that impose death, estate, or inheritance, it is critical to determine whether there is an applicable tax treaty in place that may help to minimize or avoid double taxation. The U.S. currently

[1] Different jurisdictions in the U.S. will employ alternate naming conventions and terminologies for these general estate planning documents. This list is not meant to serve as an exhaustive list of estate planning documents and is included for general purposes of discussion.

has estate tax treaties with fifteen (15) countries, including Australia, Austria, Canada[2], Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, South Africa, Switzerland, and the U.K.[3]

This outline will cover a number of key non-tax factors to take into consideration when assisting a client who owns an asset or assets outside the United States and the type of estate planning document, if any, that may be preferable. Set forth below are some of the factors to consider.

I. Checklist of Considerations for U.S. Persons Who Own Foreign Property

A. Understanding the facts

1. Understanding the person – who is the client?

a. Is the client a U.S. person for estate tax purposes? For U.S. estate tax purposes, a U.S. person is a U.S. citizen or domiciliary. Whether someone is a U.S. domiciliary is based on the facts and circumstances. The Treasury Regulations state that a person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.[4] Essentially, there are two requirements for determining whether an individual has changed domicile– the first is physical presence, and the second is intent.

b. Does the client have a nationality other than the United States?

c. What is the client's current residency status? What are the client's future residency goals?

d. How has the client accumulated his or her wealth?

e. Is the client married?

f. If the client is married, where did they marry? Did they make any representations, written or otherwise, concerning the characterization of their property (i.e., separate or community property)? Did the laws of the jurisdiction in which they married or in which they resided at the time of their marriage have any presumptions concerning marital assets? Will the assets be considered "community" assets, owned equally by both spouses or will the assets be considered owned only by earning or acquiring spouse?

g. Does the client have children or plan to have children? How old are the children?

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[2] Article XXIXB of the United States-Canada Income Tax Treaty.

[3] Please see IRS website "Estate & Gift Tax Treaties (International)," last updated September 8, 2025, available at Estate & gift tax treaties (international) | Internal Revenue Service.

[4] Treas. Reg. § 20.0-1(b)(1).

h. What is the client's state of health?

i. For the U.S. citizen-client residing abroad, will the laws of the country in which the person resides apply to such person? Does the client have foreign counsel and advisors? Does the client have domestic counsel and advisors?

2. Understanding the assets – what does the client own?

a. What assets does the client own globally? What is the composition of assets by jurisdiction, by class (i.e., financial assets, real property, collectibles, other tangible personal property, etc.), and by value?

b. How is title held to such assets? Are there issues concerning actual ownership versus how title is held?

c. Are there any restrictions regarding transferring any of the assets, such as forced heirship or religious restrictions? If so, to whom do the rules apply and can or should they be avoided?

3. Understanding the objective – what does the client ultimately desire?

a. Is asset protection an objective?

b. Is anonymity an objective?

c. Is generational planning an objective?

d. Is tax optimization an objective?

e. Is charitable giving and philanthropic pursuit an objective?

f. Is carrying on a specific legacy an objective?

g. Is ensuring the proper transition of certain companies or other holdings an objective?

h. Is preventing interfamily disputes an objective? Is promoting interfamilial harmony an objective?

4. Understanding the larger picture – who is the family?

a. Who are the beneficiaries?

b. What is the nationality of each beneficiary?

c. How old are the beneficiaries? If the beneficiaries are minor children, are there guardians for them and if so, where do they reside?

d. Where do the beneficiaries reside?

e. Is there a desire to disinherit a descendant or treat one or more descendants differently than the others?

f. Are there any tax or reporting issues concerning the receipt of a bequest or inheritance? If so, are there any planning opportunities or exemptions/exceptions that could be applied?

g. Are there any health issues concerning the beneficiaries? Is the client concerned with the planning surrounding any medical disabilities or special health care needs?

h. What are the family dynamics?

As a matter of practical application, for clients working with foreign counsel, it is important to clarify whether the attorney-client privilege applies. In the U.S., confidentiality of attorney-client communications is protected. This is not always the case in other countries. In fact, some countries place a requirement on attorneys to notify authorities of certain suspicious activities, such as money laundering.

II. What are the Main Legal Systems in the World?

It is important to have an understanding of which legal system a country has because it will effect judicial jurisdiction, characterization of property, disposition of property and the recognition and enforcement of foreign judgments. In general, there are four main legal systems of the world: civil law, common law, and religious law or a combination of these. In very general terms, with civil law legal systems, only legislative enactments (rather than legal precedents) are considered legally binding. Common law, on the other hand, looks to both legislation and judicial decisions and interpretations of such legislation. The main kinds of religious law are Sharia in Islam and Halakha in Judaism, and to some extent canon law in some Christian groups, with the Islamic legal system of Sharia the most widely used of the religious legal systems. It is important to bear in mind that each country, and sometimes regions within a country, will vary. A number of countries, one of which is Israel, has a combination of legal systems. For example, Israel is based on common law, but incorporates facets of civil law. Set forth below are some key general attributes of the legal systems.

A. Are there any restrictions on the disposition of assets?

1. Common law countries – control in one's own hands. As discussed above, in common law countries, a person typically has considerable control over how he or she disposes of his or her estate, with few restrictions. Examples of common law countries include: Australia, Belize, Barbados, Barbuda, British Virgin Islands, Canada, England and Wales, Hong Kong, India, Ireland, New Zealand, Singapore, and the United States.

2. Civil law countries – designations by default. Civil law countries often have in place laws that designate beneficiaries who are entitled to benefit from a decedent's estate, by default. The proportion of inheritance distribution invariably depends on the composition of heirs. See forced heirship below. Examples of civil law countries include: Armenia, Austria, Belgium, Bolivia, Brazil Cambodia, People's Republic of China, Chile, Columbia, Denmark, Ecuador, Finland, France, Germany, Greece, Guatemala, Italy, Japan, Luxembourg, Mexico, Netherlands, Norway, Panama, Peru, Russia, Slovenia, Spain, Sweden, and Switzerland.

3. Islamic law countries – driven by Sharia law. A number of countries are governed under Sharia law, which is often combined with elements from either common law or civil law. Although the rules may vary, Sharia law specifies how much a surviving spouse and children shall receive, similar to the requirements of forced heirship rules, with the exception that often under Sharia law, a son is typically entitled to receive twice the property of a daughter. Examples of countries with Islamic legal systems include, but are not limited to, Iran, Iraq, Oman, Qatar, Saudi Arabia, Sudan, Yemen, and certain regions of Indonesia, Nigeria, and the United Arab of Emirates.

B. Will the relevant country(ies) recognize trusts?

1. In General. Most common law counties recognize trusts, while most civil law countries do not. However, a few civil law countries have codified trust laws, such as Japan and South Africa.

2. Hague Convention signatory status. If the country has not codified trust laws, it is important to determine whether the applicable country is a signatory to the Hague Convention on the Law Applicable to Trusts and Their Recognition (also known as the "Hague Trust Convention"), which was concluded on July 1, 1985, and effective on January 1, 1992.[5] If the country is a signatory, the Hague Trust Convention generally requires the country to recognize a trust, provided the trust is valid under the domestic law of a jurisdiction the trust is established.

3. Practical Implications. Even if a foreign country recognizes the validity of a trust, the client may run into practical implications, e.g., to being able to title real property in the name of the trust. Moreover, it is important to properly strategize prior to the transfer of foreign assets into a trust. It is important, for example, to consider the tax ramifications of the transfer of assets into a trust because some countries impose a tax on the transfer of property to a trust, even if the trust is a revocable trust.

C. Does the foreign country have "forced heirship" or other default rules?

1. Religious designations. Some religions designate who will inherit one's assets on death. For example, under Sharia law, as a general rule, a Muslim may not dispose by will more than one-third of the surplus of his or her estate after payment of funeral expenses and debts. Any bequests in excess of that amount require the consent of the heirs after the testator's death

2. Forced heirship. In many civil law countries, like France, Germany, South Korea and Japan, there are laws that govern who must inherit assets on death. These laws are commonly referred to as "forced heirship" laws because the legal systems force or require that certain beneficiaries, often spouses and children, have certain rights to a decedent's assets, by default. This often times generates interfamily disputes

[5] There are currently fourteen (14) signatories to the Hague Trust Convention, including Australia, Canada, the PRC, Cyprus, France, Italy, Luxembourg, Malta, Monaco, Netherlands, Panama, Switzerland, the U.K., and the U.S. Please see HCCH website "30: Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition: Status Table," last updated 19-November-2017, available at https://www.hcch.net/en/instruments/conventions/status-table/?cid=59.

in relation to children born out of wedlock or children born without the knowledge of the decedent.

3. Common law jurisdictions – freedom and flexibility. Common law jurisdictions, in contrast, offer greater freedom and flexibility in the disposition of property such that a testator may even disinherit offspring. Spouses are generally afforded some degree of statutory protection, however.

4. State variations in the U.S. In the U.S., the laws of each state govern the disposition of inheritances. In California, for example, a person may dispose of his or her assets to whomever he or she wants. There are no requirements that a percentage or amount must pass to a spouse or descendants.

5. Forced heirship avoidance. A client faced with forced heirship laws that do not fit with the client's estate planning objectives may take or have taken some of the following actions (not intended as an exhaustive list) to avoid forced heirship:

   a. Remove assets from country with forced heirship laws.

   b. Hold title to the property through an intermediate entity, such as a corporation or company, and establish a trust in the U.S. to own the shares or interests in the corporation or company.

   c. Change domicile to a non-forced heirship jurisdiction.

III. Which Country's Laws Will Apply?

If a U.S. person owns property in a foreign country, will the law of the United States or that of the foreign country govern?

A. Choice of law in the U.S., generally. The general rule is that a U.S. court will uphold a testator's choice of law selection in a testamentary document. The choice of law rules do not require that the law selected by the testator have a substantial connection to the testator or to the real property itself, aligning with the general trend of control, freedom, and flexibility in the U.S. This does not necessarily mean the foreign country will accept that choice of law, particularly if the testamentary document attempts to dispose of real property located in that foreign country and such disposition violates the foreign country's laws on disposition, e.g., forced heirship rules.

B. Common law jurisdiction – domicile and situs. In general terms, common law provides that the law of jurisdiction of domicile governs disposition of personal property and the law of jurisdiction of the situs governs disposition of real property. For example, if a U.S. citizen domiciled in the U.S. passed away intestate (i.e., without a will) owning personal property and real property in France, the laws of the U.S. would govern the disposition of the personal property and the laws of France would govern the disposition of the real property situated in France.

C. Civil law jurisdiction – nationality centric. In general terms, civil law provides that the law of the person's country of nationality will govern succession law matters. Note, however, that the European Union ("EU") passed legislation to harmonize succession laws across

the EU, which provides generally that the law of the person's habitual residence will govern succession, but also allows persons to select a governing law in certain circumstances. See discussion of EU Succession Regulation below.

D. EU Succession Regulation Affecting Governing Law

1. EU Succession Regulation

a. On July 4, 2012, the European Union adopted the EU Succession Regulation 650/2012 ("Brussels IV"), applicable to estates of decedents after August 17, 2015. The Brussels IV applies to all EU member states except Denmark and Ireland. Brussels IV attempts to harmonize the succession regime for a decedent's property located throughout the Brussels IV zone such that the decedent's entire estate is treated under a single law and by a single authority.

b. Under Brussels IV, the law that governs the succession of the estate of a decedent "as a whole" shall be the law of the state of the decedent's habitual residence at the time of death, unless the decedent chose the law of the state of his nationality (at the time of the choice or the time of death) to govern his succession. It is important to note that the law chosen need not be the law of a Brussels IV member state, nor does the state of habitual residence need to be a Brussels IV member state. The governing law shall apply to the succession of the decedent's estate as a whole. Brussels IV also allows one state's court to have jurisdiction of the entire estate succession, and to issue a European Certificate of Succession that will be recognized in all Brussels IV member states.

c. As a result of Brussels IV, it may now be possible to avoid the forced heirship laws of EU countries in which a testator resides or has property, if the testator is a national or habitual resident of a country without forced heirship laws. Practitioners must still consider conflicts of law principles, as the doctrine of renvoi applies if no election is made. For example, if U.S. law is applied as the governing law under the default rule of the testator's habitual residence, the doctrine of renvoi would result in the application of the law of the situs to real property. By contrast, if an election is made by the testator, the election applies the substantive law of the governing nation, and the doctrine of renvoi is not applied. As an additional caveat, a Brussels IV state may refuse to apply the law of another state if it would be "manifestly incompatible with the public policy" of the Brussels IV state.

d. Note that Brussels IV only applies to the law of succession. The regulations do not apply to other laws such as matrimonial property law, trust law, and tax law.

