

**INTERNATIONAL ESTATE PLANNING  
FOR THE GLOBALLY MOBILE**

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American Bar Association

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## **Books and Treatises (Editor/Author)**

Contributing author, Asset Protection Strategies Vol. I, Second Edition, Ed. Alexander A. Bove, Jr. (2019)

Contributing editor, Asset Protection: Domestic and International Law and Tactics, Thomson/West Group (four volumes, updated quarterly)

## **Professional Publications/Presentations**

"International Estate Planning for the Globally Mobile," State Bar of Texas, Advanced Estate Planning & Probate (June 4-6, 2025)

"Coming to America: Inbound Estate Planning for Non-Citizens," State Bar of Texas, Estate Planning & Probate Drafting (October 31, 2024)

"Marital Property Issues in Trust Funding," State Bar of Texas, Handling Your First (or Next) Trust (April 18, 2023)

"Everything You Always Wanted to Know About Offshore Planning," Estate, Trust & Wealth Preservation Practice Group, Quarles & Brady, LLP (February 2021)

"Dealing with International Assets in Estate Planning," BNA Tax Management International Journal (August 2016)

"Inbound Estate Planning for Nonresident Aliens," BNA Tax Management International Journal (June 2015)

"Inbound Essentials: Estate and Income Tax Planning for Nonresident Aliens," BNA Tax Management Estates, Gifts, and Trust Journal (September 2014)

"IRS Releases Final FFI Agreement," Trusts & Estates (January 2014)

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# International Estate Planning for the Globally Mobile

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## I. Introduction

As cross-border mobility increases, more clients present with multinational assets, international family structures, or foreign residency and domicile issues. This paper offers a detailed analysis of U.S. federal estate and gift tax implications for both U.S. citizens with foreign assets and non-citizen residents and nonresident aliens with ties to the United States. Key topics include the use of multiple wills, revocable and irrevocable trusts, civil-law constructs such as usufructs, and the planning utility of the European Succession Regulation (Brussels IV) to avoid forced heirship rules. The paper also addresses determinations of residency for U.S. income tax purposes and domicile for U.S. transfer tax purposes, the impact of U.S. tax treaties, and the use of qualified domestic trusts (QDOTs) in planning for non-citizen spouses. Practical advice for selecting fiduciaries across jurisdictions and structuring foreign ownership of U.S.-situs property are also discussed. This paper will serve as a helpful resource for practitioners advising globally mobile clients on tax-efficient and legally sound cross-border estate planning strategies.

## II. Estate Planning for U.S. Clients with Multi-Jurisdictional Assets

It is widely recognized that globalization has significantly diminished the practical boundaries between jurisdictions, resulting in a world that is more interconnected than at any previous point in history. In light of this development, estate planning professionals are encountering a growing subset of clients who require guidance on the integration of foreign assets into comprehensive estate plans. Analogous to the approach employed when a client holds assets across multiple states in the U.S., the initial inquiry in the context of foreign asset ownership should focus on whether probate or estate administration can be circumvented in the relevant non-U.S. jurisdiction. Once this threshold determination is made, the retention of local counsel becomes essential to further evaluate jurisdiction-specific options, identify applicable tax implications, and implement the selected planning strategy. The involvement of qualified foreign legal professionals is indispensable in ensuring both the legal validity and practical efficacy of the cross-border estate plan, and in mitigating the risk of procedural inefficiencies or unintended legal consequences.

The complexity of each client's circumstances, coupled with the potentially intricate interplay of U.S. and foreign tax regimes, necessitates a nuanced and fact-specific approach to planning. Accordingly, this Section II endeavors to provide a conceptual overview of the principal mechanisms available to U.S. individuals seeking to avoid probate in non-U.S. jurisdictions.

### A. Probating a U.S. Will in a Foreign Jurisdiction

The simplest solution is to have the client's estate plan addressed in a single document to avoid confusion and to minimize complication. Jurisdictions that have signed on to the Hague Convention on the Conflict of Laws relating to the Form of Testamentary Dispositions of 5 October 1961 (the "Convention") will recognize a validly executed U.S. will. In non-signatory jurisdictions, however, the internal laws of the foreign jurisdiction will need to be explored to determine whether the jurisdiction will recognize a client's U.S. will without excess cost and hassle.

### B. Multiple Wills

In most cases, even in countries that have signed on to the Convention, executing a local will is nonetheless preferable. For example, although a country may be a signatory to the Convention, executing a situs will to dispose of local assets, in particular real property, creates much less cost and fewer headaches in the long run because the form and execution of the situs will is typically simpler to offer for probate in the local jurisdiction as compared to probating a U.S. will under the Convention. If a situs will is warranted, then the client's U.S. will and non-U.S. will should reference each

other's existence in order to ensure that one does not inadvertently revoke the other. Consider including the following provision in a second Will to reference the Texas Will and thereby avoid revocation:

#### **Texas Will:**

I, [Testator], a resident of Travis County, Texas, and dual citizen of the United States and the United Kingdom, hereby make this, my last will and testament, to govern the disposition of all of my property situated outside of the United Kingdom. I have executed a will under the laws of the United Kingdom to dispose of my property situated within the United Kingdom (my "UK will"), and this Will is not intended to revoke my UK will (nor any codicils thereto). I hereby revoke all my former wills and codicils executed under the laws of any state of the United States.

#### **Situs Will:**

I, [Testator], of Austin, Travis County, Texas, United States of America revoke all former wills and testamentary dispositions made by me in so far as they relate to my assets at my death situated in the United Kingdom ("my United Kingdom Property") and declare this to be my Will in respect of my United Kingdom property only ("my UK Will").

#### **C. Revocable Trusts**

In jurisdictions where probate proceedings are particularly onerous—such as California, where the process is both time-consuming and expensive—fully-funded revocable trusts are routinely employed as the principal estate planning mechanism. These instruments, variously referred to as "revocable management trusts" or "living trusts," are designed to circumvent probate by transferring title to all assets that would otherwise pass through probate, including real property, financial accounts, and other traditionally probate-eligible assets. A pourover will is typically executed in conjunction with the trust to capture any residual assets not previously transferred, directing them to the trust upon the testator's death. Revocable trusts are also commonly utilized in multistate estate planning. Where a decedent holds assets in multiple jurisdictions, placing those assets in a revocable trust can eliminate the need for ancillary probate administrations in each state, thereby streamlining post-mortem administration and reducing associated costs.

This rationale, while conceptually extendable to non-U.S. assets, encounters significant practical limitations. In many civil law jurisdictions, the common law concept of a trust lacks legal recognition. As a result, assets cannot be titled in the name of a trustee, or if they are, local law may treat the trustee as both the legal and beneficial owner, thereby triggering probate in the foreign jurisdiction upon the trustee's death. Furthermore, in certain jurisdictions (most notably the United Kingdom) the transfer of assets into a revocable trust may constitute a lifetime disposition subject to immediate inheritance taxation.

Accordingly, while the use of revocable trusts to directly hold foreign assets during life remains relatively rare, it represents a strategy that warrants careful examination in the context of cross-border estate planning.

#### **D. Irrevocable Trusts and Foundations**

The use of an irrevocable gifting trust to hold foreign assets may encounter the same limitations as transferring title to a revocable trust, particularly in jurisdictions that do not recognize the trust as a legal owner of property. Nonetheless, the objectives underlying the creation of an irrevocable trust often diverge significantly from those of a revocable trust. Accordingly, in jurisdictions that recognize trust structures but impose inheritance or transfer taxes upon their creation, the transfer of foreign property to an irrevocable trust may still serve a strategic role within a comprehensive estate plan. Moreover, even in instances where the settlor is unable to fund the trust during life, testamentary transfers to the trustee of a formerly revocable trust (now functioning as a testamentary trust) may facilitate the avoidance of probate and, potentially, estate or inheritance taxation in future generations.

Certain foreign jurisdictions—including Liechtenstein, Switzerland, Panama, and the Cook Islands—offer statutory foundations, which, while distinct from charitable private foundations, serve analogous functions to common-law trusts. These foundations are recognized as separate legal entities under their domestic laws and permit the founder to designate a succession of beneficiaries. The foundation's governing board may be vested with varying degrees of discretion concerning asset management and distribution. From the perspective of U.S. tax law, such entities are generally classified as foreign trusts, with the associated foreign tax reporting and compliance requirements.

In many Latin American jurisdictions, statutory mechanisms such as the fideicomiso may offer a functional alternative. A fideicomiso, if properly structured, can replicate the features of a common-law trust and thereby enable the avoidance of probate proceedings in the foreign jurisdiction. For U.S. federal tax purposes, the classification of a fideicomiso depends on the terms of the arrangement and the fiduciary obligations imposed on the trustee. Depending on these factors, the fideicomiso may be treated either as a nominee arrangement or as a foreign trust, thereby triggering the associated foreign tax reporting and compliance requirements.<sup>1</sup>

#### E. Usufructs

In many civil-law jurisdictions, the usufruct serves as a strategic alternative to probate for foreign assets. A usufruct allows one party, the “usufructuary,” to retain the right to use and enjoy the income or benefits from a property while transferring the “naked title” to another, typically a successor. Upon the usufructuary’s death, full title reverts to the naked titleholder. This legal construct resembles the U.S. life estate, where a life tenant enjoys use during their lifetime, with fee simple vesting in a remainderman upon death.

However, while potentially advantageous under foreign law, the creation of a usufruct may yield adverse U.S. tax consequences. For gift tax purposes, such an arrangement is treated as a completed gift of the remainder interest (naked title), calculated as the fair market value of the property less the actuarially determined value of the retained life interest.<sup>1</sup> Despite valuation discounts at the time of the gift, U.S. estate tax law under §2036(a)(1) and related regulations mandates that the full fair market value of the property is includible in the donor’s gross estate if the donor retained a right to enjoy the property. As such, the donor’s unified credit is both depleted at the time of the gift and again burdened by full inclusion at death—a phenomenon sometimes referred to as the “gift and estate tax whipsaw.”

Nevertheless, the use of a usufruct should not be categorically dismissed. Given the historically high federal estate and gift tax exemption (currently approximately \$27,980,000 for married couples), many taxpayers may still benefit from this structure without incurring federal transfer taxes. Furthermore, assets transferred via a usufruct arrangement receive a basis adjustment at the usufructuary’s death, potentially eliminating capital gains exposure for the remainder beneficiary.

#### F. Brussels IV and Circumventing EU Forced Heirship

The European Succession Regulation (Regulation (EU) No. 650/2012), widely known as *Brussels IV*, offers a significant planning opportunity for U.S. nationals with assets situated in the European Union. In force since August 17, 2015, the regulation permits individuals—regardless of their nationality or the participation of their home country in the regulation—to designate the law of their nationality as the governing law for the succession of their assets located within EU member states. This provision is especially advantageous in avoiding the mandatory application of local forced heirship regimes prevalent in many continental jurisdictions.

By invoking a valid choice-of-law clause in their will, U.S. individuals can elect to have their domestic law govern the disposition of foreign assets, thereby maintaining testamentary freedom. Absent such an election, the default rule under Brussels IV is that the law of the decedent’s “habitual residence” at the time of death governs succession—unless the decedent had a manifestly closer connection to another jurisdiction.

An additional complexity resolved by Brussels IV is the doctrine of *renvoi*, a principle under private international law where a court may be directed to apply the foreign law of another state, which in turn refers the matter back to the law of the forum—a circular and often unresolvable conflict. The regulation expressly excludes the application of *renvoi*, thereby enhancing legal certainty and reducing procedural inefficiencies in the administration of cross-border estates.

