THE FINAL CHAPTER: TESTAMENTARY INSTRUMENTS FOR GLOBAL FAMILIES

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INTRODUCTION

As more families live, invest, and hold assets across multiple countries, estate planning increasingly requires coordination between legal systems that are not designed to work together. A foreign Will alone may not effectively administer U.S. assets, while a U.S. Will drafted in isolation can unintentionally disrupt an existing foreign estate plan. Although global families often focus on *inter vivos*, or lifetime, structures for generational wealth planning, testamentary planning remains equally important, particularly for families who are not prepared to transfer significant wealth during the lifetime of the parents.

One objective in cross-border estate planning is to create complementary structures globally that minimize probate friction, provide efficient tax planning for beneficiaries, and preserve the client's intended dispositive scheme across multiple jurisdictions. This article explores several key cross-border testamentary planning considerations for global families with U.S. beneficiaries and U.S. assets, as well as practical and logistical considerations for U.S. estate administration of a foreign estate.

USE OF A POUR-OVER U.S. DOMESTIC TRUST

In General

A common scenario in cross-border estate planning arises when a noncitizen, nonresident of the U.S. (an "N.R.N.C. individual") prepares a Will leaving her assets to her children upon death, one of whom is a U.S. person, as defined in §7701(a)(30) of the Internal Revenue Code ("Code").

Foreign succession law or local tax treatment may make it unfavourable for assets to pass to a beneficiary in trust. However, for a U.S. beneficiary, directing an inheritance to a U.S. domestic pour-over trust can provide efficient U.S. tax planning to complement the foreign Will or inheritance law. Because a U.S. individual's estate is subject to U.S. estate tax on worldwide assets, structuring the inheritance through a meticulously designed trust established by the N.R.N.C. individual is advantageous, as the assets passing in trust can generally be excluded from the U.S. beneficiary's own taxable estate at the conclusion of his or her lifetime. As a result, the U.S. beneficiary may preserve the estate tax exemption for personal assets that are acquired during that person's lifetime. Additionally, generation-skipping transfer ("G.S.T.") tax[1]

[1] In broad terms, G.S.T. tax is imposed when property passes from an individual or decedent to a family member that is two or more generations removed from that individual or decedent. See Code §§2601 to 2664. The archetype is a transfer from the deceased to a grandchild directly or over time through a trust.

would not be imposed when succeeding generations become entitled to receive distributions from the trust.

The pour-over trust should be drafted as revocable during the lifetime of the N.R.N.C. individual, allowing the terms to be modified by the settlor to reflect evolving estate planning objectives over the course of a lifetime. Upon the N.R.N.C. individual's death, the trust becomes irrevocable automatically and is treated as a U.S. domestic nongrantor trust for U.S. taxation purposes.[2] A properly structured trust can also offer protection from creditor claims, including those arising in the context of divorce.

The Pour-Over Trust Particulars

For a trust to qualify as a U.S. domestic trust, it must satisfy two requirements, namely (i) the Court Test and (ii) the Control Test.[3] A trust that fails to meet either test will be classified as a foreign trust for U.S. tax purposes, even if it was created under U.S. law.

It is advisable to structure the trust as a dynasty trust, meaning a trust that may continue for multiple generations under applicable law. Structuring the trust in this manner can provide the U.S. beneficiary and descendants with continued U.S. estate tax protection and creditor protection. In principle, assets remaining in the trust are not treated as the beneficiary's personal assets.

The appointment of a U.S. corporate trustee, such as a trust company, may be particularly advantageous for long-term dynasty trusts, especially if the N.R.N.C. individual does not have suitable U.S. persons available to serve in a fiduciary capacity.

To preserve flexibility for future generations of a globally mobile family, the trust instrument should grant the fiduciaries authority to migrate the trust to a foreign jurisdiction or to terminate the trust if the U.S. beneficiary ceases to be a U.S. person.[4] Consider including language such as the following:

> The Trustees may change the situs of any trust hereunder, and to the extent necessary or appropriate, move trust assets to a state or country other than the one in which the trust is then administered if the Trustees shall determine it to be in the best interest of the trust or the beneficiaries. The Trustees may elect that the law of such other jurisdiction shall govern the trust to the extent necessary or appropriate under the circumstances. Notwithstanding the foregoing, the Trustees shall first consult with tax advisors in the relevant jurisdictions prior to such change of situs in order to ensure no unacceptable adverse tax consequences would result from the change of situs under §684 of the Internal Revenue Code or otherwise.

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2 A "nongrantor" trust is considered a separate U.S. taxpayer for U.S. income tax purposes, taxed on worldwide income accumulated and realized in the trust.

3 Code §7701(a)(30)(E); see also Treas. Reg. §301.7701-7(a)(1). Generally speaking, a trust satisfies the Court Test if a court within the U.S. can exercise primary supervision over the trust administration (Code §7701(a)(30)(E)(i)). A trust satisfies the Control Test if one or more U.S. persons control all substantial decisions of the trust (Code §7701(a)(30)(E)(ii)).