E. Hague Convention on the Law Applicable to Succession to the Estates of Deceased Persons. Hague Convention on the Law Applicable to Succession to the Estates for

Deceased Persons ("Hague Convention on Succession") attempted to establish common provisions concerning the law applicable to succession of the estate of deceased persons.[6]

a. The Hague Convention on Succession specifically did not address the form of dispositions of property upon death, the capacity to dispose of property upon death, issues pertaining to matrimonial property or property rights, interests or assets created or transferred otherwise by succession, such as in joint ownership with right of survival, pension plans, insurance contacts or arrangements of a similar nature.[7]

b. The applicable law governing succession is the law of the state in which the deceased at the time to his death was habitually resident, if he was then a national of that state.[8]

c. Succession is also governed by the law of the state in which the deceased at the time of his death was habitually resident if he had been resident there for a period of no less than five (5) year immediately preceding his death.[9]

d. In other cases, succession is governed by the law of the state of which at the time of his death the deceased was a national, unless at the time the deceased was more closely connected with another state, in which case the law of the latter applies.[10]

e. The Hague Convention on Succession has little bearing as only three countries are signatories (Argentina, Luxembourg, and Switzerland) and no country has ratified, accepted or approved of it and it is not yet entered into force.

F. Conflicts of law. Understanding the potential conflicts of law will help in identifying what issues may arise and developing a plan to mitigate or altogether eliminate such issues. A summary outline of key conflicts of law issues that arise in relation to estate planning is included below:

1. Conflicts between choice of law rules. It is important to carefully consider and identify potential conflicts between choice of law rules. For example, if a U.S. citizen owns real estate in a civil law country that follows the succession rules based on the person's nationality, what rules will govern the disposition of the real property? In the U.S., we would look to the rules of the foreign country (i.e., the situs). As a general rule, however, many civil law countries would look to the rules of the person's nationality, e.g., the U.S. See discussion of the doctrine of renvoi below.

2. Holistic worldwide planning. It is important to avoid estate planning based solely on domestic U.S. law without considering the consequences to the foreign

[6] 1989 Hague Convention on the Law Applicable to Succession to the Estate of Deceased Persons (August 1, 1989).

[7] Hague Convention on Succession, Article 1.

[8] Hague Convention on Succession, Article 3.

[9] Id.

[10] Id.

beneficiaries overseas or the tax ramifications in other jurisdictions. For example, under German inheritance tax laws, inheritances transferred to residents of Germany and distributions passing from a trust of any sort are treated as deriving from a non-related party, and thereby subject to the highest rate of tax. Therefore, if a revocable trust is established by a U.S. person-parent with German resident beneficiaries (even if those German resident beneficiaries are U.S. citizen children living in Germany), the distributions passing from such trust may well be treated as deriving from a non-related party and be subject to the highest rate of tax. Had the gift or bequest been transferred directly from the U.S. person-parent to the German beneficiary-children, the tax liability would have been substantially reduced. Therefore, it will be important to consider other planning options, such as payable on death accounts, beneficiary designations, outright distributions set forth in the decedent's will. Whether to use one will or multiple wills is discussed below.

3. Doctrine of Renvoi. In conflicts of law, the doctrine of renvoi (of French origin, meaning "send back" or "to return unopened") is a subset of the choice of law rules and it may be applied whenever a forum court is directed to consider the law of another state or country. In the example above in Article III B, the U.S. would apply the law of the civil law country (i.e., the situs where the real property is located) and the civil law country would apply the laws of the person's nationality (i.e., the U.S.). The doctrine of renvoi arises when the conflicts of law rules of one jurisdiction refers a matter to the law of another jurisdiction. The critical question is whether the reference is to the substantive law of the other jurisdiction or to the substantive law and the choice of law rules of the other jurisdiction. Generally, U.S. courts have interpreted "law" to mean only the substantive laws and not the choice of law rules. An exception to this rule involves succession law matters related to real property, in which case a U.S. court would likely apply both the substantive law and the conflict of rule laws of that country.

IV. Trusts and Choice of law.

A. Choice of law and treatment of trust in the U.S. Where trusts are involved, most U.S. courts respect the law designated by the settlor to govern questions of contribution, administration, and validity (i.e., a choice of law clause). If the trust remains silent on the choice of law, courts would make a determination based on the law of the jurisdiction most significantly related to the trust or specific issue. Some of the factors taken into consideration include, but are not limited to: location of assets, place of administration, trustee's place of business, place of execution of the trust agreement, and settlor's domicile. Where the trust asset involves real property, however, less weight is given to the settlor's intent and more weight is given to the law of the situs.

B. Choice of law and treatment of trust in civil law jurisdictions. Many civil law jurisdictions do not recognize the concept of a trust. The Hague Conference on Private International Law adopted a Convention on the Law Applicable to Trusts and Their Recognition ("Hague Trust Convention"). While the Hague Trust Convention provides that a trust should be governed by the law chosen by the settlor as evidenced in the trust instrument, the Hague Trust Convention provides that its provisions will not prevent the application of some mandatory laws, such as marital rights, succession rights, and creditors' rights.

V. Will Your Will be recognized?

A. The Hague Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions.

1. Purpose. The purpose of the Hague Convention on the Conflicts of Law Relating to the Form of Testamentary Dispositions ("Hague Convention on Testamentary Dispositions") is to recognize as valid, in terms of the formalities of execution, a will that complies with the domestic law of any one of the following: the place where the testator made the will, the nationality of the testator (either at the time of making the will or at the time of death), the domicile of the testator (either at the time of making the will or at the time of death), the place of "habitual residence," or with respect to immovable assets, the place where they are situated. [11]

2. Validity of wills. A person who has assets in a country that signed the Hague Convention on Testamentary Dispositions should be able to take advantage of the convention even if the nationality of the person involved or the law to be applied by virtue of the convention is not a contracting state of the Hague Convention on Testamentary Dispositions.[12]

B. Washington Convention.

1. Purpose of the Washington Convention. In 1973, the International Institute for the Unification of Private Law (UNIDROIT)[13] held the Convention Providing a Uniform Law on The Form of an International Will (the "Washington Convention") to resolve the issue of conflicts of laws relating to the international recognition of wills by establishing a uniform law on the formalities of an international will without invalidating or superseding the laws of other countries. This is an especially useful mechanism for persons with assets in various jurisdictions outside of their country of domicile.

2. Formalities of an International Will. The signatory members to the Washington Convention all agreed to the requirements that must be met for a will to constitute a valid International Will, as recognized by the signatory members. The key requirements are as follows:

a. The will may not apply to the testamentary disposition made by two or more persons in one instrument (i.e., it may only apply to the testamentary disposition of one person) (Article 2);

b. The will shall be made in writing (Article 3.1);

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[11] The U.S. has not ratified the Hague Convention on Testamentary Dispositions, but about thirty (30) other countries have, including but not limited to Australia, Belgium, Denmark, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, and the U.K.

[12] The Hague Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions, Article 6.

[13] There are currently sixty-three (63) signatory member nations to UNIDROIT. Please see UNIDROIT website "Membership," last updated 09-February-2018, available at https://www.unidroit.org/about-unidroit/membership.

c. The will may be written in any language, by hand or by other means (Article 3.3);

d. The testator shall declare in the presence of two witnesses and of a person authorized to act in connection with international wills that the document is his will and that he knows the contents thereof (i.e. legal counsel) (Article 4);

e. In the presence of the witnesses and of the authorized person, the testator shall sign the will (Article 5.1);

f. The witnesses and the authorized person shall attest the will by signing in the presence of the testator (Article 5.3);

g. The signatures shall be placed at the end of the will (Article 6.1);

h. If the will consists of several sheets, each sheet shall be signed by the testator. In addition, each sheet shall be numbered (Article 6.2);

i. This date shall be noted at the end of the will by the authorized person (Article 7.2); and

j. The authorized person shall attach to the will a certificate in the form prescribed in Article 10 establishing that the obligations of this law have been complied with (Article 9).[14]

3. Signatories to the Washington Convention. Countries that are signatory to the Washington Convention include, but are not limited to, the following:

a. Australia

b. Belgium

c. Bosnia-Herzegovina

d. Canada

e. Cyprus

f. Ecuador

g. France

h. Italy

i. Libya

j. Niger

[14] See Annex, UNIDROIT website "Convention Providing a Uniform Law on The Form of an International Will," available at https://www.unidroit.org/instruments/international-will.

k. Portugal

l. Slovenia.

m. The U.S. is an original signatory of the Washington Convention. The client's counsel will need to check the relevant state law to determine whether the state has adopted the Uniform International Wills Act, either as stand-alone legislation or as part of the Uniform Probate Code.

C. Country Not Signatory to Washington Convention or Hague Convention

In countries that have not adopted the Washington Convention or the Hague Convention on Testamentary Dispositions, you will need to determine which law applies to determine the validity of the will and then analyze the will under those laws.

D. Special Rules for Dubai Wills and Probate Registry for Non-Muslims

1. Effective April 30, 2015, Dubai has created a registry to allow Non-Muslims to register a will bequeathing their Dubai assets to their chosen beneficiaries, without regard for Sharia law. This will also allow Non-Muslims parents the freedom to nominate guardians for their minor children, and to devise jointly-owned property to their spouse or civil partner by survivorship, both otherwise prohibited under Sharia law.

2. The Dubai International Financial Centre (DIFC) has established a Wills and Probate Registry that will register English-language wills for non-Muslim expatriates and will work with the DIFC courts to produce grants and court orders for the distribution of assets and guardianship of dependents, simplifying the succession process for non-Muslims residing in Dubai.

VI. How is Title Taken?

A. Restriction on foreign ownership. Some countries, such as parts of Mexico, the People's Republic of China, and some parts of Switzerland, do not allow a foreigner to hold title to real property directly in the foreigner's individual name. In such instances, title is usually taken through a vehicle established in that particular country for the specific purpose of allowing a foreign person to take title, e.g., a fideicomiso in Mexico. In other instances, title may be taken through a third-party under a nominee arrangement in which a nominee is the legal holder of title and the foreigner is the beneficial owner.

B. Individual name. With the exception of the restrictions on foreign ownership noted above, most countries will permit a person to take title to property in his or her own name.

C. Concurrent Estate (Co-ownership), including joint tenancy. A concurrent estate is a concept in property law that provides for the various methods in which two or more persons may hold title to real property as co-owners. One common form in which two or more persons hold title to real property in the U.S. is by "joint tenancy with rights of survivorship," a form of concurrent estate in which co-owners are entitled to a right of survivorship (i.e., if one owner dies, such owner's interest in the property will automatically pass to the surviving owner(s) by operation of law) - a probate avoidance

and time/cost savings mechanism (in addition to maintaining privacy). However, many civil law countries do not recognize the concept of joint tenancy with rights of survivorship. Rather, the interests of concurrent estates in many civil law countries must pass through a formal probate proceeding to transfer the decedent's interest to beneficiaries. Because of the lack of recognition of the joint tenancy with rights of survivorship in civil law countries, it is very important to undertake proper planning, from a worldwide planning perspective, to optimize interspousal and generational wealth transfer for clients.

D. Trust Structure. Trusts are commonly used throughout the United States to hold title to assets. As noted above, many civil law countries do not recognize trusts. Further, some countries will impose taxes upon the transfer of assets into the trust (e.g., the United Kingdom) and periodic taxes thereafter on property held in the trust (e.g. Canada). Therefore, the global asset position and residency of the client and the client's family needs to be considered in determining whether a trust structure is feasible and optimal.

E. Entity Structure. Holding title in an entity, whether foreign or U.S., is a common tool for estate planning purposes. For countries that have forced heirship laws, entity structures, such as a limited liability company ("LLC"), may be established as a means to avoid the application of the forced heirship rules. For example, if an LLC is used, it should be possible to have the client's U.S. estate planning documents, e.g. a revocable trust, to control the disposition of the LLC and thus the foreign asset. For U.S. income tax purposes, if a foreign entity is used, the formation documents should be carefully reviewed to determine the proper tax treatment of such entity for U.S. tax purposes and whether there will be informational reporting.

1. Types of Entities. For U.S. tax purposes, business entities are generally characterized as corporations, partnerships or disregarded entities. Entities that are characterized as corporations are treated as separate taxable entities for U.S. tax purposes. Entities that are characterized as partnerships are treated as flow-through entities for U.S. tax purposes, meaning that all of the profits and losses of the partnership "pass through" to the partners, who pay taxes on their share of the income. Disregarded entities have just one owner and are generally considered entities that are not separate from its owner for U.S. tax purposes.[15]

2. Check-the Box Rules. In 1996, the IRS implemented "check-the-box" rules allowing eligible entities to make an election to be treated as a corporation or partnership/disregarded entity for U.S. tax purposes. Certain business entities that are organized as corporations under state statutes in the U.S., entities that are taxable as corporations under a special provision of the Code, and specified foreign entities that have the characteristics of U.S. corporations (often referred to as "per se" corporations) are excluded from this elective status regime.[16] A specific list of foreign entities that are considered per se corporations, and thus not eligible to make a check-the-box election are listed in the Treasury Regulations.[17] A trust is not an eligible entity.

[15] A "disregarded entity" is treated as separate from its owner for certain tax purposes, including employment tax excise tax, and reporting in some instances.

[16] Treasury Regulations ("Treas. Reg.") § 301.7701-3(a).

[17] Treas. Reg. § 301.7701-2(b)(8).

