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Structuring Foreign Investments in U.S. Real Estate After the Tax Cuts and Jobs Act

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OVERVIEW

This article explains how nonresident alien individuals can structure investments in U.S. real estate to minimize their U.S. income, gift, and estate tax exposure.

The article provides an overview of the federal income, gift, and estate taxation of non-U.S. individuals, before moving to a discussion of federal income, gift, and estate taxation of holding U.S. real estate. The third section of the article walks through the different structuring options for foreign investments in U.S. real estate, such as foreign blocker corporations, foreign parterships, and U.S.

trusts, explaining the pros and cons of each option. The final section discusses new reporting requirements that may affect non-U.S. individuals and entities acquiring interests in U.S. real estate through disregarded entities.

This article also addresses the impact of the Tax Cuts and Jobs Act (TCJA),[1] which was signed into law on December 22, 2017. Although TCJA did not fundamentally alter the taxation of inbound investments in U.S. real estate, it will affect the relative merits of each structure. For example, the reduction in corporate tax rates could make foreign blocker corporations more attractive vehicles for holding U.S. real estate. Other relatively recent developments, such as new reporting requirements that could affect foreign investors who use wholly owned limited liability companies to acquire interests in U.S. real estate, are discussed as well.

INCOME, GIFT, AND ESTATE TAXATION OF NON-U.S. INDIVIDUALS

Income Taxes

U.S. Citizens and Residents

U.S. citizens and resident aliens are subject to U.S. federal income taxes on a net basis on their worldwide income at graduated rates of up to 37%.[2] A 20% deduction may apply to the non-wage portion of "pass-through" income earned by an eligible taxpayer from a qualified trade or business.[3] Long-term capital gains and qualified dividends from U.S. corporations and foreign corporations eligible for treaty benefits (subject to certain limitations) generally are taxed at a 20% rate.[4] An additional 3.8% Medicare tax is imposed on the net investment income of individuals with modified adjusted gross income in excess of $200,000 (if single) and married couples with modified adjusted gross income in excess of $250,000 (if filing jointly).[5] State and local income taxes also may apply.

Nonresident Aliens

In contrast, individuals who are not U.S. citizens or resident aliens ("nonresident aliens") generally are subject to federal income taxes only with respect to the following types of income:

- Income that is effectively connected with the conduct of a trade or business in the United States, including business profits and operating income ("effectively connected income"), which is taxed on a net basis at the federal level at graduated rates of up to 37% (possibly with a 20% deduction for eligible pass-through income);[6]
- Fixed or determinable annual or periodical income (FDAP) from U.S. sources (generally, dividends, interest, rents, royalties, and other portfolio income that is not effectively connected with a U.S. trade or business), which is taxed on a gross basis and subject to withholding at the source at a flat rate of 30%.[7] There are statutory exclusions for certain types of income earned by non-U.S. persons who are not engaged in a U.S. trade or business, including interest on bank deposits and "portfolio" debt obligations;[8]
- Gains from the sale of real property situated in the United States by nonresident aliens are taxable under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) even if the property is held solely for personal or nonbusiness investment purposes.[9] The buyer may be required to withhold 15% of the gross proceeds (including noncash consideration). If this amount exceeds the actual tax due, the seller can file a tax return and apply for a refund.[10]

Gains from the sale by a nonresident alien of most types of assets other than inventory and certain other assets used in a U.S. trade or business and interests in U.S. real estate generally are not taxable.[11] Further, the 3.8% Medicare tax does not apply to nonresident aliens.[12] Many types of U.S. source income are taxed at reduced rates—or exempt from federal income taxation altogether—if the beneficial owner is an eligible tax resident of a country with an income tax treaty in force with the United States.

Estate and Gift Taxes

Federal Estate Tax

U.S. citizens and domiciliaries are subject to U.S. federal estate tax at death on all of their assets, wherever situated. In contrast, noncitizens domiciled abroad (hereinafter "noncitizen nondomiciliaries") are subject to estate tax only with respect to that part of the gross estate that, at the time of death, is situated (or deemed situated) in the United States ("U.S. situs assets").[13] U.S. situs assets include real property and tangible personal property situated in the United States, as well as certain designated types of intangible property, such as stock in U.S. companies.[14]

Treaty Situs Provisions. Some estate and gift tax treaties modify the situs rules for intangible property, granting the country of domicile exclusive taxing rights over stock and debt issued by companies incorporated in the other contracting state. However, even if there is a situs provision granting exclusive taxing jurisdiction over intangible property to the country of domicile, many such provisions allow the country where the underlying real property is located to tax the decedent if more than 50% of the value of the corporation's assets is comprised of interests in U.S. real property.[15]

Federal Gift Tax

The estate tax is backstopped by a gift tax for gifts made during an individual's lifetime. A noncitizen nondomiciliary is subject to U.S. federal gift taxes only with respect to real and tangible personal property situated in the United States. Gifts of intangible property by a noncitizen domiciled abroad (including stock in a U.S. corporation that would otherwise be includable in the decedent's estate) are not generally subject to the gift tax.[16] The top marginal rate for gift, estate, and generation-skipping transfer (GST) tax purposes is 40%.

Reduced Exemption Amounts for Non-U.S. Decedents

Although noncitizen nondomiciliaries are subject to estate tax only on U.S. situs assets, they have a much lower lifetime exemption than their U.S. counterparts. TCJA temporarily doubled the lifetime exemption equivalent amount to $11.18 million (as indexed for inflation) for 2018.[17] However, it made no change to the lifetime exemption for noncitizen nondomiciliaries, which remains at $60,000.[18]

Noncitizen nondomiciliaries are not entitled to a lifetime credit for gift tax purposes. However, they are eligible for the same $15,000 annual exclusion (indexed for inflation) available to U.S. citizens and domiciliaries. Gifts and bequests to a U.S. citizen spouse are eligible for an unlimited marital deduction regardless of the citizenship or domicile of the donor or decedent. Gifts to a spouse who is *not* a U.S. citizen are eligible only for a limited annual exclusion ($152,000 in 2018, as indexed for inflation), again without regard to the citizenship or residence of the donor/decedent.[19]

Prorated Exemption Under Treaty. Although the exemption amount for non-U.S. decedents remains unchanged, a noncitizen domiciled in a treaty jurisdiction who qualifies for the benefits of an estate and gift tax treaty may see an increased exemption on a prorated basis—at least while the increased threshold remains in effect. A number of U.S. estate and gift tax treaties provide eligible residents of the other treaty country a prorated portion of the exemption equivalent amount afforded to U.S. decedents based on the ratio of U.S. situs assets to total assets worldwide (if higher than the $60,000 exemption equivalent amount otherwise available to a non-U.S. decedent).[20] For example, if 20% of an individual's worldwide estate is made up of U.S. situs assets, the prorated exemption would have increased from $1,098,000 in 2017 (20% of $5.49 million) to $2,236,000 in 2018 (20% of $11.18 million). For many owners, this could be sufficient to exclude a pied-à-terre.

