Extra tax considerations for US citizens or people with assets in the USA

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American citizens are subject to US estate taxation with respect to their worldwide assets. An estate tax return[1] is required for a deceased American citizen, if the fair market value at death of the decedent's worldwide assets exceeds the "unified credit exemption"[2] amount in effect on the date of death.

Effectively, there is a tax-free threshold of US$5.34 million (in 2014) for US citizens. The bad news is that this is reduced to US$60,000 for those who are non-US citizens and not US domiciled and applies to their assets in the US, although there may be some limited relief available under the US/Australia Estate Tax Treaty which provides to an Australian estate a portion of the tax-free threshold. Quite apart from any relevant state based estate or inheritance taxes,[3] the Internal Revenue Service (IRS) applies a tax of 40% to the taxable amount over the threshold.

From 1 January 2011, any unused threshold amount is "portable" between a husband and wife. When one spouse dies, the other typically can get the deceased spouse's unused exemption amount. This election is made on a timely filed estate tax return for the decedent with a surviving spouse but is only available to US citizens and tax residents.

The IRS may collect any unpaid estate tax from any person receiving a distribution of the decedent's property under transferee liability provisions of the tax code.

US-situated assets include American real estate, tangible personal property, and securities of US companies. A nonresident's stocks in American companies are not subject to gift tax so gifting such stocks inter vivos may be a strategy for some.

Executors for nonresidents must also file an estate tax return[4] if the fair market value at death of the decedent's US-situated assets exceeds US$60,000.

This has been the case for several years but the Foreign Account Tax Compliant Act (FATCA), enacted in 2010, has brought concern about enforcement of the rules front of mind. There were reports recently[5] from the UK that an Individual Savings Account (ISA) available to all UK residents, regardless of citizenship, was refused to a US citizen by the UK Post Office for reasons related to the FATCA. The Post Office subsequently reversed its position but the writer can understand their anxiety about their reporting obligations in respect of US customers to the Internal Revenue Service.

Other organisation, such as National Savings & Investments, have refused[6] to have US customers, such is the compliance burden. We have been talking about the burden of US compliance issues for years prior to the passing of FATCA in 2010. One of the issues is the significant fact of up to 40% estate tax.

While the cost of FATCA will not be direct to individuals as opposed to estate tax, for some, it is the straw that is breaking their back and we are seeing more US citizens considering severing their ties with the US. Expatriation, apart from the political issues, is easiest for non "covered expatriates"[7] who have:

1. net wealth less than US$2 million;
2. average annual net income less than a specified amount being around US$150,000 over the five years ending before the date of expatriation;
3. stated that they have all US tax obligations for the five years ending before the date of expatriation.

If a client is a "covered expatriate", a mark-to-market regime applies which means that all of their property is deemed to be sold for its fair market value on the day for the expatriation date. The gain can be reduced by US$680,000 in the 2014 calendar year. The maximum tax rate of 39.6% will apply on the ordinary income component and the lower capital gains rate of 20% may apply to some of the gain. The 3.8% Medicare surtax on net investment income also applies. A US person receiving a transfer at death or by gift from a "covered expatriate" must pay an inheritance tax at the top estate and gift tax rate, currently 40%, on the value of such assets received from the "covered expatriate". This is a considerable hit for many clients.

The bad news for clients is that this "global" approach is becoming more common. For practitioners, the identification of a client's citizenships, domicile and location of all of their assets is becoming more important.

Another practical issue which clients often do not raise is the issue of probate for assets overseas. This can be a huge burden for legal personal representatives if not thought through.

One way of managing this for US assets is to make a transfer on death registration for US stocks. By setting up a trading account or having stocks registered this way, the stocks will, on receipt of a copy of the death certificate and an application for re-registration, be registered in the named person without the need to get a grant of representation from the local authorities. The estate tax is still due and the broker may not transfer until the estate has obtained a transfer certificate from the IRS.

The complexity arises from the fact that not all brokers and not all States offer this type of registration under the Uniform TOD Security Registration Act[8] and some firms do not allow transfer on death provisions to apply where the transferee is not a US resident.

Who is a US taxpayer?

It is well known that if you are a US citizen or long-term resident, you are subject to US tax on worldwide income. What is less well known is that children, not born in the US, of at least one US citizen, can be caught in this net. This can happen for instance if the child is under 18 and lived in the US under the care of the US citizen, and will also happen even if the child has never lived in the US but the parent, who is a US citizen, lived in the US during a significant part of his or her teenage years.

What to do?

The good news is that there are options available. We have access to specialist US legal advice[9] for people with connections to Australia.

Some clients are seeing the benefit of acquiring US situs assets in an American corporation. Once owned by a corporation, the person's taxable interest in the asset can be watered down through shares having different voting rights, control being exercised in a particular way and other strategies.

As always, a client's entire situation needs to be considered and the author has noted that, despite tax being a motivator in many situations for a client, emotional considerations often prevail in this area.

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Footnotes

1. Form 706, United States Estate (and Generation-Skipping) Tax Return, Estate of a citizen or resident of the United States.
2. To determine the "unified credit exemption" amount for American citizens for any particular year, refer to the Instructions to Form 706 or to Publication 559, Survivors, Executors, and Administrators. For US.
3. "States You Shouldn't Be Caught Dead In", (25 October 2013) *Wall Street Journal*.
4. Form 706NA, United States Estate (and Generation-Skipping) Tax Return, Estate of a nonresident not a citizen of the United States.
5. *Daily Telegraph*, 6 September 2014.
6. "Yanks? No thanks", says National Savings (4 June 2014) *The Times*.
7. IRC 877A.
8. www.uniformlaws.org.
9. The author would like to thank John Campbell US Attorney for his contribution to this article but the views expressed are purely those of the author.