3. Default Classification of Eligible Entities. If an eligible entity formed in the United States does not make a check-the-box election, its default U.S. tax classification is a partnership if it has two or more members; or a disregarded entity if it has a single owner.[18] The default U.S. tax classification of a foreign eligible entity is a partnership if it has two or more members and at least one member does not have limited liability; a corporation if all members have limited liability; or a disregarded entity if it has a single owner that does not have limited liability.[19]

4. Entity Classification Election. An eligible entity can make an election to change its default tax classification by filing Form 8832, Entity Classification Election, with the Internal Revenue Service.[20] The effective date of the check-the-box election may be made up to 75 days prior to or up to 12 months after the date the election is filed.[21] Further, if a check-the-box election is made by an eligible entity, another check-the-box election cannot be made within 60 months of the effective date of the original classification election except in certain instances with authorization from the IRS.[22]

F. Alternative vehicles to hold foreign property. Civil law countries often provide vehicles for holding property that allow owners to achieve results similar to holding property through trusts, though such alternative vehicles are often less flexible and are generally of limited duration.[23] The following are a few examples:

1. Usufruct. A usufruct is a civil law construct. It is a limited in rem right that divides property between the usufructuary and the bare owner. The usufructuary interest holder possesses the right to use the property for a term of years or measuring life, has a duty to maintain the property, and is entitled to the income. The bare owner holds legal ownership and may transfer title but may not disturb the usufructuary interest. Because there is no separate fiduciary, the usufruct generally should be treated as a life estate under U.S. law.[24] However, in one IRS private letter ruling, a German usufruct was treated as a trust where the usufructuary served as the executor for the duration of the usufruct. One must therefore look to the particular facts and circumstances to determine the proper classification of a usufruct for U.S. purposes.[25]

a. If the usufruct is treated as a gift of the remainder interest and the gift is by a foreign person (the usufructuary) to a U.S. person, the U.S. person will need to file Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts (Form 3520) if the value of the gifts exceeds $100,000. In Private Letter Ruling 201032021, the IRS ruled that

[18] Treas. Reg. § 301.7701-3(b)(1).

[19] Treas. Reg. § 301.7701-3(b)(2)(i) .

[20] Treas. Reg. § 301.7701-3(c)(1).

[21] Treas. Reg. § 301.7701-3(c)(1)(iii).

[22] Treas. Reg. § 301.7701-3(c)(1)(iv).

[23] See generally, Christensen, Henry, III, International Estate Planning (Second Edition), Matthew Bender, 1999.

[24] See P.L.R. 201032021 (Aug. 13, 2010).

[25] See P.L.R. 9121035 (Feb 25, 1991) (usufruct determined to be a trust).

the gift took place in the taxable year in which the donor transferred title in the underlying assets and retained a usufruct interest in such asset.[26]

b. If the usufruct is treated as a trust, an Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts (Form 3520) and Annual Information Return with a U.S. Owner of Foreign Trust (Form 3520-A) likely will be required, along with a Statement of Specified Foreign Financial Assets (Form 8938) and possibly Report of Foreign Bank and Financial Accounts (FinCEN Report 114).

2. Stiftung or foundation. A stiftung or foundation is a civil law construct. It is a statutory entity with a separate legal identity from the founder and is established to pursue a purpose of such founder. Assets are irrevocably transferred to the foundation and managed by a council for a specific purpose. Foundations can have charitable or non-charitable purposes. The IRS will look to the actual purpose of the foundation to determine if it should be treated as a trust or business entity.[27]

3. Fideicomiso. The Mexican trust or fideicomiso is required to be used by non-Mexican nationals to acquire and hold land in the "restricted zone." The restricted zone includes 50 kilometers from all Mexican coastlines and 100 kilometers from all Mexican borders. Pursuant to the Mexican Constitution, real property located within the restricted zone that will be used for residential purposes may only be owned by Mexican nationals (those individuals who are Mexican by birth or naturalization) and Mexican entities, provided, however, that such Mexican entities may not be owned by non-Mexican persons. If, however, the real property is used for nonresidential purposes, the property may be owned by a Mexican entity, which in turn may be owned by non-Mexican persons.

a. For real property that is located within the restricted zone and is used for residential purposes, title to such property must be held in a Mexican trust or fideicomiso. By law, only a Mexican bank or financial institution may serve as trustee. Although the title to the real property is held in the name of the trustee, the beneficiary (i.e., non-Mexican national) has all the corresponding rights to use, lease, or sell the rights derived from the trust. The Mexican government must grant a special permit to establish these type of trusts. The permits are granted for a fifty-year renewable term.

b. Any individual or legal entity, whether Mexican or foreign, may be the beneficiary under a fideicomiso. This includes but is not limited to a U.S. person, a U.S. LLC, a U.S. trust, or a company (U.S. or Mexican). Most fideicomiso instruments do not contemplate U.S. estate taxes. Accordingly, care should be taken to review the instrument carefully and tailor the trust instrument to fit the particular family situation and to provide for an orderly succession and minimize or defer U.S. transfer taxes. At a minimum, where the beneficiary is not a separate entity (e.g., a corporation or a limited liability company), the fideicomiso instrument should provide for successor

[26] See P.L.R. 201032021 (Aug. 13, 2010).

[27] See Estate of O.T. Swan, 24 T.C. 829 (1955), aff'd 247 F.2d 144 (2d Cir. 1957); PLR 200302005; and IRS Advice Memorandum 2009-012.

beneficiaries. Based on experience, a Mexican trustee generally will not designate successor beneficiaries based on a U.S. will or "pour over will" designating such beneficiaries. Rather, the Mexican trustee may well require a probate proceeding and a U.S. court order, which must then be domesticated under Mexican law before the beneficial property rights are passed to the successor beneficiary. Thus, care should be taken in scenarios where the client has opted for having separate multiple wills, for example a U.S. will for U.S. situs properties and a Mexican will for Mexican situs properties.

c. In the past, there was doubt whether a U.S. revocable trust could be named as the beneficiary of a Mexican fideicomiso. As noted above, it is now generally recognized that a U.S. revocable trust may be named as the beneficiary or successor beneficiary. In one such instance that the author encountered, the Mexican trustee required an order from a U.S. court recognizing the authority of the successor trustee of the U.S. revocable trust in order to allow the transfer of interest under the Mexican trust. An alternative structure has been to name a U.S. LLC as a beneficiary of the Trust. This approach has been better received by the involved parties, particularly the Mexican trustee and the participating notary.

d. As discussed in more detail below, care must be taken to comply with all United States foreign reporting. U.S. taxpayers have long questioned whether fideicomisos are "trusts" for U.S. tax purposes. If a fideicomiso is considered a trust for U.S. tax purposes, an Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts (Form 3520) and Annual Information Return with a U.S. Owner of Foreign Trust (Form 3520-A) likely will be required, along with a Statement of Specified Foreign Financial Assets (Form 8938) and possibly Report of Foreign Bank and Financial Accounts (Form FinCEN Report 114). In Revenue Ruling 2013-14, the fideicomiso in the ruling was ruled not to be a trust based on the terms of the fideicomiso. Key in that decision was the fact that the trustee did not engage in activity other than holding title to the land. Thus, the terms of the fideicomiso should be reviewed to determine if the Revenue Ruling applies.

4. Anstalt. A Liechtenstein anstalt is a type of incorporated organization established when the founder transfers assets to a board of directors, which manages the assets as directed by the articles of incorporation. The anstalt has a separate legal identity from the founder. Under default Liechtenstein law, the founder reserves the right to amend the articles. The anstalt may be treated as a trust or corporation, depending on its operations or the purposes for which it is established.[28] One must therefore look to the particular facts and circumstances to determine the proper classification of an anstalt for U.S. purposes.

[28] See Rev. Rul 79-116; IRS Advice Memorandum 2009-012.

5. Trust or Business Entity? With a foreign entity, it is sometimes difficult to determine at first blush how the entity will be classified for U.S. tax and reporting purposes.

   a. Section 301.7701-1(b) of the Treasury Regulations provides that the classification of organizations that are recognized as separate entities is determined under § 301.7701-2, § 301.7701-3, and § 301.7701-4 unless a provision of the Internal Revenue Code provides for special treatment of that organization. Section 301.7701-4(a) provides that, in general, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit. If an entity has both associates and a business purpose, it cannot be classified as a trust for federal income tax purposes.

   b. A business entity is any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701-3) that is not properly classified as a trust under § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code.[29] As noted above, a business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership. A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner. But see discussion above on check-the-box elections for eligible entities.

   c. A general rule of thumb to follow is that if an entity exists to carry on a trade or business and has associates, it will be taxed as a business entity (e.g., a corporation, partnership or disregarded entity) and if the entity exists in order to hold and invest property, but not to conduct a business and does not have associates, it will be classified as a trust.

VII. <u>What estate planning documents should be drafted for the disposition of the foreign property, and what issues should be considered by the drafting attorney?</u>

A. Recognition of trusts. As noted above, most civil law countries do not recognize trusts, which is often times the central, if not most important, component of U.S. estate plans. Therefore, taking title in the name of a trust or having a pour over will that pours assets into a U.S. trust may not work from the foreign country's perspective. If the foreign country recognizes trusts and there are no negative tax consequences associated with holding and administering the property in the trust, a trust may be considered.

B. Will Options. If not a trust, what type of will should be used?

[29] Treas. Reg. §301.7701-2(a).

1. U.S. will. It may be possible for the client to use a U.S. will (i.e., a will prepared in accordance with the laws of one of the 50 states) to dispose of foreign property. While using one U.S. will to dispose of all assets would be a simple and straightforward method, you will need to confirm that the foreign county will accept the will as a valid will. See above discussion on The Hague Convention and the Washington Convention.

    a. Advantages of a U.S. will to dispose of foreign assets:

        i. Simplicity

        ii. Arguably less expensive

    b. Disadvantages of a U.S. will to dispose of foreign assets:

        i. Possible issues with validity in foreign country

        ii. Possible need for translation of document(s)

        iii. If pour over will, pouring assets into a trust where trusts are not recognized in country where asset is situated

        iv. If the foreign court requires the production of the original will, there may be issues complying if the will has been lodged for probate with a court within the U.S.

        v. Some courts will require full disclosure of all assets if the will disposes of all assets (i.e., loss of privacy)

        vi. Possible need to name a person to administer the estate who is not resident in the country in which the assets are located, particularly if foreign country has restrictions on who may serve as executor

2. Situs will. A situs will is a type of will that specifically states it is disposing of property situated within a certain country, for example, a German will that disposes of only German real property and business interests. The drafter should be careful to define what property is being disposed of under the will and the scope of the will. In particular, the drafter should be sure all wills are coordinated to avoid inadvertent revocation of one will and/or inadvertently failing to cover assets in other jurisdictions. Although costs for multiple wills may be more expensive at the outset, there are often cost savings when the estate is administered as a result of the foreign country administering a will that has familiar provisions and covers only assets in such country. For EU countries under Brussels IV, consider whether the election should be made to the law of the jurisdiction of the testator's nationality or habitual residence.

    a. Advantages of a situs will to dispose of foreign assets:

        i. It is simpler and more efficient to administer assets limited to those located within the jurisdiction

ii. It is less expensive to administer estate because there are less assets in estate to administer

iii. A will is drafted tailored to the specific jurisdiction so there are fewer issues of ambiguities and clearer application of relevant laws

iv. There is no need for translation of the will into a foreign language if jurisdiction is one in which English is not the primary language

v. Whether the will is valid in the country should not be an issue as it will have been drafted in compliance with such country's laws and rules regarding will execution formalities

vi. The original will may be produced to the local court without the potential issue of complying if the will has been lodged for probate with a court within the U.S.

vii. The administration (and thus disclosure) may be limited to the assets disposed of under the will

b. Disadvantages of a situs will to dispose of foreign assets:

i. Accidental revocation and unintended consequence

ii. Possible need for translation of document

iii. Inefficiency and potential conflict issues of administering several situs wills (if assets are located in several jurisdictions)

3. International Will. The client may also consider using an international will if the foreign country the client is subject to is a signatory of the Washington Convention, as discussed above. The primary benefit of using an international will is that there is certainty and finality that the will would be deemed valid in a country that is a signatory to the convention.

C. Use of Notary Publics. If the property is located in a civil law country, it is likely that the client will require civil law notarial service. Civil-law notaries undertake a drastically different role than their common-law counterparts, the notary public. Civil-law notaries are lawyers of non-contentious private civil law who draft, deliver, and record legal instruments for private parties; render legal advice; and are public officers vested with the authentication power of the State. Unlike common-law notary publics, civil-law notaries are highly trained and licensed practitioners providing a full range of regulated legal services. While they hold a public office, they nonetheless operate usually—but not always—in private practice and are paid on a fee-for-service basis. They often receive the same education as attorneys at civil law but without qualifications in advocacy, procedural law, or the law of evidence, somewhat comparable to solicitor in training in certain common-law countries.

D. Probate proceedings in foreign countries. The client will want to consult with local counsel to determine the level of complexity of the relevant matter should a probate be required.

In some civil law countries, the process of probate may be handled by a notary public and may be quite straightforward. In other countries, however, the property will pass by operation of law without the need for a formal probate proceeding.

