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JENNIE CHERRY



Tax Year 2009: The More Things Change, the More They Stay the Same

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The new year has brought talk of stimulus packages and the Internal Revenue Service (IRS) has stepped up its investigation of foreign bank accounts. But as investors grapple with the new financial landscape, life goes on - and so does death. Therefore, for international families planning to make gifts in 2009 and for those who sadly lose a family member this year, it is important to know the relevant transfer tax exclusion and exemption amounts. It is also time to be aware of ever-increasing filing requirements and upcoming deadlines to report 2008 transfers. Looking forward, President Obama's 2010 budget proposal, released on February 26 2009, proposes to stop the scheduled repeal of the estate tax in 2010 and to impose a 45% tax rate with an exclusion amount of \$3.5 million per individual.

Gift Tax and Reporting

Gifts made by US persons

US citizens and domiciliaries making gifts in 2009, regardless of the recipient, will be subject to the following tax rate, exclusion and exemption

amounts:

- top tax rate - 45%;
- annual exclusion from gift tax - \$13,000;
- annual exclusion for gifts to a non-US citizen spouse - \$133,000; and
- gift tax unified credit - \$345,800 (this lifetime credit exempts \$1 million from gift tax).

Gifts in excess of the annual exclusion amount and those which a US person elects to split with a US spouse are to be reported on a gift tax return, Form 709. For 2008 gifts (subject to an annual exclusion amount of \$12,000 or \$128,000 for gifts to a non-citizen spouse), the gift tax return is due on April 15 2009.

Gifts received from non-US persons

US persons who received gifts in excess of \$100,000 from non-US persons in 2008 must remember to file Form 3520 to report receipt of the gifts, even though no tax is due. This return is due on the same date as the US gift recipient's income tax return is due - generally April 15, but including extensions. The same will be true for such gifts received in 2009.

Gifts of US situs real property and tangibles

Non-US persons are subject to US gift tax only on gifts of US real property and US situs tangible personal property (for further details please see the Overview (March 2008)).

Estate Tax and Reporting

Estates of US decedents

A tax on the worldwide value of a US decedent's estate is still in effect for US persons dying in 2009. This tax is levied on the estate of a US citizen, regardless of where the decedent was living at the time of death. The relevant rate, credit and exemption amounts are a top tax rate of 45% and an estate tax unified credit of \$1,455,800 (this credit exempts \$3.5 million from estate tax, but any use of the gift tax credit during the person's lifetime decreases the amount exempted from estate tax).

An estate tax return, Form 706, is due nine months from the date of death (for a detailed discussion of when a decedent will be considered domiciled in the United States at death, please see the Overview (March

2008)).

Estates of non-US decedents owning US situs property

Estates of non-US persons who die owning US situs property must file Form 706-NA. For estate tax purposes, US situs property includes stock in US companies, in addition to US situs real property and tangibles also subject to the gift tax. The credit against estate tax for a non-US decedent shelters only \$60,000 from estate tax.

Generation-Skipping Transfer Tax

US citizens and domiciliaries who make a transfer to a person two or more generations below that of the transferor (a 'skip person'), no matter whether such transfer is made during life or at death, are subject to a generation-skipping transfer (GST) tax in addition to any gift or estate tax that may be due. A transfer by a non-resident alien can also be subject to GST tax if it is subject to US estate or gift tax. A GST tax exemption of \$3.5 million for tax year 2009 (\$2 million for tax year 2008) is available to both US and non-US transferors. For 2008 and 2009 the GST tax is calculated at a flat rate of 45%.

Scheduled Temporary Repeal of Estate Tax in 2010

Under the Tax Relief Reconciliation Act 2001 the estate tax and generation-skipping transfer tax are scheduled for repeal only in 2010. The act does not repeal the gift tax, but does reduce the maximum marginal gift tax rate to the top income tax rate. However, under the sunset provision of the act, on January 1 2011 the estate, gift and generation-skipping transfer tax provisions are scheduled to revert to those in effect prior to the act (ie, a credit that will shelter \$1 million from transfer and generation-skipping transfer tax and a maximum tax rate of 55%, plus a 5% estate tax surcharge on certain large estates). The exemption from generation-skipping transfer tax would be indexed for inflation. President Obama's 2010 budget proposal, released on February 26 2009, proposes to stop the scheduled repeal of the estate tax and to continue the top transfer rate of 45% and the unified credit that shelters \$3.5 million from estate tax.

Additional Reporting Requirements

Reporting requirements have increased in recent years and this trend is unlikely to change direction with the financial crisis and increased scrutiny of foreign accounts and investments. Family advisers will want to prepare clients who become US resident for these reporting requirements if they are likely to retain foreign holdings (for a discussion of the green card and substantial presence tests used to determine residency for US income tax purposes, please see the Overview (March 2008)). All forms are available on the IRS website at www.irs.org. Relevant filings include:

- Form 3520 – Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, due on the date that the taxpayer's individual income tax return is due (generally April 15), including extensions;
- Form 3520-A – Annual Information Return of Foreign Trust with a US Owner, generally due March 15;
- Form 5471 – Information Return of US Persons with Respect to Certain Foreign Corporations, attached to and filed with the taxpayer's income tax return;
- Form 8621 – Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, attached to and filed with the taxpayer's income tax return;
- Form 8865 – Return of US Persons with Respect to Certain Foreign Partnerships, attached to and filed with the taxpayer's income tax return;
- Form 926 - Return by a US Transferor of Property to a Foreign Corporation, filed with the taxpayer's income return;
- Form 8832 – Entity Classification Election, often filed for a foreign company to elect disregarded entity status; thus, the tax responsibility flows through to the owner so that there is no tax at the company level;
- Form 8858 – Information Return of US Persons with Respect to Foreign Disregarded Entities, filed with the taxpayer's income tax return;

- Form TD F 90-22.1 – Report of Foreign Bank and Financial Accounts, filed by June 30 of each year when, in the previous year, the taxpayer had a foreign bank or financial account worth over \$10,000 (for a discussion of recent changes to this form please see "IRS Releases Revised Foreign Bank Account Reporting Form"); and
- Form 2555 – Foreign Earned Income, generally due April 15 for US citizens and resident aliens living abroad to exclude a certain amount of foreign earnings from taxes and/or to claim the housing exclusion.

Comment

US estate and gift tax planning is still relevant for wealthy international families and provides opportunities to take advantage of available credits and exemptions, especially when family members are planning to marry a US citizen or to move to or spend significant amounts of time in the United States. The advice of a qualified tax professional can help to explain the tax implications and reporting requirements, and minimize exposure to the US transfer tax system.

For further information on this topic please contact Jennie Cherry at Kozusko Harris Vetter Wareh LLP by telephone (+1 212 980 0010) or by fax (+1 212 751 0084) or by email (jcherry@kozlaw.com).

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