State-Level Estate Taxes

Estate tax may also apply at the state level if a non-U.S. decedent dies owning real or tangible personal property situated in a given state. In some cases, a non-U.S. decedent may have a higher exemption amount at the state level than at the federal level. For example, New York's lifetime exemption amount—currently $5.25 million—does not match the increase made to the lifetime exemption amount at the federal level by TCJA. However, because New York State grants nondomiciliaries of New York the same exemption amount regardless of their status at the federal level, a noncitizen nondomiciliary will generally be afforded a higher exemption amount at the state level than at the federal level for real property situated in New York.[21]

U.S. Tax Residence: Different Rules for Income, Gift, and Estate Tax Purposes

Different rules apply for establishing residence for income tax purposes than for estate and gift tax purposes. Residence for income tax purposes is established according to (mostly) objective tests (generally, day count or green card status), while residence for estate and gift tax purposes is based on subjective intent.

Unless otherwise indicated, someone referred to as a non-U.S. individual in this outline is both a nonresident alien individual for income tax purposes and a non-citizen nondomiciliary for gift and estate tax purposes.

Income Tax Residence

Subject to certain exceptions, an individual is a U.S. resident for federal income tax purposes if he or she either (a) meets the "substantial presence test,"[22] or (b) is a lawful permanent resident (green card holder).[23] Under the substantial presence test, if an individual is physically present in the United States for thirty-one days in a calendar year and the sum of (1) such individual's days present in the United States during the current calendar year, (2) one-third of such individual's days present during the immediately preceding calendar year, and (3) one-sixth of such individual's days present during the second preceding calendar year that adds up to 183 days or more, then he or she generally will be considered a U.S. resident. Under this formula, an individual whose annual presence on average adds up to more than 121 days out of the year is likely to become a resident under the substantial presence test.

There are a number of statutory and treaty-based exceptions to the substantial presence test:

- An individual who otherwise satisfies the substantial presence test but who is present in the United States for less than 183 days during a calendar year can still claim nonresident status by filing IRS Form 8840 ("Closer Connection Exception Statement for Aliens") establishing that he or she maintains a tax home in another country and has a closer connection to that country than to the United States.
- An individual who is present in the United States for 183 days or more during a calendar year may still be able to determine his or her income tax liability as if he or she was a nonresident alien if such individual is a dual resident of the United States and a treaty country and is eligible to claim residence of the other treaty country under the "tie-breaker" provision in the treaty.[24] Typically, a treaty tie-breaker provision will look first to permanent residence, then to the individual's center of vital interests, third to his or her place of habitual abode, and fourth to nationality (and, finally, to the competent authorities).

- Further, the day count is actually suspended for certain types of visas, allowing students, teachers, trainees, professional athletes, and certain foreign government-related individuals, as well as for individuals who intended to leave the United States (as evidenced by facts and circumstances), but who were unable to do so because of a non-preexisting medical condition.[25]
- Note that the IRS will deny many of these exemptions if the individual does not timely file the requisite exemption form.

Estate and Gift Tax Residence (Domicile)

An individual is a U.S. domiciliary for U.S. estate and gift tax purposes if his or her primary residence, or domicile, is in the United States, based on physical presence in the United States and intention to remain indefinitely.[26] Intent is measured by various factors including, among other things:

- length of time spent in the United States and abroad;
- visa and income tax filing status;
- location, value, and size of real and personal property and, in the case of real property, whether such property is owned or rented;
- social, business, and religious affiliations;
- jurisdiction(s) where an individual was registered to vote;
- jurisdiction(s) where an individual has been issued a driver's license; and
- statements of domicile made in legal documents.

Because of the subjective nature of the test, it is possible for an individual to be considered a resident for income tax purposes but to continue to take the position that he or she is not a domiciliary for transfer tax purposes. For example, an individual sent to the United States for a temporary work assignment may never become a U.S. domiciliary, while, at the other end of the spectrum, an individual who applies for a green card soon after he or she arrives could become a domiciliary very shortly after arrival based on long-term plans.[27]

Impact of Treaty on Domicile. Certain estate and gift tax treaties modify the rules for domicile, providing fixed periods during which a domiciliary of the other contracting state may remain in the United States and avoid being considered a

U.S. domiciliary without regard to subjective intent, providing eligible taxpayers with more certainty regarding their domicile status and potential estate tax exposure in both countries.

INTERESTS IN U.S. REAL PROPERTY: BASIC RULES FOR NONRESIDENTS

FIRPTA Tax on Gains

Gains from the sale of real property situated in the United States are taxed as effectively connected income under section 897. However, property held for more than a year (other than inventory) may be eligible for long-term capital gain rates (currently 20%). FIRPTA applies to both direct and indirect interests in U.S. real property, including property held through U.S. corporations and both domestic and foreign partnerships. The tax does not apply to the disposition of stock in a foreign corporation that holds U.S. real property unless it elects under section 897(i) to be treated as a U.S. corporation for purposes of the FIRPTA tax.[28]

15% FIRPTA Withholding

A buyer purchasing U.S. real property from a non-U.S. seller generally must withhold 15% of the gross consideration paid and remit this amount to the U.S. Treasury under section 1445.[29] In the case of property that will be used by the transferee as a personal residence, the withholding rate is reduced to 10% if the amount realized does not exceed $1 million,[30] and no withholding is required if the amount realized is $300,000 or less.[31] *Noncash consideration (including the assumption of debt) is subject to withholding.*

The 15% withholding rate imposed on gross proceeds typically results in over-withholding, particularly when the seller is eligible for the long-term capital gain rate of 20% on the gain. The buyer or seller may apply for a withholding certificate from the IRS to reduce the amount required to be withheld if it exceeds the tax owed by filing IRS Form 8288-B. Otherwise, the seller would file a tax return and apply for a refund.[32]

Caution: It is important to remember that even if a seller is over-withheld at the federal level, he or she could still owe taxes at the state or local level.

Gains from the Sale of Stock in a U.S. Real Property Holding Corporation

The sale of stock in a U.S. corporation is subject to FIRPTA tax and applicable withholding if the corporation has been a "U.S. real property holding corporation" at any time during the previous five years.[33]

A "U.S. real property holding corporation" (USRPHC) is any U.S. corporation if the fair market value of its U.S. real property interests equals or exceeds 50% of the sum of its real property interests and business assets worldwide.[34]

Because stock in a USRPHC is considered a U.S. real property interest, the normal withholding rules of section 1445 apply. In fact, certifications and IRS notices are required to establish that a U.S. corporation is not a USRPHC subject to FIRPTA withholding.[35] Stock purchase agreements often require these certifications as a condition of closing the sale.

There are statutory exceptions for interests in publicly traded corporations and REITs:

- *Publicly traded companies and REITs.* Gains from the disposition of stock in a publicly traded corporation that otherwise would be considered a USRPHC will not be subject to FIRPTA tax in the case of a person who owns no more than 5% of the publicly traded shares and who holds no other equity interest in the corporation.[36] If that publicly traded corporation qualifies as a REIT, then the maximum percentage of publicly traded stock that a non-U.S. investor could own without being subject to FIRPTA goes up to 10%.[37]
- *Domestically controlled REITs.* There is another exception for "domestically controlled" REITs.[38] In order for this exception to apply, more than 50% of the stock of the REIT must be owned by U.S. persons. Additionally, the REIT must satisfy numerous income, asset, ownership, and operational requirements in order to qualify as a REIT for tax purposes.