4 A migration of a domestic trust to a foreign jurisdiction may be treated as a taxable transaction under Code §684.

Coordination between advisors in both the U.S. and the N.R.N.C. individual's home jurisdiction is critical. U.S. counsel should review the foreign Will which details the distribution to the pour-over trust. For example, instead of the foreign Will reading "I bequeath X% of my estate to my daughter, Z," the foreign Will could provide language similar to the following:

> I bequeath X% of my estate to the then serving Trustees of the [Name of Trust], a U.S. domestic trust created for the benefit of my child, Z, to be disposed of in all respects as a part thereof.

The pour-over trust would be annexed to the foreign Will. Counsel in the foreign jurisdiction must ensure that the pour-over trust does not cause any undesirable inheritance, probate, or other tax issues in that jurisdiction.

Additional Considerations

Additional consideration should be given to the assets intended to pass to the pour-over trust. Non-U.S. situs assets bequeathed by N.R.N.C. individuals are exempt from U.S. estate and G.S.T. taxes. Nevertheless, foreign-situs assets should be carefully reviewed by U.S. counsel and counsel in the relevant jurisdictions to identify potential adverse tax consequences.

To illustrate, an interest in a foreign company passing from an N.R.N.C. testator may be classified for U.S. tax purposes as an interest in a passive foreign investment company ("P.F.I.C."). U.S. persons, including U.S. domestic trusts, holding interests in a P.F.I.C. are subject to special tax rules and excessive tax rates under Code §§1291–1298.[5] Absent timely made elections designed to eliminate deferral of tax,[6] income and gains related to a P.F.I.C. are (i) allocated to each day in the holding period, (ii) are taxed at the highest rate of tax on ordinary income for each such year, (iii) are deemed to be paid late, and (iv) subject to the payment of interest charges each year.

The Trustees of the pour-over trust may need to act soon after receiving distributions from the foreign estate. The trust agreement may expressly authorize the Trustees to make such distributions. Alternatively, these considerations may be addressed in a separate letter of wishes encouraging coordination with qualified tax counsel in the relevant jurisdictions.

In sum, with careful planning, directing the inheritance to a pour-over trust for the benefit of a U.S. child and future generations rather than distributing the assets outright to a U.S. child provides the U.S. beneficiary with a creditor-protected and tax-efficient structure through which the inheritance may be held for generations.

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[5] A detailed discussion of P.F.I.C. planning is beyond the scope of this article.

[6] Such elections may include (i) a Qualified Electing Fund ("Q.E.F.") election under Code §1295 allowing pass-through treatment for ordinary income and capital gains, (ii) a mark-to-market election under Code §1296 with regard to marketable shares, and (iii) a purging/deemed sale election pursuant to Code §1291, under which the shareholder is treated as having sold the stock of the P.F.I.C. for its fair market value on the first day of the first taxable year in which it is a Q.E.F. and the gain is treated as an excess distribution. Future capital gains from an actual sale benefit from lower capital gain tax rates in the U.S.

A U.S. WILL

In General

N.R.N.C. individuals owning certain U.S.-sitused property at death face significant U.S. estate tax exposure due to the limited estate tax exemption afforded to persons not otherwise subject to estate tax on worldwide assets.[7] Lifetime planning is critical to address these concerns. Although such planning strategies are beyond the scope of this article, it remains an important component of any efficient cross-border plan involving U.S.-situs assets.

At the same time, important testamentary planning opportunities exist. A U.S. Will can serve as a simple yet highly effective tool to provide the N.R.N.C. decedent's family with a clear and efficient path for administering the U.S. estate.

A U.S. Will can streamline the transfer of certain assets that might otherwise be difficult to release. For example, if an N.R.N.C. decedent owned a U.S. investment account, the account generally cannot be transferred to heirs or released to a foreign executor without a transfer certificate. A transfer certificate is issued by the I.R.S. only after it is satisfied that the U.S. estate tax imposed on the N.R.N.C. individual's U.S. property has been fully paid or adequately secured.

Obtaining the certificate requires (i) the filing of Form 706-NA (United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of a Non-resident Not a Citizen of the United States) ("Form 706-NA") if the value of U.S. situs assets exceeds the applicable estate tax exemption filing threshold or (ii) the submission of an affidavit and supporting documentation if the value falls below that threshold.

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Preparing and submitting the required documentation can be time consuming and costly, and families may wait more than one year after submission for the certificate to be issued. A transfer certificate is not required if the U.S. estate assets are administered by an executor or administrator who is duly appointed, qualified and acting within the U.S.[8] Use of a U.S. fiduciary eliminates the need for a transfer certificate because the fiduciary assumes the liability for unpaid estate tax in the event of the impermissible transfer of assets. Of course, even with a U.S. fiduciary appointed, any applicable U.S. estate tax must be paid.

From a practical perspective, administering an N.R.N.C. individual's U.S. estate through a separate U.S. Will also streamlines the court administration process. A U.S. Will that specifically governs the disposition of the testator's U.S. situs assets allows U.S. probate courts to proceed more efficiently. In practice, courts generally process U.S.-style Wills more quickly than foreign Wills and substantially faster than foreign estates administered without a Will. As discussed below, administration of a foreign estate without a U.S. Will in place presents numerous challenges.

