Including Noncitizens in Your Estate Planning

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Table of Contents

About Janet L. Brewer

Janet L. Brewer is the principal of the Law Office of Janet L. Brewer, which has its headquarters in Palo Alto, California. Janet serves clients throughout the Bay Area and Silicon Valley. She is certified by the California State Bar Board of Legal Specialization as an estate planning and probate specialist – one of fewer than 100 practicing in Santa Clara County and fewer than 1,100 practicing in California (out of over 250,000 lawyers statewide). For more than 20 years, she has focused her practice on estate planning and probate matters, including the preparation of wills, revocable trusts, tax-sensitive trusts, and gift planning. Janet also assists clients in the formation of family limited partnerships and limited liability companies.

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Including Noncitizens in Your Estate Planning

With our society becoming increasingly mobile and international travel becoming more affordable than ever before, families and family-like relationships have steadily grown far more diverse in terms of citizenship. It is no longer uncommon for spouses from different ountries to retain citizenship in their native countries. Many couples split their time between the United States and another country to be near their families and enjoy the many benefits of such a lifestyle. In addition, it is not uncommon for a couple's children or other loved ones to move away from their country of origin and take up permanent residence abroad, or even renounce their home country citizenship, depending on their choices of careers or domesticpartners or other considerations.

Diversity of citizenship among friends and family also creates a fair share of complications. One complication is in the area of estate planning, which may be one of the more overlooked challenges of citizenship diversity within a family. Estate planning law is already complex—adding international legal issues to the mix can exponentially increase that complexity. Therefore,

you must seek competent legal advice for your specific situation. Articles such as this one can serve, at most, only to raise awareness of some of the complexities that you are likely to encounter when engaging in such planning.

Naming Noncitizens to Handle Your Legal Affairs

An important threshold question in estate planning is whom you should name as your legal representatives to handle your personal affairs if you become incapacitated or die. If you are a US citizen and own accounts and property in the United States, there may be unforeseen consequences if you name a noncitizen spouse, friend, or family member as executor, trustee, or agent under a power of attorney.

Executors and Personal Representatives

In many states, there are few restrictions on whom you can appoint as your executor or personal representative under your will. If you have a noncitizen child or spouse and you trust that person above anyone else to handle your affairs after your death, you can name that person. As long as he or she follows the laws of the state where your will is probated, your designated person can carry out the executor or personal representative duties without a problem. Some states, such as Florida, still require that the

executor of your estate be a US citizen. It is important that you know about these state-specific differences before executing your estate planning documents.

Even if a particular state allows individuals to name a noncitizen executor or personal representative under a will, it does not necessarily mean that it is a good idea. There are important practical considerations too, such as day-to-day management of real property owned by the estate, or the collection, safeguarding, and sale of personal belongings, pets, and businesses. Asking someone who lives in a foreign country to handle such affairs could impose a heavy burden on that person and create significantly higher administration costs. In addition, having a foreign executor may make it more difficult for your beneficiaries to legally compel the executor to fulfill the position's duties if that person fails to properly carry them out.

Trustees

Today, many people use a living trust for estate planning purposes. This legal tool has many benefits, including the ability to avoid probate and ease of administration for the trustee. But take care when naming a noncitizen as the successor trustee. If the trustee is a noncitizen or a US citizen who resides outside the United States, the trust could be treated by the Internal Revenue Service (IRS) as a foreign trust, leading to adverse tax consequences for the

trust's beneficiaries. For example, if the trust is deemed to be a foreign trust, the IRS could impose mandatory withholding requirements on the trustee or recognize capital gains tax on appreciated assets such as stock, even before the property's sale.[1] Certain tests must be applied to a trust to determine whether it qualifies as a foreign trust. These tests are fairly technical, and a drafter of the estate plan documents must take great care when creating a trust that will have a noncitizen trustee or successor trustee.

