

Guide to US Federal Estate Tax



US Federal Estate Tax

US Federal Estate Tax can arise in Irish estates, even if the level of US assets held is relatively modest. The US levies Federal Estate Tax on all of the assets of the deceased if he was a US citizen, or held a US passport or green card on the date of death. Other persons come within the charge to US tax if they hold assets located in the US such as shares in US multinationals.

In recent years an increasing number of Irish estates have had to deal with the spectre of US Estate Tax simply because the deceased held US shares, either because he worked for a US company and received employee shares, or because a US company was regarded as a good investment. In many such cases the deceased would have been unaware of any US tax exposure.

Unlike Ireland, the US does not have automatic spouse relief. If US assets pass from a US citizen to a spouse who is not a US citizen relief will not be available. If both spouses are US citizens an exemption will apply.

Ireland US Double Taxation Agreement

Ireland and the United States have a Double Taxation Agreement (“DTA”) which is one of the older agreements, having come into force circa 60 years ago (on 20 December 1951). The DTA covers inheritance tax but does not apply to gift tax, and it covers US Federal Estate Tax, but does not apply to any estate tax that may be levied by individual States in the US.

Under the DTA the taxable status of an asset depends on its location (or situs). If an asset is located in Ireland it is primarily taxable in Ireland, and the US will give a credit for the Irish tax paid on that asset. If the asset is located in the United States then tax will be primarily payable in the US and the Irish Revenue will allow a credit for the US tax paid. The DTA contains a specialised set of rules to determine the situs of assets, and the taxing rights of Ireland and the US. In general assets such as real property and shares are taxable in the country in which the asset is located or where the company is incorporated. Assets such as bank accounts are taxable in the jurisdiction in which the deceased was domiciled at the date of death.

In most cases when Irish estates have an exposure to

US Federal Estate Tax, the tax arises on shares in US companies. Under the DTA such shares are deemed to be located in the US, giving the US primary taxing rights in regard to these assets. In practice the Registrar of a US company is unlikely to release the shares held by the deceased to the personal representative of the estate without being provided with IRS Form 5173 - Estate Tax Closing Document, which is the US equivalent of the old CAT Clearance Certificates. There is no set de minimus below which the Registrar cannot request this form, and our experience is that Registrars of US companies will not release shares without prior clearance from the Inland Revenue Service (“IRS”).

The position is complicated because US Estate Tax has been in a position of flux for the last 2 years. The existing legislation expired at the end of 2009, and there was some debate on what tax regime should replace it. This ultimately led to an “estate tax holiday” in 2010, with estate tax being re-introduced from 01 January 2011.

Estate Tax for Deaths Before 31 December 2009

For US citizens the threshold amount was US\$3.5m, so if the estate of a deceased US citizen was less than US\$3.5m there was no exposure to US Federal Estate Tax. A taxpayer who was not a US citizen (described for US tax purposes as a non resident alien) only had a threshold of US\$60,000. Up to 2009 the tax rates varied from the base rate of 18% up to top rate of 45%.

The US Federal Estate Tax rate increased as the value of the estate increased, based on set tax bands. For example if the US located assets had a value of US\$300,000 the 2009 tax rate would have been 34%.

Estate Tax For Deaths After 31 December 2009

In 2010 an element of uncertainty was introduced to the area of US Federal Estate Tax. The tax rules brought into effect by the Bush Administration in 2001 were due to expire at the end of 2009. It was anticipated at the time that the US Congress would introduce new legislation in order to extend the 2010 US Federal Estate Tax rules to cover later deaths, but Congress did not introduce any legislation, and US Federal Estate Tax lapsed for 2010.

Under existing US tax legislation, once the Estate Tax provisions lapsed, shares and other capital assets which

were not subject to Estate Tax were not rebased on death. The beneficiary took them at the base cost that had applied to the deceased, giving rise in some cases to a higher CGT cost on a future sale by the estate or beneficiary. There is some provision for increasing or stepping up the base cost to reflect the fact that the asset was received as a benefit from an estate. The overall effect of these rules should be a lower base cost than if the asset was rebased to date of death value, so this CGT provision goes some way towards compensating the US exchequer for the loss of 2010 Estate Tax.

There was much speculation during 2010 that some form of retrospective legislation would be introduced to extend the 2009 rules to 2010; however this did not occur. In December 2010 President Obama introduced the Tax Relief Act which set out new rules for deaths occurring after 31 December 2009. The Act gave a choice for 2010 deaths of paying Federal Estate Tax, or taking the assets free of estate tax but not rebasing for CGT purposes.

The top rate of US Federal Estate Tax was reduced from 45% to 35% for deaths occurring after 31 December 2009. For US citizens and US resident individuals the exemption amount was increased from US\$3.5m to US\$5m. For non resident aliens the threshold amount remains at US\$60,000.

Following the introduction of the new rules in December 2010, executors of an estate where the deceased died in 2010, can opt to go with CGT treatment (taking a stepped up version of the deceased's base cost which passes to the beneficiary) or opt for paying Federal Estate Tax under the new 2010 rules. This election must be made before 15 November 2011. The IRS is issuing a new form (Form 8939) that will be used to make the election. A final version of the form will be available in the autumn.

US Tax Compliance

The US Federal Estate Tax return and tax are normally due within 9 months of the date of death of the deceased. If a return is filed late, and/or the tax liability is paid late, interest and penalties will be charged by the IRS.

Taxpayers can apply for a 6 month pay and file extension but this extension must be applied for within 9 months of the date of death.



If there are mitigating circumstances the IRS may consider some abatement of the interest and penalties.

Unlike the Irish CAT system in place since 2010 (the new online ROS system) the administration of US Estate Tax returns can be a relatively slow process. The average processing time for a Federal Estate Tax return is 6 to 9 months. The administration of an estate which has a US tax element can be delayed significantly due to the US Estate Tax requirements.

If the pay and file extension is granted penalties will not be charged if the return and payment are submitted after 9 months (but before 15 months). However interest will still apply from 9 months after the date of death to the date of payment.

For estates where the deceased died in 2010 the filing date for estate tax returns will be 9 months from the passing of the Tax Relief Act (19 December 2010). Therefore the filing date for most 2010 estates will be 19 September 2011.

Conclusion

It is worth noting that US Federal Estate Tax differs from Irish CAT due to the fact that it is a tax on estates rather than on beneficiaries. Under the Irish CAT system the tax is payable by a beneficiary by reference to a valuation date which in many cases can arise over a year or more after the date of death.

In many cases the deadline for filing a US tax return will have passed by the time the Irish CAT return is filed, giving rise to US interest and penalties. Estate practitioners should consider the US tax position when identifying the non-Irish assets in preparing the Inland Revenue Affidavit.

O'Hanlon Tax Limited provides a service of preparation and filing US Federal Estate Tax returns. For more information in regard to this services please contact OHT.

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Caveat: These notes are intended as a general guide to US Federal Estate Tax. OHT has endeavoured to provide an accurate commentary but the notes cannot cover all circumstances. OHT recommends that formal tax advice be obtained before any steps are taken that may have a tax effect.