Brussels IV thus serves as a critical legal tool for practitioners advising clients with EU-based assets, ensuring that succession aligns with the testator’s intent and mitigates unintended consequences arising from foreign inheritance

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<sup>1</sup> See PLR 201032021; see also §2512(a), Reg. §25.2512-5.

law.<sup>2</sup> Estate planners should be particularly attentive to incorporating express choice-of-law provisions in wills, especially when dealing with immovable property subject to rigid local succession regimes.

### III. Estate Planning for Non-U.S. Clients with U.S. Heirs or Investments

Above we focused on estate planning for U.S. clients with respect to non-U.S. assets, although the advice is equally relevant to non-U.S. clients with multijurisdictional assets. Below, we focus on clients who may have U.S. heirs or investments and are either currently not domiciled in the U.S. for U.S. estate tax purposes or there is uncertainty surrounding their domicile and whether they will be U.S.-domiciled in the event of death.

#### A. Determining U.S. Tax Residency

Before we discuss the tax considerations of non-citizen residents of the U.S., we should first distinguish between non-citizen residents and non-resident aliens (NRAs). As shown below, a person may be a resident for income tax purposes and not be a resident for transfer tax purposes, and vice versa. Most clients and many traditional domestic estate planning attorneys overlook the distinction and may assume that having a green card is sufficient to entitle the client to the full federal estate and gift tax exemption amount enjoyed by U.S. citizens and domiciliaries, but this is not always the case. The distinction between a non-citizen resident and an NRA is key to consider when meeting with clients who have moved to the U.S. from another country.

#### B. Income Tax Residency

A non-citizen is considered a resident of the U.S. for U.S. income-tax purposes (and therefore taxed on worldwide income) if the individual meets any one of three tests: (1) the green card test; (2) the substantial presence test; or (3) the first-year election.<sup>3</sup>

##### 1. The Green Card Test

Under the “green card” test, a person who holds a permanent-residence visa, or green card, will be considered a U.S. resident for income-tax purposes.<sup>4</sup> If an individual’s green card merely expires and is not proactively relinquished, revoked, or administratively determined to have been abandoned, the individual will continue to be taxed as a U.S. resident until one of these events occurs.<sup>5</sup>

##### 2. The Substantial Presence Test

Under the “substantial presence” test, an individual who is physically present in the U.S. for a certain number of days over a three-year period will be considered a U.S. resident for income tax purposes.<sup>6</sup> An individual is substantially present in the U.S. if he is present for at least 31 days during the current year and at least 183 days for the three-year period ending on the last day of the current year using a weighted-average calculation, with days present in the current year weighted more heavily than days present in the prior two years. This weighted average is calculated as follows (with 2026 as the “current year”):

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<sup>2</sup> Note that the United Kingdom, Ireland, and Denmark have opted out of Brussels IV, and thus the regulation does not apply to assets located in these countries.

<sup>3</sup> IRC § 7701(b)(1)(A).

<sup>4</sup> IRC § 7701(b)(1)(A)(i).

<sup>5</sup> IRC § 7701(b)(6).

<sup>6</sup> IRC § 7701(b)(3).

2026: Multiply # of days present by 1

2025: Multiply # of days present by 1/3

2024: Multiply # of days present by 1/6

For example, assume an individual is present in the U.S. for 120 days in the current year (2026) and 120 days for each of the two preceding years:

2026: 120 days present x 1 = 120

2025: 120 days present x 1/3 = 40

2024: 120 days present x 1/6 = 20

Weighted Average Total: 180

In this example, the foreign individual does not meet the substantial presence test, and is therefore an NRA for 2026, because he was not present for a weighted average of at least 183 days.

There are a couple of exceptions to the substantial presence test. First, if an individual is physically present in the current year for 31 days but fewer than 183 days, and otherwise meets the substantial presence test, he will nonetheless be considered an NRA if he proves on a Form 8840 (attached to a Form 1040NR) that he has a “tax home” in a foreign country and a “closer connection” to that foreign country than to the U.S.<sup>7</sup> The location of a person’s “tax home” (defined as a person’s home for purposes of determining deductible business travel expenses while away from home<sup>8</sup>) and whether he has a “closer connection” to a foreign country are subjective inquiries and are based on criteria similar to those used to determine domicile (which will be discussed in Section III.C., Transfer Tax Residency, below). Second, if the individual is not present for at least 31 days in the current year, the substantial presence test does not apply at all, even if the three-year weighted average equals 183 (i.e., he will be an NRA automatically without the requirement to prove a closer connection to a foreign country). In any event, if an individual is present in the U.S. for 183 days in the current year, he cannot take advantage of the “closer connection” exception to the substantial presence test.

### 3. The First-Year Election

A special “first-year election” is available for an individual seeking to be treated as a U.S. resident if the individual: (i) is present in the U.S. for 31 consecutive days during the current year; (ii) is present in the U.S. for a total number of days equal to or exceeding 75% of the days in the “testing period” of the current year (which is the period starting on the first day of the consecutive 31 days and ending on December 31 of the year of the election); and (iii) meets the substantial presence test for the succeeding year.<sup>9</sup>

Because the first-year election cannot be made unless an individual also meets the substantial presence test for the succeeding year, it is not truly a third stand-alone residency test. Rather, it is a way to achieve U.S. residency for the year prior to the first year of substantial presence. The election is effective starting with the portion of the year beginning with the first consecutive 31-day period, which will not necessarily be on January 1.

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<sup>7</sup> IRC § 7701(b)(3)(B).

<sup>8</sup> IRC § 911(d)(3).

<sup>9</sup> IRC § 7701(b)(4).

The first-year election is best described with the following example, which assumes that 2026 is the first year that the individual meets the substantial presence test, and the individual wishes to elect to be treated as a U.S. resident for 2025:

Arrives in U.S.	March 11, 2025	= 5 days	Period less than 31 days is disregarded
Departs U.S.	March 15, 2025		
Arrives in U.S.	June 1, 2025	= 92 days	Testing Period = 214 days
Departs U.S.	August 31, 2025		
Arrives in U.S.	October 11, 2025	= 82 days	Present for 174 days of Testing Period
Departs U.S.	December 31, 2025		

In the above example, the individual’s testing period begins on the first day of his first consecutive 31-day presence in the U.S. (June 1) and ends on the last day of that same calendar year (December 31). There are 214 days in the testing period, of which he was present for 174 days, which is 81% of the days in the testing period. Because he was present for 31 consecutive days and also present for more than 75% of the days in the testing period, he can elect to be treated as a U.S. resident beginning on June 1, 2025.

### C. Transfer Tax Residency

As shown above, determining residency for income tax purposes generally involves objective criteria (except for the “closer connection” exception to the substantial presence test). In contrast, residency for U.S. transfer tax purposes (i.e., estate and gift taxes) involves a subjective inquiry regarding the individual’s domicile.

“Domicile” is a common-law term meaning a person’s fixed and permanent place of abode in which the person intends to remain indefinitely or to which the person intends to return.<sup>10</sup> A person can have multiple residences, but only one domicile. A person may be considered a resident of the country in which he currently lives but still be domiciled in another country if he intends to return to that country. A taxpayer’s original domicile remains until the taxpayer demonstrates the requisite intent to establish a new domicile. Therefore, domicile can be difficult to lose once established in a particular country. The Treasury Regulations provide the following general definition of domicile:

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.<sup>11</sup>

Thus, to be characterized as a U.S. domiciliary for U.S. tax purposes, a person must (i) live in the U.S., and (ii) have no intention of leaving.<sup>12</sup> Because of the subjective intent factor, there are no bright-line rules as to the required length of physical presence to establish transfer tax domicile like there are for income tax residency.<sup>13</sup> This subjective inquiry looks to many factors, including:

- the length of time spent in the U.S. and abroad, and the amount of travel to and from the U.S. and between other countries;
- the value, size, and locations of the person’s homes, and whether he owned or rented them;
- whether the person spends time in a locale due to poor health, for pleasure, to avoid political problems in another country, etc.;
- the situs of valuable or meaningful tangible personal property;

<sup>10</sup> See Black’s Law Dictionary (12th ed. 2024); see also Rev. Rul. 80-209, 1980-2 C.B. 248.

<sup>11</sup> Treas. Reg. § 20.0-1(b)(1), (2) (for estate tax); Treas. Reg. § 25.2501-1(b)(1) (for gift tax) (emphasis added).

<sup>12</sup> *Id.*

<sup>13</sup> Restatement (Second) of Conflicts of Law § 16, Comment (b).

- where the person’s close friends and family are situated;
- the locales in which the person has religious and social affiliations or in which he partakes in civic affairs;
- the locales in which the person’s business interests are situated;
- the person’s visa status;
- the places where the person states that he resides in legal documents;
- the jurisdiction where the person is registered to vote;
- the jurisdiction that issued the person’s driver’s license; and
- the person’s income-tax filing status.<sup>14</sup>

The courts look to the totality of the circumstances to determine a person’s domicile, and no one factor is determinative. Facts supporting the conclusion that the taxpayer has not abandoned his prior domicile may also lead to a conclusion that the taxpayer has not established a new one elsewhere. Also, claiming privileges based on residency (e.g., by filing a Form 1040NR instead of a Form 1040) may be considered evidence that the taxpayer has not abandoned his domicile in his home country.

Also, because domicile requires a permanent and fixed place of abode, a person can continue to be domiciled in a country he left long ago if he has not yet established a new permanent residence elsewhere. A person who sells his home in one country to move abroad but does not become a permanent resident of the new country may still be a domiciliary of the country that he left. In any case, the burden of proof is generally on the taxpayer to establish that his domicile has, or has not, changed.

Be mindful of clients who seek to establish domicile in the U.S. for transfer tax purposes but may be stuck in the tax regime of their original domicile. For example, in the United Kingdom, everyone acquires a “domicile of origin” at birth, although over time the jurisdiction in which a person is domiciled may change, if they either acquire a new “domicile of dependency” or a “domicile of choice.” There is also an additional category known as “deemed domicile” which applies to people who are long term resident in the United Kingdom (15 of the last 20 years) but who do not adopt a domicile of choice there. For purposes of clients who have been domiciled in the United Kingdom, it is hard to shake off a domicile of origin under the general law (as opposed to a deemed domicile status for tax purposes). However, it may be a longer period of time for those who had a UK domicile of origin. The non-dom legislation is a hot button in UK politics and changes to the law are frequent. For that reason, you should always seek the advice of local counsel.

In the face of conflicting evidence as to an individual’s domicile, U.S. choice-of-law rules favor the retention of the original domicile.<sup>15</sup> The Supreme Court has held that domicile is a question of state law, rather than federal law, such that an individual could demonstrate the requisite intent to establish domicile in a U.S. state under that state’s rules regardless of the individual’s federal immigration status.<sup>16</sup>

#### IV. Fiduciary Selection

Selection of potential fiduciaries for cross-border families can be difficult in terms of the practicality of appointing a trusted relative or friend who may not live in the same jurisdiction as the decedent or beneficiary. In addition, drafting attorneys should be aware of potential tax issues that might arise if a non-U.S. fiduciary is serving as trustee for a trust that is otherwise intended to be administered in the U.S. for the benefit of a U.S. beneficiary. Likewise, when establishing an inter vivos trust or a Will or revocable trust plan which will implement testamentary trusts at the settlor’s death, care should be taken when naming a relative who resides outside of the U.S. to not draw taxation in the jurisdiction of the trustee or beneficiary’s residence. Below are considerations when selecting fiduciaries.

