Taxation of Global Clients

Individuals who are neither U.S. citizens nor U.S. residents, may be subject to income tax on a net basis or withholding tax and subject to gift and estate tax on U.S. situs assets. The following is a general discussion of how U.S. income taxes and gift and estate taxes apply to Global Clients. Bear in mind that these general rules may be altered by the specific treaty between the U.S. and the Global Client's home country.

Federal Income Tax

U.S. citizens (regardless of their residences) are taxed on worldwide income by the United States, whatever its source. The net income can be taxed at rates as high as 37.9% (including the .9% Affordable Care Act medicare tax on earned income, where applicable). A preferential tax rate of 20% (plus a 3.8% Net Investment Income Tax, where applicable) applies to certain qualified dividends and long-term capital gains. Short-term capital gains can be taxed as high as 40.8% (Including the 3.8% Net Investment Income Tax, where applicable) applies to certain qualified dividends and long-term capital gains. Certain deductions and credits are allowed.

Nevertheless, an individual who is not a U.S. citizen generally is subject to federal income tax on worldwide income if he or she is a U.S. resident. For federal income tax purposes, residency is defined as either (i) lawful permanent residence in the U.S., as evidenced by issuance of a "green card" or (ii) “substantial presence” in the U.S. Generally, substantial presence means a non-citizen is present in the U.S. for 183 days or more in the current year or looking back over a three-year period.[1]

Global Clients may be subject to income tax on certain U.S. source income as follows[2]: (1) passive investment income such as dividends may be subject to a non-refundable withholding tax of 30%[3]; (2) The 30% interest income may also be subject to withholding tax but exceptions are made for most interest income such as interest on certain deposits with banks, financial institutions and insurance companies, and “portfolio interest” (which includes interest on most publicly offered debt instruments); (3) capital gains generally are not subject to U.S. tax (or withholding) for Global Clients (except as described in (4) below); and (4) under the Foreign Investment in Real Property Tax Act (FIRPTA), gain on the sale of a U.S. real property interest is considered effectively connected with a trade or business, subject to tax at rates as high as 37%. Persons purchasing U.S. real property interests from foreign persons generally are required to withhold 15% of the amount realized on the disposition.

The U.S. federal income tax treatment of various items of income and the rates of withholding applied to such items often vary depending on the relevant treaty or exceptions that may apply. Income subject to withholding tax may be taxable in the Global Client’s home

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country. In addition, credits may available in the U.S. or the taxpayer's home country to avoid double taxation.

Gift and Estate Tax

Generally, all of a U.S. citizen or resident's lifetime gifts (except those to charity or a U.S. citizen spouse) are subject to federal gift tax. There are certain exclusions. For example, gifts of up to $17,000 (indexed for inflation) per recipient per year are not subject to federal gift tax. In addition, each U.S. citizen or resident has an exemption from the gift tax of $13.66 million. (in 2024) and may gift up to $185,000 (in 2024) to a spouse who is not a U.S. citizen. Any additional gifts that are not otherwise excluded from the gift tax would be subject to federal gift tax at a top rate of 40%. Any gift tax exemption used by an individual during life reduces the individual's available estate tax exemption by a like amount. Certain states also impose a gift and/or estate or inheritance tax in addition to the federal gift and estate taxes.[4]

A Global Client is subject to gift and estate tax only on U.S. situs assets. However, residency for federal gift and estate tax purposes is defined differently than that for federal income tax purposes. Unlike the substantial presence test for income tax purposes that is based on the number of days one spends in the U.S., residency for gift and estate tax purposes is defined as the person's domicile. Domicile means living in the U.S., with no present definite intention of living elsewhere. Whether one is domiciled in the U.S. is a facts and circumstances test. Some of the factors that bear on the analysis include where one pays state income tax, where one votes, the location of property one owns, one's citizenship, the length of residence, and business and social ties to the community. Given the differences between the tests for federal income tax residency, a person can be a resident under one test, neither test, or both tests. The definition of U.S. situs assets is different for federal estate tax purposes and federal gift tax purposes.

