U.S. – MEXICO CROSS-BORDER ESTATE PLANNING: PLANNING TECHNIQUES FROM A U.S. AND MEXICAN PERSPECTIVE*

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* The authors wish to graciously acknowledge their reliance on a paper by Michael Baldwin and Abril Rodríguez Esparza presented on February 17, 2015 to the San Antonio Estate Planners Council. *See* Michael J. Baldwin & Abril Rodriguez Esparza, *US – Mexico Cross-Border Estate Planning: Planning Techniques From a U.S. and Mexican Perspective*, SAN ANTONIO EPC (Feb. 17, 2015), https://www.sanantonioepc.org/assets/Councils/SanAntonio-TX/library/US%20-%20Mexico%20Cross-Border%20Estate%20Planning%20Planning%20Techniques%20from%20a%20US%20and%20Mexican%20Perspective.pdf [https://perma.cc/6UBJ-CRWX].

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I. INTRODUCTION

The border between the United States (U.S.) and Mexico is more than 1,900 miles long.[1] Texas and Mexico share 1,251 miles of that border.[2] The two countries share more than just a line on a map; the people of Mexico and the U.S. are bound together by close economic, cultural, and historical relationships that have existed for generations.[3] This Article intends to provide advisors with a general perspective of the cross-border estate planning issues that arise from both the U.S. and Mexican perspectives.[4]

II. DETERMINING A TAXPAYER'S STATUS FOR U.S. TAX PURPOSES

A. Status for Income Tax Purposes

Under the Internal Revenue Code, non-U.S. citizens are categorized as resident aliens (RA) or nonresident aliens (NRA) pursuant to U.S. income tax purposes.[5] The consequences of being an NRA versus an RA are substantial from an income tax standpoint, as this Article will describe in detail later.[6] It is important, therefore, to examine the rules related to determining the status.[7]

1. Statutory Guidance

An alien is a resident for income tax purposes if the alien: (1) is a lawful permanent resident, (2) meets the "substantial presence test," or (3) elects to be classified as a resident in U.S. trusts with foreign beneficiaries circumstances.[8]

2. Lawful Permanent Resident

An alien who has lawfully been accorded the privilege of residing permanently in the U.S. through our immigration laws is considered a "lawful permanent resident."[9] Generally, this occurs through the acquisition of a "green card."[10] Interestingly, this rule applies to both "ordinary" green cards

1. Victor Kiprop, *U.S. States that Border Mexico*, WORLD ATLAS (Aug. 13, 2019), https://www.worldatlas.com/articles/us-states-that-border-mexico.html [https://perma.cc/6R86-A3ZQ].
2. *Id.*
3. *U.S. Relations with Mexico: Bilateral Relations Fact Sheet*, U.S. DEP'T ST. (Sept. 16. 2021), https://www.state.gov/u-s-relations-with-mexico/ [https://perma.cc/H2HE-E8PV].
4. Author's original thought.
5. I.R.C. § 7701(b).
6. *See infra* Section III.A.
7. Author's original thought; *see supra* notes 5–6 and accompanying text.
8. I.R.C. § 7701(b)(1)(A)(i)–(iii).
9. *Id.* § 7701(b)(6).
10. Treas. Reg. § 301.7701(b)-1(b).

and "commuter" green cards.[11] Although an individual may voluntarily abandon the individual's green card, in which case the individual will lose U.S. resident status immediately, mere absence from the U.S. will not change their U.S. tax status until an official loss of green card status has occurred.[12]

3. Substantial Presence Test

An alien will meet the substantial presence test for the current calendar year if the alien is present in the United States for thirty-one or more days during the current year, and the total number of days when the alien was within the U.S. during the current year and the two previous years is either equal to or greater than 183 days.[13] In calculating the two preceding years, each day of the first preceding year is calculated at one-third of one day, and each day of the second preceding year is calculated at one-sixth of one day.[14] Under this formula, an NRA may be in the U.S. for 121 days each year without becoming a resident.[15]

However, the substantial presence test does not apply to certain individuals who are exempt for purposes of determining residency status: foreign government employees, diplomats, teachers and trainees, students, professional athletes, and the families of the individuals in each respective category listed above.[16]