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<sup>14</sup> See Tax Management Portfolio 837-4th: Non-Citizens — Estate, Gift, and Generation-Skipping Transfer Taxation, III.C.

<sup>15</sup> *E.g., Margani v. Sanders*, 453 A.2d 501 (Me. 1982).

<sup>16</sup> *Elkins v. Moreno*, 435 U.S. 647 (1978) (holding that federal law did not bar an individual present in the U.S. under a G-4 diplomatic visa from establishing a domicile in Maryland for the purposes of qualifying for in-state tuition rates at the state university).

## A. Foreign Fiduciaries

### 1. Foreign Trustees

From a U.S. income tax perspective, careful drafting is essential to avoid classification of a testamentary trust—whether created under a will or a revocable trust—as a foreign non-grantor trust. Section 7701(a)(30)(E) of the Internal Revenue Code defines a trust as a U.S. person if (i) a court within the United States is able to exercise primary supervision over the administration of the trust, and (ii) one or more United States persons have the authority to control all substantial decisions of the trust.<sup>17</sup> These are referred to as the court test and the control test. The Code defines a foreign trust in the negative: a trust is not a U.S. person (and therefore is a foreign trust) if it is a trust other than a U.S. trust.<sup>18</sup> A trust that fails either the court test or the control test will be a foreign trust.

Although most wills and revocable trusts are governed by the laws of a U.S. state—typically based on the testator’s domicile at the time of execution—the selection of fiduciaries plays a determinative role in the trust’s tax characterization. The mere inclusion of U.S. governing law is insufficient to ensure domestic status. Instead, the identity and residence of the trustees are pivotal. If a non-U.S. person is appointed as sole trustee, or if a foreign person is appointed alongside a U.S. person with equal decision-making authority requiring unanimity, the trust may fail the control test. Consequently, the trust will be characterized as a foreign trust, potentially subjecting U.S. beneficiaries to the burdensome throwback rules applicable to foreign non-grantor trusts where income is accumulated rather than distributed annually.<sup>19</sup>

Clients should be specifically advised of these consequences when naming non-U.S. fiduciaries, particularly where non-citizen clients wish to appoint close relatives—such as parents or siblings—as successor trustees. While this preference is understandable, particularly in cases where the client has yet to develop strong ties in the United States, it may inadvertently trigger adverse tax treatment. Rather than compelling the client to forego trusted foreign fiduciaries based solely on potential tax exposure, a more balanced approach involves incorporating a flexible trustee qualification clause. Such a provision can allow for the appointment of a U.S. co-trustee or successor trustee in circumstances where the presence of a foreign trustee would otherwise result in foreign trust classification.

### 2. Foreign Executors

For U.S. income tax purposes, an estate will be classified as a foreign estate if its income is derived from sources outside the United States and is not effectively connected with the conduct of a trade or business within the United States. This standard differs materially from the classification framework applicable to trusts, which relies on the satisfaction of both the “court test” and “control test” under Internal Revenue Code § 7701(a)(30)(E). In the context of estates, the residency of the executor does not, in itself, determine the estate’s status as domestic or foreign.

Accordingly, a foreign individual may serve as executor of a U.S. estate without causing the estate to be characterized as a foreign estate for income tax purposes. Nonetheless, from a practical standpoint, clients should be advised of the procedural considerations associated with appointing a nonresident executor. In particular, local law typically requires the designation of a resident agent for service of process on behalf of the estate if the named executor resides outside the state. Courts have increasingly permitted nonresident executors to participate in probate proceedings remotely, including appearances at initial hearings via virtual platforms. Alternatively, where permissible, the probate court may accept proof-of-death testimony from an individual other than the named executor—provided such individual possesses sufficient knowledge of the decedent—to facilitate the initiation of proceedings without necessitating the executor’s travel or in-person appearance.

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<sup>17</sup> IRC § 7701(a)(30)(E).

<sup>18</sup> IRC § 7701(a)(31)(B).

<sup>19</sup> To the extent the estate planning documents include fiduciaries in addition to the trustee, such as a protector, investment advisor, or distribution advisor, these roles can also have an effect on the control test and the individuals or entities selected for these positions should be reviewed carefully to determine whether the trust will be a U.S. trust at the death of the testator/settlor.

## V. Treaty Considerations

Where a client is a tax resident of the U.S. and also tax resident in a jurisdiction with a well-developed and robust tax regime—such as the United Kingdom, France, or Canada—it is critical to obtain competent tax advice in the foreign jurisdiction to ensure that U.S.-based estate or gift tax planning does not inadvertently trigger adverse tax consequences abroad. The risk of conflicting tax treatment is particularly acute in cross-border planning, and proper coordination with foreign counsel is essential to achieving a globally tax-efficient outcome.

If the foreign jurisdiction maintains an estate or gift tax treaty with the United States, the U.S. tax liability of an NRA may be mitigated or eliminated altogether. For example, certain bilateral treaties may permit a non-citizen surviving spouse to claim the full marital deduction otherwise denied under domestic U.S. law, while others may provide a credit mechanism designed to alleviate double taxation. However, estate and gift tax treaties are highly jurisdiction-specific and their terms vary widely. Thus, reliance on general principles without reference to the specific treaty language may yield misleading or incomplete conclusions.

Estate planners should also be mindful that the United States maintains estate or gift tax treaties with only a limited number of countries—currently 15—while it has income tax treaties with more than 60 jurisdictions. As such, for clients with international connections a preliminary review of applicable treaty protections should be a foundational step in the planning process.<sup>20</sup>

## VI. Bequests to Non-Citizen Spouses Using a QDOT

An important estate-planning mechanism for married U.S. citizens and residents is the unlimited estate-tax marital deduction for bequests to a surviving spouse. The value of property transferred to a surviving spouse is deducted from the deceased spouse's gross estate to arrive at the deceased spouse's taxable estate. However, the marital deduction is available only for transfers to surviving spouses who are U.S. citizens. If the surviving spouse is not a U.S. citizen, it is available only for transfers to a "qualified domestic trust" for the spouse's benefit (commonly referred to as a "QDOT"). A U.S. citizen or resident who uses a QDOT to leave property to a non-citizen spouse is permitted an estate-tax marital deduction for the value of the property transferred to the trust. A QDOT defers estate tax in the deceased spouse's estate by imposing estate tax on: (i) distributions of capital from the trust to the surviving spouse during his or her lifetime; and (ii) the value of the property remaining in the trust on the date of the surviving spouse's death.

### A. Qualifications

In general, to qualify as a QDOT, a trust must: (i) have at least one trustee who is a U.S. citizen or domestic corporation; and (ii) provide that no distribution (other than a distribution of income) may be made from the trust, unless the trustee who is a U.S. citizen or domestic corporation has the right to withhold from such distribution the estate tax described in the paragraph above. The deceased spouse's executor must also make an election on the estate tax return to treat the trust as a QDOT.

A "large QDOT" (one funded with assets having a value of more than \$2 million on the U.S. spouse's date of death) carries with it more cumbersome administrative requirements than a "small QDOT."<sup>21</sup> This is because the Code requires additional assurance that the IRS will be able to collect the tax from a large QDOT as opposed to a small QDOT. These collection assurances are provided by requiring a large QDOT to satisfy one of the following three so-called "Security Requirements": (i) a U.S. bank must serve as a trustee; (ii) the trustee must furnish a bond in favor of the IRS equal to 65% of the fair market value of the trust assets; or (iii) the trustee must provide the IRS with a letter of credit in an amount equal to 65% of the fair market value of the trust assets. By contrast, a small QDOT can satisfy the Security Requirements by merely containing provisions that prohibit the trust from holding foreign real estate.

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<sup>20</sup> Assuming DOGE hasn't deleted it, further information can be found on the IRS website at the following URLs:

<http://www.irs.gov/Individuals/International-Taxpayers/Tax-Treaties> and <https://www.irs.gov/businesses/small-businesses-self-employed/estate-gift-tax-treaties-international>.

<sup>21</sup> Treas. Reg. § 20.2056A-2(d).

Because of the more stringent Security Requirements on large QDOTs, it is preferable to maintain small-QDOT status if possible. For example, if the deceased spouse's estate consists of both U.S. and non-U.S. assets, and the surviving non-citizen spouse is not domiciled in the U.S., it might be desirable to leave only U.S.-situs assets to the QDOT and leave the foreign-situs assets to the surviving spouse outright or in a regular testamentary trust to keep the QDOT below the \$2 million limit. In calculating the \$2 million threshold, the executor of the decedent spouse's estate may elect to exclude up to \$600,000 in the value of real property (and related furnishings) that is used or held for the use of the surviving spouse as a personal residence, is owned directly by the QDOT, and passed or is treated as passing to the QDOT under the rules for the marital deduction when the surviving spouse is not a U.S. citizen.<sup>22</sup>

## B. QDOTs and Portability

QDOTs are available for testamentary transfers, but not for lifetime gifts.<sup>23</sup> A QDOT can be established via the deceased spouse's will or revocable management trust, but if the non-citizen spouse receives a spousal bequest outright, he or she can create or fund a QDOT with the outright bequest prior to the filing of the decedent's estate-tax return.<sup>24</sup> Making a QDOT election allows a non-citizen spouse to opt for portability subject to certain caveats. IRC §2010(c) allows the estate of a U.S. citizen or resident decedent who is survived by a spouse to make a portability election, which generally allows the surviving spouse to apply the decedent's deceased spousal unused exclusion ("DSUE") amount to the surviving spouse's own transfers during life and at death. However, for spouses who are not U.S. citizens, the final DSUE amount is subject to adjustments.<sup>25</sup> At the surviving spouse's death, or when the trust is terminated, the value of the DSUE is reduced by the value of the assets in the QDOT. This means that the non-citizen spouse benefits from portability to the extent that the value of the assets in the QDOT are less than the DSUE amount upon the trust's termination (which triggers estate tax liability). In addition, the non-citizen surviving spouse generally cannot use the DSUE to offset lifetime gifts while the QDOT is operating; however, the decedent's DSUE may be applied to the surviving spouse's taxable gifts made in the year of the surviving spouse's death or, if the terminating event occurs prior to the surviving spouse's death, then in the year of that terminating event and in any subsequent year during the surviving spouse's life.<sup>26</sup> If the surviving spouse becomes a U.S. citizen and if the requirements of §2056A(b)(12) and the corresponding regulations are satisfied, the QDOT tax ceases to apply; thus, the decedent's DSUE amount is no longer subject to adjustment.<sup>27</sup>

## C. Planning Considerations

The limitation on the availability of the marital deduction for transfers to non-citizen spouses does not alter the need for each spouse to have sufficient property in his or her own name before a spouse dies in order to utilize both spouse's respective unified credits. This planning requirement remains critical where one or both of the spouses is a not a U.S. citizen. Where both spouses are U.S. citizens, the process of rearranging the couple's assets—whether by outright gifts between spouses or by severance of jointly owned property—is relatively simple, because the unlimited marital deduction eliminates any adverse federal gift tax consequences. However, the unavailability of the unlimited federal gift tax marital deduction for transfers to non-citizen spouses and limitation to a \$100,000 super annual exclusion for gift transfers indexed for inflation (\$194,000 for 2026)<sup>28</sup> require careful planning in rearranging the couple's assets (See Section VII.B.3 to 5 for details). Equalization of each spouse's estate is less of a concern in light of the availability of the elective spousal portability provision for U.S. resident spouses and in community property states, if there are sufficient community assets.