E. Drafting considerations. When undertaking planning for a client with an international footprint, there are significant drafting considerations whether you draft a U.S. situs will, an International will, or a trust as part of his or her estate plan. A summary overview of such key considerations are included below:

1. Scope. A U.S. situs will must state its scope, that is, is it applicable to all of the testator's assets excluding those located in a specific foreign jurisdiction, or does the will only cover U.S. situs assets? One must ensure that the scope of the U.S. situs will and that of the foreign will(s) do not overlap.

2. Revocation. Typically, a will includes a provision revoking all prior wills and codicils, which may not be the testator's intent if he or she already has a situs will in place. Careful steps must be taken to ensure that one does not (inadvertently) revoke a foreign will. This often times requires coordination with local counsel to confirm that a foreign will does not revoke the U.S. situs will. To avoid accidental revocation, it would be prudent to include a provision that the will may only be revoked if specifically referred to in the revoking document.

3. Definitions Section. Although often considered as "boilerplate" language, the definitions section in a will or trust should be carefully reviewed and tailored, as required under the circumstance, to ensure that the terms meet the client's objectives. For example, the term "children" in one jurisdiction may include adopted children, but in another jurisdiction, children may refer only to biological descendants unless explicitly defined to include otherwise. By no means intended to serve as an exhaustive list, other examples include the terms "per stirpes," "incapacitated," and "perpetuity date," all of which should be defined in the will or trust agreement as interpretations may vary under the laws of different jurisdictions.

4. Fiduciary Provisions. The will or trust agreement should include detailed provisions stating how fiduciaries are appointed, compensated, removed (including who may remove and appoint successor fiduciaries), resigned (including to whom notice of such resignation must be provided) as well as whether the requirement for bond should be. In drafting a will that may be probated in a foreign jurisdiction, one may desire to include a provision providing fiduciaries the power to appoint a local resident to serve as a fiduciary for the foreign probate process.

5. Beneficiaries. If situs wills are used and different beneficiaries receive assets in different countries, care should be taken to avoid issues such as running afoul of forced heirship, lack of liquidity to pay taxes and expenses in one estate, disproportionate distribution of estate assets without equalization if desired, and preemptively addressing issues if an asset is sold.

6. Choice of Law Provisions. To eliminate any doubt regarding the law governing the trust or will instrument, it is recommended to include a provision that specifies the law that will govern. In many cases, such a clause will be honored if the jurisdiction

specified has sufficient contact with the testator or settlor and the clause does not violate public policy.

7. Tax apportionment. A U.S. citizen or domiciliary will be taxed on his or her worldwide estate for U.S. federal estate tax purposes, and foreign property owned by the client may also be taxed by the foreign jurisdiction. Thus, it is important to ensure that the tax apportionment and payment clauses are coordinated if there are situs wills or if property will pass outside of the wills (such as in trust or by operation of law). One should also consider whether to specifically allocate any tax credits to offset U.S. or foreign estate taxes.

VIII. Planning and Tax Matters Concerning Foreign Trusts

A. Definition of Trust. For U.S. tax purposes, the term "trust" generally refers to an arrangement by which title to property is held by a person or entity with a fiduciary responsibility to conserve or protect the property for the benefit of beneficiaries.[30] Usually, the beneficiaries of a trust do no more than accept the benefits of the trust. Generally, an arrangement will be recognized as a trust under the Internal Revenue Code if it can be demonstrated that the purpose of the arrangement is to vest in the trustee responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business or profit. In general terms, an entity that conducts an active trade or business will likely be classified as an association or partnership.[31]

B. Tax Treatment of Trust. A U.S. trust is subject to U.S. income tax on its worldwide income, while a foreign trust is generally subject to U.S. income tax in the same way as non-resident aliens, namely on its U.S. source income and on income or gain that is effectively connected with a U.S. trade or business. The rules, and therefore, planning, are necessarily more complicated when undertaking planning for individuals that begin spending significant amounts of time in the U.S. or are planning to immigrate to the U.S. At every major juncture, the tax ramifications of the trust structure must be thoughtfully considered.

C. Definition of Foreign Trust. The Small Business Job Protection Act of 1996 established a two part objective test for determining the situs of a trust. Specifically, a trust will be treated as a U.S. trust for tax purposes if (a) a court within the U.S. is able to exercise primary supervision over the administration of the trust (the "Court Test"), and (b) one or more U.S. persons have the authority to control all substantial decisions of the trust (the "Control Test").[32] Any trust that does not meet these two criteria will be considered a foreign trust.[33]

1. Court Test. A trust will meet the Court Test if: (a) the trust instrument does not direct that the trust be administered outside of the U.S.; (b) the trust in fact is administered exclusively in the U.S.; and, (c) the trust is not subject to an automatic migration provision (a provision that causes the situs of the trust to change if a court attempts to exercise jurisdiction).[34] It is important to keep in mind that even if you

[30] Treas. Reg. § 301.7701-4(a).

[31] Treas. Reg. § 301.7701-4(a).

[32] Internal Revenue Code of 1986, as amended ("IRC") §7701(a)(30)(E).

[33] IRC §7701(a)(31).

[34] Treas. Reg. § 301.7701 -7(c).

have a U.S. citizen who is the trustee of his or her standard U.S. revocable trust that applies the laws of a U.S. state, it may fail the Court Test if that person moves outside of the United States and administers the trust outside of the United States.

2. Control Test. A trust will meet the Control Test if one or more U.S. persons have the authority to control all "substantial decisions" of the trust.[35]

   a. In applying this test, the term "U.S. person" includes a U.S. citizen or a U.S. resident for income tax purposes (rather than for immigration or transfer tax purposes).[36]

   b. "Substantial decisions" means those decisions that persons are authorized or required to make under the terms of the trust instrument and applicable law that are not ministerial. Decisions that are ministerial include decisions regarding bookkeeping, collecting rent, and executing investments decisions. Substantial decisions include, but are not limited to, decisions concerning:

      i. whether and when to distribute income or corpus;

      ii. the amount of any distributions;

      iii. the selection of a beneficiary;

      iv. whether a receipt is allocable to income or principal;

      v. whether to terminate the trust;

      vi. whether to compromise, arbitrate, or abandon claims of the trust;

      vii. whether to sue on behalf of the trust or to defend suits against the trust;

      viii. whether to remove, add, or replace a trustee;

      ix. whether to appoint a successor trustee to succeed a trustee who has died, resigned, or otherwise ceased to act as a trustee, even if the power to make such a decision is not accompanied by an unrestricted power to remove a trustee, unless the power to make such a decision is limited in such a way that it cannot be exercised in a manner that would change the trust's residency from foreign to domestic, or vice versa; and

      x. investment decisions; however, if a U.S. person hires an investment advisor for the trust, investment decisions made by the investment advisor will be considered substantial decisions controlled by the

[35] Treas. Reg. § 301.7701-7(d).

[36] Treas. Reg. § 301.7701-7(d)(1)(i).

U.S. person if the U.S. person may terminate the investment advisor's power to make investment decisions at will.[37]

c. The term "control" means having the power, by vote or otherwise, to make all of the substantial decisions of the trust, with no other person having the power to veto any of the substantial decisions. To determine whether U.S. persons have control, it is necessary to consider all persons who have authority to make a substantial decision of the trust (not only the trust fiduciaries).[38]

d. If a U.S. trust contains certain powers, such as the power to remove and replace the trustee, those powers may be exercised in such a way as to cause the trust to become a foreign trust (i.e. appointing a foreign person as sole successor trustee). If this happens, the trust will be treated as having made, immediately before becoming a foreign trust, a gratuitous transfer of all of its assets to the foreign trust and such a transfer will be treated as a sale or exchange of the assets for an amount equal to the fair market value of the property transferred. As a result, the trust would have to recognize as gain the excess of (a) the fair market value of the property so transferred, over (b) the adjusted basis (for purposes of determining gain) of such property in the hands of the trust.[39] Importantly, loss may not be recognized under this rule, nor may a loss be used to offset gain realized.[40] The principal exception to this gain recognition rule is for transfers to foreign trusts if any person is treated as owner of the trust under the grantor trust rules, as discussed further below.

e. In the event of an inadvertent change in any person that has the power to make a substantial decision of the trust that would cause the domestic or foreign residency of the trust to change, the trust is allowed twelve (12) months from the date of the change to make necessary changes, either with respect to the persons who control the substantial decisions or with respect to the residence of such persons to avoid a change in the residency of the trust. For this purpose, an inadvertent change means the death, incapacity, resignation, change in residency, or other change with respect to a person that has a power to make a substantial decision of the trust that would cause a change to the residency of the trust but that was not intended to change the residency of the trust. If the necessary change is made within twelve (12) months, the trust is treated as retaining its pre-change residency during the twelve (12)-month period. If the necessary change were not made within twelve (12) months, the residency of the trust would change as of the date of the inadvertent change.[41]

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[37] Treas. Reg. §§ 301.7701-7(d)(1)(ii)(A)-(J).

[38] Treas. Reg. §301.7701-7(d)(1)(iii).

[39] IRC §684.

[40] Treas. Reg. §1.684-1(a)(2).

[41] Treas. Reg. §301.7701-7(d)(2).

D. Income Taxation of Foreign Trust. Once a determination has been made that the entity is a foreign trust, it will be classified as either a foreign grantor trust or a foreign nongrantor trust, each having different income and estate tax consequences that must be carefully considered and explained to the client. As discussed further below, there are several special rules applicable to foreign trusts with U.S. grantors and/or beneficiaries.

1. Foreign Grantor Trust. For income tax purposes, a trust is a grantor trust when the grantor is treated as the owner of the trust's assets because the grantor or another non-adverse party has retained certain powers over the trust income or principal.[42]

a. A foreign trust established by a U.S. person that has, or may have, U.S. beneficiaries will be considered a grantor trust, even if the grantor has retained no interests in or powers over the trust.[43] In addition, a foreign trust established by a non-U.S. person who becomes a U.S. person within five years of transferring property to the trust, directly or indirectly, will be a grantor trust if, at the grantor's residency starting date, the trust has a U.S. beneficiary.[44] See discussion below on the filing of Form 3520-A.

b. A trust established by a non-U.S. person generally will be treated as a grantor trust if: (i) it is revocable by the grantor (either alone or with the consent of a related or subordinate party who is subservient to the grantor); or (ii) distributions (whether of income or corpus) may be made only to the grantor or the grantor's spouse during the grantor's lifetime.[45] In the case of a foreign grantor trust, all items of income, deductions, and credits of the trust are includible in the grantor's income as if the assets were owned by the grantor personally.[46]

2. Foreign Nongrantor Trust. If a foreign trust is not a grantor trust, then it is a nongrantor trust. This means that the grantor is not treated as the owner of the trust assets for income tax purposes. A foreign nongrantor trust is treated as a separate taxpayer for income tax purposes and is treated as a nonresident alien individual.

a. In calculating its taxable income, a foreign nongrantor trust will receive a deduction for distributions to its beneficiaries to the extent that these distributions carry out the trust's distributable net income ("DNI") for the taxable year.[47] The term DNI is generally defined to mean taxable income of the trust with certain modifications, such as adding back certain deductions (e.g., distribution deduction, personal exemption, capital losses, extraordinary dividends, and tax exempt income).[48]

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[42] IRC §671.

[43] IRC §679.

[44] IRC §679(a)(4).

[45] IRC §672(f).

[46] IRC §671.

[47] IRC §661 (a).

[48] IRC §643(a).

b. A foreign nongrantor trust is subject to the "throwback" rules.[49] The throwback rule effectively results in tax being levied at the U.S. recipient's highest marginal income tax rate for the year in which the income or gain was earned by the trust. The throwback rule adds an interest charge to the taxes on a throwback distribution in order to offset the benefits of tax deferral. The interest charge accrues for the period beginning with the year in which the income or gain is recognized and ending with the year that the undistributed net income amount is distributed, and is assessed at the rate applicable to underpayments of tax, as adjusted, compounded daily.[50] Further, any capital gain accumulated by a foreign trust for distribution in a later taxable year will lose its tax favored status as a capital gain and will be taxed at the currently higher rate as ordinary income.

c. A transfer by a U.S. person to a foreign nongrantor trust will trigger gain recognition under Internal Revenue Code section 684.

d. A distribution from a foreign trust to a U.S. person may trigger U.S. informational reporting requirements, as further discussed below.

IX. Planning and Tax Matters Concerning Foreign Corporations

A. Introduction. For the U.S. person who owns an interest in a closely held business in a foreign country (directly or indirectly), there are a number of U.S. tax considerations. The Tax Cuts and Job Acts was signed into law by President Trump on December 22, 2017 (the "2017 Tax Reform" or the "TCJA") and included numerous changes that impacted the taxation of foreign income. Some changes that were set to expire at the end of 2025 have been permanently extended, and new tax provisions or modifications have been added in the One Big Beautiful Bill Act (the "OBBBA") which was signed into law by President Trump on July 4, 2025. While many of the changes, introduced by the TCJA and as extended or modified by the OBBBA, target U.S. multinationals doing business abroad, a number of the changes impacted smaller businesses and U.S. individuals who inherit from a foreign person through commonly structured foreign holding companies. Set forth below is an overview of the rules pertaining to foreign corporations, along with a brief summary of the 2017 Tax Reform as modified by the OBBBA that impact the tax and reporting of a controlled foreign corporation, along with some specific examples as they relate to U.S. persons who own or acquire a controlled foreign corporation ("CFC") or passive foreign investment company ("PFIC"). Articles X and XI provide a summary on the CFC and PFIC rules as they pertain to U.S. persons from an estate planning perspective, and are not intended nor cover the broader application rules of CFCs and PFICs.