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7 Each N.R.N.C. individual has an estate tax exclusion of $60,000. This amount is not indexed for inflation. Generally, the first $1,000,000 of taxable value will be taxed at graduated rates totaling $345,800. Thereafter, the estate tax is imposed at a flat 40% rate. There are certain seemingly U.S. situs assets that are treated as having a foreign situs, and for that reason are not subject to estate tax. See generally Code §2105. In certain circumstances, a U.S. tax treaty may apply that permits a higher exclusion amount against estate tax or gives primary taxing authority to the country of domicile.

8 Treas. Regs. 20.6325-1(c).

The U.S. Will Particulars

The Will must govern U.S. assets only. Consider including language such as the following:

> I, [Name of Testator], a citizen and domiciliary of Country X, declare this to be my Will, relating, however, only to those assets that have situs within the United States, revoking all prior Wills and Codicils thereof that relate to such assets made by me at any time previously.

The Will must direct probate to a particular U.S. state for its courts to exercise jurisdiction. While such a direction does not guarantee that a court will accept jurisdiction, considerable weight is often given to the testator's expressed preference, particularly where a meaningful nexus to the state exists. It is advisable to select a state in which the nominated executor resides or where the U.S. situs property is located. Consider including language such as the following:

> This Will shall only affect the disposition of my probate assets located within the United States. I request that this Will be admitted to probate in the Probate Court of [XYZ] County of the State of [ABC] and that my estate under this Will be administered as far as may be practicable in such state. I direct that all provisions of this Will, including, without limitation, all dispositive provisions in respect of my property situated within the United States and any real property situated within the State of [ABC], be governed by and construed under the laws of such state and my fiduciaries possess all discretionary and other powers provided under such laws.

Caveat

The U.S. Will and the Will in the N.R.N.C. individual's home jurisdiction cannot contain conflicting provisions. Because Wills dispose of a testator's assets wherever situated, ambiguity may arise as to which instrument governs U.S.-situs property. Accordingly, the U.S. Will should expressly apply to U.S. assets only, as described above, and the foreign Will should be written to refer to property wherever situated, other than in the United States. Proper planning of the U.S. and foreign Wills promotes clarity and consistency across the testator's global estate plan.

ORIGINAL & ANCILLARY ESTATE PROCEEDINGS

At the conclusion of an individual's lifetime, a decedent's estate is generally administered in the country of domicile through probate of a Will or pursuant to applicable succession laws. When an N.R.N.C. decedent owned U.S. situs assets at the time of death, a separate U.S. estate administration proceeding is often required before those assets may be transferred to a foreign executor[9] or to the decedent's heirs.

The form of U.S. administration depends largely on the proceedings conducted in the decedent's country of domicile. If no formal estate proceeding occurred abroad, an original estate administration may be commenced in the U.S. When a foreign

[9] As used in this section, the term "executor" includes comparable fiduciary roles, including a personal representative or an administrator, the latter typically being a fiduciary appointed to administer an estate where no Will exists.

probate or inheritance proceeding has taken place and a fiduciary was appointed, the foreign executor may instead seek ancillary administration. Ancillary administration is a secondary estate proceeding initiated in a jurisdiction other than the decedent's domicile that enables a foreign executor to administer assets located in the jurisdiction by obtaining recognition of the foreign estate settlement.

As discussed above, a separate U.S. Will can streamline U.S. administration of an N.R.N.C. decedent's estate. Absent such planning, original or ancillary proceedings often involve additional procedural complexity. Often, they arise due to differences in identifying the person having authority to act on behalf of the estate. In many jurisdictions outside of the U.S., authority vests directly in the heirs as statutory successors rather than in a court-appointed fiduciary. As a result, U.S. courts often require legal opinions from foreign counsel explaining the applicable succession system to confirm the individual or individuals who are authorized to act in the U.S.

At a minimum, a foreign executor must provide to the U.S. probate court authenticated documentation that must be notarized and apostilled. Examples include the death certificate, the foreign probate record when applicable, and the petition to the court for original or ancillary administration. Depending on the U.S. jurisdiction, appointment of a U.S. co-executor may also be required.

Once appointed, the executor must marshal and administer U.S. assets, satisfy applicable debts and expenses, obtain any required transfer certificate, and, if applicable, file Form 706-NA and pay any U.S. estate tax due. Practical challenges may arise when U.S. assets must be liquidated and deposited into a U.S. estate bank account. In recent years, some financial institutions have expressed reluctance to onboard non-U.S. fiduciaries. In some cases, foreign executors resign in favour of a U.S. fiduciary for logistical ease.

CONCLUSION

There are many considerations involved in designing a testamentary plan, particularly where assets and beneficiaries span multiple jurisdictions. Thoughtful planning can ease the administrative burden on a decedent's family and help ensure that a testator's intentions are carried out as originally expected. One of the most valuable gifts a testator can provide to heirs is a coordinated testamentary plan in which instruments executed in several jurisdictions work together to facilitate administration, preserve intent, and transfer wealth to the next generation in a timely and tax-efficient manner.