Estate planners often adopt a default strategy of directing all assets to a marital trust in cases where the surviving spouse may be a non-citizen, with the intention that the trust will qualify as a QDOT. While this method

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<sup>22</sup> Instructions for Form 706-QDT (Rev. 9-2021).

<sup>23</sup> See Section VII.B.3. regarding limitations on gifts to non-citizen spouses.

<sup>24</sup> Treas. Reg. § 20.2056A-2(b)(2).

<sup>25</sup> Treas. Reg. § 20.2010-2(c)(4)(i).

<sup>26</sup> Treas. Reg. § 25.2505-2(d)(3)(i). See Treas. Reg. § 25.2505-2(d)(3)(iii) *Ex.*

<sup>27</sup> Treas. Reg. § 20.2010-2(c)(4)(ii). See Reg. § 20.2010-2(c)(5) *Ex.* 4.

<sup>28</sup> IRC § 2523(i)(2); Treas. Reg. § 25.2523(i)-1(a), (c)(2); Rev. Proc. 2023-24, 2023-48 I.R.B. 1287, §3.43(2).

offers a degree of protection in situations where the surviving spouse has not yet obtained U.S. citizenship, it may prove unnecessarily rigid or impractical if the couple's financial circumstances or estate planning objectives do not independently warrant the use of a marital trust. For clients without tax exposure or other compelling reasons to employ a marital trust structure, this default approach may impose undue complexity and administrative burden—particularly if the surviving spouse acquires U.S. citizenship by the time of the first spouse's death or within the nine-month period thereafter. In the most unfavorable scenario, a surviving non-citizen spouse could fail to establish a QDOT within the required timeframe or inadvertently access inherited property before recognizing the need for a QDOT. In such cases, the intended marital bequest would not qualify for the estate tax marital deduction, thereby subjecting the transferred assets to immediate estate taxation.

An increasingly favored alternative to the traditional marital trust structure is the use of a disclaimer trust designed with provisions enabling it to qualify as a QDOT, if necessary. This approach introduces greater post-mortem planning flexibility without committing the bequest to a trust structure that may ultimately be unnecessary. In light of the substantial increase in the federal estate and gift tax exemption over the past two decades—and particularly with the introduction of portability and the concept of the deceased spouse's unused exclusion (DSUE)—estate planners have moved away from rigid default planning models that direct bequests to a marital or credit shelter trust for non-taxable estates. While there remain valid personal and tax-driven reasons for leaving assets to a surviving spouse in trust, for clients who would otherwise prefer an outright distribution the disclaimer trust model accommodates this preference while preserving planning flexibility. Under this structure, the deceased spouse may leave all assets outright to the surviving spouse (or to a survivor's trust in the case of a joint revocable trust). Following the decedent's death, the surviving spouse may consult legal and tax advisors to determine whether to execute a qualified disclaimer, thereby funding the embedded disclaimer trust. This determination may be made for tax-related reasons—such as preserving the marital deduction via a QDOT—or for non-tax considerations, such as asset protection concerns or the incapacity of the surviving spouse, in which case an agent acting under a durable power of attorney may effectuate the disclaimer.

For plans that incorporate the option of a disclaimer trust, it is quite simple to add QDOT provisions that would allow the disclaimer trust to qualify as a QDOT in the event that the surviving spouse has not obtained U.S. citizenship or will not be able to within nine months of the deceased spouse's death.

## VII. U.S. Transfer Taxation of NRAs

At its core, estate planning primarily focuses on the desired disposition of the client's assets upon death. For estates with a value in excess of the then-applicable federal estate and gift tax exemption amount, the estate and gift tax issues attributable to the transfer of wealth during life and at death may usurp how the client would dispose of assets absent tax concerns. This concern is especially acute when the failure to properly structure the disposition of a citizen spouse's estate plan to his or her non-citizen surviving spouse could result in currently payable estate tax due to the unavailability of the full marital deduction.

A client seeking advice from an estate planning attorney will often be a resident for income tax purposes and arguably a U.S. domiciliary with access to the full federal estate and gift tax exemption. Accordingly, it may appear unnecessary to analyze the resulting gift and estate tax implications for NRAs. However, consider the possibility that the client, currently a resident and domiciliary of the U.S., moves his or her domicile outside of the U.S. in the future for any number of reasons. Due to this ever-present possibility for non-citizens, it is important to understand estate and gift tax implications of ownership of U.S.-situs property in the hands of an NRA. Negative estate tax implications can arise when a resident changes domicile while still owning certain U.S.-situs property at death. Gift tax implications may arise, for example, if the surviving spouse leaves the U.S. and attempts to gift U.S.-situs assets, perhaps to children who remain in the U.S., after losing his or her U.S. domicile (and full federal estate and gift tax exemption). More commonly, the gift tax rules applicable to NRAs are important to know when advising your client regarding planning techniques for receiving property from NRA parents. Later on, we will also address income tax considerations relevant to NRAs.

## A. Estate Taxation of NRAs

### 1. Imposition of Estate Tax

Unlike U.S. citizens and residents, who enjoy a \$10 million estate-tax exemption indexed for inflation (\$15,000,000 for 2026), as well as an unlimited estate-tax marital deduction that allows spouses to avoid estate tax on \$20 million of assets (indexed to \$30,000,000 for 2026), NRAs are allowed a mere \$60,000 exemption, which is not indexed for inflation and has not been increased in decades.<sup>29</sup> NRAs must therefore plan carefully for U.S.-situs property held at death.

A non-citizen spouse is also restricted in how he or she can use the deceased citizen spouse's unused exemption (DSUE) amount by means of a portability election. For estate planners who have grown accustomed to assuming that DSUE will be available to shield the surviving spouse's assets that exceed his or her own exemption amount, this assumption is not available for a non-citizen surviving spouse, absent the use of a QDOT or treaty relief where applicable.

### 2. Property Taxed

While NRAs are subject to gift tax only on transfers of U.S.-situs real property and tangible personal property, all property situated in the U.S. and owned at the death of the NRA is included in the NRA's U.S. taxable estate.<sup>30</sup> For estate tax purposes, U.S.-situs property includes the following, subject to a few exceptions where indicated.

#### a) U.S. Tangible Personal Property

Any tangible personal property (automobiles, furnishings, jewelry, etc.) physically located in the U.S. will be subject to estate tax.<sup>31</sup> Cash and currency are considered tangible personal property and will thus be taxable if located in the U.S. at the decedent's death.

#### b) U.S. Intangible Property

While intangible property transferred by an NRA during lifetime is not subject to gift tax, intangible property owned by an NRA at death is generally subject to U.S. estate tax.<sup>32</sup>

The following U.S. intangible assets are included in an NRA's U.S. estate:

- funds in bank or other brokerage accounts that are used in a U.S. trade or business
- qualified retirement plans held in the U.S.
- stock in domestic corporations
- life insurance policies held by the decedent on the life of another person, issued by a U.S. insurance company
- annuities on the life of another, issued by a U.S. insurance company

However, the following U.S. intangible assets are not included in an NRA's U.S. estate:<sup>33</sup>

- savings accounts, checking accounts, or certificates of deposit with a U.S. bank (if not used in a U.S. trade or business)
- funds held in a U.S. bank custody account
- funds deposited in a foreign branch of a U.S. bank

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<sup>29</sup> See IRC §2010(c), IRC §2056; Rev. Proc. 2023-34, 2023-48 I.R.B. 1287, §2.41; IRC §2102; IRC §6018.

<sup>30</sup> IRC § 2103; Treas. Reg. § 20.2103-1.

<sup>31</sup> Treas. Reg. § 20.2104-1(a)(2).

<sup>32</sup> Treas. Reg. § 20.2104-1(a)(4).

<sup>33</sup> Treas. Reg. § 20.2105-1.

- proceeds of a life insurance policy on the life of the decedent, owned by the decedent, and issued by a U.S. insurance company
- debt obligations and certain short-term OID obligations of a U.S. person that qualify for the portfolio interest exemption under Section 871(h).

c) U.S. Real Property

U.S. real property held directly by the NRA is included in the NRA's U.S. estate and includes land, buildings, fixtures, and improvements on the property.<sup>34</sup>

d) Certain Retained Interests<sup>35</sup>

U.S.-situs property that is gratuitously transferred by an NRA decedent while he is alive, by trust or otherwise, is includible in the decedent's estate if:

- the decedent retained for his life (or for a period that cannot be ascertained without reference to his death) some type of possession, control, or enjoyment of the property or its income, or the right to designate who will possess or enjoy the property;<sup>36</sup>
- possession or enjoyment of the property could be obtained only by surviving the decedent and the decedent retained a reversionary interest in the property that exceeds 5% of the value of the property at the time of the decedent's death;<sup>37</sup>
- the property was, on the date of the decedent's death, subject to his right to alter or revoke the transfer (or if such a power was relinquished by the decedent within three years of the date of his death);<sup>38</sup> or
- the decedent transferred within the three-year period prior to his death an interest in property that would have been included in his estate under any of the foregoing rules, **and if the property so transferred was situated in the U.S. at the time of the transfer or at the time of the decedent's death.** For this reason, it's best to transfer only non-U.S. assets to a trust structure and to ensure that the structure never acquires U.S. assets.<sup>39</sup>

e) Partnerships and Limited Liability Companies

The determination of the situs of a partnership or LLC interest for U.S. estate tax purposes is the subject of much debate, which is rooted in the history of partnership law. Partnerships originated in ancient Roman law, and when they emerged in English statutory law over a century ago, partnerships were viewed as aggregate-ownership vehicles (known as the "aggregate theory" of partnerships, where each partner owns a pro-rata interest in the partnership's operations and assets). But as limited partnerships and limited liability companies emerged as more evolved versions of general partnerships over the past century, partnership statutes also evolved to treat these entities as separate from their owners, and interests in the entity were treated as personal property (known as the "entity theory" of partnerships). U.S. estate taxation of an NRA's interest in a partnership or LLC can be summarized under each of these theories as follows.

- **Aggregate Theory.** Because this approach views a partnership interest as pro-rata ownership of the partnership's underlying assets, the place of organization of the partnership is irrelevant, and we must look to the situs of the partnership's property to determine the situs of a partner's interest.

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<sup>34</sup> Treas. Reg. § 20.2104-1(a)(1).

<sup>35</sup> IRC § 2104(b).

<sup>36</sup> See IRC § 2036.

<sup>37</sup> See IRC § 2037.

<sup>38</sup> See IRC § 2038.

<sup>39</sup> See IRC § 2035.

- Entity Theory. Because this approach treats the partnership as an entity separate from its partners, we must look to (i) the location where the partnership conducts its business, or (ii) the residency of the partnership for income tax purposes (i.e., its place of organization) to determine the situs of a partner's interest in the entity.

Generally, a partnership interest is deemed to be a U.S.-situs asset if: (i) the partnership does not qualify as a separate legal entity under the law of the jurisdiction where it was established, or is dissolved on the death of one partner, and the underlying assets of the partnership are situated in the U.S.; or (ii) the partnership is a separate legal entity under the laws of the jurisdiction where it was established, it survives the death of a partner, and the partnership carries out its business in the U.S.<sup>40</sup>

In the past, the IRS has not suggested that the aggregate theory should be applied to the question of the situs of a partnership interest for purposes of applying transfer taxes to a gift or to the estate of an NRA. However, very little guidance is available to instruct advisors on how the interests will be characterized, and therefore caution must be taken when planning. Some very outdated pronouncements indicate that the IRS seems to favor the use of the entity theory to determine the situs of the partnership interest based on where the entity itself is engaged in business.<sup>41</sup> However, the location of a partnership's business is a facts-and-circumstances determination. And still other authorities prefer a look-through theory to determine the situs of the partnership interest based on the location of the assets.<sup>42</sup>

Because uncertainty exists with regard to partnership interests (and interests in LLCs that are taxed as partnerships), an NRA should plan conservatively by assuming that any U.S. connection will cause the partnership or LLC interest to be considered a U.S.-situs asset.