Gains from the Sale of an Interest in a Partnership That Owns U.S. Real Property

Gains from the disposition of an interest in a partnership, whether domestic or foreign, are subject to FIRPTA tax to the extent attributable to U.S. real property interests owned by the partnership.[39]

15% FIRPTA withholding and 50/90 test. Under section 1445, 15% FIRPTA withholding applies to the disposition of an interest in a U.S. or foreign partnership if 50% or more of the value of the gross assets consists of U.S. real property interests *and* 90% or more of the value of the gross assets consists of U.S. real property interests plus cash or cash equivalents.[40] Even if there is no withholding, the sale may be subject to FIRPTA.

New 10% withholding regime. Even if the sale is not subject to FIRPTA withholding, the disposition may be subject to 10% withholding under new section 1446(f). TCJA added new section 864(c)(8) to the Code. This provision treats gains and losses from the sale or exchange of a partnership interest on or after November 27, 2017, as effectively connected gain or loss to the extent a sale by the partnership of its assets for fair market value would have given rise to effectively connected gain or loss (although gains from the sale of a partnership that holds U.S. real property already would have been characterized as effectively connected income under FIRPTA anyway). However, TCJA also added section 1446(f), which requires buyers to withhold 10% of the amount realized by the seller from the sale or exchange of a partnership interest after December 31, 2017, if any portion of the seller's gain on the sale of the interest would be effectively connected income and the seller cannot certify its non-foreign status.[41] As a practical matter, this means that even if an interest in a partnership would not be subject to FIRPTA withholding under the 50/90 test, it may nonetheless be subject to 10% withholding under new section 1446(f).[42]

Section 1446 foreign partner withholding. If a partnership sells an interest in U.S. real property, even if the sale by the partnership is not subject to FIRPTA withholding (*e.g.*, because the partnership is a U.S. partnership), the partnership itself would have a withholding obligation with respect to the effectively connected income (including FIRPTA gains) allocable to its foreign partners under section 1446.

Rental Income from U.S. Real Property

Non-U.S. owners of U.S. real estate who decide to rent out their U.S. property have a strong incentive to file a U.S. tax return and elect under section 871(d) to be taxed on their rental income as if it were effectively connected income ("net rent election"). Absent an election, rental income is taxed as FDAP at a 30% rate (plus applicable state taxes), with no offsetting deductions.

Net rent election. A non-U.S. owner who makes a "net rent" election to treat rent as effectively connected income may be taxed at higher marginal rates, but the owner could deduct property taxes and other expenses and claim depreciation deductions against the rental income. The owner would have to file a federal and possibly state income tax return to report the income.

Estate and Gift Tax Exposure

U.S. real property owned directly or through a wholly owned disregarded entity is includable in the estate of a non-U.S. decedent and subject to gift tax if the owner gifts the property while he or she is still alive.[43] Stock in a U.S. corporation or U.S. partnership is similarly includable in a non-U.S. decedent's estate unless taxing jurisdiction is assigned to the treaty of domicile under an estate tax treaty.

Situs treaties. As previously discussed, some treaties will override the U.S. situs of stock in a U.S. corporation, but usually not if the corporation's assets consist primarily of real property or business assets situated in the United States.

Basis step-up. The "consolation prize" for the estate tax inclusion is a step-up in basis at death under section 1014, reducing taxable gains on a future sale. Note, however, that basis may be stepped *down* if the property has lost value.

COMPARISON OF U.S. REAL PROPERTY OWNERSHIP STRUCTURES

This section compares different structuring options—direct ownership, partnerships, corporations, and trusts. As explained below, the appropriate structure depends in part on who will be using the property and how it will ultimately be owned. For example, if a nonresident is making a sizeable investment and does not expect the property to ultimately be owned by a U.S. person, then a foreign blocker corporation (perhaps with a separate U.S. corporate subsidiary for each underlying property) might be a suitable structure, particularly now that corporate tax rates have come down. If the property will be used by U.S. beneficiaries, then a U.S. nongrantor trust might be preferable. If the property does not have significant value and is not expected to be held long term, then direct ownership (or ownership through a disregarded entity) might be a reasonable option, particularly if the owner can acquire insurance to manage his or her estate tax exposure or is comfortable self-insuring against the potential risk.

Planning Point

It is critical to coordinate with tax advisors in the owner's home jurisdiction, as the optimal structure for U.S. tax purposes may create unworkable tax complications in the client's country of residence. Often, finding the best structure entails identifying the "least bad" option that works in both jurisdictions.

Direct Ownership

Pros and Cons of Direct Ownership

The pros and cons of direct ownership include income tax efficiency and simplicity on the one hand, and estate tax exposure on the other, as the following illustrates:

A non-U.S. person buys an apartment in the United States for her personal use for $2 million and sells the property several years later for $3 million (after closing costs and applicable real estate transfer taxes). Her federal income tax liability would be $200,000 (20% capital gains tax).[44] If the property is located in a high-tax jurisdiction like New York City or California, the total federal, state, and local income tax liability could exceed $300,000.

Direct ownership is the simplest option. Further, the non-U.S. owner could hold the property through a wholly owned limited liability company to limit liability and/or a revocable trust to avoid probate.

If the owner died owning the property after it had appreciated in value to $3 million, the federal estate tax liability would be over $1.1 million. Although there would be a basis step-up, reducing taxable gains on a future sale, the potential income tax savings on a hypothetical future sale would be dwarfed by the estate tax liability. The owner would be wise to take steps to mitigate her estate tax exposure.

With direct ownership, there are a number of options for mitigating—or at least deferring—a non-U.S. owner's potential estate tax liability from U.S. real property held in the United States, including:

(a) acquiring a life insurance policy to cover the estate tax (possibly held in a life insurance trust);

(b) nonrecourse financing; and

(c) a qualified domestic trust (QDOT), if the owner is married to a non-U.S. person.

Each of these three options is discussed in the following sections.

Acquiring Life Insurance

Policies on life of decedent. Proceeds paid on an insurance policy on the life of a nonresident nondomiciled decedent are excluded from the decedent's estate without regard to whether:

(i) the issuer is a U.S. insurance carrier;

(ii) the proceeds are payable to the decedent's estate; or

(iii) the decedent dies owning the policy.[45]

Note: This exception does *not* cover policies issued by a U.S. carrier on the life of someone other than the decedent. The date of death value for such policies would be includable in the decedent's estate.[46]

Non-U.S. Issuer. An alternative is to buy a policy issued by a non-U.S. carrier. Such a policy would not be includable in a non-U.S. person's estate, but could present future tax complications if the holder later becomes a U.S. resident.

Insurance Trust. A non-U.S. person could title the property in a revocable trust to avoid probate and designate the trust as beneficiary of the insurance policy on that non-U.S. person's life. The trust, in turn, could purchase a U.S.-compliant insurance policy.

The inside build-up within a U.S. tax-compliant policy would not be taxable and proceeds paid to the beneficiaries of a policy on the life of a non-U.S. decedent (and only the decedent) would not be includable in the non-U.S. decedent's estate.

