Enduring Wealth

THE LAW OFFICES OF JOHN C. MARTIN

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Estate Planning for International Clients: Three Traps for the Unwary

International clients living in the United States face a number of Estate Planning challenges. For the unwary, a lack of planning can lead to disaster. Imagine, for instance, the shock of a British citizen working at a Silicon Valley startup when he learns that only $60,000 of his estate will be shielded from estate tax. In this article, the author discusses three traps for the unwary expatriate who passes through, lives, or works in the United States.

First Trap: It's Not What you Know, it's What you Don't Know

Often times, non-US citizens are uncertain whether they will be subject to different kinds of tax, and at what amount. Perhaps a nonresident working under a business visa pays income tax on their worldwide earnings, and reckons that they therefore are treated the same as a US permanent resident for all other types of tax. Wrong. The rules subjecting one to income tax differ from those for transfer tax. An individual has to pay income tax if they meet one of the following tests:

1. He or she has a green card (is a lawful permanent resident);
2. He or she has "substantial presence" in the States, measured by the number of days a person is present in the country;
3. He or she makes a special election to be treated as a permanent resident for income tax purposes.

Non-US citizens who meet one of these tests are then taxed at a flat 30 percent rate! Of course, if a tax treaty is in place, the toll may be reduced.

On the other hand, an individual is subject to transfer tax based on a much different test. Transfer tax includes the many types of taxes that Estate Planning attorneys are hired to reduce or eliminate. They include gift tax, estate tax, and generation skipping transfer tax (GSTT). Capital gains tax is not a "transfer tax," but it sometimes comes into play when a transfer of assets is made. Who will be subject to transfer tax? The internal revenue code, section 2001(a), provides that a "tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen ….*Continued on Page 2*

What's Making News at Law Offices of John C. Martin

- Estate Planning Course to be Taught at College of San Mateo by John Martin
- John's Article on Irrevocable Life Insurance Trusts Selected For Syndication

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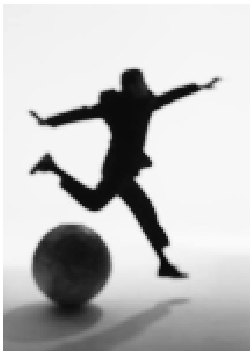
Three Lessons on Durable Powers of Attorney

Durable Powers of attorney are an essential ingredient in a complete estate plan. In the event that one becomes incapacitated, the attorney in fact designated in the durable power of attorney manages one's financial decisions. The level of control given to the attorney in fact varies with the principal's comfort, and the particular needs of his asset situation. In this article, the author teaches three lessons on Durable Powers of Attorney.

First Lesson: Why would I Need One Now?

The effectiveness of durable powers of attorney stems from the law of agency. Under agency law principals, an individual with capacity may give an agent powers—to contract, to represent the principal or to revoke or amend a trust, for instance. In the case of a non-durable power, the agency terminates upon the principal's incapacity. Durable powers survive incapacity, but the principal must have capacity at the time of execution in order to effect a valid power.

Accordingly, executing a durable power of attorney for financial management should be done prior to incapacity. Waiting until one becomes … *Continued on Page 3*



Estate Planning for International Clients

Continued from page 1 ...or resident of the United States." But a "resident" for income tax purposes, discussed above, is different from a "resident" for transfer tax purposes. The more important question for transfer tax purposes is whether one is domiciled in the country. To be domiciled in the United States:

1. The person must intend to permanently live in the United States;
2. At the time the person intends to remain permanently in the United States, the person must also actually be physically present in the United States; and
3. The person must be capable of making an informed, intelligent decision about living permanently in one place or another.

Does this mean that a person who maintains a residence in the United States might not be domiciled there for transfer tax purposes? Yes. If the individual intended to move back to their country of origin, and that fact could be clearly demonstrated by the facts and circumstances, then the IRS might consider the person to be domiciled in their country of origin. As we will see below, this determination is important for the types of tax that can be imposed on transfers and at what amount.

"NON-RESIDENTS… CAN TRANSFER UP TO $60,000 WITHOUT PAYING AN ESTATE TAX."

Second Trap: The $60,000 Estate Tax Exemption for non-Residents

For United States permanent residents and citizens, the 2009 estate tax exemption is equal to $3,500,000. That means that estates valued at less than $3,500,000 will not be subject to estate tax for decedents dying in 2009. Non-residents, however, can only transfer up to $60,000 without paying an estate tax. Thus, many non-residents living in the United States, some only with modest assets, will leave their heirs with a large estate tax bill!

If a non-resident has a US Citizen spouse, they can take advantage of the IRC §2523 unlimited marital deduction, which defers all estate tax until the death of the second spouse. Yet, many non-residents do not have a US citizen spouse. For those with non-citizen spouses, a Qualified Domestic Trust ("QDOT") can be established to make qualified transfers to one's spouse to reduce or eliminate the estate tax bill. Together with a Credit Shelter Trust that sets aside the $60,000 exemption amount, the QDOT can be a powerful planning strategy. Nevertheless, upon his or her death, the non-Citizen spouse will still leave their heirs with a large taxable estate.