### 3. Jointly-Owned Property

#### a) Joint Ownership with a Non-Spouse

For U.S. citizens who hold property in a non-spousal joint tenancy with right of survivorship, the general "consideration furnished rule" presumes that the value of the entire jointly-owned asset is included in the gross estate of the first joint tenant to die unless the surviving tenant or tenants can prove that they provided adequate and full consideration for their share of the joint tenancy.<sup>43</sup> In that case, the value of the joint tenancy that is proportionate to the consideration furnished by the surviving joint tenants will be excluded from the decedent-joint tenant's estate. There is an exception where the entire property was acquired by all of the joint tenants at the same time in the form of a gift, bequest, devise, or inheritance; in that case, the value included in a decedent-joint tenant's estate is his fractional share of the property.<sup>44</sup>

The consideration-furnished rule applies to all non-spousal joint tenancies regardless of citizenship, and if the property is U.S.-situs property, it will be subject to estate tax in the hands of an NRA decedent up to the amount of consideration that the NRA furnished.

#### b) Joint Ownership with a Non-Citizen Spouse

For tenancies in which the only two tenants are spouses and U.S. citizens, only one-half of the value of the joint tenancy or tenancy by the entirety is included in the decedent's estate, and the passage of the deceased spouse's interest to the surviving spouse by right of survivorship will be covered by the estate-tax marital deduction.<sup>45</sup> This is

<sup>40</sup> See *Sanchez v. Bowers*, 70 F.2d 715 (2d. Cir. 1934); Rev. Rul. 55-701, 1955-2 C.B. 836.

<sup>41</sup> Rev. Rul. 55-701, 1955-2 C.B. 836; see also G.C.M. 16164, XV-1 C.B. 363 (1936), *rev'd* by G.C.M. 18718, 1937-2 C.B. 476 (later declared obsolete by Rev. Rul. 70-59, 1970-1 C.B. 280, which applied the entity theory to partnership interests).

<sup>42</sup> *Sanchez v. Bowers*, 70 F.2d 715 (2d. Cir. 1934). See Richard A. Cassell, Michael J.A. Karlin, Carlyn S. McCaffrey, and William P. Streng, "U.S. Estate Planning for Nonresident Aliens Who Own Partnership Interests," Tax Notes Int'l, Aug. 11, 2003, p. 563, Doc 2003-14517, or 2003 WTD 154-13.

<sup>43</sup> IRC § 2040(a).

<sup>44</sup> *Id.*

<sup>45</sup> IRC §§ 2040(b), 2056(a).

known as the “50-50 rule.” However, if the surviving spouse is not a U.S. citizen, the 50-50 rule does not apply, and the consideration-furnished rule applies instead.<sup>46</sup>

Consider planning for the marital assets of Wife who is not a U.S. citizen and Husband who is a U.S. citizen. If the non-citizen spouse, Wife, dies first, the 50-50 rule applies, and one-half of the value of assets held jointly with Husband will be included in Wife’s estate, regardless of who provided the funds for such assets. However, if Husband is the first to die, leaving a non-citizen surviving spouse, the default consideration-furnished rule applies, meaning that Wife will have to prove the source of funds for any jointly-held assets to determine the portion of those assets to be included in Husband’s gross estate. Furthermore, Husband’s share of the joint property passing to Wife will not be eligible for the marital deduction.

With regard to how these rules will apply to U.S. assets versus non-U.S.-situs assets, the answer again differs depending on who dies first and whether the non-citizen spouse is also a non-resident for estate tax purposes. If the U.S. citizen, Husband, dies first, both U.S.- and non-U.S.-situs assets will be implicated because his gross estate includes worldwide assets. If the non-citizen Wife dies first and if she is also a non-resident, the only joint tenancy assets that will be included in her U.S. gross estate are U.S.-situs assets.

Due to the wide variance in the tax treatment depending on which spouse will die first, where the couple’s property is located, and whether the non-citizen spouse is a resident or a non-resident for transfer tax purposes, we do not recommend creating joint-tenancy property with a non-citizen spouse.<sup>47</sup>

## B. Gift Taxation of NRAs

### 1. Property Transfers Subject to Gift Tax

The U.S. gift tax generally applies to gratuitous transfers of property made during the donor’s lifetime. For U.S. citizens and non-citizen residents,<sup>48</sup> the gift tax applies to gratuitous transfers of any property, wherever situated.<sup>49</sup> For NRAs, the gift tax applies only to gratuitous transfers of U.S.-situs real and tangible personal property. This presents planning opportunities for NRAs if they receive advice prior to moving their domicile to the U.S.

Gifts of intangible U.S.-situs property by NRAs are not subject to U.S. gift tax.<sup>50</sup> Unfortunately, “intangible property” is not exhaustively defined in the Internal Revenue Code or the Treasury Regulations, an omission which has led to a great deal of uncertainty for NRAs and their U.S. tax and estate-planning counsel. However, it is clear that the following types of property are intangible property, and therefore not subject to gift tax:

- Stock in a domestic corporation<sup>51</sup>
- Debt obligations, including bank deposits, issued by a U.S. borrower<sup>52</sup>

Physical currency (bank notes and coins, i.e., “cash”) is considered tangible personal property for gift tax purposes.<sup>53</sup> Therefore, advisors should caution their NRA clients with regard to transfers that could be construed as

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<sup>46</sup> IRC §§ 2056(d)(1)(B), 2040(b)(2)(B).

<sup>47</sup> For further explanation of these complicated rules as they relate to the estate tax consequences of joint tenancies, see PLR 9551014.

<sup>48</sup> Although the test for transfer-tax purposes is one of “domicile,” rather than “residence,” as described in Section III.C. above, we will refer to “residence” here for ease of discussion. And the term “NRA” in this Section will mean a non-U.S. domiciliary.

<sup>49</sup> IRC §§ 2501(a), 2511(a).

<sup>50</sup> IRC § 2501(a)(2).

<sup>51</sup> Treas. Reg. § 25.2511-3(b)(3).

<sup>52</sup> Treas. Reg. § 25.2511-3(b)(4); see also *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995); *Gade Est. v. Comm’r*, 10 T.C. 585 (1948); *Fabbricotti Fara Forni Est. v. Comm’r*, 47 BTA 76 (1942).

<sup>53</sup> *Blodgett v. Silberman*, 277 U.S. 1, 48 S. Ct. 410 (1928).

cash gifts, including the transfer of a U.S. safe deposit box holding cash<sup>54</sup> and writing a check from a U.S. bank account.<sup>55</sup>

The guidelines for wire transfers from a U.S. bank remain muddy. Though some commentators believe that a wire transfer is intangible property because it is an obligation of the bank to electronically shift the deposit from one bank to another with no physical transfer from the donor to the donee, it would be less risky to use another method to transfer ownership of a bank's obligations (for instance, by transferring an actual certificate of deposit in-kind to the donee).<sup>56</sup>

It is also unclear whether transferring ownership of a bank deposit account, which is definitively intangible property, will be characterized as a taxable transfer. This is because the bank, rather than simply changing the name on the account, might instead move the funds into a newly-created account in the name of the donee, inadvertently converting the "bank deposit" into cash en route. Generally, it would be safest to have the NRA move funds to an offshore account and wire the funds to the donee from there. Alternatively, the NRA may use the cash to invest in an intangible form of property such as equities (stock in a domestic corporation) or U.S. Treasury bills (debt obligations).

With regard to partnership interests, the IRS has stated that it will not rule on the issue of whether they should be treated as intangible property for gift tax purposes.<sup>57</sup>

## 2. Gift Tax Exclusions, Unified Credit, and Imposition of Tax

NRAs can make tax-free transfers of U.S.-situs real property and tangible personal property up to the applicable annual-exclusion amount of \$10,000 per donee, per year, indexed for inflation (\$19,000 for 2026).<sup>58</sup> Gifts of U.S. real estate and tangible personal property by an NRA that exceed the annual exclusion amount will be subject to current gift taxation, because NRAs do not receive the benefit of the unified estate and gift tax credit that allows U.S. citizens and residents to avoid paying gift tax during life through the "pre-use" of their estate-tax exemption via lifetime gifting. However, NRAs can make unlimited charitable gifts and gifts on behalf of donees directly to educational and medical institutions.<sup>59</sup>

If gift tax is imposed during the donor's lifetime, the tax is calculated at a progressive rate schedule, and gifts are accumulated over the lifetime of the taxpayer.<sup>60</sup> The calculation of the tentative gift tax requires computing the tax on the aggregate sum of the taxable gifts for that year and for each of the preceding calendar periods, and dividing that tentative tax by the tentative tax on the aggregate sum of the taxable gifts for the preceding calendar periods.<sup>61</sup> Taxable transfers by NRAs are subject to gift tax at rates ranging from 18% to a maximum 40%, and the result of the cumulating lifetime gifts means that taxable gifts made in subsequent years will be taxed at increasingly higher rates up to the maximum rate of 40%.

## 3. Gifts to Spouses

In general, there is an unlimited deduction from gift tax for transfers made to spouses. However, this does not apply to gifts made to a spouse who is not a U.S. citizen.<sup>62</sup> Gifts to non-citizen spouses are limited to a special "super annual exclusion" amount of \$100,000 per year, indexed for inflation (\$194,000 for 2026).<sup>63</sup> Note that the taxation of

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<sup>54</sup> Rev. Rul. 55-143, 1955-1 C.B. 465.

<sup>55</sup> GCM 34845 (4/17/72); GCM 36860 (9/24/76).

<sup>56</sup> See Aballi, Arturo, "Gifts of Certain Intangible Property by Foreign Persons—Principles, Pitfalls, and Planning Opportunities," *Estates, Gifts and Trusts Journal* (March 8, 2012).

<sup>57</sup> Rev. Proc. 2014-7, 2014-1 I.R.B. 238, §4.01(28).

<sup>58</sup> See §2503(b); Rev. Proc. 2023-24, 2023-48 I.R.B. 1287, §3.43(1).

<sup>59</sup> IRC §§ 2503(b), 2503(e), 2522(b).

<sup>60</sup> IRC § 2001(c).

<sup>61</sup> IRC § 2502(a).

<sup>62</sup> IRC § 2523(i)(1).

<sup>63</sup> IRC § 2523(i)(2); Treas. Reg. § 25.2523(i)-1(a), (c)(2); Rev. Proc. 2023-24, 2023-48 I.R.B. 1287, §3.43(2).

gifts of U.S.-situs property between spouses depends entirely on the **citizenship** of the **donee** spouse (not the domicile of the donor). Thus, a non-citizen spouse could make unlimited gifts of U.S.-situs real and tangible personal property to a citizen spouse, but not the other way around.