Even if an alien meets the substantial presence test, the alien may still avoid classification as a U.S. resident if the alien has a "closer connection" with another taxing jurisdiction.[17] This may happen if an alien: (1) is within the U.S. for fewer than 183 days during the current year, (2) maintains a tax home in another country during the entire year, (3) has a closer connection during the said year to the foreign country where his tax home is located than to the United States, and (4) has not personally applied or taken other steps to modify the alien's status to that of a lawful permanent resident of the U.S.[18] Obviously, exception four above will not apply and the substantial presence test formula will apply if the individual has applied for a green card.[19]

4. First-Year Election

There may be certain situations in which it is beneficial for an alien to be a "resident" for U.S. tax purposes, even though the alien has failed the

11. I.R.S. Service Center Advisory Mem. 199950009 (Dec. 17, 1999).
12. Treas. Reg. § 301.7701(b)-1(b).
13. I.R.C. § 7701(b)(3).
14. *Id.*
15. *See id.*
16. *Id.* § 7701 (b)(5); Treas. Reg. § 301.7701(b)-3(b).
17. Treas. Reg. § 301.7701(b)-2(a).
18. I.R.C. §§ 7701(b)(3)(B), (C).
19. *See id.*

lawful permanent resident test or the substantial presence test (i.e., to take advantage of foreign losses or to avoid limitations placed on NR aliens with respect to certain exemptions and deductions).[20] Generally, an individual may elect to be treated as a resident if the individual is present for a minimum of thirty-one consecutive days in the election year and meets the substantial presence test in the year following the election.[21]

5. NRA Election to be Treated as an RA

An NRA can elect with the NRA's U.S. citizen or RA spouse to be treated as a RA for income tax purposes by filing a jointly-filed U.S. income tax return, but in doing so, may lose some or all of the treaty protections.[22]

6. Mexican-U.S. Income Tax Treaty

There are certain situations in which an individual is considered a resident for both U.S. income tax purposes and Mexican income tax purposes.[23] In such cases, the following tiebreakers generally apply:

> a. Taxpayer is a resident of the state where a permanent home is available. If a permanent home is available in both states, then the taxpayer is a resident of the state with which the person's personal and economic relations are closer (center of vital interests);
> b. If the taxpayer's center of vital interests cannot be determined or if the taxpayer does not have a permanent home available in either country, then the country where the taxpayer last had a "habitual abode" will be deemed the taxpayer's residence;
> c. If habitual abode existed in both states, then the deemed residence will be the state where the individual is a national; and
> d. In the event none of the above apply, competent authorities of the contracting states shall settle by mutual agreement.[24]

B. Status for Transfer Tax Purposes (Estate, Gift, and Generation-Skipping Transfer Tax)

The Internal Revenue Service (IRS) has not offered as much statutory guidance on how residency is determined for U.S. transfer tax purposes, so

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20. *See id.* §§ 7701(b)(1)(A)(iii), (b)(4).
21. *Id.*
22. *Id.* § 7701(b)(6).
23. Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Mex.-U.S., art. 4, Sept. 18, 1992, S. TREATY DOC. No. 103-7 (1993).
24. *Id.*

taxpayers must rely on case law and the guidance provided under Treasury Regulations.[25]

1. General Rules

Residency as an RA or NRA for transfer tax purposes is determined based on the individual's domicile.[26] Generally, to establish domicile, the alien must reside in the U.S. for some time and have demonstrated an intent to stay at that domicile.[27] "A resident decedent is a decedent who, at the time of his death, had his domicile in the United States."[28]

A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom.[29] Residency without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.[30]

2. Relevant Factors

The following factors have been considered for purposes of establishing an alien's domicile for transfer tax purposes:

a. the duration and purpose of stay in the U.S. and other countries;
b. type and cost of dwelling places in the U.S.;
c. geographical location of U.S. residence, i.e. resort vs. non-resort;
d. location of cherished possessions;
e. personal motivations for location of residence including health, pleasure, and political repression;
f. address or declaration of intent on legal documents;
g. visa status;
h. location of business interests; and
i. location of close friends and family.[31]

25. Treas. Reg. § 20.0-1(b)(1).
26. *Id.*
27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.*
31. *See id.* § 301.7701(b)-2(d).