Third Trap: Gift Tax on taxable transfers

Non residents cannot make any "taxable transfers" for gift-tax purposes without incurring a gift tax. IRC §§2102, 2106(a)(3), 2505. However, they should keep in mind that they can take advantage of gift-tax exclusions, such as the IRC §2503(b) annual exclusion, and the special IRC §2523(i) for non citizen spouses.

Also, the type of property will make a difference on whether a taxable transfer is subject to gift tax. For non-resident non-domiciliaries, only those assets regarded to be situated within the United States are subject to gift tax. Gifts of intangible assets, on the other hand, will not be subject to gift tax. Why is that important? Since shares of stock are considered intangible assets, they may be transferred in certain circumstances without triggering any gift tax. Non-residents should review which assets will be subject to gift tax in order to plan accordingly.

Non-residents should review which assets will be subject to gift tax in order to plan accordingly. For non-resident non-domiciliaries, only those assets regarded to be situated within the United States are subject to gift tax. Plus, gifts of intangible assets will not be subject to gift tax. Why is that important? Since shares of stock are considered intangible assets, they may be transferred in certain circumstances without triggering any gift tax.

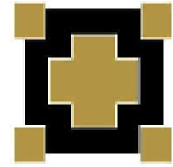
Conclusion: Be Prepared

Non-residents should seek education in order to minimize an unfavorable level of exposure to transfer tax both now and upon their death. Consulting with an estate planning attorney who works with international clients can help mitigate these and other issues.

Non-residents should seek education in order to minimize an unfavorable level of exposure to transfer tax

Attorney John Martin will Teach for San Mateo County Community Education

Attorney John Martin has accepted an invitation from the board of Community Education in San Mateo County to teach a seminar on Estate Planning at the College of San Mateo. The course will be launched in November 2009 and will take place on Tuesdays from 6:30 to 9:00 pm on the College of San Mateo campus. Subjects will include a background on the most popular estate planning devices; charitable giving strategies; and advanced estate planning approaches. For more details, visit www.johncmartinlaw.com



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Durable Powers of Attorney: 3 Lessons to Remember

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unable to coherently express one's wishes with regards to financial management decisions is too late, and a court-appointed conservatorship may become necessary. What about the successor trustee designated in my trust, or the executor of my will? Would they be able to step in? Since the principal does not die at incapacity, only an attorney in fact designated under a properly executed power of attorney may step in to make financial management decisions. A last-minute durable power of attorney executed during incapacity would not survive a court challenge, however expensive or damaging the result.

"A LAST-MINUTE DURABLE POWER OF ATTORNEY EXECUTED DURING INCAPACITY WOULD NOT SURVIVE A COURT CHALLENGE, HOWEVER EXPENSIVE OR DAMAGING THE RESULT.."

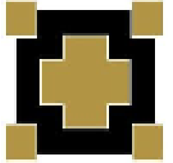
Second Lesson: Consider making the Power Immediately Effective
Often, unwary estate planners will execute "springing durable powers of attorney," which only become effective upon the incapacity of the principal. Incapacity is determined according to a test set out in the power, such as a determination made by a medical doctor or a court rendered decision. But who wants to go through the expense, difficulty, and uncertainty of initiating a legal procedure to determine incapacity? Isn't one of the goals of estate planning to prevent unnecessary expense and delay? Moreover, doctors frequently hesitate to make determinations of incapacity because of liability they may face.

In most cases, a better strategy would be to execute an immediately effective durable power of attorney, which gives an attorney in fact the power to make decisions on behalf of the principal without any finding of incapacity. Many are fearful of an immediately effective power of attorney, reasoning that no one should be given such power over their financial affairs unless they are totally incompetent. If they have such a lack of trust for the attorney in fact , why are they executing a power of attorney in the first place? One would think that even more trust would be required when the principal is incompetent and has little influence over the attorney in fact. Finally, simple measures can be taken to avoid disasters before incapacity. Consider sealing a copy of the durable power of attorney in an envelope labeled "do not open until my incapacity." In addition to oral instructions, this can help to avoid the scenario of a run-away attorney in fact who uses the power of attorney to access financial accounts before incapacity.

A Durable Power of Attorney ensures that an attorney in fact will hold the keys to manage your finances in the event of incapacity

Third Lesson: What powers should the Attorney-in-Fact be given?
The powers given to an attorney in fact depend upon the principal's desires and the particular concerns that stem from the types of assets held. The durable power of attorney should be coordinated with the will, trust and advance health care directive to ensure that they do not contradict each other. Namely, should the attorney in fact have the power to create trusts? To rescind or amend existing trusts? Should the attorney in fact have a power to make gifts to himself or to others? These powers can help ensure that preparation for long term care (medical) or tax planning can take place even after incapacity.

Before executing a power of attorney, individuals should be fully informed of the powers that they are granting, and the possible consequences of such sweeping grants of power. In all cases, it's best to consult with an attorney who can advise on specific risks.



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