#### 4. Spousal Gift-Splitting

As mentioned above, for gifts to non-spouses, an NRA is limited to the regular annual exclusion amount of \$10,000 per year, indexed for inflation (\$19,000 for 2026).<sup>64</sup> Spouses are typically allowed to “split” gifts of non-community property made to third parties, which means that both annual exclusions are applied to a single gift, thereby doubling the total annual exclusion available per donee.<sup>65</sup> However, gift-splitting is not available where one of the spouses is a non-resident (unless a gift tax treaty provides otherwise).<sup>66</sup> Gift-splitting is available if either (or both) of the spouses is a non-citizen, but both spouses must be U.S. residents for transfer tax purposes.<sup>67</sup>

A nonresident surviving spouse who was not a citizen of the United States at the time of making a transfer subject to gift tax shall not take into account the DSUE amount of any deceased spouse except to the extent allowed under any applicable treaty obligation of the United States.<sup>68</sup>

#### 5. Creation of Jointly-Owned Property

##### a) General Rule: Joint Ownership with Non-Spouse

The general rule with regard to the creation of a joint tenancy in property where one party provides all or a disproportionate share of the consideration for that property is that the donor will have made a gift to the donee to the extent that the donee did not provide full consideration for his interest.<sup>69</sup> Assuming that the laws of the jurisdiction where the property is located allow a joint tenant to unilaterally sever his interest, the value of each person’s interest in the property is his proportionate share; otherwise value is determined on an actuarial basis (i.e., each joint tenant’s likelihood of surviving the other joint tenant). As with any other gift, the value of the transfer of an undivided interest in property is reduced, for gift-tax purposes, by the annual-exclusion amount.

For example, assume that a father purchases real property for \$100,000 and titles it in the names of himself and his daughter, as joint tenants. Daughter does not furnish any consideration for the purchase of the property. Daughter has received an undivided one-half interest in the property, valued at \$50,000 at the time of the transfer. Assuming the jurisdiction allows unilateral severance of each tenant’s interest, the interests are valued on a pro-rata basis (50%) rather than on an actuarial basis. The father may exclude the annual exclusion amount (\$19,000 for 2026) from the value transferred (\$50,000), so the taxable gift is \$31,000.

##### b) Joint Ownership with Non-Citizen Spouse

The above gift tax treatment for the creation of joint tenancies differs when the joint tenants are spouses. Prior to the enactment of the unlimited gift-tax marital deduction by the Economic Recovery Tax Act of 1981,<sup>70</sup> the creation of a spousal joint tenancy with right of survivorship or a tenancy by the entirety had gift-tax consequences in accordance with the general rules applicable to non-spousal joint tenancies. But with the enactment of the unlimited gift-tax marital deduction, such transactions between citizen spouses have no gift tax consequences, and so the Internal Revenue Code

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<sup>64</sup> IRC § 2503(b).

<sup>65</sup> IRC §2513.

<sup>66</sup> IRC §2513(a)(1).

<sup>67</sup> *Id.*

<sup>68</sup> Treas. Reg. § 25.2505-2(f).

<sup>69</sup> Treas. Reg. § 25.2511-1(h)(5).

<sup>70</sup> P.L. 97-34.

sections which provided guidance on spousal joint tenancies were repealed.<sup>71</sup> However, gifts to non-citizen spouses remain subject to gift tax, and so we must look for guidance to Treasury Regulations that refer to these repealed statutes.

### (1) Real Property

For joint tenancies in real estate, where the donee spouse is a non-citizen, the creation of the joint tenancy (and additional improvements to the property) is not a taxable gift, regardless of the proportion of the consideration furnished by each spouse.<sup>72</sup> However, if the joint tenancy terminates, other than by reason of the death of a spouse (which may have estate-tax consequences, discussed above), a taxable gift occurs to the extent that the non-citizen donee spouse receives proceeds that are not proportionate to the amount of the consideration that such spouse furnished.<sup>73</sup>

Consider the following example: A non-citizen Husband and his non-citizen Wife take title to U.S.-situs real property, creating a joint tenancy with right of survivorship. If Husband paid \$350,000 for the real property and took title in the names of both Husband and Wife as joint tenants, there will be no gift tax upon the purchase. If, however, the couple sells the property for \$500,000, and the proceeds are distributed equally to both Husband and Wife, Husband is deemed to have made a gift of one-half of the proceeds (\$250,000) to Wife. The annual exclusion amount (\$194,000 for gifts to a non-citizen spouse in 2026) will be excluded from the proceeds for purposes of calculating the gift tax, assuming that the exclusion has not already been used for prior gifts to Wife that year. Thus, \$56,000 of Wife's proceeds will be subject to gift tax, and Husband must report the gift on a Form 709.

As a result, a joint tenancy or tenancy by the entirety cannot be used as a disguise to transfer property to a non-citizen spouse on a tax-free basis because gift tax will arise if the tenancy is terminated before the death of the donor spouse. If the tenancy terminates due to death, there may be estate-tax consequences, described in more detail in Section VII.A.3.

### (2) Personal Property

Unlike spousal joint tenancies in real property, which are subject to gift tax on the termination of the joint tenancy, spousal joint tenancies with a non-citizen spouse in personal property are subject to tax upon creation.

The Treasury Regulations state that the creation of a spousal joint tenancy with a non-citizen spouse in personal property results in each spouse retaining a one-half interest in the property.<sup>74</sup> Treating each spouse as retaining a one-half interest in the property avoids the need to calculate the actuarial value of each spouse's interest; instead, where the consideration is entirely furnished by the donor spouse, it's treated as a gift of one-half of the total value of the property, and taxed accordingly after application of the annual exclusion amount (\$194,000 for gifts to a non-citizen spouse in 2026). At termination of the joint tenancy (other than by death), no gift tax is imposed as long as the proceeds are distributed 50/50.

#### C. Generation-Skipping Transfer Taxation of NRAs

Generation-skipping transfer ("GST") tax generally applies to certain transfers to "skip persons." In very general terms, skip persons are those who are assigned to a generation that is two or more generations below the donor, or if the donor and donee are not closely related, a skip person is a donee who is more than 37½ years younger than the donor.<sup>75</sup> However, GST tax will not apply to gifts or bequests made by NRAs to skip persons if the gift or bequest

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<sup>71</sup> Treas. Reg. § 25.2523(i)-2, promulgated under former §§ 2515; 2515A (repealed) (the current Section 2515 is a generation-skipping transfer tax provision).

<sup>72</sup> Treas. Reg. § 25.2523(i)-2(b)(1).

<sup>73</sup> Treas. Reg. § 25.2523(i)-2(b)(2). The rules differ for pre-July 1988 transfers. *See* Treas. Reg. § 25.2523(i)-2(ii).

<sup>74</sup> Treas. Reg. § 25.2523(i)-2(c) (note the exception for property in which the fair market value cannot be determined without reference to the life expectancy of one or both spouses).

<sup>75</sup> IRC §§ 2613, 2651(d).

is not subject to U.S. gift or estate tax.<sup>76</sup> Therefore, transfers of non-U.S. property from an NRA to a U.S. person will not incur GST tax.

To the extent that GST tax applies, NRAs are allowed a \$1,000,000 GST tax exemption on GST taxable transfers.<sup>77</sup> The Treasury Regulations set the GST tax exemption at \$1,000,000 for both residents and nonresidents in 1995; since then, the exemption amount was increased for residents, but the Regulations for nonresidents have not been amended. Commentators have noted that the Treasury presumably intended for the GST tax exemption for NRAs to track the exemption for residents. Therefore, it's likely that the IRS would recognize a \$10,000,000 GST tax exemption, indexed for inflation (\$15,000,000 for 2026).<sup>78</sup>

## VIII. U.S. Income Taxation of NRAs

While an estate planner will primarily focus on estate taxation at death and potentially navigating tricky gift tax scenarios during life, estate planning is a good opportunity to review a client's balance sheet and to issue spot with respect to any income tax traps that might lead to unexpected tax reporting or compliance failures. This is particularly true where the client is a non-citizen and currently a U.S. resident, but whose domicile may change. Clients who are accustomed to a certain income tax regime while they are U.S. residents may not be fully aware of the implications of their ownership of U.S.-income producing assets in the event they return to their home country or their transfer tax domicile changes based on life circumstances in any given tax year. This issue can be especially dire with respect to ownership of U.S. real property, as addressed in more detail in the FIRPTA section below.

In general, an NRA is taxable only on certain types of U.S.-source income. A great deal of case law and volumes of treatises deal with navigating the source rules for determining whether income is derived from U.S. sources or foreign sources, especially where activities are conducted by an NRA or foreign corporation in the U.S. through an agent.<sup>79</sup> For our purposes, we will not delve into determining the source of income, but will focus on the taxability of different types of U.S.-source income in the hands of NRAs.

### A. Effectively Connected Income ("ECI")

Foreign taxpayers' income that is "effectively connected with a U.S. trade or business" (referred to as "effectively-connected income" or "ECI") is taxed at graduated rates on a net-income basis (rather than at a flat rate on a gross basis, as with FDAP income discussed below).<sup>80</sup>

An NRA will be considered engaged in a U.S. trade or business if his activities (or those of his agents) in the U.S. are "considerable . . . as well as continuous and regular."<sup>81</sup> For example, owning rental real property may qualify as a trade or business if it is managed regularly, systematically, and continuously.<sup>82</sup> It can qualify as a trade or business even if the foreign person hires a U.S. manager to handle the rental activities. On the other hand, if the foreign person rents out the U.S. real property but is not in the "business of renting," the property will be considered an investment, rather than a rental business, and any rental income will thus be considered FDAP income (described below).

### B. FDAP Income

An NRA's U.S.-source income that is "fixed, determinable, annual, or periodic" ("FDAP" income) is subject to a flat 30% tax on gross income, or a lower rate if an income tax treaty applies (which will typically reduce the rate from 15% to as little as 5%). The 30% tax is collected through withholding at the source of the income (e.g., the bank paying the interest; the U.S. corporation paying a dividend). In general, FDAP income consists of interest, dividends,

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<sup>76</sup> Treas. Reg. § 26.2663-2(a).

<sup>77</sup> *Id.*

<sup>78</sup> Federal Tax Coordinator 2d., ¶R-9528, "Application of GST tax to transfers by nonresident aliens (NRAs)."

<sup>79</sup> *Lewenhaupt v. Comm'r*, 20 T.C. 151 (1953); *See* IRC § 861-865.

<sup>80</sup> IRC § 871(b) (for individuals); IRC § 882 (for corporations).

<sup>81</sup> Rev. Rul. 70-424, 1970-2 C.B. 150; IRC § 864; Treas. Reg. § 1.864-2; *Pinchot v. Comm'r*, 113 F.2d 718, 719 (2d Cir. 1940).

<sup>82</sup> *Alvary v. United States*, 302 F.2d 790 (2d Cir. 1962).

rents, and royalties that are not effectively connected with a U.S. trade or business (i.e., passive investment income).<sup>83</sup> That being said, there are two broad categories of investment income that fall outside of the FDAP withholding regime: interest and capital gains, discussed below.

### C. Portfolio Interest & Bank-Deposit Interest

Two forms of U.S.-source investment income received by an NRA that are not subject to U.S. tax are portfolio interest and interest on U.S. bank deposits.<sup>84</sup> The portfolio interest exemption is aimed at helping U.S. borrowers compete with foreign borrowers for loans from foreign lenders, who, without the portfolio interest exemption, would be subject to 30% withholding on all interest paid by the U.S. borrower. Similarly, the bank-deposit interest exemption helps U.S. banks compete with foreign banks for non-U.S. customers.