Leveraging Property with Nonrecourse Debt

Leveraging the property with non-recourse debt can reduce the net value of the property includable a non-U.S. decedent's estate.

Purchase-money mortgage. Although purchase-money mortgages are often nonrecourse in states like California, this is not always the case with other states that require the property owner to be personally liable on the mortgage. Also, it is much more difficult to refinance an existing mortgage on a nonrecourse basis. A recourse loan is not as effective because recourse liabilities must be allocated among the decedent's U.S. and non-U.S. assets.

Nonrecourse loan. It may be possible to obtain a nonrecourse loan that is secured by the underlying property from a friendly or related non-U.S. party. Because the property owner is a non-U.S. person living outside the United States, the interest would be foreign-source income and would not be taxable to a non-U.S. lender.[47] Even if the property owner became a U.S. resident, the interest potentially could be excludable from income of a non-U.S. lender under the portfolio interest exception in the Code.[48]

Qualified Domestic Trusts (QDOTs) for Married Couples

If the property owner is married, then there may be options for deferring the estate tax until the death of the surviving spouse. Whether an individual is a U.S. or non-U.S. person, he or she is entitled to a 100% estate tax marital deduction for assets left to his or her surviving spouse *if the spouse is a U.S. citizen*. If the surviving spouse is not a U.S. citizen, the estate tax marital deduction is not available—even if the surviving spouse is a green card holder—unless the deceased spouse leaves assets in a qualified domestic trust or the surviving spouse creates a QDOT and adds the assets to it.

Requirements for QDOT. To qualify, a QDOT must meet the following requirements:[49]

- All income must be payable to the surviving spouse for life.
- No principal distributions are permissible to anyone other than the surviving spouse during his or her life, and the principal is subject to estate tax upon the death of the surviving spouse or upon an earlier distribution.
- There must be at least one U.S. trustee with the power to withhold estate tax on any such distribution.
- If the value of the assets transferred to the trust exceeds $2 million—or if the value of offshore real property held by the trust exceeds 35% of its total assets—*then either a U.S. institutional trustee must be appointed or a bond or letter of credit must be posted in an amount equal to 65% of the initial value of the trust's assets.* As a practical matter, where significant assets are involved, this will necessitate the appointment of an institutional trustee.

Note: A QDOT only defers the estate tax until the death of the surviving spouse (or earlier distribution from the QDOT). It does not eliminate estate tax exposure.

Indirect Ownership

U.S. Real Property Holding Corporations

Shares of a USRPHC are U.S. situs assets includable in the estate of a non-U.S. decedent and subject to FIRPTA tax if sold by a non-U.S. person. However, a non-U.S. person could make a gift of the same shares without triggering gift tax because the gift tax does not apply to gifts of intangible property by non-U.S. persons.

Co-op shares. A gift of shares in a co-op by a non-U.S. person would not be subject to gift tax if the shares are respected as intangible property in the relevant jurisdiction. A longstanding tenet of estate and gift taxation is that state law creates property rights and interests, and federal tax law then defines the tax treatment of those property rights.[50] For example, in New York, co-op shares generally are respected as intangible property and can be gifted by a non-U.S. person without triggering gift tax.

Partnerships

Income tax efficiency. Foreign partnerships offer a degree of income tax efficiency because the income is taxed at the partner level, where it may be eligible for long-term capital gain rates. However, the relative income tax advantages over a foreign blocker corporation have been greatly reduced now that corporate tax rates have come down to 21% and are likely overshadowed by the potential estate tax exposure. That said, there may be situations where, due to a foreign tax issues created by the foreign blocker, a foreign partnership is the least bad option for a given client.

- It may also be possible to achieve the equivalent of a basis step-up at death by making a section 754 election after the death of one of the partners.
- Dispositions of an interest in a partnership that holds U.S. real property will likely be subject to withholding under either section 1445 or 1446(f).

Uncertain situs rules and estate tax exposure. Interests in a foreign partnership arguably are not subject to estate tax in the hands of a non-U.S. decedent, but the law is not well developed in this area. There is a risk that the IRS could take an "aggregate" or "look-through" approach and look to the situs of the underlying assets, particularly after Congress adopted an explicitly aggregate approach to the treatment of sales and exchanges of partnership interests in sections 864(c)(8) and 1446(f). Characterization of a partnership interest for estate tax situs purposes may hinge on how the partnership is treated under local law.

Some older IRS authorities and cases look to whether a foreign partnership is a "juridical person" (*i.e.*, an entity that can sue or be sued in its own name apart from its owners) to determine whether situs should be established at the partnership level (*e.g.*, respecting an interest in the partnership as a property interest in the entity, rather than a fractional interest in the underlying assets).[51] Other authorities have looked to factors such as whether the decedent was entitled to the underlying assets and whether there was corporate or partnership continuity after the decedent's death[52] and at least one ruling looked to where the partnership conducted business.[53] The bottom line is that this is an area of law that remains unsettled.

Intangible property for gift tax purposes. Gifts of intangible property by a non-U.S. person are not subject to gift tax, so the gift of an interest in a partnership (domestic or foreign) that holds U.S. real property generally should be treated as a nontaxable gift.

Leveraged partnerships. If the partnership has outstanding liabilities, the donor is deemed to receive consideration equal to his or her share of the partnership's nonrecourse obligations under sections 705 and 752. Thus, a gift of an interest in a leveraged partnership that holds U.S. real estate could be subject to FIRPTA or section 1446(f) withholding.

Foreign Blocker Corporations

The reduction in corporate tax rates to 21% by TCJA has made foreign blocker corporations an attractive vehicle for non-U.S. individuals who wish to acquire U.S. real estate. If properly structured to manage branch profits tax exposure, a foreign blocker can offer income tax efficiency comparable to direct ownership or ownership through a partnership without the estate tax exposure.

Estate tax blocker. Non-U.S. individuals often set up foreign blocker corporations in low-tax jurisdictions (such as the British Virgin Islands or the Cayman Islands) to hold U.S. real property. If corporate formalities are duly observed, a foreign blocker can be an effective shield against estate or gift tax.

Planning Point

Some countries have foreign anti-deferral rules that could make a foreign blocker corporation in a low-tax jurisdiction prohibitively costly from a non-U.S. tax standpoint. Such countries may favor structures that are treated as partnerships under local law. For example, Mexican clients often prefer an Ontario or Scottish partnership structure over, say, a BVI corporation, which could result in adverse tax consequences for Mexican residents. In such cases, a foreign partnership that "checks the box" (files an entity classification election pursuant to Treasury regulations sections 301.7701-1 to 301.7701-3) to be treated as a foreign corporation for U.S. tax purposes may be one way to accommodate the need for U.S. estate tax protection without triggering adverse tax consequences in the client's home jurisdiction.

