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Estate Tax Issues for the Foreign Investor

Mexican investment in particular plays a pivotal role in the long term success of the Rio Grande Valley. However, foreign investment often contains hidden and unexpected legal and tax implications of which few investors and their attorneys are aware. Residency status, transfer tax liability, and income classification complicate the implications of owning many U.S. based assets. Therefore, it is important for Mexican investors to understand the implications of acquiring and transferring U.S. real estate assets, and the various planning tools available to facilitate the process and minimize the amount of tax liabilities. Estate or "death" taxes, which are the focus of this article, can be particularly harsh and costly.

To assess a Mexican investor's exposure to estate tax liability, one must first determine the investor's status as a "resident" or "nonresident" for U.S. estate tax purposes. This determination is complex and involves a variety of factors. In short, a party is considered a resident for estate tax purposes if he or she is "domiciled" in the U.S. at the time of death. Domicile, for estate tax purposes, is determined by reviewing a person's presence in the United States and his or her "intent" to stay. The "intent" test is not entirely subjective. Many non-citizens may not understand that residing in the U.S. for extended periods of time, even with no intention to stay, can open their global estate to U.S. estate tax liability, or *vice versa*. Moreover, the IRS defines "residency" differently for income tax than it does for estate tax purposes. This makes a person's status even more difficult to ascertain. Because residency status is so important for estate tax planning purposes, a person should seek competent legal and tax counsel to determine his or her status before undertaking any tax planning.

Currently, there are no laws that prohibit Mexican citizens from owning U.S. property. But while the first $5.3 million value in the estate of a U.S. citizen or Resident Alien is generally exempt from U.S. death taxes, only a measly $60,000 exemption is available to non-residents for their "U.S. situated" assets. Thus, for most non-residents, the value of their U.S. situated assets that exceed the $60,000 exemption will be subjected to an estate tax that currently sits between a whopping 35% to 40% of the assets' value. Without proper planning, a non-resident alien's plans for passing on property upon his or her death can be severely compromised.

While the estate tax consequences for foreigners owning U.S. real property may be severe, proper estate planning can help reduce or even eliminate these consequences. The creation of business entities to own the assets, or the establishment of special trusts, are among the many tools that advisors can use to minimize estate tax liability. Therefore, it is particularly important for the non-citizen, the non-resident alien, and even the resident alien with assets outside the U.S., to meet with counsel to discuss the tools and techniques available. ©

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