B. Definition of a foreign corporation. A foreign corporation is a corporation incorporated in a country other than the United States.

C. General planning considerations.

a. If your client owns an interest in a foreign corporation, the general non-tax guidelines discussed above should be followed. For example, if your client

[49] See IRC §666.

[50] IRC §668.

owns shares in an Italian company, you will need to consider whether U.S. or Italian law applies, how title in the shares should be taken, will Italian taxes apply as a result of owning the shares, what taxes will result when the person dies owning shares in the Italian, company, will forced heirship rules apply, etc. In addition to the nontax consideration, there are a number of important U.S. tax issues and reporting obligations to take into account, as briefly described below and in Article XV on tax reporting obligations.

b. For U.S. tax purposes, the starting point will be to determine if your client is subject to the CFC or PFIC rules. Generally, when a foreign corporation is considered both a CFC and a PFIC as to your client, during such overlap period, the CFC rules apply.[51]

X. Controlled Foreign Corporations

A. Definition of a controlled foreign corporation. A foreign corporation is a *controlled* foreign corporation ("CFC") if on any day during its tax year one or more "U.S. shareholders" directly, indirectly, or constructively own more than 50% of the total combined voting power of all classes of the foreign corporation's voting stock or more than 50% of the total value of the foreign corporation's stock.[52] The OBBBA reinstates I.R.C. § 958(b)(4) which limits downward attribution of stock by prohibiting downward attribution from foreign persons. However, recognizing the tax avoidance that originally motivated the repeal of I.R.C. § 958(b)(4), the OBBBA enacts a new protective regime under I.R.C. § 951B which allows a limited exception to downward attribution from foreign persons, as discussed below in more detail.

1. Who is a U.S. Shareholder? A U.S. shareholder is defined as a U.S. person who owns, directly, indirectly or constructively 10% of the stock of a CFC either by vote or by value.[53] A U.S. person includes a citizen or resident of the United States for U.S. income tax purposes, a domestic partnership, a domestic corporation, and any estate or trust (other than a foreign estate or trust).[54]

   a. Prior to the 2017 Tax Reform, only *voting* stock that the U.S. shareholder owned was taken into consideration.

   b. The 2017 Tax reform changed this so that a U.S. person who owns, directly, indirectly or constructively, 10% or more of the total *value* of shares of all classes of stock are now taken into consideration. This definition also continues under the OBBBA. Therefore, a U.S. person will no longer be able to avoid U.S. shareholder status or prevent a foreign company from being a CFC by holding only nonvoting stock. It is believed that the change to the definition of U.S. shareholder was in response to planning techniques to avoid U.S. shareholder status by providing non-voting stock to U.S. persons who owned more than 10% of the value of the foreign corporation.

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[51] IRC §1297(d)(f).

[52] IRC §957(a).

[53] IRC §951(b).

[54] IRC §957(c).

2. Example. Assume there are 11 U.S. persons, each owning a 5% interest in a Hong Kong company ("HK Company"). Assume further that the U.S. persons are all unrelated to each other. HK Company is not a CFC because none of the U.S. shareholders meet the definition of owning directly, indirectly or constructively 10% of the stock of HK Company. This is true despite the fact that 55% of HK Company is owned by U.S. persons. However, if the U.S. persons were related, i.e., parents, children and grandchildren, the attribution rules discussed below would apply and HK Company would be deemed a CFC.

3. Elimination of 30 Day Rule. Prior to the 2017 Tax Reform, if a foreign corporation was not a CFC for an uninterrupted period of at least 30 days or more during a tax year, then there was no Subpart F inclusion for the U.S. shareholder. The 2017 Tax Reform eliminated the 30 day uninterrupted period as a CFC during the tax year. This change eliminated a common tax planning strategy used when a CFC was owned by a foreign person or foreign grantor trust that would pass at death to U.S. persons. Under the OBBBA, further modification was made to specify that a U.S. shareholder includes Subpart F in income if they held the stock of a CFC at any time during the year.

B. Direct, Indirect or Constructive Ownership. A U.S. shareholder can own shares in a CFC directly, indirectly, or constructively.

1. Direct ownership. Direct ownership by an individual is when the individual owns shares in his or her individual name.

2. Indirect ownership. If a U.S. person has an interest in a foreign corporation, foreign partnership, foreign estate, or foreign trust that owns shares in a foreign corporation, the foreign entity will be deemed to be "indirectly" owned proportionately by its shareholders, partners, grantors or (other persons treated as owners under income tax rules), or beneficiaries.[55] Any interest attributed to a U.S. person under the indirect ownership rules is considered to be actually owned by such person.

a. This indirect attribution of ownership rule applies only up to the first U.S. person that is deemed to own a foreign entity. Thus, if a U.S. person owns a domestic corporation, which in turn owns a foreign corporation, the attribution rules stop at the domestic corporation (i.e., the owner of the domestic corporation is not considered a U.S. shareholder).[56]

b. The Treasury Regulations provide that the determination of a beneficiary's "proportionate interest" in a foreign entity, including a foreign estate, depends on the facts and circumstances of the situation. The CFC indirect ownership regulations have one example that addresses beneficiaries of a foreign estate. The example provides that among the assets of foreign estate W are Blackacre and a block of stock, consisting of 75 percent of the one class of stock of foreign corporation T. Under the terms of the will governing estate W, Blackacre is left to G, a nonresident alien, for life, remainder to H, a nonresident alien, and the block of stock is left to United

[55] Treas. Reg. §1.958-1(b).

[56] Treas. Reg. §1.958-1(b).

States person K. By the application of this section, K is considered to own the 75 percent of the stock of T Corporation, and G and H are not considered to own any of such stock.[57]

3. Constructive ownership. A U.S. person is deemed to constructively own shares of a foreign corporation that are owned by a U.S. family member (a spouse, parents, children, and grandchildren).[58] There is also attribution from corporations, partnerships, estates and trusts to shareholders, partners and beneficiaries.[59] There is no attribution from siblings, and there is generally no attribution from family members who are nonresident aliens.[60]

   a. The constructive ownership rules apply for certain purposes, including the determination of whether a U.S. person is a U.S. shareholder, and whether a foreign corporation is a CFC, but do not apply for purposes of determining the amount included in a U.S. shareholder's Subpart F income.

   b. Prior to the 2017 Tax Reform, under I.R.C. § 958(b)(4), stock owned by a foreign corporate shareholder, a foreign partner, or a foreign beneficiary of a trust or estate was not downwardly attributed to a U.S. person such as domestic corporation partnership or trust, respectively for purposes of defining a CFC or a U.S. shareholder.[61] The 2017 Tax Reform changed that by allowing downward attribution of stock from a foreign corporation, foreign partnership, foreign estate or foreign trust to a U.S. person

   c. Although OBBBA reinstated the prohibition against downward attribution in determining whether a foreign corporation is a CFC, it does introduce two new categorizations which if both present, cause Subpart F and GILTI inclusion. Under I.R.C. § 951B, Subpart F and GILTI inclusion are applicable to Foreign Controlled US Shareholder ("FCUS") with respect to their Foreign Controlled Foreign Corporation ("FCFC"). FCUS is defined as a U.S. shareholder in accordance with IRC § 951(b) except that the shareholder holds 50% of the vote or value of the foreign corporation (as opposed to 10%) and downward attribution can be applicable.[62] A FCFC is defined as a foreign corporation other than a CFC with a FCUS.[63] With respect to the previous example, A would be considered a FCUS of C, a FCFC. However, since A is not a direct or indirect shareholder of C, Subpart F and GILTI do not apply. But suppose A owned 5% of C. Through downward attribution under I.R.C. § 951B, A is considered a FCUS of B, a FCFC, and is subject to Subpart F and GILTI on its 5% interest in B.

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[57] Treas. Reg. §1.958-1(d), Example 4.

[58] IRC §§318(a)(1) and 958(b).

[59] IRC §318(a)(2).

[60] IRC §958(b)(1).

[61] Prior to the 2017 Tax Reform, IRC section 958(b)(4) provided that the downward attribution rules of IRC §318(a)(3) did not apply for purposes of the constructive ownership rules. This section was repealed in the 2017 Tax Reform, but is reinstated in the OBBBA.

[62] IRC § 951B(b).

[63] IRC § 951B(c).

4. CFC attribution rules regarding foreign grantor trusts. For foreign grantor trusts, the foreign grantor will be treated as the owner of the trust's stock.[64]

5. CFC attribution rules regarding nongrantor trusts. The Treasury Regulations under the CFC regime establish two different approaches for determining a proportionate interest in a foreign corporation held by a foreign nongrantor trust with U.S. beneficiaries.

   a. For purposes of determining a U.S. person's *indirect* ownership (such as through a foreign trust) of a foreign corporation, the Treasury Regulations provide that the determination of a U.S. beneficiary's proportionate interest in a foreign trust under such subsection will be made on the basis of "all the facts and circumstances."[65] The regulations go on to say that: the purpose for which the rules of section 958(a)…are being applied will be taken into account. Thus, if the rules of section 958(a) are being applied to determine the amount of stock owned for purposes of section 951(a), a person's proportionate interest in a foreign corporation will generally be determined with reference to such person's interest in the income of such corporation. If the rules of section 958(a) are being applied to determine the amount of voting power owned for purposes of section 951(b) or 957, a persons' proportionate interest in a foreign corporation will generally be determined with reference to the amount of voting power in such corporation owned by such person.

   b. The Service has provided some guidance in interpreting the above-quoted Treasury Regulation in a 1999 Field Service Advice. In such advice, the Service determined that, for purposes of Code §958(a), the trust beneficiaries who were entitled to receive all current income should be treated as owning all of the stock of the foreign corporation held by the trust, while the remainder beneficiaries were treated as owning no stock.[66]

   c. For purposes of determining a U.S. person's *constructive* ownership (such as through family attribution) of a foreign corporation, the Treasury Regulations state that for purposes of this subsection, CFC stock owned by a nongrantor trust will be considered as owned by its beneficiaries in proportion to their actuarial interests in the trust.[67] CFC stock owned by a grantor trust will be considered as owned by solely the grantor.[68] This rule implies that the remainder beneficiaries will be attributed some portion of the ownership of the foreign corporation, unlike the Service's conclusion with regard to Code §958(a).

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[64] Treas. Reg. § 1.958-1(b).

[65] Treas. Reg. § 1.958-1(c)(2).

[66] FSA 199952014.

[67] Treas. Reg. § 1.958-2(c)(1)(ii)(a).

[68] Treas. Reg. § 1.958-2(c)(1)(ii)(b).

d. There appears to be no specific guidance in either the Treasury Regulations or from the Service with regard to the application of the above two approaches in the case of a discretionary trust.

e. The OBBBA's reinstatement of I.R.C. § 958(b)(4) should prevent any constructive ownership attribution to a U.S. beneficiary of a foreign corporation interest held by a nongrantor trust, where such attribution would otherwise arise from the ownership interest of a non-U.S. family member beneficiary.

C. Income tax consequences of CFC share ownership[69]

1. In General. In general terms, a shareholder of a corporation will not be subject to income tax until the income is distributed to the shareholder as a dividend. However, if the corporation is a CFC, each U.S. shareholder with a 10% or more interest in the CFC (directly or indirectly, but not constructively) is subject to U.S. income tax on the shareholder's proportionate share of the CFC's Subpart F income.[70] Subpart F income, broadly speaking, is income from the CFC's non-operating or passive assets. This is true regardless of whether or not the CFC distributes that income. Subpart F income generally includes certain insurance income (not life insurance proceeds) foreign base company income, and certain illegal payments or payments to certain blacklisted countries.[71] Foreign base company income includes foreign personal holding company income (including investment income such as dividends, interest, rents, royalties and annuities); foreign base company sales income (income in connection with the purchase or sale of property involving a related person), and foreign base company services income (income derived in connection with the performance of certain services for or on behalf of a related person).[72] Under the permanently extended "look-through" rule in the OBBBA, Subpart F income does not include amounts received by a CFC from a related CFC if the income was not Subpart F income to the payor CFC, i.e., it was generated through an active business.[73]

2. Prior to the OBBBA, a U.S. shareholder who directly or indirectly had an interest in a CFC was subject to its pro rate share of Subpart F income only to the extent the U.S. shareholder held an interest in the CFC on the last day of the CFC's year. This caused taxpayers to sell their CFC stock mid-year and not be subject to Subpart F. The OBBBA now subjects U.S. shareholders to Subpart F if the shareholder owned shares in the CFC at any point during the year, to the extent the Subpart F income is attributable to the shareholder's shares. This codifies and clarifies the TCJA's elimination of the 30 day rule, where prior to the TCJA, U.S. shareholders

[69] This outline is meant to provide a brief overview of all aspects to consider when a U.S. person has foreign assets. For a detailed discussion of the income tax issues relating to trusts and estate that own CFCs and PFICs, please see Moore, *Don't Block the Box: U.S. Federal Income Tax Issues for Trusts and Estates That Own Shares in Foreign Corporations*, presented at ALI Continuing Legal Education, International Trust and Estate Planning, Nov. 1-2, 2018.