Income tax efficiency. Until TCJA, there were two main drawbacks to a foreign blocker: (1) corporations were taxed at higher rates than individuals on long-term capital gains (up to 35%), and (2) if the corporation was inherited by U.S. persons, it would be a very tax-inefficient structure, exposing the U.S. owners to double taxation and potential phantom income exposure. The reduction in corporate tax rates to 21% has eliminated the first issue, making foreign corporations much more attractive estate tax blockers to foreign owners who do not plan to gift or bequest their interests in the property to U.S. persons.[54]

Net rent election. If the property will be rented out and the foreign blocker owns the property either directly or through a disregarded entity (such as a single-member LLC), consideration should be given to making a "net rent" election and filing tax returns in the United States so that property taxes and maintenance costs may be deducted against rent.[55]

Branch profits tax. If a foreign corporation owns U.S. real property directly or through a pass-through entity, net gains and other earnings may be subject to a 30% "branch profits" tax on top of any federal or state corporate income tax due.[56] The tax, which is intended to emulate the 30% tax that would apply to dividends from a U.S. corporation, generally can be avoided if the foreign corporation is liquidated in the year of sale and certain other procedural requirements (including a three-year prohibition on effectively connected income and use of the property by certain related parties) are satisfied.[57] The tax may not apply at all (or may apply at a reduced rate) to corporations formed in certain treaty jurisdictions.[58]

Double blocker structures for multiple U.S. properties. If the foreign corporation will hold multiple properties in the United States, it is generally advisable to set up a separate U.S. corporate subsidiary for each property. Although each U.S. subsidiary would be a U.S. real property holding corporation subject to FIRPTA, a U.S. corporation that sold all of its U.S. real property in a taxable sale could be liquidated and its earnings repatriated to the foreign parent without triggering a second level of tax under either FIRPTA or the branch profits tax regime.

Common Reporting Standard. There may be reporting back to the non-U.S. owners' home countries under the Common Reporting Standard (CRS) developed by the Organisation for Economic Co-operation and Development (OECD). Many offshore financial centers (including the Cayman Islands, Bermuda, the British Virgin Islands, Panama, and Mauritius, among others) have committed to the automatic exchange of information under CRS at this point.

Situations Where a Foreign Blocker Corporation May Not Be Efficient. A foreign blocker corporation might not be the best option if the property will ultimately be inherited by U.S. persons, as this would subject the future U.S. owners to double taxation (and possibly phantom income inclusions, depending on the other income earned by the corporation). Another scenario where a foreign blocker corporation might not be the most efficient option from an income tax standpoint is where the property is being rented out and will generate positive income each year. Any distributions from a U.S. subsidiary (or deemed distributions from an unincorporated branch) will be subject to double taxation, and reinvesting the rents may generate the type of income that will be subject to phantom income inclusions.

Irrevocable Trusts

Income tax efficiency and estate tax protection. If the property will be acquired for the benefit of a U.S. person, then a U.S. irrevocable trust may be the most tax-efficient structure, as it balances income tax efficiency with estate tax protection for the settlor. A trust that will invest in U.S. real estate holdings can be structured to provide the same estate tax protections as a foreign blocker corporation (assuming the settlor will not retain any "impermissible strings" under section 2036 and 2038), while preserving long-term capital gain treatment (if applicable). The trust would be taxed on long-term capital gains at a 23.8% rate (including the 3.8% Medicare tax), as compared with 21% for a corporation and 20% for a nonresident individual.

Favorable state laws. It is becoming increasingly common for nonresident individuals to settle trusts in states such as Nevada, Wyoming, Delaware, and South Dakota. These states have favorable trust laws and strong creditor protection. Further, a trust established in the U.S. can still be structured as a foreign trust for U.S. tax purposes if that is desired.

When a U.S. trust is preferable to a foreign trust. If the trust has or is ultimately likely to have U.S. beneficiaries, it generally should be structured as a U.S. trust for tax purposes:

- If a foreign nongrantor trust has U.S. beneficiaries and income is not distributed currently, punitive tax rules apply to distributions of income earned in prior years while the trust was a nongrantor trust. Accumulation distributions generally are taxed as ordinary income and subject to an interest charge for the period over which they were earned. *These rules do not apply to U.S. trusts.*

- There is no FIRPTA withholding when the property is sold by a U.S. trust.
- Uncompensated use of property of a foreign nongrantor trust by a U.S. beneficiary is reportable on IRS Form 3520 as a constructive distribution and can carry out income.[59] However, U.S. beneficiaries can use property owned by a U.S. trust rent-free without triggering a constructive distribution or filing obligation.

When a foreign trust is preferable to a U.S. trust. There are relatively few situations where it is preferable for a trust established to hold U.S. real property to be structured as a foreign trust.

If the trust will have only non-U.S. beneficiaries, then structuring the trust as a foreign trust will prevent any gains from the sale of U.S. real property from being subject to the 3.8% Medicare tax.

Caution: If there is any likelihood that the trust will eventually have U.S. beneficiaries, then the modest tax savings may not be worth the risk of subjecting a U.S. beneficiary to the accumulation distribution rules.

Qualifying a trust as a U.S. trust. In order for a trust to qualify as a U.S. trust for tax purposes, it must satisfy both a "court" test—a court in the United States must be able to exercise primary (but not exclusive) jurisdiction over the administration of the trust[60]—and a "control" test—U.S. persons must control *all* "substantial decisions" of the trust (such as power over distributions, appointment, and removal of trustees, etc.).[61] Power (including veto rights) over a single substantial decision of the trust can cause a trust to "flunk" the control test and be treated as a foreign trust for tax purposes.

Hybrid trusts. Because it is easy to "flunk" the control test, a trust settled in a U.S. jurisdiction with a U.S. trustee can still be considered a foreign trust for U.S. tax purposes if a non-U.S. person has control over a substantial decision.

Accidental expatriations. If a trustee or protector who is a U.S. resident moves abroad and ceases to be a U.S. person, this can cause a U.S. trust to become a foreign trust for tax purposes, triggering a mark-to-market tax on any appreciated property held in trust under section 684. Only gains are recognized, with no offsetting losses.

Funding. If the trust will hold U.S. real property, it is very important that the non-U.S. settlor fund the trust with cash from a non-U.S. account, as a transfer from a U.S. account could be subject to gift tax. The U.S. property should be acquired by the trust (or an LLC created by the trust) and not the settlor. Otherwise, there is potential for an inadvertent taxable gift of U.S. real property to the trust.

Title to Artwork and Other Valuables Held at Residence

Tangible property situated in the United States is considered a U.S. situs asset. If the non-U.S. settlor of a trust set-up to hold U.S. real property keeps a collection of artwork or other valuable collectibles at the apartment and those works are owned by the settlor and not the trust, then those valuables are includable in the settlor's estate. The same considerations apply to a non-U.S. shareholder of a foreign corporation that owns an apartment or other residence in the United States.

NEW REPORTING REQUIREMENTS

Background: Use of Single-Member LLCs

It has become increasingly common for non-U.S. investors to set up U.S. LLCs (typically formed in states like Delaware, Wyoming, or Nevada) to hold U.S. real property. Single-member LLCs are "disregarded entities" for most federal tax purposes under the "check-the-box" regulations unless the owner elects to treat the LLC as a corporation.[62] Holding U.S. real property through a wholly owned LLC—whether the LLC is owned directly or through another entity—generally does not offer any additional tax protection. Rather, the LLC offers liability protection and a measure of anonymity if formed in a state that does not require beneficial ownership information. However, new reporting requirements have begun to chip away at the anonymity offered by this structure.

