Recent Death of Non-U.S. Parent with U.S. Children – What Do We Do?

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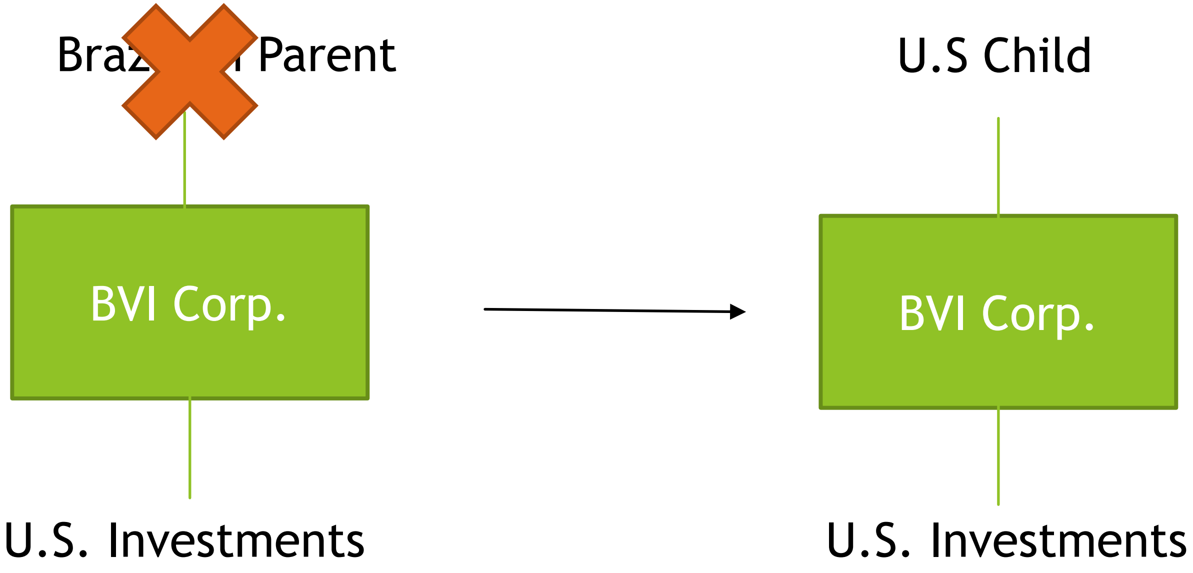
Review of U.S. Estate Tax

- Who is taxed?
  - U.S. residents – worldwide assets
  - Non-U.S. residents – U.S. situs assets
    - Includes U.S. investments, stock, equities, real estate
- Exemption amount
  - 2017: $5.49 Million
  - 2018: $11.18 Million
  - Combined with lifetime gifts
  - Non-U.S. residents: $60,000

Case Study for this Presentation

- Brazilian parent owns a BVI corporation holding U.S. investments.
- Brazilian parent dies; ownership of the BVI corporation is transferred to U.S. child.



No U.S. estate tax – BVI Blocker

Controlled Foreign Corporations

- CFC: a foreign corporation owned over 50% by a U.S. person.
- Undistributed income of CFC taxed at highest ordinary income rates to U.S. person each year.
- Without making an election, the BVI corporation in our example would be a CFC.

Prior to 2018…

- “Check the box” election on IRS Form 8832 – Entity Classification
  - Specify type of entity and effective date.
  - Effectively is a “liquidation” of the foreign corporation.
- Had 30 days to file after death of beneficial owner of company before subsequent owner was taxed as owning a CFC
  - Can also be retroactive 75 days (therefore 105 days).
- New U.S. shareholder receives stepped up basis in the shares
  - No adverse tax consequences.

After January 1, 2018...

- What did the new tax law change?
  - Elimination of 30 day window.
- Result is CFC status immediately at death of Brazilian parent.
- If the effective date of the check the box election is prior to the death of the Brazilian parent, there would be no estate tax insulation.

Solutions?