[70] IRC §951(a)(1).

[71] IRC §952(a).

[72] IRC §954.

[73] IRC 954(c)(6).

only had to include Subpart F Income if the foreign corporation had been a CFC "for an uninterrupted period of 30 days or more during any taxable year."

3. How taxed. Subpart F income is effectively taxed as dividend income that does not qualify for the 15% federal rate on qualified dividends. This characterization applies regardless of the source of the Subpart F income, including realized capital gains. Said another way, capital gains will not qualify for the currently lower capital gain tax rate. Rather, the U.S. shareholder will be required to treat such gain as dividend income subject to the higher ordinary income tax rates. Note that a U.S. shareholder will have Subpart F income only if the corporation has earnings and profits in the relevant calendar year, computed using U.S. tax principles.

4. Non-Subpart F Income. Prior to the 2017 Tax Reform, a CFC's non-Subpart F income was not taxed to a shareholder until the CFC distributes that income to a shareholder. As discussed directly below, the 2017 Tax Reform changed this with the addition of the global intangible low-taxed income, which post the OBBBA is referred to as net CFC tested income or "NCTI."

D. Net CFC Tested Income or (NCTI), previously known as "GILTI"

1. Tax on non-Subpart F income. The 2017 Tax Reform added a new category of income referred to as the global intangible low taxed income or "GILTI".[74] Prior to the 2017 Tax Reform, there was no U.S. income tax on business income from an operating business other than certain types of related party sales and service income. Under the OBBBA, GILTI has been rebranded to NCTI, signaling a shift from a focus on intangible income to a broader taxation of all foreign earnings of controlled foreign corporations.

2. Computation of tax. Pre the OBBBA, GILTI was income of a CFC that exceeded a nominal return of 10 percent on tangible assets.[75] GILTI was calculated by taking a CFC's net tested income minus tested loss and subtracting 10% of qualified business asset investment ("QBAI"). The OBBBA has eliminated the QBAI exclusion, i.e., there is no longer an offset for tangible investments, thereby broadening the base for net tested income. A U.S. corporation that must include GILTI in income receives a Section 960 deemed foreign tax credit based on foreign taxes paid by the CFC on this income.[76] This deemed foreign tax credit is subject to a 90 percent limitation, an increase from an 80 percent limitation under the TCJA.[77] However, under the OBBBA, 10 percent of foreign tax credits related to previously taxed income are disallowed.[78] Neither carryback nor carry forward of these foreign tax credits is permitted.

3. NCTI, previously known as GILTI, is included in gross income. A U.S. shareholder of a CFC must include in income its NCTI similarly to how it accounts

[74] IRC §951A(b)(2)(A).

[75] IRC §951A(b)(2)(A), 951A(d).

[76] *See* §960.

[77] IRC §960(d)(1).

[78] IRC 960(d)(4).

for Subpart F income. Like Subpart F income, NCTI is generally treated as previously taxed income and is thus not taxed again when distributed.

4. Potential timing issues. Timing differences between U.S. and foreign laws could result in recognizing NCTI for U.S. tax purposes, before foreign tax credits (FTC) for foreign taxes paid on the income are available. This timing issue will create higher taxes for the U.S. shareholder as a result of not being able to take advantage of FTCs.

5. Lack of deductions and credits for non-corporate shareholders. It is important to note that an individual CFC shareholder or one in a flow-through entity with NCTI is taxed at ordinary tax rates without the benefit of the foreign-derived intangible income (FDII) deduction discussed below, NCTI deductions, or foreign tax credits and can thus be taxed on NCTI income up to the maximum federal tax rate. Note, U.S. shareholders who are individuals (including estates and trusts) may make an election to be taxed at corporate rates, which would entitle them to the foreign tax credit as well as a 21% tax rate on Subpart F income.[79]

6. CFC's with only Subpart F income. The NCTI rules do not apply to a CFC whose only income is passive investment income as that income would generally already be taxed under the Subpart F rules.

7. Effective date. The application of GILTI is effective for the first tax year of a CFC beginning after December 31, 2017, and the changes made through the OBBBA, which rebrands GILTI as NCTI, are effective for tax years beginning after December 31, 2025.

E. Foreign-Derived Deduction Eligible Income (FDDEI), previously known as "FDII"

1. In general. Introduced in the 2017 Tax Reform, the foreign-derived intangible income or "FDII" regime provides, in effect, significant tax breaks to domestic corporations' earnings from offshore exports of tangible and intangible assets, foreign services, and other offshore income.[80] The OBBBA's rebranding eliminates reference to "intangibles," removing interpretive ambiguity and broadening the base of income that qualifies for the deduction. The deduction is available to U.S. C corporations that sell goods and/or produce services to foreign customers. This deduction reduces the effective tax rate on qualifying income to 13.9986%, which is slightly higher than the TCJA effective tax rate of 13.125%, but lower than the 16.406% that was supposed to commence at the beginning of 2026. As most estate planning clients will not qualify for this deduction because it only applies to U.S. based corporate exporters of goods and services, only a brief summary of the deduction is provided below.

2. What is FDDEI? Prior to the OBBBA, FDII assumed a fixed rate of return of 10 percent on tangible business assets and the balance of the income was the FDII, which was nominally deemed to be generated by intangibles. However, post the OBBBA, the eligible income base is broader but there is no QBAI adjustment.

[79] IRC §962(a). Treas. Reg. § 1.962-2(a).

[80] IRC §250(a).

FDDEI is derived from income from the sale of property (including leases and licenses) to foreign individuals for their use, disposition or consumption outside of the United States and services performed by a person or for property outside the United States.[81]

3. Deduction. A U.S. corporation includes FDDEI in gross income then takes a related deduction, which also appears to be allowed to a U.S. corporation owned by non-U.S. persons.[82] FDII/FDDEI produces an effective tax rate, based on the 21% corporate tax rate, as follows:

   a. 13.125% for tax years beginning after Dec. 31, 2017, and before Jan. 1, 2026; and

   b. Approximately 14% for tax years beginning after Dec. 31, 2025.[83]

F. Transition Tax

1. In general. The 2017 Tax Reform added a new tax that taxes past income earned indirectly by U.S. corporations through overseas companies which has been retained offshore and has yet to be taxed by the United States. Foreign income accumulated in "specified foreign corporations" and not distributed by January 1, 2018, now gets collectively taxed.[84] This income will be taxed to corporations at a 15.5 percent rate on cash, and at 8 percent on less liquid assets (for individuals and other non-corporate U.S. taxpayers, at 17.5 and 9.05 percent, respectively,[85] with S corporations being curiously alone in their ability to elect to defer this income acceleration).[86] OBBBA did not make any changes to the transition tax regime.

2. Option to defer. Shareholders are able to elect to pay the tax over eight years.[87] The deferred foreign income is the greater amount of such income as determined as of November 2, 2017, or, alternatively, as of December 31, 2017 (curiously without referring to the end of the fiscal year date of foreign corporations with non-calendar fiscal years).

3. Acceleration of tax on certain events. Payment of the elected transition tax installments is accelerated if a taxpayer pays late, or sells or substantially liquidates the corporation.

4. Corporations to which tax applies. Specified foreign corporations whose shareholders are subject to the transition tax include CFCs and any other foreign corporation that has one or more U.S. corporations which is a defined United States shareholder (i.e., owning directly, indirectly, or by attribution 10% by vote or value

[81] IRC §250(b).

[82] IRC §250(b)(4) and §250(b)(5).

[83] IRC §250(a).

[84] IRC §965.

[85] IRC §965(c).

[86] IRC § 965(i)

[87] IRC §965(h).

of the foreign corporation).[88] But once there is a specified foreign corporation, all United States shareholders, whether corporate or non-corporate domestic shareholders, are taxable on their pro rata shares of the specified corporation's deferred, accumulated foreign income at the above-mentioned rates. Once taxed, the foreign corporation's distribution of these accumulated earnings avoids taxation a second time upon its distribution as previously taxed income.[89]

5. Indirect foreign tax credit. While a domestic corporation currently receives an indirect foreign tax credit for the foreign corporation's income taxes associated with the taxable percentage of the accumulated earnings,[90] a non-corporate taxpayer does not. As a result, the non-corporate taxpayer could now end up facing a much larger transition tax bill. Non-corporate U.S. shareholders, therefore, may want to consider whether they want to elect under Section 962 to be treated as corporate shareholders in order to access the Section 960 indirect foreign tax credit; by so electing, they will forego having future distributions from the foreign corporation treated as excluded previously taxed income.

XI. Passive Foreign Investment Companies

A. Definition of a passive foreign investment company. A foreign corporation is a passive foreign investment company ("PFIC") if it meets either the income or asset test.

1. Income test. 75% or more of the corporation's gross income for its taxable year is passive income.

2. Asset test. At least 50% of the average percentage of assets held by the foreign corporation during the taxable year are assets that produce income or that are held for the production of passive income.[91]

B. Examples of PFICs. Examples of common PFICs include foreign mutual funds and shares in a foreign holding company and such holding company holds stocks and bonds.

C. Ten Percent (10%) Shareholder. The PFIC tax regime does not apply to a U.S. taxpayer who is a 10% shareholder of a controlled foreign corporation.[92] Because such a shareholder is currently taxable on her share of the CFC's Subpart F income (and now GILTI), it is unnecessary to subject him or her to the PFIC tax regime; the CFC rules accomplish Congress's anti-deferral objectives. However, if a foreign corporation that was originally considered a PFIC subsequently also meets the CFC rules, it will continue to be subject to the PFIC rules for any period that it was not considered a CFC.

D. Tax treatment of a passive foreign investment company. All U.S. persons who own stock in a PFIC (regardless of their percentage of stock ownership) are generally subject to U.S.

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[88] See IRC §951(b).

[89] See IRC §959.

[90] The indirect foreign tax credit under §902 was repealed but only with respect to tax years beginning after December 31, 2017. Act §14301(a). See IRC §965(g) which limits the foreign tax credit to the percentage of the accumulated earnings taken into income under the transition tax computation.

[91] IRC §1297.

[92] IRC §1297(d).

federal income tax (at ordinary income tax rates) on any gain from the sale or exchange of, and certain distributions in respect of, their stock in a PFIC. For this purpose, a disposition of shares of a PFIC by a foreign non-grantor trust may be treated as a disposition of PFIC stock by the U.S. beneficiaries of such trust. As with the CFC regimes, PFIC stock owned directly or indirectly by a partnership, estate or trust is considered to be owned proportionately by its partners or beneficiaries, respectively.[93]

1. Excess Distributions. Distributions to U.S. shareholders of "excess distributions" are taxed at ordinary rates, regardless of original character, and do not qualify as "qualified dividends." "Excess distributions" are the portion of the distribution that exceeds 125% of the average distributions made to the U.S. shareholder over a holding period and the realized appreciation on a sale of the interest. Interest is then applied on the unpaid tax at the applicable federal underpayment rate (the surcharge).[94]

2. Unrealized Appreciation. Similar to a CFC, upon liquidation of the PFIC, a U.S. person would be taxed on his or her pro rata share of unrealized appreciation and, if the interest in the PFIC is received as a bequest, only the income tax basis of the shares in the PFIC (and not its underlying assets) would receive the IRC §1014 adjustment at the NRA donor's demise.

E. Gains on Disposition. If no qualified electing fund ("QEF") election (discussed below) is made or if a QEF election is not made for the first year of the U.S. shareholder's holding period, gains on disposition of PFIC stock will be subject to ordinary income tax rates (plus an interest charge).

F. Elections

1. Qualified Electing Fund. Instead of paying the additional tax when the PFIC is disposed or deemed to be disposed, a U.S. shareholder of a PFIC may elect to treat the corporation as a qualified electing fund ("QEF").[95] If a QEF election is made, the electing U.S. shareholder must take into account on an annual basis his or her pro rata share of the PFIC's ordinary income and net capital gains.[96]

   a. Unlike the CFC provisions that result in ordinary income to the U.S. shareholder, PFIC income inclusion retains the character of the income (ordinary or capital gain) as earned by the corporation.[97] A QEF election can also preserve the possibility of a capital gains tax treatment under certain circumstances upon the disposition of a U.S. shareholder's PFIC stock.

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[93] IRC §1298(a)(3)

[94] IRC §1291.

[95] IRC §1293-1295.

[96] IRC §1293-1295.

