Deliver to: Ronda Zivalich

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Davis Schilken, PC

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Watch Out for Tax Traps for Foreigners

As advisors, it is critical to remember that non-citizens and non-resident aliens (NRAs) are taxed radically differently than U.S. citizens.

When Congress passed the Heroes Earning Assistance and Relief Tax Act of 2008 (HEART), it had a significant impact on state and gift taxes for non-citizens, non-resident aliens (NRAs) and former U.S. citizens.

A resident is defined as someone living in a particular location, for even a brief period of time, with no definite intention of leaving.

Different Taxes for Different Statuses

Residency comes into play not only with respect to the estate tax, but also the federal gift tax.

Here's a quick rundown of how the estate and gift tax rules apply to U.S. citizens, U.S. residents, NRAs, former U.S. citizens, and former U.S. residents:

- U.S. Citizen — Currently, there is no federal estate tax. It is set to automatically reappear in 2011 at an exemption rate of $1M per person, unless Congress acts to renew it at a higher rate. We are monitoring this issue and will alert you as to any changes. A citizen may take an unlimited marital deduction for any assets in his estate, passing to a citizen spouse. But a citizen is not allowed to take a marital deduction for any assets passing to a spouse who is not a citizen.

  With respect to the gift tax, a U.S. citizen has a $1 million lifetime exemption for all property, wherever situated in the world. Citizens receive a $13,000 annual gift tax exclusion per transferee, per year. Citizens are allowed unlimited gift tax exclusions for any lifetime transfers to a spouse who is also a citizen.
- U.S. Resident — Estate and gift tax laws are almost identical for U.S. residents as for citizens.
- Non-Resident Alien — An NRA has a $60,000 estate tax exemption amount. An NRA is subject to the gift tax for lifetime transfers of real or tangible property situated in the United States. An annual gift tax exclusion of $13,000 per gift recipient per year applies for each transfer.
- Former U.S. Citizen/Former U.S. Resident — U.S. citizens and U.S. residents who have left the United States are informally referred to as "expatriates" for transfer-tax purposes. Expatriates who severed ties with the United States before June 17, 2008, are not subject to the new HEART legislation, but are instead subject to the "10-year rule."

'Exit Tax' on Former U.S. Citizens

A common estate planning technique for wealthy U.S. citizens was to renounce their citizenship. Congress closed this with an "exit tax" in HEART.

The Internal Revenue Service presumes expatriates subject to the "10-year rule" to be leaving the United States for tax avoidance reasons, if they:

- had an average annual income of $145,000 for the five years before expatriating from the United States;
- had a net worth of $2 million or more;
- failed to comply with expatriation filing requirements for the five years prior to leaving the United States.

Before HEART, there was no trigger of any federal tax upon a U.S. citizen or resident leaving the United States. HEART imposes significant exit taxes.

As always, I hope this article has helped you and your clients. If you have a specific case or concern you'd like to discuss, please contact our office.

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