Naming a noncitizen as a trustee may raise challenges similar to the ones described above for an executor or personal representative. Because of the potential risks and complications associated with naming a noncitizen as trustee, consider naming a US citizen who resides in the United States as a co-trustee to serve alongside the noncitizen trustee. Naming a trustee who resides outside the United States may also subject the trust's assets to the laws of a foreign country and expose the trust to potential taxation by that country.

If there is no one whom you trust to carry out this important responsibility, you may need to hire a professional trustee, such as a US corporation, bank, or accounting firm that routinely performs this function. Doing so can protect your named beneficiaries from unintended negative tax and legal consequences. Of course, there may be higher administrative costs with a

[1] *I.R.S., Foreign Trust Reporting Requirements and Tax Consequences, https://www.irs.gov/businesses/international-businesses/foreign-trust-reporting-requirements-and-tax-consequences (Sept. 19, 2020).*

professional trustee, but the value that the corporate trustee's professionalism and efficiency will generate often far outweighs the higher costs, resulting in potentially greater savings to the trust and its beneficiaries than you would gain by choosing a family member or friend to be trustee.

Financial and Healthcare Agents

There is also some question as to whether a US citizen can name a noncitizen as an agent under a financial or healthcare power of attorney. In most cases, you can name any person whom you trust to be your agent under a durable financial power of attorney, healthcare power of attorney, or advance healthcare directive. However, some states may have specific requirements for a noncitizen serving as an agent.

It is most important that you choose someone you trust to make decisions for you if you are incapacitated; naming a noncitizen that you trust may be worth any hassles the person may face. Nevertheless, you may still want to consider the practical challenges that can arise if your chosen agent is living outside the United States when the agent needs to act on your behalf. Will the distance and travel requirements impair the agent's ability to act quickly? For that reason, it may be a better idea to name a resident US citizen whom you trust to act as your agent to avoid any question about the person's authority to act and

the ability to act quickly because of proximity to you, your healthcare providers, and your US-based accounts and property.

Naming a Foreign Person as a Beneficiary of Your Estate or Trust

A related but different problem arises when a beneficiary of a US-based trust or estate is a noncitizen or a US citizen who lives in another country. An executor or trustee that pays income from a trust or estate to a foreign person as defined by the tax code is typically required to withhold 30 percent of the funds prior to making such distributions, regardless of what the ultimate tax liability will be.[2] These mandatory withholdings can create additional complexity and administrative costs and result in smaller distributions for the beneficiary than what the creator of the trust may have intended. In addition to the withholding requirement, naming a beneficiary who resides in a foreign country may allow the foreign country to tax the property and accounts of the trust.

Another important issue to consider is that, in contrast to spouses who are both citizens of the United States, if you have a noncitizen spouse, the unlimited marital deduction

[2] *In most cases, a foreign person is subject to US tax on its US source income. Most types of US source income received by a foreign person are subject to US tax of 30 percent. A reduced rate, including exemption, may apply if there is a tax treaty between the foreign person's country of residence and the United States. The tax is generally withheld (Chapter 3 withholding) from the payment made to the foreign person. See I.R.S., Publication 515 (2020), Withholding of Tax on Nonresident Aliens and Foreign Entities, https://www.irs.gov/publications/p515 (Feb. 14, 2020).*

for gifts and inheritances passed between spouses is not available to you. Certain complex rules apply when determining what you can leave to your noncitizen spouse free of estate taxes. In addition, the noncitizen spouse is not subject to the presumption that each spouse owns 50 percent of jointly owned property. Instead, a noncitizen spouse must be able to trace the amount of the spouse's own money or earnings contributed to the purchase of the joint property. Failure to do so could result in significant additional tax liability at the death of the citizen spouse.

Note that some international tax treaties between the United States and other countries may impact the withholding requirements imposed by these IRS rules. Thus, it is important to obtain competent legal advice if you intend to name a foreign beneficiary in your estate documents.

All this being said, do not let the fact that you have loved ones who live abroad or who have maintained citizenship in other nations discourage you from planning for your estate. Just realize that you may need additional help to understand how state, federal, and international law will apply to the decisions you make. It will be well worth the effort, and we are delighted to help you along the way. Give us a call today.

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