[97] It should be noted that although he QEF election is often thought of as making the foreign corporation with respect to which the election is made a pass-through entity for the electing U.S. shareholder, only gains, not losses, pass through the corporation to the shareholder.

b. The inclusions are made for the shareholder's tax year in which or with which the QEF's tax year ends. Once made, the QEF election is revocable only with the IRS's sent and is effective for the current ax year and all subsequent tax years. [98]

c. A QEF election may be made for any year during which PFIC stock is owned, but, in order to maximize the benefit of a QEF election, a U.S. shareholder is generally required to make the election by the due date (determined with extensions) for filing his or her U.S. federal income tax return for the first year that he or she was a holder of the PFIC stock. To the extent that a U.S. shareholder's share of QEF income is subject to taxation under the CFC regime, such income will generally not be subject to taxation under the QEF regime. [99]

2. Market-to-Market election. A U.S. shareholder of a PFIC may elect to mark-to-market the PFIC stock if the stock is "marketable stock." Marketable stock is PFIC stock that is regularly traded on (i) a national securities exchange that is registered with the Securities and Exchange Commission (SEC); (ii) the national market system established under section 11A of the Securities Exchange Action of 1934; or (iii) a foreign securities exchange that is regulated or supervised by a governmental authority of the country in which the market is located, along with stock in certain PFICs.

a. A shareholder who makes a mark-to-market election must include in gross income as ordinary income an amount equal to the excess fair market value of the PFIC stock as of the close of the tax year over its adjusted basis. If the stock has declined in value, ordinary loss deduction is allowed limited to the net amount of gain previously include in income. [100]

G. PFIC attribution rules

1. Code §1298(a)(3) specifies that stock owned directly or indirectly by a trust is treated as owned proportionately by its beneficiaries. Although there are no final regulations interpreting this rule, proposed regulations suggest that the determination of a person's indirect ownership should be made on the basis of "all the facts and circumstances in each case." The proposed regulations go on to say that "the substance rather than the form of ownership is controlling, taking into account the purpose of section 1291." There does not appear to be any further guidance under the proposed regulations, or provided by the Service, regarding the application of the facts and circumstances test. [101]

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[98] IRC §1294.

[99] *See* Code §951(f) for the priority of the CFC rules over the QEF rules. *See* Code §551(g) for the priority of the FPHC rules over the QEF rules

[100] IRC §1296.

[101] IRC §1291(f); Prop. Treas. Reg. §1.1291-1(b)(8)(iii).

XII. Planning for Gifts or Bequests of Foreign Corporations to U.S. Persons

A. In General – Transfer of PFIC Interests to U.S. Person. In general, a U.S. shareholder will not recognize gain on a direct or indirect disposition of PFIC stock that results from a gift or bequest where the transferee is a U.S. person if: (i) the transfer does not result in an increase in basis of the stock; (ii) the transferee's holding period in the PFIC shares is at least as long as the transferor's holding period (i.e., the holding period is tacked); and (iii) the aggregate ownership of the U.S. shareholder and the transferee after the transfer is the same as or greater than the U.S. shareholder's ownership before the transfer.[102] Note that this exception does not apply to a transfer of PFIC stock to a partnership, S corporation, trust, or estate, but other exceptions to gain recognition may apply.[103]

1. Bequest of PFIC shares. A bequest of PFIC shares in which a QEF election has not been made generally triggers gain unless the shares are transferred to the taxpayer's domestic estate or directly to another U.S. person. Gain is also triggered on the transfer to a domestic estate if, under the terms of the will, the PFIC shares may be transferred to a trust or a foreign beneficiary.[104]

2. Gift of PFIC shares. A gift of non-QEF PFIC shares is also generally subject to gain, unless the taxpayer incurs gift tax, in which case the shareholder will not recognize gain but will be liable for the deferred tax amount as if the shareholder recognized gain in the amount of the gift tax that is added to the basis of the transferred stock.[105]

   a. Example: M, a U.S. person, purchased 1,000 shares of NQF, a PFIC, on December 31, 1989. M did not elect to treat NQF as a QEF. M gave the NQF stock to her daughter, H, also a U.S. person, on December 31, 1993. M paid $100x of gift tax. As provided in section 1015(a) and (d)(6), H's adjusted basis in the NQF stock is M's adjusted basis, increased by $60x of gift tax paid. As a result, pursuant to § 1.1291-6(c)(2)(v), M is liable for the deferred tax amount that M would have owed if M recognized $60x of gain on a taxable transfer of the NQF stock. For purposes of calculating the deferred tax amount, the $60x is allocated over M's four-year holding period, with the deferred tax amount calculated with respect to the $45x allocated to 1991, 1992, and 1993. Other than for the $60x of gift tax paid, there are no further adjustments to H's basis in the NQF.[106]

B. In General – Gifts or Bequests of CFCs to U.S. Person. Traditional planning has involved a non-U.S. person establishing a foreign trust for the current or eventual benefit of family members, including U.S. beneficiaries. The trust may be a "grantor trust" for U.S. tax purposes, with the power to revoke held by the trustor. The trust allowed a "step up" in the income tax basis of the underlying assets upon the trustor's demise. If the trust – or the trustor without the benefit of a trust – directly holds U.S. investments, then the U.S. estate tax would apply to such assets at a 40% rate. U.S. investments were thus made via a non-

[102] Prop. Treas. Reg. §1.1291-6(c)(2).

[103] *See* Prop. Treas. Reg. §1.1291-6(c)(3).

[104] Prop. Treas. Reg. §1.1291-6(c)(2)(iii).

[105] Prop. Treas. Reg. §1.1291-6(c)(2)(v).

[106] Prop. Treas. Reg. §1.1291-6(c)(5), *Example*.

U.S. company so the testator was deemed to own a non-U.S. asset (the non-U.S. company) at his or her demise and no U.S. estate tax would apply.

C. Planning before 2017 Tax Reform. With this traditional planning, the non-U.S. company could create income tax issues for the U.S. beneficiaries upon the testator's demise under the CFC and FPIC anti-deferral rules. Typically, income earned by a U.S. person from foreign corporations is subject to U.S. income tax when the income is distributed as dividends. Until such repatriation, the U.S. income tax is deferred. As discussed above, under the anti-deferral rules, however, the U.S. person may be subject to U.S. income tax on the income earned by the foreign corporation regardless of whether the income has been distributed. In order to address the CFC issues, the trustees of the now non-grantor foreign trust would cause a "check the box" election (CTB Election) under Treas. Reg. §301.7701-3 to be made effective within 30 days of the testator's demise. A deemed liquidation would occur but there would be no phantom income for the U.S. beneficiaries and the testator would not be deemed to own the underlying assets for purposes of the U.S. estate tax.

D. 2017 Tax Reform. The 2017 Tax Reform substantially changed the algorithm to apply when a foreign individual wishes to invest in U.S. property and will have U.S. beneficiaries. While the 2017 Tax Reform favors the formation of corporations for income tax purposes, the ownership of foreign entities by the U.S. beneficiaries is fraught with inefficiencies. Several of the 2017 Tax Reform provisions that have an effect on planning for U.S. beneficiaries who will receive shares in a foreign company are set forth below.

XIII. Foreign and Domestic Taxes

What taxes are levied in foreign country and will the taxes apply to the client and/or the property acquired? Some laws apply to citizens, some to residents, and some are based on the situs of property.

A. General U.S. Estate Tax Matters.

1. A U.S. citizen and a person resident in the United States for transfer tax purposes is subject to U.S. estate tax on his worldwide assets. Even if the property is located outside the United States and is subject to tax in that foreign country, the property must be included on the decedent's estate tax return (assuming an estate tax return is required to be filed).

2. One of the trickier issues is how to value foreign assets. No special rule exists for valuing foreign property. Thus, the general rules that apply to determining the value for U.S. assets will also apply to foreign assets.[107] Challenges may arise when trying to locate a qualified appraiser in a foreign country to provide a valuation of an asset located in that foreign country. This is particularly true in the context of obtaining a valuation of a minority interest in a business.

3. All appraisals and supporting documentation as to value must be translated into English if in a language other than English.

4. All values must be reported in U.S. currency.

[107] Treas. Reg. §20.2031-1(b).

5. To claim a foreign tax credit, Schedule P to the Form 706 must be completed and filed with the return. In addition, Form 706-CE, Certificate of Payment of Foreign Death Tax, must be attached to Form 706. Form 706-CE must be signed by the foreign government to whom was paid the tax, certifying that indeed the tax was paid. If the foreign government refuses to certify Form 706-CE, the executor must file it directly with the Internal Revenue Service Center, along with a statement under penalties of perjury to explain why the foreign government did not certify it. In addition, a copy of the foreign death tax return and a copy of the receipt or cancelled check for the payment of the foreign death tax must be included with the U.S. estate tax return (Form 706).

   a. The credit is authorized either by statute or by treaty. If a credit is authorized by a treaty, whichever of the following is the most beneficial to the estate is allowed.

   b. The foreign tax credit figured under the treaty; or the credit figured under the treaty, plus the credit figured under the statute for death taxes paid to each political subdivision or possession of the treaty country that are not directly or indirectly creditable under the treaty.

   c. Under the statute, the credit is authorized for all death taxes (national and local) imposed in the foreign country. Whether local taxes are the basis for a credit under a treaty depends upon the provisions of the particular treaty.

   d. The total credit allowable for any property, whether subjected to tax by one or more than one foreign country, is limited to the amount of the federal estate tax attributable to the property. The anticipated amount of the credit may be figured on the return, but the credit cannot finally be allowed until the foreign tax has been paid and a Form 706-CE evidencing payment is filed.

B. Inheritance tax. Civil law countries often have an inheritance tax.

1. A typical inheritance tax is based on the citizenship or residency (usually the latter) of the recipient of the transferred property and taxes the recipient, not the donor. The citizenship and residency of the donor is often irrelevant.

2. Some countries with inheritance taxes will have different tax rates, depending on the relationship of the transferor and transferee. Usually, the closer the relationship, e.g., spouses, the lower the rate, and the more distant the relationship, the higher the rate. Note that some countries may view a trust as "unrelated" and will thus subject the transfer to its highest inheritance tax rate.

3. Client may be subject to possible double taxation, but there could also be tax treaty relief.

4. Some countries that currently do not have an estate tax are considering legislation that would introduce such a tax, e.g., Mexico.

C. Estate tax – some countries, including the United States, have an estate tax. Some countries that currently do not have an estate tax are considering legislation that would introduce such a tax.

D. Gift tax – some countries, including the United States, have a gift tax.

E. Income tax – with the exception of tax haven jurisdictions, most countries have an income tax. The United States has entered into over 65 income tax treaties with other countries, so always be sure to review the terms of any applicable income tax treaty.

F. Acquisition tax – some countries have a tax that must be paid by the buyer at the time of acquiring property, e.g., at the time of purchasing real property. The tax is often based on the value of the property at time of purchase.

G. Tax on transfer of property – some countries will tax a transfer of property. The tax often includes transfers to trusts.

H. Asset based tax or wealth tax (usually an annual tax).

XIV. U.S. Gift or Estate Tax Treaties

A. In general. If a decedent dies with multiple citizenships and/or property located in multiple jurisdictions or if the beneficiaries reside in a different jurisdiction than that of the decedent, consider whether or not the other country (or countries) impose a transfer tax, such as a gift tax, inheritance tax or estate tax. If there is more than one country imposing a tax on the transfer, there may be a tax treaty in place that the client may use to minimize and/or eliminate any double taxation.

B. Purpose

1. Reduction of Tax. Treaties serve to (i) prevent double taxation; (ii) prevent discriminatory tax treatment of a resident of a country; and (iii) permit reciprocal administration to prevent tax avoidance and evasion. Treaties often substantially reduce estate and gift taxes. If an estate claims an estate tax position based on an estate tax treaty with another country, an explanation of the treaty-based position should be attached to the estate tax return. The purpose of the transfer tax treaties is to prevent or minimize the double taxation of both lifetime gifts and transfers at death of domiciliaries of the two (2) contracting states (i.e., treaty countries). This is usually accomplished in one of several ways:

   a. Either by giving one country priority in taxing the property deemed by the treaty to be located in that country; or

   b. Giving one country priority to tax the estate or the gifts of the individual based on a determination of the decedent's or the donor's fiscal domicile.

2. Credit. Where application of the treaty gives rise to the imposition of tax in both countries, a credit mechanism is employed to minimize the double tax burden.

3. Deductions. Some of the transfer tax treaties provide for more beneficial deductions, such as the marital deduction.

4. Pro Rata Credit. Some transfer tax treaties provide for pro rata allocation of estate tax exclusion amount. For example, if an Australian decedent dies with assets that would be subject to U.S. estate tax under U.S. law, the U.S.-Australia transfer tax treaty (estate tax) provides that an Australian resident decedent will enjoy a pro rata portion U.S. estate tax exclusion amount based on the value that the U.S. situs assets have as a percentage of the worldwide estate.