Reasons for New Reporting Requirements

The United States has enjoyed considerable success with its efforts to combat offshore tax evasion and other financial crimes overseas, in large part due to cooperation from other countries in the enforcement of the Foreign Account Tax Compliance Act (FATCA), which requires foreign financial institutions to identify and report their U.S. account holders to the IRS, and non-financial foreign entities to identify their U.S. owners (if any) to withholding agents. The U.S. network of intergovernmental agreements (IGAs) with partner jurisdictions has been critical to FATCA's success. However, Congress has not been willing to enact implementing legislation that would enable the United States to fully reciprocate.

Spurred by FATCA's success, the OECD developed the Common Reporting Standard (CRS) to facilitate the collection and reporting of information about the beneficial ownership of accounts held at financial institutions in participating jurisdictions. More than 100 countries have agreed to adopt the CRS. However, the United States—almost alone among developed nations—has opted not to join. As global information sharing to combat tax evasion and money laundering becomes the norm with the adoption of the CRS, the United States has faced increasing pressure from other countries to collect information on foreign owners of U.S. entities and increasingly has come to be seen as a potential tax haven for foreign nationals trying to hide assets from tax authorities back home.

The United States is uniquely vulnerable to abuse by non-U.S. persons seeking to launder money or evade taxes in other countries due to the interplay of the entity classification regulations and state laws in jurisdictions that afford a high degree of privacy to the owners of business entities and trusts. Because single-member LLCs are disregarded entities, funding them is a non-event for federal income tax purposes and, until recently, would not have triggered any reporting obligation. Some states require only minimal information to form an entity or trust. For example, in Delaware only the company name and the name and address of the registered agent appear on the certificate of formation. The Division of Corporations does not request, obtain, or store information on an LLC's members or managers.

Until recently, less scrupulous taxpayers could use single-member LLCs to hide their income and assets from tax authorities back home without triggering any tax liabilities or reporting obligations in the United States. With no exchange of information under the CRS—and often no information collected at the state level when LLCs are formed—foreign investors could use such vehicles to launder the proceeds of illegal activities. For example, an investor could use an LLC to anonymously make an all-cash purchase of high-end real estate. The vulnerability of the United States to such abuses was cited in a March 2017 report issued by the European Parliament on tax evasion, money laundering, tax transparency, and U.S.-EU cooperation. The report went as far as to describe the United States as "an emerging leading tax and secrecy haven for wealthy foreigners."[63] More recently, the Tax Justice Network ranked the United States second (behind Switzerland) in its 2018 Financial Secrecy Index.[64]

Measures Adopted by United States

The United States has not adopted automatic disclosure of ownership of entities or trusts comparable to what many EU members have already put in place, but in the last two years it has adopted more limited measures:

1. geographic targeting orders requiring title insurers to identify the beneficial owners of shell companies;
2. updated customer due diligence rules for financial institutions; and
3. IRS Form 5472 reporting requirements for U.S. disregarded entities with foreign owners.

These measures are aimed at the vulnerabilities previously identified—namely, the ability to use single-member LLCs as shell companies to hide assets without triggering any tax liabilities or reporting obligations.

Geographic Targeting Orders

The U.S. Department of the Treasury issued geographic targeting orders (GTOs) requiring title insurers to determine the identities of the owners of limited liability companies, limited liability partnerships, corporations, and similar business entities that buy high-end residential real estate in *all cash* transactions above specified dollar thresholds in designated markets.

Real estate transactions were identified by FinCEN as an area that is particularly ripe for abuse. As explained in an August 2017 FinCEN advisory: "Criminals can use all-cash purchases to make payments in full for properties and evade scrutiny—on themselves and the origin of their wealth—that is regularly performed by financial institutions in transactions involving mortgages."[65] As of May 2, 2017, more than 30% of the real estate transactions reported under the GTOs involved a beneficial owner or purchaser that had previously been the subject of unrelated suspicious activity reports by U.S. financial institutions.[66]

The following are some highlights:

- Individuals who directly or indirectly own 25% or more of the purchasing entity must be reported on FinCEN Form 8300.
- The GTOs do not extend to purchases financed in whole or in part by a bank loan, as financial institutions already are subject to customer due diligence and suspicious activity reporting requirements under the Bank Secrecy Act and FinCEN regulations.
- The GTOs do not yet extend to purchases made by trusts.
- The original GTOs were limited to all-cash purchases in Manhattan and Miami, but were expanded in July 2016 and August 2017 to cover purchases in other geographic areas.[67]
- The GTOs did not previously cover wire transfers, but as of August 22, 2017, they now extend to all cash purchases made by wire or funds transfer.

The thresholds for each metropolitan area covered by the GTOs as of August 2017 are laid out in the following table:

Geographic Area	Reporting Threshold
Manhattan	$3,000,000
Honolulu, Hawaii	$3,000,000
Northern California Bay Area: San Francisco, San Mateo, and Santa Clara Counties	$2,000,000
Southern California: San Diego and Los Angeles Counties	$2,000,000
Brooklyn, Queens, Bronx, and Staten Island, New York	$1,500,000
Miami-Dade, Broward, and Palm Beach Counties, Florida	$1,000,000
Bexar County, Texas (San Antonio area)	$500,000

However, we note that the latest extension of the GTOs in March 2018 was not announced by the usual press releases that accompanied previous GTOs.[68] We have heard anecdotally that the reporting thresholds may have been reduced in some jurisdictions and that the reporting requirements have been further expanded, but no new details have been published by FinCEN.

FinCEN Customer Due Diligence Regulations

On May 11, 2016, FinCEN announced new customer due diligence (CDD) rules, effective May 11, 2018, for banks, brokers, mutual funds, and futures commission merchants. Technical amendments to the CDD rules were issued September 29, 2017.

Under the new CDD rules, affected financial institutions are now required to collect information on individuals who own (directly or indirectly) 25% or more of the equity of the entity holding the account or who have significant responsibility to control, manage, or direct the entity (such as a CEO, CFO, COO, president, vice president, managing member, general partner, treasurer, or other officer with similar authority).

Trusts are not covered by the new rules because they are not legal entities, so institutions are not required to report information on trust beneficiaries. However, covered institutions are required to obtain information on the trustees and any other control persons (for example, the settlor in the case of a revocable trust).

Form 5472 Filing Requirements for U.S. Disregarded Entities with Foreign Owners

The IRS announced final regulations On December 12, 2016, requiring U.S. disregarded entities (such as single-member limited liability companies) with foreign owners to file IRS Form 5472 information returns identifying their foreign owners and reporting certain related party transactions.[69] The following overview outlines the regulations' new requirements:

- The new reporting requirements are effective for tax years beginning on or after January 1, 2017 and ending on or after December 13, 2017.
- Entities covered by the new rules will continue to be disregarded for most federal tax purposes, but they will be "regarded" for Form 5472 reporting, record-keeping, and other compliance requirements.[70]

- Covered entities need to obtain EINs. This could present potential complications in some cases. If the responsible person is a nonresident alien who does not already have an ITIN or a Social Security number, then he or she will need to apply for an ITIN by filing IRS Form W-7. The process can take a few months and requires original or certified copies of the applicant's passport or other official documents confirming his or her identity.[71]
- The disregarded entity is required to keep permanent books and records sufficient to establish the correct U.S. tax treatment of any transactions with related parties, including information, documents, and records of the foreign owner that may be relevant.
- The penalty for failure to timely file a correct Form 5472 was $10,000 for the 2017 tax year, but was increased by TCJA to $25,000 for future tax years. If the IRS issues notice of the reporting entity's failure to file and no form is filed within ninety days of such notice, an additional $25,000 penalty will apply for each additional thirty days that the form is delinquent.