Bank-deposit interest is self-explanatory, but portfolio interest requires a bit more explanation. Foreign lenders can take advantage of the portfolio interest exemption only if: (i) the obligation is in registered form (i.e., it cannot be in “bearer” form); and (ii) the U.S. borrower obtains a statement that the beneficial owner of the obligation is not a U.S. person.<sup>85</sup> The registration requirement can be met with a “book entry” system, whereby the issuer maintains a record of ownership of the obligation.<sup>86</sup> The interest payable on the obligation cannot be contingent (e.g., based on the value of the debtor’s property or cash flow),<sup>87</sup> and in the case of a corporate or partnership borrower, the lender cannot own 10% or more of the borrower’s stock, capital, or voting power.<sup>88</sup>

### D. Capital Gains (Non-Real Estate)

Capital gains received by an NRA from the sale of U.S.-situs property are not subject to U.S. tax, as long as such gains are not attributable to property that is effectively connected with a U.S. trade or business (ECI, as discussed above) or gains from the disposition of U.S. real property interests (discussed below).<sup>89</sup>

### E. Capital Gains (Real Estate)

The Foreign Investment in Real Property Tax Act of 1980 (“FIRPTA”)<sup>90</sup> created an exception to the general rule that NRAs are not subject to tax on U.S.-source capital gains. FIRPTA treats an NRA’s gain (or loss) from the sale or exchange of a U.S. real property interest (“USRPI”) as if the NRA was engaged in the conduct of a trade or business in the U.S. and the gain (or loss) was effectively connected with such trade or business.<sup>91</sup> In other words, FIRPTA treats U.S. real-estate gains as ECI.

A USRPI is defined as (1) an interest in U.S. real property, which includes: (i) land and buildings or other improvements on the land; (ii) growing crops and timber and mines, wells, and other natural deposits that have not been severed or extracted from the land; (iii) “shared appreciation loans” (i.e., loans with direct or indirect rights to share in appreciation in value, gross or net proceeds, or profits from real property); and (2) an interest in a U.S. corporation that was a “U.S. real property holding corporation” (“USRPHC”) at any time during the shorter of the 5-year period preceding the sale or the taxpayer’s holding period.<sup>92</sup>

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<sup>83</sup> IRC §§ 871(a), 881(a). *But see* IRC §§ 871(d) and 882(d), which allow an NRA to elect to treat real property income as ECI even if it would not otherwise be ECI. This “net election” permits net taxation at graduated rates instead of 30% FDAP withholding on gross income.

<sup>84</sup> IRC §§ 871(h), (i), 881(c), (d).

<sup>85</sup> IRC § 871(h)(2)(B).

<sup>86</sup> Joint Comm. Staff, Tech. Expln. of the Revenue Provisions contained in Senate Amendment 3310, the Hiring Incentives to Restore Employment Act, under Consideration by the Senate (JCX-4-10), 2/23/2010, p. 52-53.

<sup>87</sup> IRC § 871(h)(4).

<sup>88</sup> IRC § 871(h)(3).

<sup>89</sup> IRC § 871(a)(1).

<sup>90</sup> P.L. 96-499.

<sup>91</sup> IRC § 897.

<sup>92</sup> IRC § 897(c); Treas. Reg. § 1.897-1(d)(2).

A USRPHC is any corporation in which the fair market value of its USRPIs equals or exceeds 50% of the fair market value of such corporation's: (i) USRPIs; (ii) its interests in real property located outside of the U.S.; and (iii) any of its other assets which are used or held for use in a trade or business.<sup>93</sup>

A USRPI does NOT include (1) an interest in real property held solely as a creditor;<sup>94</sup> (2) a mortgage loan at a fixed or variable rate of interest (such as prime, LIBOR, etc.) that is not principally tied to the fluctuation of the value of real property;<sup>95</sup> or (3) an interest in a real estate investment trust ("REIT"), provided that the REIT is (i) "domestically controlled," (ii) not a USRPHC, or (iii) publicly traded and the foreign shareholder owned less than 5% in the last five years.<sup>96</sup>

FIRPTA applies a look-through rule for partnerships and trusts holding a USRPI. An interest in a partnership is a USRPI if 50% or more of the value of the partnership's gross assets are USRPIs and 90% or more of the value of the gross assets of the partnership consists of USRPIs plus cash or cash equivalents where gain on the disposition is attributable to USRPIs.<sup>97</sup> Gains from the sale or exchange of foreign taxpayers' interests in partnerships, trusts, or estates that hold USRPIs are treated as received from the sale or exchange of USRPIs to the extent attributable to such USRPIs.

In order to collect the taxes imposed on foreign investors, FIRPTA imposes a withholding scheme in which 15% of the **amount realized** on the disposition of a USRPI must be withheld by the transferee, regardless of the amount of the foreign person's gain.<sup>98</sup> If, at the end of the year, the amount withheld would not actually be owed, the foreign person can then file a U.S. income tax return (using Form 1040NR, Form 1041, or Form 1120F, as appropriate) to calculate any tax due, and may receive a credit or a refund for amounts withheld.<sup>99</sup> Excess withholding can be avoided based on the maximum tax.<sup>100</sup> Some states also require withholding on a sale of real estate by a nonresident.

FIRPTA withholding does not apply to the following:<sup>101</sup>

- sales of property for less than \$300,000 if such property will be the transferee's residence (this amount has not been increased to adjust for inflation in the past 30+ years);<sup>102</sup>
- sales of publicly-traded stock where the seller owns no more than 5% of the total stock;
- sales for which the seller provides a non-foreign affidavit;
- sales for which the seller provides a non-U.S. real property holding company affidavit; or
- situations in which withholding is required under the partnership withholding rules of Section 1446 (i.e., the partnership withholding rules trump the FIRPTA withholding rules).

Until 2023, the prevailing view among practitioners was that, for purposes of determining whether a foreign person owns 5% or less of a USRPHC's stock to fall within the publicly-traded stock exemption, one must look through any partnership (whether foreign or domestic) to identify its foreign partners and calculate their indirect ownership of the stock. This interpretation was grounded in Reg. § 1.897-1(c)(2)(iii), which focuses on the "beneficial ownership" of USRPHC stock. However, a recent general legal advice memorandum (referred to as "GLAM") issued by the IRS

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<sup>93</sup> IRC § 897(c)(2).

<sup>94</sup> Treas. Reg. § 1.897-1(c), (d).

<sup>95</sup> Treas. Reg. § 1.897-1(d)(2)(ii)(D).

<sup>96</sup> IRC § 897(h).

<sup>97</sup> Temp. Reg. § 1.897-7T(a); Notice 88-72, 1988-2 CB 383.

<sup>98</sup> IRC § 1445(a); see also IRC § 1445(c)(4) which reduces withholding to 10% where amount realized on a residence does not exceed \$1,000,000.

<sup>99</sup> Treas. Reg. § 1.1445-1(f)(1).

<sup>100</sup> See IRS Form 8288-B; Rev. Proc. 2000-35.

<sup>101</sup> See IRC § 1445(b).

<sup>102</sup> The seller may still be subject to U.S. tax on the sale, but FIRPTA withholding does not apply (e.g., a vacation home that was a rental property for the NRA seller but will be used as a personal residence by the buyer).

marked a departure from this approach.<sup>103</sup> In that memorandum, the IRS treated a partnership as a separate entity, and thus as the relevant shareholder, for purposes of applying the 5% ownership test. In the scenario discussed, a partnership held 8% of a USRPHC's stock, which was regularly traded on an established securities market. A foreign individual, NRA, held no direct interest in the USRPHC but owned a 25% stake in the partnership. When the partnership sold all of its USRPHC stock in a taxable transaction, the Chief Counsel's Office concluded that, because the partnership held more than 5% of the stock, the 5% exemption did not apply. As a result, the gain from the sale was allocated proportionately to all the partners, including NRA, who had only a 2% indirect economic interest in the USRPHC stock.

As stated above, under FIRPTA, an NRA's gain on the sale of a USRPI or certain gains from interests in a USRPHC are treated as income effectively connected with a U.S. trade or business.<sup>104</sup> This ECI is taxed at regular U.S. income tax rates on a net basis. If the USRPI is a capital asset in the hands of a foreign individual, the gain will be eligible for the lower capital gains rates if the asset is held for over a year. If the USRPI is held by a foreign corporation, it will be subject to regular corporate income tax rates (as corporations do not get the benefit of lower capital gains rates).

## IX. U.S. Estate & Income Tax Planning for NRAs

Due to the limited \$60,000 estate tax exemption available to NRAs, the ownership of U.S.-situs assets by such individuals can result in substantial and potentially punitive estate tax liability. Accordingly, U.S. transfer tax exposure often predominates in planning strategies for NRAs, with income tax considerations taking a secondary role. However, the planning techniques that are effective for mitigating transfer tax liability may not always yield favorable income tax outcomes, and vice versa. This tension is particularly pronounced where a non-citizen is classified as a U.S. resident for income tax purposes but remains a non-domiciliary for transfer tax purposes—an increasingly common and complex scenario. While a full analysis of that issue is beyond the scope of this paper, for present purposes it is assumed that the individual is a nonresident alien for both income and transfer tax purposes.

As discussed below, the most widely used strategy to mitigate U.S. estate tax exposure is for an NRA to hold U.S.-situs property through a foreign corporation. Because stock in a foreign corporation is not treated as U.S.-situs property, it is excluded from the NRA's gross estate for U.S. estate tax purposes. Nevertheless, this structure carries its own set of drawbacks, particularly with respect to income taxation and basis adjustments upon death or transfer. These disadvantages must be weighed against the benefits on a case-by-case basis. What follows is a comparative analysis of the principal ownership structures available to NRAs investing in U.S. property, with particular attention to basis considerations, the use of foreign versus domestic corporations, tiered structures, foreign trusts, and the implications for U.S. beneficiaries inheriting interests in foreign entities.

### A. Income Tax & Basis Considerations

A discussion of optimal ownership structures for NRAs should also consider an analysis of the income tax consequences to U.S. beneficiaries upon a subsequent disposition of assets received by gift or bequest. Under the Internal Revenue Code, property acquired by gift generally carries over the donor's basis, whereas property received by inheritance is afforded a step-up in basis to its fair market value as of the decedent's date of death.<sup>105</sup> In most cases, this step-up eliminates built-in gain and thus reduces or eliminates capital gains tax upon a future sale by the beneficiary.

However, where the inherited asset consists of shares in a foreign holding company, only the shares themselves, not the underlying assets, receive a basis adjustment at the time of the NRA's death. Consequently, any built-in gain embedded in the underlying U.S.-situs assets is preserved, potentially subjecting the U.S. beneficiary to tax upon liquidation or disposition of the corporate structure. To mitigate this result, NRAs may periodically consider harvesting

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<sup>103</sup> AM 2023-003.

<sup>104</sup> IRC § 897(a)(1).

<sup>105</sup> IRC § 1015(a); IRC § 1014(a).

gains by selling and reacquiring appreciated assets within the holding company, thereby incrementally increasing the entity's internal basis.

The planning becomes even more nuanced where an NRA gifts shares of a foreign corporation to a trust benefitting U.S. persons. In such cases, the gifted shares do not receive a step-up in basis at the NRA's death, and the trust may hold shares with built-in gain both at the entity level and the share level. Although planning alternatives exist to manage this exposure, these basis rules remain critical to any cross-border estate strategy involving corporate structures and U.S. beneficiaries.

#### B. Direct or Pass-Through Ownership by Foreign Individuals

The most straightforward method for an NRA to invest in U.S. property is direct ownership or ownership through a disregarded or pass-through entity. This approach has several advantages: it avoids the double taxation associated with corporate structures, offers preferential capital gains rates, and provides for a step-up in basis at death. Additionally, losses from one U.S. property may offset gains from another, enabling more efficient tax reporting during the NRA's lifetime.