   If X, an Australian citizen and resident, dies in 2025 with an estate of $5 million, of which $2 million consists of U.S. real property, X would normally be subject to U.S. estate tax on the entire $2 million of U.S. situs property, less a $60,000 exclusion. However, under the treaty, X will receive a U.S. estate tax exclusion amount equal to:

   $2 million/$5 million x $13,990,000 = $5,596,000

   Thus, no U.S. estate tax would be owed by the estate of X. The executor must file IRS Form 706-NA and invoke the treaty to claim the pro-rata exemption. Supporting documentation of worldwide assets and valuations is required. Note that there may be state-level estate taxes that still apply depending on the location of the U.S. property.

C. Situs-type Treaties. Transfer tax treaties generally fall into two categories, situs-type treaties and domicile-type treaties Situs-type treaties generally allocate primary taxing jurisdiction to the treaty country in which particular property is situated. Because situs rules are generally determined under local law, which may lead to double taxation, situs-type treaties generally specify rules for determining the situs of a variety of typically owned assets. If a decedent is considered a resident of a non-situs country, the country of residence may still impose estate tax on the property, which would be reduced by a credit for tax imposed by the situs country.

   1. Country List. List of countries with Situs-type treaties:

      a. Australia (but note Australia has abolished its death tax; also note that there is a separate gift tax treaty)

      b. Finland

      c. Greece

      d. Ireland

      e. Italy

      f. Japan (combined estate, inheritance and gift tax treaty)

      g. Republic of South Africa

      h. Switzerland

   2. Generally Limited to Estate Tax. Situs-type treaties generally only apply to estate tax, except for the US-Japan treaty, which also applies to gift tax. Note, there is

also a separate gift tax treaty with Australia, but this is of no practical consequence as Australia repealed its gift tax. Situs-type treaties also generally do not apply to state or local estate taxes.

D. Domicile-type Treaties. Domicile-type treaties generally allocate primary taxing jurisdiction to the treaty country in which particular property is situated. Because situs rules are generally determined under local law, which may lead to double taxation, situs-type treaties generally specify rules for determining the situs of a variety of typically owned assets. If a decedent is considered a resident of a non-situs country, the country of residence may still impose estate tax on the property, which would be reduced by a credit for tax imposed by the situs country.

1. Country List. List of countries with domicile-type treaties:

a. Austria (combined estate, inheritance and gift tax treaty)

b. Canada (this treaty ceased to have effect for estates of persons deceased on or after January 1, 1985; however, see Article XXIX B of the U.S.-Canada Income Tax Treaty regarding the application of estate and gift taxes)

c. Denmark (combined estate, inheritance and gift tax treaty)

d. France (combined estate and gift tax treaty)

e. Germany (combined estate, inheritance and gift tax treaty)

f. Netherlands

g. United Kingdom (combined estate and gift tax treaty)

2. A special provision in the U.S.-U.K. treaty states that where property may be taxed in the U.S. on the death of a United Kingdom national who was not a U.S. citizen or resident, the U.S. estate tax may not exceed the U.S. estate tax that would have been imposed on the decedent's worldwide assets had the decedent died domiciled in the United States.

E. Savings Clause. Because of the savings clause, a U.S. citizen cannot invoke the treaty to avoid or minimize U.S. tax. The client can only avail himself/herself of an increased foreign tax credit.

XV. Reporting Requirements for Foreign Assets

Is the foreign property held in a foreign trust or other entity? Does the client have foreign financial accounts? If yes, there may be informational reporting requirements that must be met.

A. Form 3520. Form 3520 is the form used to report certain transactions with foreign trusts and receipt of certain large gifts or requests from certain foreign persons. Generally the responsible party required to file Form 3520 is a U.S. person who has any connection with a foreign trust. Secondly, for U.S. persons who during the current tax year received either more than

1. US$100,000 in the aggregate from non-resident alien individuals or foreign estate including foreign persons related to that nonresident alien individual or foreign estates that the tax payer treated as gifts or requests, or

2. more than US$20,116 (for 2025) from foreign corporations or foreign partnerships (including foreign persons related to such foreign corporations or foreign partnerships) that the client treated as gifts.

Generally, the initial penalties for failure to file a timely and complete Form 3520 is equal to the greater of $10,000 or:

3. 35% of the gross value of any property transferred to a foreign trust for failure by U.S. transfer or to report the transfer;

4. 35% of the gross value of the distributions received from a foreign trust for failure by U.S. person to report receipt of the distribution; or

5. 5% of the gross value of the portion of the trust's assets treated as owned by a U.S. person for failure to comply with the required reporting.[108]

6. Additional penalties may be imposed if noncompliance continues for more than 90 days after the IRS mails a notice of failure to comply with required reporting.

7. For failure to report a foreign gift, the penalty is 5% of the amount of the foreign gift for each month the failure continues up to a maximum penalty of 25% of the gift.[109]

8. Penalties will not be imposed if the failure to file was due to reasonable cause and not willful neglect.[110] Further, penalties will only be imposed to the extent that the transaction is not reported and may not exceed the gross reportable amount.[111]

B. Form 3520-A

1. Form 3520-A is the Annual Information Return of Foreign Trust with a U.S. owner. The form provides information about the foreign trust, its U.S. beneficiaries and any U.S. person who is treated as the owner of any portion of the foreign trust.

2. Additionally, if a foreign trust has a U.S. owner and the trust fails to file the required annual reports (3520-A) on trust activities and income, the U.S. owner is subject to an initial penalty equal to the greater of $10,000 or 5% of the gross value of the portion of the trust assets treated as owned by the U.S. person.[112] Additional penalties may be imposed if noncompliance continues after the IRS mails a notice of failure to comply with required reporting. However, this penalty may not exceed the gross reportable amount. Also, penalties will only be imposed to the extent that

[108] IRC § 6677(a)

[109] IRC § 6039F(c); IRS Notice 97-34, 1997-1 C.B. 422.

[110] IRC § 6677(d).

[111] IRC § 6677(a).

[112] IRC § 6677(b).

the transaction is not reported.[113] Thus, if a U.S. person transfers property worth US$1 million to a foreign trust but only reports US$400,000 of that amount, penalties could be imposed on only the US$600,000 unreported amount.

3. U.S. citizens and residents are subject to U.S. income tax on their worldwide income. In addition, there are foreign reporting requirements associated with foreign bank accounts. See below.

C. FinCEN Report 114

1. FinCEN Report 114 (Report of Foreign Bank and Financial Accounts or "FBAR") is required to be filed annually by a United States person who has a "financial interest" in or "signature authority" or any "other authority" over a financial account (foreign bank, brokerage, or other financial account) located outside the U.S. and the aggregate value of these financial accounts exceeds US$10,000 at any point in the taxable year. In addition, a United States person who has such an account must file IRS Form Schedule B, Part III to report information about "foreign accounts" on his or her Form 1040.

2. For FBAR purposes, a United States person includes United States citizens and residents, and U.S. entities, including corporations, partnerships, or limited liability companies created or organized in the United States or under the laws of the United States; and trusts or estates formed under the laws of the United States. This definition differs than the general definition of U.S. persons for income tax purposes. As such, there may be instances where an entity is treated as foreign for federal tax purposes but is still required to file an FBAR. For example, an entity that is disregarded for US tax purposes may still be required to file an FBAR.

3. Disclosure of this information is mandatory. The penalties for failing to file this form include both a penalty for non-willful and willful violations. Non-willful reporting violations are subject to penalties not to exceed US$10,000 per year[114]. Willful reporting violations are subject to a penalty which equals the greater of either (1) US$100,000 or (2) 50% of the amount of either (a) a transaction in violation of the reporting requirements or (b) the balance in an account which is improperly reported. Criminal penalties could, under certain circumstances, amount to a fine of up to US$500,000 and imprisonment for up to 10 years. Please note that this form is merely for reporting purposes and does not create an additional tax liability for the person reporting such accounts.

D. Form 5471 – Information Return of U.S. Persons With Respect to Certain Foreign Corporations

1. Client must file a Form 5471 for each applicable foreign corporation and if any of the following applies:

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[113] IRC § 6677(a).

[114] The United States Supreme Court held in Bittner v. United States, No. 21-1195, that the Bank Secrecy Act's penalty for non-willful failure to file a Report of Foreign Bank and Financial Accounts (FBAR) applies on a per-form basis—and not on a per-account basis, as argued by the government.

a. If client is an officer or director of a foreign corporation and have acquired shares in one or more transactions shares representing 10 % or more of the aggregate voting power or value of the corporation. Form 5471 is required only for the year in which the transaction occurs.

b. If client acquires 10% of the voting or participating shares in a foreign corporation, acquire voting or participating shares that, when added to the shares owned on the date of acquisition, equals or exceeds 10% or more of the voting or participating shares, or dispose of voting or participating shares in a foreign corporation that reduces ownership to less than 10%. Form 5471 is required only for the year in which the transaction occurs.

c. If client owns more than 50% of the aggregate voting power or value of a foreign corporation for an uninterrupted period of at least 30 days during the foreign corporation's year. Form 5471 is required for each year in which the more than 50% ownership threshold is met.

d. If client owns 10% or more of the voting shares of a controlled foreign corporation. Form 5471 is required for each year this requirement is met.

E. Form 8858 – Return Information Return of U.S. Persons With Respect To Foreign Disregarded Entities

1. Client must file Form 8858 if:

a. If client owns a foreign disregarded entity at any time during the taxable year or annual accounting period.

b. In certain circumstances in which a foreign disregarded entity is owned by a foreign corporation in which the client has a filing obligation as a Category 4 filer of Form 5471 or as a Category 5 filer of Form 5471.

c. In certain circumstances in which a foreign disregarded entity is owned by a foreign partnership in which the client has a filing obligation as a Category 1 filer of Form 8865 or a Category 2 filer of Form 8865

F. Form 8865 – Return of U.S. Persons With Respect to Certain Foreign Partnerships

1. Client must file Form 8865 if:

a. Client owns more than 50% interest in a foreign partnership.

b. Client owns, at any time during the tax year, a 10% or greater interest in a foreign partnership while the partnership was controlled by U.S. persons each owning at least 10% interests.

c. Client contributed property to a foreign partnership in exchange for an interest in the foreign partnership and client owns directly or constructively at least a 10% interest in the foreign partnership immediately after the contribution; or the value of the property contributed when added to the

value of any other property contributed during the 12 month period ending on the date of the transfer exceeds $100,000.

G. Form 8621 – Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

1. Client must file Form 8621 if client is a direct or indirect shareholder of a passive foreign investment company (PFIC) for each tax year under the following five circumstances if client:

a. Received certain direct or indirect distributions from a PFIC,

b. Recognize gain on a direct or indirect disposition of PFIC stock,

c. Are reporting information with respect to a qualified electing fund or mark-to-market election,

d. Are making an election reportable in Part II of the form, or

e. Are required to file an annual report.

H. Form 8938, Statement of Specified Foreign Financial Assets. For tax years beginning after March 18, 2010 (i.e., 2011 returns filed in 2012), individuals with an interest in a "specified foreign financial asset" during the tax year must attach a disclosure statement (i.e., Form 8938) to their income tax return for any year in which the aggregate value of all such assets is exceeds the reporting threshold. The reporting threshold varies depending on whether an individual lives in the United States or files a joint income tax return with his or her spouse. In addition, to the extent provided by the IRS in regulations or other guidance, IRC Section 6038D applies to any domestic entity formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if the entity were an individual.

1. "Specified foreign financial assets" are: (1) depository or custodial accounts at foreign financial institutions, and (2) to the extent not held in an account at a financial institution, (a) stocks or securities issued by foreign persons, (b) any other financial instrument or contract held for investment that is issued by or has a counterparty that is not a U.S. person, and (c) any interest in a foreign entity (including but not limited to a foreign trust).

2. Importantly, it should be noted that compliance with IRC Section 6038D does not relieve a person of the responsibility to file an FBAR, if the FBAR is otherwise required to be filed. The FBAR must be filed in addition to Form 8938.

3. No duplicative reporting is required. Thus, if one of the following forms has been timely filed by a client, the client is not required to report a specified foreign financial asset on Form 8938 (but note that Form 8938 must still be filed):

a. Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts;

b. Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations;

c. Form 8621 Information Return by Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund;

d. Form 8858. Information Return of U.S. Persons With Respect To Foreign Disregarded Entities

e. Form 8865, Return of U.S. Persons with Respect to Certain Foreign Partnerships; and

f. Form 8891, U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans.

I. Form BE-10, Benchmark Survey from the Bureau of Economic Analysis (BEA) under the U.S. Department of Commerce. The survey is conducted every five years, with the next survey occurring in 2020. Any U.S. person, company, trust or estate that owns more than 10% of any foreign business or holds more than 10% of the voting rights; performs self-employment or business activities outside the U.S., or owns more than 10% of any real estate outside the U.S. (except personal use residential real estate), must file Form BE-10A, B, C, or D. The most recent survey was due in 2025, , and the next filing obligation is in 2030. Failure to file could result in a civil penalty between $2,500 and $25,000. Willful failure to file could result in a fine of $10,000 and imprisonment of one year or less.

XVI. Foreign Counsel

A. Consultation with foreign counsel may be advisable where client has assets or beneficial interests in multiple jurisdictions, as foreign law may control the character of property, client's rights and interests in the property, and the determination of how to characterize an entity, structure, or ownership or beneficial interest.