3. Relevant Case Law

a. Estate of Jack ex rel. Blair v. United States*, 54 Fed. Cl. 590 (2002)*

In *Jack*, the decedent was a Canadian citizen who came to the U.S. to teach on a temporary, non-immigrant work visa.[32] The decedent's estate argued that it was impossible for the decedent to form the requisite intent to stay because such intent would be in violation of the visa.[33] The court of claims held that notwithstanding the fact that the intent to stay would have been in violation of the terms of the work visa, the IRS should still be permitted to prove as a factual matter that the decedent did in fact possess such intent.[34]

b. Estate of Khan v. Commissioner*, 75 T.C.M. (RIA) 1597 (1998)*

In *Khan*, the decedent's estate took the somewhat unusual position of arguing that the decedent was a domiciliary to afford the decedent the unified credit.[35] The IRS had assessed an estate tax based on Khan's NRA status.[36] The decedent had lived off and on in the U.S. for several years before obtaining a green card in 1985.[37] The decedent's primary business contacts were in the U.S., as was his son.[38] In 1986, the decedent returned to Pakistan for business purposes with the intent of returning to the U.S., but the decedent's health began to fail, and he died in Pakistan in 1991.[39] The tax court held that he had obtained a U.S. domicile in 1985 and did not abandon it.[40]

III. NONRESIDENT ALIEN (NONRESIDENT/NON-U.S. CITIZEN)

A. Income Tax Issues

1. Fixed or Determinable Annual or Periodical Gains, Profits, and Income

A flat rate of 30% is withheld (and collected) at the source by the U.S. payor on amounts paid to an NRA who has U.S.-source fixed or determinable annual or periodical (FDAP) income.[41] FDAP income is defined as all

32. Est. of Jack *ex rel.* Blair v. United States, 54 Fed. Cl. 590, 591 (2002).
33. *Id.* at 594.
34. *Id.* at 599.
35. Est. of Khan v. Comm'r, 75 T.C.M. (RIA) 1597, at *1 (1998).
36. *Id.*
37. *Id.* at *2–3.
38. *Id.*
39. *Id.* at *5.
40. *Id.* at *10.
41. *Fixed, Determinable, Annual, Periodical (FDAP) Income*, IRS, https://www.irs.gov/individuals/

income except (a) "[g]ains derived from the sale of real or personal property including market discount and option premiums," (but not including original issue discount) and (b) items of income excluded from gross income, without regard to the U.S. or foreign status of the owner of the income, "such as tax-exempt municipal bond interest and qualified scholarship income."[42] Therefore, FDAP income generally consists of compensation for personal services, alimony, pensions and annuity income, real property income other than from the sale of real property, interest, dividends, and royalties.[43] FDAP income can arise in a trust or partnership context, as well (e.g., distributable net income (DNI) of a trust or estate that is FDAP income and must be distributed currently or has been paid or credited during the tax year to an NRA beneficiary or a partnership distribution or amount (though not distributed), that is FDAP income and includible in the gross income of an NRA partner.[44] Generally, few deductions are allowed on FDAP Income.[45]

2. FDAP Income Exceptions and Other Matters

a. Portfolio Interest Exception

The "portfolio interest" exception is the most important exception to the general FDAP income 30% withholding requirement.[46] Generally, interest on U.S. treasuries, U.S. corporate obligations, and most other U.S. obligations will not be subject to the tax.[47] This exception is particularly important because it does not depend on a treaty for its application.[48]

b. Bank Interest Exception

Interest on bank deposits that is not effectively connected with a U.S. trade or business generally is not subject to the tax.[49]

c. Capital Gains Property

Generally, U.S.-source capital gains are not FDAP income and are not subject to the withholding requirement if the NRA is not present more than

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international-taxpayers/fixed-determinable-annual-periodical-fdap-income (Sept. 29, 2021) [https://perm.cc/FA7M-6UL4].

42. *Id.*
43. *See id.*
44. *See* I.R.C. § 871(a)(1).
45. *See id.* § 873(a).
46. *See id.* § 871(h)(1).
47. *See id.* § 871(k)(1)(E).
48. *Id.* § 894(c)(2).
49. *Id.* § 871(i)(A).