For federal estate tax purposes, U.S. situs assets include U.S. real property, tangible property located within the U.S. and stock in U.S. corporations. U.S. situs assets do not include debt obligations of U.S. corporations and of the U.S. and its political subdivisions if the interest on such obligations qualifies as portfolio interest. Cash in a U.S. bank account is not a U.S. situs asset for estate tax purposes.

In contrast, for federal gift tax purposes, U.S. situs assets include only real estate and tangible personal property. Cash physically located in the U.S. (such as cash in a safety deposit box) is U.S. situs tangible personal property. U.S. situs intangible property, such as stocks and bonds of U.S. corporations, is not subject to federal gift tax. Global Clients also may give U.S. situs assets worth up to $17,000 per recipient per year without triggering a U.S. gift tax. However, Global Clients are not eligible for the $12.92 million federal gift and estate tax exemption (in 2023). They are limited to $60,000 gift and estate tax exemption.

Estate and gift tax treaties can affect residency status for non-U.S. citizens and also limit the kinds of property taxed by the U.S.

With respect to interspousal transfers (including the opening of joint accounts), particular attention must be paid to the fact that only transfers to a U.S. citizen spouse are free of gift and estate tax. Transfers to a non-U.S. citizen spouse will generally be subject to federal gift or estate tax. Normally, there is an annual exclusion for gifts to a non-spouse recipient of $17,000 per person per year in 2024. However, that annual exclusion is increased when the recipient is a non-citizen spouse to $175,000 in 2024. Other techniques, including Qualified Domestic Trusts or "QDOTs," may be used to defer estate tax (but not gift tax) with respect to bequests to non-U.S. citizen spouses.[5]

Gift and estate tax planning for Global Clients frequently focuses on avoidance of the direct ownership of U.S. situs property, the transfer of which may incur federal gift tax or estate tax. An example of a common (though not necessarily ironclad) planning technique involves utilizing a foreign corporation to purchase U.S. property. In that case, the Global Client would own non-U.S. situs property – shares of a foreign company – not the underlying assets. Formation of any such entity would require coordination with the laws of the Global Client's home country. However, note that the federal income taxation of any such entity could become very complex if ownership ever passes to a U.S. citizen or someone who is a resident for income tax purposes.

In summary, the main differences between assets subject to gift and estate taxes are shown in the chart below.

Conclusion

Proper planning may reduce the tax exposure applicable to Global Clients with property in the U.S. However, cross-border income and transfer tax planning is highly complicated. Clients are strongly encouraged to seek the advice of experienced international tax professionals versed in the laws of both the U.S. and their home country.

TABLE

Global Clients are subject to federal gift and estate tax only on U.S. situs property.

	Gift Tax		Estate Tax	
Property Type	**Yes**	**No**	**Yes**	**No**
Tangible Personal Property in U.S. (e.g. jewelry)	X		X	
Currency in U.S. Safe Deposit Box	X		X	
Cash Deposits in a U.S. Bank	Possibly			X
U.S. Real Property	X		X	
Non-U.S. Real Property		X		X
U.S. Stocks		X	X	
Non-U.S. Stocks		X		X
U.S. Government and Corporate Bonds		X		X
U.S. States/Muni Bonds		X	Possibly	
U.S. Partnership/LLC Interest	X		Possibly	
U.S. Treasury Bills		X		X
U.S. Mutual Funds and ETFs		X	X	
Non U.S. Mutual Funds and ETFs (i.e. UCITs)		X		X
Life Insurance Death Benefits		X		X

[1] The substantial presence test is met if the sum of the days spent in the U.S. in the current year plus one-third of the total days spent in the U.S. in the prior year plus one-sixth of the days spent in the U.S. in the year before that year equals at least 183.
[2] For purposes of this discussion, it is assumed that the Global Client is not conducting a U.S. trade or business.
[3] A treaty may reduce the withholding rate.
[4] For purposes of this discussion, the federal estate tax essentially mirrors the federal gift tax except as otherwise noted.
[5] While generally there is no "forced heirship" policy in the U.S., states grant spouses (and in Louisiana, children) certain property rights, which can impact the distribution of property on the dissolution of a marriage or death. Such state law issues must also be considered when entering the U.S.

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