The new Form 5472 reporting requirements for foreign-owned disregarded entities were piggybacked onto the existing Form 5472 reporting obligations under section 6038A for 25% foreign-owned U.S. corporations:

- The new regulations not only extended the filing requirements to disregarded entities, but also greatly expanded the range of transactions and activities that would trigger a reporting obligation if the U.S. "reporting corporation" is an otherwise disregarded entity.
- As explained in the preamble to the proposed regulations, the new reporting requirements are specifically intended to capture transactions—such as contributions to, and distributions from, disregarded entities—that would not otherwise have any income tax significance or trigger a reporting obligation.[72]

Form 5472 only needs to be filed in a given tax year if the U.S. disregarded entity engages in a "reportable transaction." However, reportable transactions include a broad range of transactions between the disregarded entity and any "related party" (including the direct or indirect foreign owner and certain other foreign persons related to the owner). This can include transactions for which cash or other property is received as consideration, as well as transactions for which no monetary consideration is received or for which less than adequate consideration is paid.[73]

- Reportable transactions include "any sale, assignment, lease, license, loan, advance, contribution, or any other transfer of any interest in or a right to use any property (whether tangible or intangible, real or personal) or money, however such transaction is effected, and whether or not the terms of such transaction are formally documented. Reportable transactions also include the performance of any services for the benefit of, or on behalf of, another taxpayer."[74]
- In the case of a disregarded entity, reportable transactions also include amounts paid or received in connection with the formation and dissolution of the entity, *including contributions to and distributions from the entity*, whether or not such amounts would otherwise be reportable.[75]
- Note that if the LLC checks the box to be treated as a corporation (for example, to serve as the U.S. corporate subsidiary of a foreign blocker corporation), the funding of the (now corporate) LLC by the foreign blocker corporation will not be a reportable transaction.[76] However, the LLC will have to file U.S. tax returns (IRS Form 1120).

There is no grandfathering rule for existing structures. Thus, it is very difficult to unwind an existing structure with assets held by a non-U.S. person through a U.S. disregarded entity without triggering a reporting obligation under the new rules.

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NOTES

1. Pub. L. No. 115-97, 131 Stat. 2954 (2017) [hereinafter TCJA].
2. The top marginal rate for individuals was reduced from 39.6% to 37% by TCJA. The top rate is scheduled to return to 39.6% in 2026.
3. I.R.C. § 199A (all references to the "I.R.C." and the "Code" are to sections of title 26 of the U.S.C.).
4. *Id.* § 1(h)(11); I.R.S. Notice 2004-70, 2004-44 I.R.B.724. Higher rates apply in the case of certain collectibles and depreciable property that has been placed in service (to the extent that depreciation recapture applies.
5. I.R.C. § 1411.
6. *Id.* §§ 871(b), 199A. No deductions are allowed if the taxpayer fails to file a U.S. federal income tax return. *See id.* § 874(a).
7. *Id.* §§ 871(a) and 1441. Note that nonresidents may elect on their federal income tax returns to be taxed on rental income from the leasing of real property on a net basis (as if the rent was active business income). Higher marginal rates may apply, but offsetting deductions for property taxes, depreciation and other expenses may reduce the effective tax rate. *See id.* § 871(d).
8. *Id.* §§ 871(h), 871(i), 881(c), and 881(d). Interest on many debt obligations issued after July 18, 1984, is excludable from income in the hands of a nonresident alien and exempt from withholding tax under the "portfolio interest" exception in I.R.C. §§ 881(c) and 1441(c). The exception does not apply to contingent interest or interest paid to someone who owns 10% or more of the voting stock of the issuing corporation or 10% or more of the capital or profits interest of the issuing partnership. The debt instrument must be in "registered" form and the withholding agent must obtain certification of foreign status and eligibility from the holder on the appropriate Form W-8.
9. *Id.* §§ 897, 1445. If the seller is not a developer and does not otherwise hold the property as inventory, gains will be eligible for long-term capital gain treatment if the property has been hold for more than one year (subject to depreciation recapture if the property has been placed in service and depreciated).
10. The withholding tax may be reduced or eliminated in some cases by applying for a withholding certificate on I.R.S. Form 8288-B ("Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests").
11. Note that a nonresident who is present in the United States for more than 183 days in a calendar year potentially may be taxed in the United States on his or her capital gains under Code sections 871(a)(2) and 865(g)(1)(A)(i)(II) if his or her "tax home" (generally, a principal place of work or business) is in the United States.
12. *Id.* § 1411(e).
13. *See id.* §§ 2101(a), 2103.
14. *Id.* § 2104(a); Treas. Reg. § 20.2104-1(a)(5).
15. *See, e.g.*, Estate Tax Treaty, U.S-France, art. 5, Nov. 24, 1978.

16. Certain individuals who expatriated under prior law and are subject to the alternative tax regime of Code section 877(b) are subject to gift tax on gifts of intangible property. *See* I.R.C. §§ 2501(a)(3)(A), 2501(a)(5).
17. The exemption returns to pre-TCJA levels (as adjusted for inflation) in 2026.
18. I.R.C. § 2102(b). Noncitizens who are not domiciled in the United States still should have the same GST tax exemption equivalent amount as U.S. citizens and domiciliaries based on earlier Treasury regulations. *See* Treas. Reg. § 26.2663-2(a).
19. *See* I.R.C. §§ 2056(d), 2523(i). U.S. residence (even green card status) is not sufficient "U.S." status for the unlimited deduction.
20. The proration requirement is spelled out in some treaties and imposed by the Code for others. Code section 2102(b)(3)(A) provides that, to the extent required by any treaty obligation of the United States, the exemption amount available for U.S. residents will be prorated for nonresidents based on the ratio of U.S. situs assets to total worldwide assets.
21. N.Y. Tax Law § 960(c)(2) imports a number of federal estate tax provisions governing the estate taxation of nonresidents, but notably excludes Code section 2102, which limits the lifetime credit for nonresidents to $13,000 (a lifetime exemption equivalent of $60,000). Note, however, that if New York property exceeds the New York exemption amount by more than 5%, then the decedent loses the state-level exemption entirely and the full value of the New York property is subject to New York estate tax.
22. I.R.C. § 7701(b)(1)(A)(ii) and (b)(3)(A).
23. An individual who is a permanent resident alien for U.S. immigration purposes holds a "green card." Code section 7701(b)(1)(A)(i) and Treas. Reg. § 301.7701(b)-1(b)(1) define a lawful permanent resident as an individual meeting the green card test.
24. Note that a dual resident who takes a treaty-based return position to be taxed as a nonresident is still considered a U.S. resident for most other federal income tax purposes, including, for example, in determining whether a foreign corporation owned by such individual is a controlled foreign corporation under section 957 and whether a trust of which such individual is a trustee would be considered a U.S. trust or a foreign trust under section 7701(a)(30)(E). *See* Treas. Reg. § 301.7701(b)-7.
25. I.R.C. § 7701(b)(3)(D), (5); Treas. Reg. § 301.7701(b)-3. The taxpayer would have to file IRS Form 8843 ("Statement of Exempt Individuals and Individuals with a Medical Condition").
26. Treas. Reg. §§ 20.0-1(b) and 25.2501-1(b).
27. There is some precedent indicating that an individual who is present in the United States on a temporary nonimmigrant visa may nevertheless be capable of forming the intent to be a U.S. domiciliary. Estate of Jack v. United States, 54 Fed. Cl. 590 (2002); Rev. Rul. 80-29, 1980-2 C.B. 248.
28. A nonresident alien who owns U.S. real property might make this election so that he or she can contribute the property to a foreign blocker corporation for estate tax protection without triggering gain recognition under FIRPTA. In general, the contribution of U.S. real property to a foreign corporation would trigger gain recognition under FIRPTA, but this election allows the contributor to defer recognition of gain in exchange for being taxed on any subsequent disposition of the shares of the foreign corporation.