183 days in the taxable year.[50]

d. Gain on the Sale of Intangibles Is FDAP Income

Gains from the sale of certain types of intangibles, including intellectual property—such as patents and copyrights—are deemed FDAP income and subject to the withholding requirements.[51]

e. Rent

An NRA may make an election to treat the NRA's rental income or gains from U.S. real property as "effectively connected" income.[52]

f. Trust Distributions

Trust distributions are taxed in accordance with the kinds of income that make up the distribution.[53]

g. Mexican/U.S. Treaty Benefits

See attached Exhibit A.[54]

3. Effectively Connected Income

Income connected with a U.S. trade or business (effectively connected income, or ECI) is subject to the same tax rate as that of U.S. citizens.[55]

a. Foreign Source Income

If an NRA is engaged in a trade or business within the U.S. and has a U.S. office, certain foreign-source rents, royalties, dividends, interest, and gain or loss derived from the sale or exchange of inventory property attributable to the U.S. office will be considered ECI.[56]

50. Treas. Reg. § 1.871-7(d)(2)(i).
51. I.R.C. § 871(a)(1)(D).
52. *Id.* § 871(d).
53. *See id.* § 1445(e).
54. *See infra* Exhibit A.
55. *See* I.R.C. § 871(b)(1).
56. *See id.* § 864(c)(4).

b. Sale of U.S. Real Estate

Generally, gain on the disposition of "U.S. real property interests" will be treated as effectively connected income (ECI) under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), which imposes income tax on NRAs disposing of U.S. real property interests.[57]

> (1) "U.S. real property interests" include both direct interests in U.S. real property and interests in certain domestic corporations, partnerships, trusts, and estates that hold U.S. real property in excess of certain thresholds.[58]
> (2) "Disposition" includes contributions to the capital of a foreign corporation.[59]
> (3) The FIRPTA withholding burden is born by the transferee of the real property, accordingly the transferee is usually required to withhold 15% of "the amount realized on the disposition."[60]

4. Withholding Agents

a. Form W-8s

There are multiple types of Form W-8s.[61] A foreign person earning income in the U.S. should submit Form W-8 to their withholding agent to help determine their tax status, claim treaty benefits, and/or establish whether the form treats the payment as effectively connected income.[62] A withholding agent, according to the IRS, is any person, U.S. or foreign, "that has control, receipt, or custody" of an amount subject to withholding, or who can disburse or make payments of an amount "subject to withholding."[63] It can be an individual, corporation, partnership, trust, association, or any other entity.[64] It is usually a bank, a broker, a hedge fund, a private equity firm, a mutual

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57. *Id.* § 897(a)(1).
58. *Id.* § 897(c)(1).
59. *Id.* § 897(j).
60. *Id.* § 1445.
61. *See generally Tax Treaty Tables*, IRS, http://irs.gov/individuals/international-taxpayers/tax-treaty-tables (May 11, 2021) [https://perma.cc/TNE9-ZMS6] (explaining the different Form W-8s: (a) Form W-8BEN: *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding*; (b) Form W-8ECI: Certificate of Foreign Persons Claim that Income Is Effectively Connected with the Conduct of a Trade or Business in the United States; (c) Form W-8EXP: Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding; (d) Form W-8IMY: Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding; and (e) Form W-8CE: Certificate of Foreign Persons Claim that Income Is Effectively Connected with the Conduct of a Trade or Business in the United States).
62. *See Withholding Agent*, IRS, http://irs.gov/individuals/international-taxpayers/withholding-agent (Feb. 16, 2021) [https://perma.cc/58XE-9Z9Q].
63. *Id.*
64. *See id.*

fund, or a non-profit organization such as a foundation, association, casino, college, or the like.[65] Form W-8 also provides information about which countries currently have tax treaties with the U.S., and in certain instances, the foreign person must obtain an Individual Taxpayer Identification Number (ITIN) in order to benefit from a tax treaty.[66] Form W-8s are not filed with the IRS; instead, the withholding agent should keep them in their records.[67]

b. Government Indemnity

The federal government indemnifies a withholding agent for withholding per its reasonable belief.[68] The effect is that a person who has been erroneously withheld upon must submit a claim to the indemnitor by filing a claim for refund on the proper form, and non-U.S. filers (who wish to remain non-U.S. filers) therefore may not have any practical remedy.[69]