Nevertheless, direct ownership also brings with it significant estate tax risks. U.S.-situs property owned at death in excess of \$60,000 is subject to U.S. estate tax, often at graduated rates that can reach 40%. Although it may be possible to avoid inclusion by holding U.S. assets through certain foreign entities, such as partnerships, ambiguity persists regarding the situs of interests in pass-through entities for transfer tax purposes. The IRS has not definitively addressed whether partnership interests are to be treated under the aggregate or entity theory, leaving practitioners to interpret case law and limited guidance in an inherently uncertain area.

To the extent that the NRA's U.S. holdings consist of assets statutorily excluded from the estate tax base (such as U.S. bank deposits or certain life insurance contracts) direct ownership may still be advisable. Additionally, bilateral estate tax treaties may alleviate exposure; for instance, the U.S.-Canada estate tax treaty permits a credit for U.S. property transferred to a Canadian-resident spouse, effectively restoring a modified marital deduction.<sup>106</sup>

#### C. Ownership Through a Foreign Corporation

Perhaps the most commonly employed strategy to avoid U.S. estate taxation is for the NRA to hold U.S.-situs assets through a foreign corporation. Under U.S. transfer tax rules, shares in a foreign corporation are considered non-U.S.-situs property and, therefore, are excluded from an NRA's gross estate, regardless of the situs of the corporation's underlying assets. This estate tax "blocker" structure also allows the NRA to transfer shares by gift without incurring U.S. gift tax and to sell such shares free of U.S. income tax. In addition, dividends distributed by the foreign corporation to an NRA are generally exempt from U.S. withholding tax, provided they are not effectively connected with a U.S. trade or business.

Despite its apparent advantages, corporate ownership has notable drawbacks. Most significantly, if the corporation disposes of U.S. real property, the gain will be treated as effectively connected income (ECI) under FIRPTA and subject not only to corporate-level income tax, but also to the 30% branch profits tax. Moreover, corporate gains do not qualify for preferential capital gains rates and are taxed at flat corporate rates.<sup>107</sup>

Furthermore, while the NRA's death may result in a step-up in basis for the shares in the foreign corporation, the underlying assets held by the entity do not receive a corresponding basis adjustment. As a result, any unrealized appreciation in those assets is preserved, potentially resulting in a second layer of tax when the assets are sold or the corporation is liquidated by U.S. beneficiaries. Nonetheless, this built-in gain is often deemed a lesser burden than the estate tax that would otherwise apply to the gross value of the underlying assets, making foreign corporations a useful tool in many cases.

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<sup>106</sup> Article XXIX.B. of the United States-Canada Income Tax Convention.

<sup>107</sup> IRC §§ 897(a)(1)(B), 884.

#### D. Ownership Through a U.S. Corporation

An alternative structure involves the use of a U.S. domestic corporation to hold U.S.-situs assets. This structure avoids the branch profits tax applicable to foreign corporations with ECI and may be simpler to administer from a corporate governance and compliance standpoint. Moreover, stock in a U.S. corporation, like that of a foreign corporation, may be transferred by gift free of U.S. gift tax. Corporate earnings are also taxed at a flat rate, currently lower than the top marginal individual rate.

However, the key limitation of this structure lies in its transfer tax treatment. Stock in a U.S. corporation is considered U.S.-situs property and is therefore included in the NRA's gross estate. As a result, this structure offers no protection from estate tax. Additionally, the issue of unadjusted inside basis persists: while the shares may receive a step-up in basis at death, the underlying corporate assets will not. Consequently, U.S. heirs may face significant income tax burdens upon liquidation or asset sale.

#### E. Foreign Corporation (Parent) / U.S. Corporation (Subsidiary) Structure

To reconcile the competing goals of transfer tax minimization and income tax efficiency, practitioners often recommend a tiered structure comprising a foreign parent corporation that wholly owns a U.S. subsidiary. This arrangement preserves estate tax protection—since the NRA owns shares of a foreign corporation—and eliminates the branch profits tax, as U.S.-source income is earned by the domestic subsidiary.<sup>108</sup>

The U.S. corporation will be subject to corporate income tax on its worldwide income, necessitating careful structuring to ensure the entity only holds U.S.-situs assets. Moreover, distributions from the U.S. subsidiary to the foreign parent are subject to dividend withholding, but this exposure may be mitigated through expense management or payment of deductible compensation to the NRA.

Additional complexities arise upon liquidation. In general, a liquidating distribution from a U.S. subsidiary to a foreign parent does not qualify for non-recognition treatment.<sup>109</sup> However, no gain is recognized if the foreign parent uses the distributed property in a U.S. trade or business for at least ten years post-liquidation.<sup>110</sup> Care must also be taken when the NRA intends to use U.S. property held by the subsidiary for personal purposes, as such use may trigger constructive dividend treatment and associated withholding under FDAP rules. To avoid these consequences, the NRA should pay fair market rent for any personal use of corporate assets.

Despite these challenges, the foreign parent/U.S. subsidiary structure remains one of the most flexible and tax-efficient planning vehicles for NRAs investing in U.S. real property—particularly when FIRPTA exposure and transfer tax mitigation are of primary concern. The NRA should first form the foreign corporation, which will then form the domestic corporation, which can then be used to acquire the U.S. property. To avoid a deemed disposition under FIRPTA, U.S. real estate that is already owned directly by the NRA should not be transferred to a corporate structure.<sup>111</sup>

#### F. Ownership Through a Foreign Trust

Ownership of U.S.-situs property through a foreign trust offers another potential strategy for NRAs, particularly where lifetime gifting or multi-generational planning is contemplated. For U.S. income tax purposes, a trust may be classified as a grantor trust or a non-grantor trust. In the grantor trust context, all income, deductions, and credits of the trust are attributed to the grantor, preserving the favorable tax treatment associated with direct ownership. However, to qualify as a grantor trust, the arrangement must generally be either revocable or benefit only the grantor and/or the grantor's spouse during life.<sup>112</sup> These retained interests are problematic for transfer tax purposes. As discussed previously, revocability and retained enjoyment or control are impermissible interests that cause the trust assets to be included in the NRA's gross estate under IRC § 2036. A possible exception exists where the NRA funds

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<sup>108</sup> IRC § 884(d)(2)(C).

<sup>109</sup> IRC §§ 367(e)(2); *but see* Treas. Reg. § 1.897-5T(b)(3)(iv) (regarding liquidating distributions of a U.S. subsidiary that is a USRPHC under FIRPTA).

<sup>110</sup> Treas. Reg. § 1.367(e)-2(b)(2).

<sup>111</sup> IRC § 897(e).

<sup>112</sup> IRC § 672(f).

the trust with separate property and names only a spouse as the current beneficiary; in that case, it may be possible to achieve grantor trust status for income tax purposes while still avoiding estate inclusion, provided no prohibited interest is retained.<sup>113</sup>

A non-grantor trust, by contrast, is treated as a separate taxpayer and, while subject to compressed income tax brackets, avoids the corporate-level tax inefficiencies described above.<sup>114</sup> Crucially, a properly structured foreign non-grantor trust can also avoid U.S. estate tax, provided the NRA grantor relinquishes all retained powers and the trust is irrevocable.<sup>115</sup> However, when U.S. beneficiaries are involved, this structure becomes significantly less attractive due to the throwback rules applicable to undistributed income of foreign non-grantor trusts. These rules can impose punitive ordinary income taxation, interest charges, and complex reporting obligations under the anti-deferral regime of Subpart D.<sup>116</sup> To avoid the application of the throwback tax, foreign non-grantor trusts must distribute all income annually to U.S. beneficiaries—a requirement that may be impractical in many cases. Consequently, when a trust is intended to benefit U.S. persons, planners often prefer to use a U.S. domestic trust structure, either for lifetime gifts or testamentary transfers. Such an approach facilitates compliance, avoids throwback taxation, and simplifies the long-term administration of the trust.

#### G. Inheritance of Shares in a Foreign Corporation by U.S. Beneficiaries; CFCs

Finally, estate planners must anticipate the long-term income tax consequences to U.S. beneficiaries who inherit shares in a foreign corporation established as an estate tax blocker. While NRAs are not subject to the anti-deferral regimes of Subpart F, their U.S. descendants may face significant tax consequences upon inheriting or holding interests in such entities. A “controlled foreign corporation” (CFC) is defined under Subpart F as any foreign corporation in which U.S. shareholders—each owning at least 10% of the total voting power—collectively own more than 50% of the stock, by vote or value. Importantly, constructive ownership rules apply, meaning that indirect ownership through trusts, partnerships, or other entities, and certain family relationships, can trigger CFC classification.<sup>117</sup>

If a foreign corporation becomes a CFC upon the inheritance of shares by U.S. beneficiaries and earns passive income (e.g., dividends, interest, rents, capital gains), that income may be deemed distributed to its U.S. shareholders under Subpart F and taxed at ordinary income rates—regardless of whether any actual distribution occurs. In such cases, the U.S. shareholders must report the income annually and file Form 5471, even if their interest is held indirectly through a foreign trust.<sup>118</sup>

To avoid the Subpart F regime, beneficiaries may wish to liquidate the foreign corporation or elect pass-through treatment upon the NRA’s death. Either option is treated as a deemed liquidation for U.S. tax purposes, with significant consequences. While the stepped-up basis in the shares may eliminate gain at the shareholder level (the “outside basis”), the corporation’s basis in its assets (the “inside basis”) does not adjust.<sup>119</sup> Thus, the deemed liquidation can result in gain recognition at the corporate level, which passes through as Subpart F income to the U.S. shareholder, triggering ordinary income tax. If the fair market value of the assets distributed exceeds the shareholder’s outside basis, a second layer of capital gain is realized. However, if the value is less than basis, a capital loss is generated—though its utility may be limited by the \$3,000 annual deduction cap. This mismatch, in which corporate-level gain is taxed as ordinary income while offsetting losses are subject to capital limitations, can result in a net tax cost to the U.S. beneficiaries.

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<sup>113</sup> IRC §§ 672(f)(2)(A).

<sup>114</sup> IRC §§ 1(e), (f)(1) (for 2025, a non-grantor trust’s taxable income over \$15,650 is taxed at 37%).

<sup>115</sup> IRC §§ 2035-2038, 2104(b).

<sup>116</sup> IRC § 668.

<sup>117</sup> IRC § 957(a); IRC § 951(b); IRC § 958.

<sup>118</sup> IRC § 951, *et seq.*

<sup>119</sup> IRC § 1014(a); *but see* § 1291(e) regarding a PFIC’s basis.

Accordingly, where long-term U.S. ownership is anticipated, practitioners should evaluate alternatives that avoid CFC status or allow for an orderly unwinding of the structure at the NRA's death. These considerations must be central to any estate plan involving foreign corporate ownership structures and U.S. heirs.

## X. Conclusion

As globalization continues to reshape the landscape of wealth ownership and family dynamics, estate planning for internationally mobile clients demands an increasingly sophisticated and jurisdictionally nuanced approach. Advisors to clients with multi-jurisdictional concerns must not only be conversant in U.S. transfer and income tax rules, but also sensitive to the legal, tax, and practical realities of foreign jurisdictions. Successful planning requires coordination with local counsel, awareness of treaty protections, and a keen understanding of the client's unique residency, domicile, asset, and income profile. By proactively addressing the challenges outlined in this paper, ranging from fiduciary selection to cross-border tax implications, practitioners can help clients preserve wealth, honor testamentary intent, and navigate the global estate planning environment with clarity and confidence.