Podcast Transcript

Estate and Tax Planning for Globally Mobile Clients: Estate and Trust Planning by Non-Americans for American Family Members

Date: August 13, 2024

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Run Time: 7:38

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Lee: The United States has a complex tax system that can differ from that of one's home country. For that reason, there are many tax issues non-Americans should be aware of when undertaking estate, gift, and trust planning for their American citizen or resident family members. I'm Leanne Lee, and you're listening to BakerHosts.

On today's episode, we'll discuss estate and trust planning by foreign nationals who are considering estate or gift planning for their American family members. We're joined by a Private Wealth partner, George McCormick, who is located in our New York office. In his practice, George focuses on tax and estate planning for international clients who have a connection to the United States. Welcome to the show, George.

McCormick: Hi, Leanne. Thanks for having me today.

Lee: So, to start us off, what are the main tax issues or consequences someone should keep in mind when doing estate or gift planning for American family members?

McCormick: Well, the most important tax issue that I would point out to them is that U.S. citizens and U.S. residents are subject to U.S. tax on a worldwide basis. And there are two main types of taxes to think about. So, there is the U.S. federal estate and gift tax, which applies to gifts made during lifetime or death by a U.S. person, and that is assets located anywhere in the world or a U.S. person that lives anywhere in the world, and those gifts could be subject to a 40% rate of tax. And U.S. citizens or residents are also subject to U.S. federal income tax on their worldwide income. So, again, it doesn't matter where the U.S. person lives or where they earn income.

Lee: Great. So, you mentioned estate tax concerns for Americans who are inheriting assets. So, what steps can someone take to minimize tax exposure?

McCormick: Well, the estate and gift tax can apply if a U.S. person owns assets in their own name. So, one of the main strategies that we use is to try to use trust so that the U.S. person doesn't inherit the assets outright in their own name, but through a trust. Now, a trust is a legal arrangement seen in many Western countries or former British colonies, where the ownership of an asset is divided between the legal owner, who is the trustee, and the beneficial owner, who are the beneficiaries of the trust. And very notably, the beneficiaries are not treated as owning the assets directly if the trust is properly structured. So, if assets are left in trust for the beneficiary, they're not subject to U.S. estate or gift tax for the U.S. persons. Now, it is important no matter where the trust is being created that a U.S. lawyer is involved to make sure the trust is structured properly. We have to strike a balance between the U.S. person having some influence and control over the trustee and at the same time not having too much control. Otherwise, it could be treated as owning the assets.

So, for example, a U.S. person beneficiary can't have an unlimited power to make distribution of trust assets to themself. I'll also point out when it comes to trust is that, generally speaking, you think of a trust is created during the lifetime of the person who creates it, right? We call that an inter vivos trust. It is possible in many jurisdictions to also create a trust through the will of the person passing on the assets. So, they can retain ownership of the assets during their lifetime and then their will pours over assets into a trust or creates a trust which, again, they can have the benefit of protecting the assets from U.S. estate and gift tax for U.S. person beneficiaries.

Lee: Great. Now what are some of the non-tax issues to consider with respect to estate and gift planning for Americans?

McCormick: Well, another concern about U.S. persons inheriting assets outright are those assets being exposed to their creditors. As you know, the U.S. is a very litigious place and so people who live in the U.S. are potentially subject to lawsuit for a whole range of potential reasons. For example, personal injury lawsuits, also, business lawsuits or business disputes. And so, utilizing a trust is important because, again, if the person doesn't own an asset in their own name, through a properly structured trust, it can be protected from their creditors. And creditors don't just include, for example, like you said, business creditors from a lawsuit, but also potentially a divorcing spouse. And it is worth knowing, for people who are from outside the U.S., a few things about divorce in the U.S.

So, number one, most states have what we call no-fault divorce. So, a person doesn't have to provide a reason like adultery or abuse to file for divorce. They can just file. Also, for spouses, most states in the U.S. have something what we call the elective share. So, assuming there has been no divorce when a spouse passes away, usually their surviving spouse can elect to obtain a certain percentage of their assets or a certain amount. So, another potential use for trust is to keep assets out of their own name to avoid that. Another issue I would mention when it comes to married persons, is that many countries around the world have a concept of forced heirship, so that the local law mandates or requires how their assets can be inherited. When it comes to estate planning for non-U.S. persons, while trusts are usually a very effective strategy in many places, there are certain countries that have forced heirship rules or other rules under regimes, like Sharia, that actually dictate how their assets can be inherited. So, we have to be very creative during their lifetime to see if there is ways that we can avoid or minimize the U.S. persons inheriting assets outright under those regimes.

Lee: Great. And I have one final question for you today. Clearly, there are so many issues to consider before making arrangements for American family members. What are the main points you'd like them to take away from our chat?

McCormick: Well, I would like them to consider other ways under the law of where they live or where they own assets to minimize or avoid their U.S. family members inheriting assets outright. As I mentioned, the U.S. person inherits assets outright, then going forward, there is assets can be subject to U.S. estate or gift tax and also U.S. Federal income tax. If they reside in the U.S., the assets may also be subject to state or local tax. And from a non-tax perspective, if a U.S. person inherits assets outright, it could be exposed to their creditors, including divorcing spouses.

Lee: This has been a great and very informative conversation. Thank you, George.

McCormick: Thank you, Leanne.

Lee: If you have any questions for George, his contact information is in the show notes. And, as always, thanks for listening to BakerHosts.