29. I.R.C. § 1445(a).
30. *Id.* § 1445(c)(4).
31. *Id.* § 1445(b)(5).
32. The seller generally would be required to file a tax return to report any gains from the sale anyway.
33. I.R.C. § 897(c)(1)(A)(ii).
34. *Id.* § 897(c)(2).
35. Treas. Reg. § 1.897-2(h).
36. I.R.C. § 897(h)(1).
37. *Id.* § 897(k). Note that stock in such a security still would be considered a U.S. situs asset for estate tax purposes.
38. *Id.* § 897(h)(2).
39. *Id.* § 897(g); Treas. Reg. § 1.897-7T.
40. Treas. Reg. § 1.1445-11T.
41. The partnership itself has a secondary withholding obligation.
42. The IRS has authority to reduce the amounts required to be withheld (for example, if the amount required to be withheld exceeds the actual tax owed). This would be similar to existing procedures under the FIRPTA withholding regulations. The IRS announced in Notice 2018-08 that it would hold off on imposing the new withholding obligations sales of certain publicly traded partnerships. However, sellers who recognize effectively connected income from the sale of a partnership interest still must file a tax return to report the gains.
43. *See* I.R.C. §§ 2101(a), 2103, 2104(a); Treas. Reg. § 20.2104-1(a)(5).
44. There would be no 3.8% Medicare tax since the seller is a nonresident alien. *See* I.R.C. § 1411(e).
45. *Id.* § 2105(a); Treas. Reg. § 20.2105-1(g).
46. Treas. Reg. § 20.2104-1(a)(4). The fair market value of the policy at the owner's death, rather than the face amount of the policy, is included in the owner's gross estate. *Id.* §§ 20.2031-1(b), 20.2031-8(a).
47. *See* Treas. Reg. § 1.861-2; I.R.S. Chief Counsel Advice 201205007 (Oct. 18, 2011).
48. *See* I.R.C. § 871(h).
49. *See id.* § 2056A; Treas. Reg. § 20.2056A-2.
50. *See* Morgan v. Comm'r, 309 U.S. 78 (1940).
51. *See* I.R.S. Gen. Couns. Mem. 18,718, 1937-2 C.B. 476 (Jan. 1, 1937).
52. *See* Sanchez v. Bowers, 70 F.2d 715 (2d Cir. 1934).
53. *See* Rev. Rul. 55-701, 1955-2 C.B. 836 (Jan. 1, 1955).
54. There may be state or local differences in the tax treatment of individuals and corporations that may favor one form of ownership over another.
55. *See* I.R.C. § 882(d).
56. *See id.* § 884.
57. *See* Treas. Reg. § 1.884-2T(a)(1), (2). There is a three-year prohibition on effectively connected income and use of the same U.S. assets by certain related parties.
58. The branch profits tax does not apply to eligible corporations formed in countries that have treaties that were in force (and which have not since been amended) when the branch profits

tax was introduced in 1987, including China, Korea, Norway, Cyprus, Egypt, and Pakistan, among others. The branch profits tax also does not apply to treaty-eligible corporations formed in France, the United Kingdom, the Netherlands, Mexico, Australia, and Japan that own 80% or more of a U.S. "branch" (including a wholly owned limited liability company). The tax applies at reduced rates to corporations formed in many other treaty jurisdictions.

59. *See* I.R.C. § 643(i).
60. *See* Treas. Reg. § 301.7701-7(c).
61. *See id.* § 301.7701-7(d).
62. *See id.* § 301.7701-2(a).
63. European Parliamentary Research Serv., EU-US Trade and Investment Relations: Effects on Tax Evasion, Money Laundering and Tax Transparency: Ex-Post Impact Assessment (Mar. 6, 2017), www.europarl.europa.eu/RegData/etudes/IDAN/2017/598602/EPRS_IDA(2017)598602_EN.pdf.
64. *See* Tax Justice Network, Financial Secrecy index 2018: Narrative Report on USA (Jan. 30, 2018), www.financialsecrecyindex.com/PDF/USA.pdf; *see also Financial Secrecy Index*, Tax Justice Network—2018 Results, www.financialsecrecyindex.com/introduction/fsi-2018-results (last visited May 30, 2018).
65. FinCEN Advisory FIN-2017-A003 (Aug. 22, 2017).
66. *Id.*
67. *See* News Release, U.S. Dep't of Treasury, FinCEN Targets Shell Companies Purchasing Luxury Properties in Seven Major Metropolitan Areas (Aug. 22, 2017), www.fincen.gov/news/news-releases/fincen-targets-shell-companies-purchasing-luxury-properties-seven-major.
68. *See* Nicholas Nehamas & Kevin G. Hall, *The Hunt for Dirty Money in Miami Real Estate Is Working—and Will Continue, Feds Say*, Miami Herald (Mar. 21, 2018), www.miamiherald.com/news/business/real-estate-news/article206232819.html#storylink=cpy.
69. *See* Treatment of Certain Domestic Entities Disregarded as Separate From Their Owners as Corporations for Purposes of Section 6038A [T.D. 9796], 81 Fed. Reg. 89,849 (Dec. 13, 2016).
70. *See* Treas. Reg. § 301.7701-2(c)(2)(vi).
71. We note that taxpayers have been able to obtain EINs for limited liability companies in some cases by fax without a responsible person ITIN or social security number. However, there is a significant risk of pushback from the IRS, so one would be wise to apply for one well in advance.
72. 81 Fed. Reg. 28,784 (May 10, 2016).
73. *See* Treas. Reg. § 1.6038A-2(a)(2), (b)(3), and (b)(4).
74. *See id.* § 1.482-1(i)(7) (cited by the section 6038A regulations).
75. *Id.* § 1.6038A-2(b)(3)(xi).
76. Certain other related-party transactions could still trigger a filing obligation in subsequent years.