1. Selling and repurchasing assets periodically

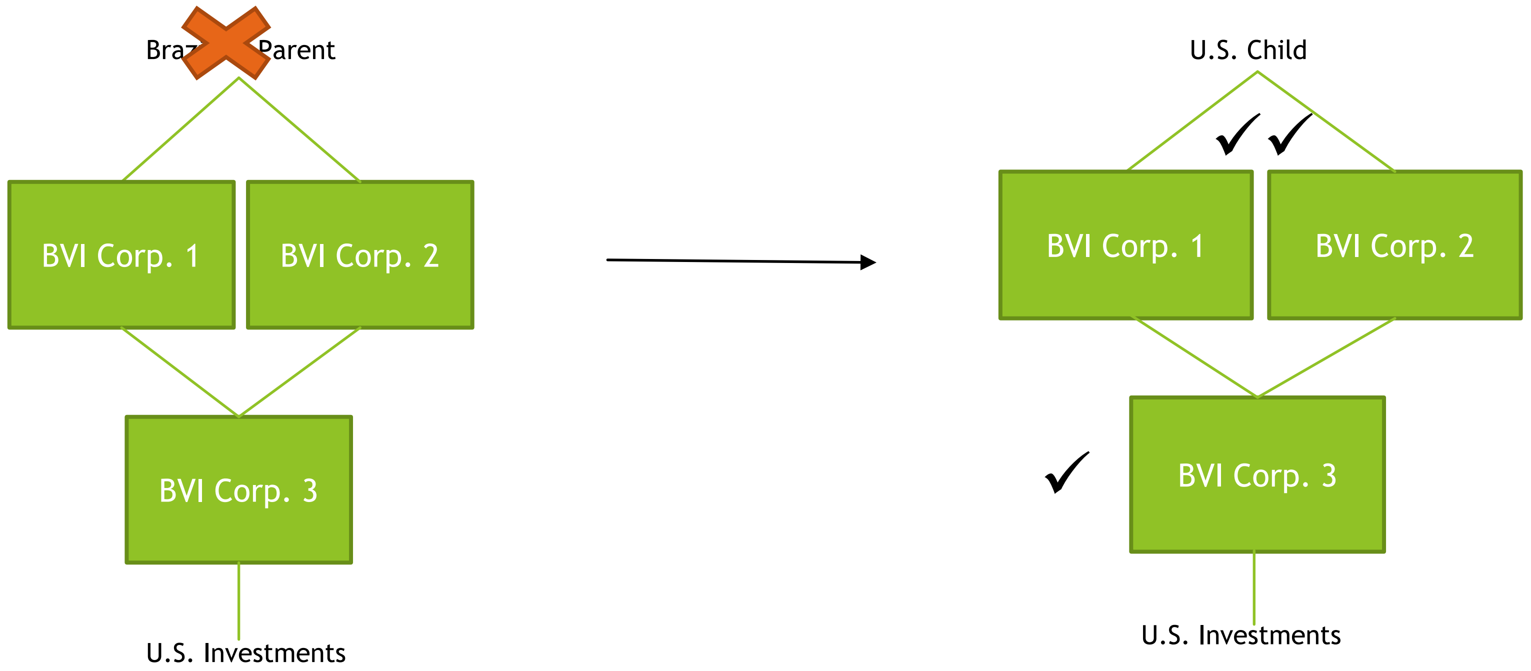
2. Begin with a multi-tiered structure

3. “Check the box” immediately after death

Sell / Repurchase

- Sell and repurchase U.S. investments periodically while Brazilian parent is alive.
- Increases income tax basis of the equities held by the BVI corporation.
  - Less gain is taxed as CFC gain after death.
- Disadvantages?
  - Still some CFC gain.
  - Due diligence may be required for each sale.
  - Requires attention as this must be done periodically.
  - Assets may be out of the market during turnover.

Creating a Multi-tiered Structure



1. First, "retroactive" check the box election on BVI Corp. 3, deemed liquidation prior to death, no CFC issue and basis steps up.
2. Next, check the box elections on BVI Corp. 1 and 2 after death. They are CFCs, but no gain because of prior step up of BVI Corp 3.

Disadvantage: more costs to keep three companies active over time instead of one.

Check the box Immediately after Death

- IRC § 951(a)(2)(A) and (B) discuss “pro rata share” with regard to CFCs.
- If a corporation is a CFC for only a portion of a tax year, only the proportionate amount of the CFC income for that tax year is taxed as a CFC.
- Example 1 (single tier structure):
  - Brazilian parent dies on January 9th. Check the box election made on January 10th.
  - Deemed liquidation of BVI corporation results in a 10 day tax year for the corporation.
  - It was a CFC 1 /10 days, so only taxation at ordinary income rates on 10% of the income.
- Example 2 (single tier structure):
  - Brazilian parent dies on March 31st. Check the box election made on December 31st.
  - Deemed liquidation of BVI corporation results in a 365 day tax year for the CFC.
  - It was a CFC 9 / 12 months, so taxation at ordinary income rates on 75% of the income.

How is this important? Well…

- Brazilian parent's initial investment in BVI Corporation was $20 million.
- At the time of death of Brazilian parent, BVI shares valued at $60 million when U.S. child takes ownership.
- A retroactive election would cause no CFC issue but would bring $60 million into Brazilian parent's taxable U.S. estate, approximately a $24 million tax liability.
- Estate tax protection is imperative. With the elimination of the check the box 30 day rule, we must be careful to provide good alternatives for our clients.

More Questions?

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