

Tax Reform Update: Tax Planning Opportunities for Noncitizens Residing in the United States

The Tax Cuts and Jobs Act (the "TCJA"), signed into law on December 22, 2017, includes significant changes to U.S. transfer taxes (i.e., U.S. federal gift, estate and generation-skipping (GST) taxes), in addition to having far-reaching income tax consequences. This alert highlights a few discrete aspects of transfer tax changes of particular relevance to noncitizens resident (or who may become resident) in the U.S. for a period of years.

Federal gift, estate and GST exemption amount changes

Federal gift and estate taxes apply at a rate of up to 40%. Each individual who is a citizen or resident of the U.S. is allowed a lifetime exclusion amount, which can be used to shelter transfers made during life or at death from gift and estate taxes. Importantly, a "resident" for purposes of U.S. transfer taxes is different than a resident for income tax purposes. For U.S. transfer tax purposes, a resident is an individual domiciled in the U.S. Thus, an individual living in the U.S. on an investor visa who files a U.S. resident income tax return (IRS Form 1040) is not necessarily a U.S. domiciliary. Legal permanent resident status (also known as having a "green card") is a good indication of having acquired a U.S. domicile, but the determination is based on all facts and circumstances.

Under the TCJA, for estates of U.S. citizen or resident individuals (i.e., domiciliaries) dying and transfers made on or after January 1, 2018, the gift and estate tax exclusion is doubled to approximately \$11.2 million per person (\$22.4 million for a married couple), and will continue to be adjusted for inflation in future years. In certain cases, a surviving spouse may use a deceased spouse's unused exclusion amount. The GST exemption amount is also doubled to approximately \$11.2 million per person, but is not transferable between spouses.

These increases are scheduled to be in effect through December 31, 2025, after which the amounts will revert to current levels (\$5.6 million per person, adjusted for inflation).

These increases *do not apply to transfers made by noncitizens who are not domiciled in the U.S.* (so-called "noncitizen nonresidents"), except insofar a treaty provides a benefit. For noncitizen nonresidents making transfers of property situated in the United States, the exemption amount continues to be a mere \$60,000 for transfers at death; there is no exemption for lifetime transfers.

Depending upon an individual's circumstances, it may be advisable to establish a U.S. domicile upon relocating to the U.S. (or even years after having arrived) in order to take advantage of the significant increase in exemption amounts, particularly in the case of an individual who owns substantial U.S. property. At times, the question of domicile may not be entirely clear; in that case, it may be possible to hedge by gifting property that is not considered "U.S. situs property" for gift tax purposes. Such property includes stock, including U.S. stock, which is considered to have a U.S.-situs for estate tax purposes but not for gift tax purposes, as well as cash located abroad, which is not considered to have a U.S.-situs for either gift or estate tax purposes. We encourage such individuals to seek the advice of foreign counsel as to the foreign consequences of any transfers. With the proper planning, it may be possible to make significant transfers free of both U.S. and foreign transfer tax. Further, it is possible that even if such an individual one day returns to his or her home country, the assets subject to a lifetime transfer made while domiciled in the U.S. will not be subject to estate tax in the individual's country of residence at death, even where that country has a far lower exemption amount.

Basis adjustment upon death

No changes have been made to tax provisions which permit appreciated property to pass to heirs at death with a "stepped-up" income tax basis. If such property is inherited by a tax resident of a foreign jurisdiction, then the foreign jurisdiction basis rules would continue to apply for purposes of determining the foreign income tax consequences upon a sale of that inherited property. In the case of U.S. real estate, a sale by the foreign heir may not generate much in the way of U.S. tax, but it is possible that there may be foreign tax due to differing basis rules.

State estate taxes will continue to apply

Many states, including New York, apply a separate estate tax at rates of up to 16%. State estate taxes may continue to be imposed at current exemption levels notwithstanding the changes to federal tax laws. For example, the New York estate tax exemption is currently \$5,250,000, and was scheduled to increase on January 1, 2019, to match the federal exclusion amount. However, the New York exemption amount will not match the newly-doubled federal amount absent further action by the New York State legislature. New York does not impose gift or GST taxes.

Increase of annual exclusion amount

Based on our estimates of scheduled inflationary adjustments, the gift tax annual exclusion amount has increased to \$15,000 per donee (or \$30,000 per donee for a married couple) as of January 1, 2018. This exclusion is available to non-U.S. domiciliaries as well as U.S. citizens and residents. The annual exclusion amount for gifts to a spouse who is not a U.S. citizen has increased to \$152,000. We expect these amounts to be confirmed by the IRS in the coming weeks.

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