B. Transfer Tax Issues

1. Gift Tax

a. Statutory Guidance

Gifts (gratuitous transfers) by NRAs are only subject to the gift tax if the gifts are "situated" in the U.S.[70] Thus, in very general terms, NRAs are subject to gift tax on gifts of real or tangible property located in the U.S.[71] Gifts of intangible property by an NRA, regardless of where it is situated, are not subject to the gift tax.[72] No gift tax treaty exists between Mexico and the U.S.[73]

b. General Rules

i. No Unified Credit

NRAs are not entitled to a unified credit for gifts subject to the gift tax.[74]

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65. *See* Treas Reg. § 1.441-7.

66. *See Instructions for Form W-8BEN*, IRS (Oct. 4, 2021), http://irs.gov/instructions/iw8ben [https://perma.cc/ZU3A-68XG].

67. *See id.*

68. Treas. Reg. § 1.1474-1(f).

69. *Id.*

70. I.R.C. § 2511(a).

71. Treas. Reg. § 25.2511-3(a)(1).

72. I.R.C. § 2511(a).

73. *See Estate & Gift Tax Treaties (International)*, IRS (June 10, 2021), http://www.irs.gov/businesses/small-businesses-self-employed/estate-gift-tax-treaties-international [https://perma.cc/Q696-DR8V].

74. I.R.C. § 2505(a).

The tax rate is the same as applies to citizens and RAs.[75] Generally, taxable gifts by an NRA are taxed at graduated rates from 18–40%, depending on the size of the particular taxable gift and the value of all previous taxable gifts made by the NRA.[76]

ii. Annual Exclusion Gifts

NRAs are entitled to the $15,000 exclusion for annual exclusion gifts and the unlimited exclusions for educational and medical expenses.[77]

iii. Gifts to Spouse

NRAs are entitled to an unlimited exclusion for gifts to U.S. citizen spouses and a $159,000 annual exclusion for gifts to non-citizen spouses (adjusted annually for inflation).[78]

iv. Charitable Gifts

Generally, NRAs may make unlimited gifts to U.S. charities.[79]

v. Gift Splitting

Gift splitting is not available to an NRA (where the NRA can attribute one-half of the gift to the NRA's spouse).[80]

vi. Basis of Acquired Property

Generally, a recipient receives property at the NRA's basis.[81]

vii. Gifts of Tangible Personal Property

Gifts of tangible personal property, such as jewelry or art, should not be made in the U.S., as they will be subject to the gift tax.[82]

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75. *See Taxation of Nonresident Aliens*, IRS (Mar. 12, 2021), http://www.irs.gov/businesses/Taxation-of-nonresident-aliens-1 [https://perma.cc/G63G-LA6Z].

76. *See id.*

77. I.R.C. §§ 2503(b), (e).

78. *See* Treas. Reg. §§ 25.2523(i)-1(a), (c)(2).

79. I.R.C. § 2522(b).

80. *Id.* §§ 2012(c), 2523(h)(i).

81. *Id.* § 1015(a).

82. *Id.* § 2522(e)(2).

viii. Gifts of Intangibles

One might think that the definition of intangibles for gift tax purposes would be simple; however, some gifts, such as cash, have continued to befuddle the IRS.[83] In a series of letter rulings, the IRS has been unable to decide whether cash is an intangible.[84] Because of this uncertainty, it is best to make a cash gift outside of the U.S.[85] Additionally, prudence is warranted in structuring the intangible gift transaction.[86] Be wary of converting tangible property, such as real property, into intangible property.[87] In *Davies v. Commissioner*, an English NRA made a gift of funds into a foreign bank account for his son, conditioned on the son purchasing Hawaiian real estate.[88] The IRS successfully stepped the gift of funds into the foreign account (clearly an intangible) and the real estate purchase together as a gift of real property and subject to the gift tax.[89]

ix. Gifts of U.S. Stock

Contrary to the situs rules for the estate tax, gifts of a U.S. corporation are gifts of intangible property and not subject to the gift tax.[90]

x. U.S. Expatriates

These rules are substantially modified when applied to U.S. expatriates (and beyond the scope of this Article).[91]

2. Estate Tax

a. Statutory Guidance

NRAs are subject to estate tax only with respect to the portion of their taxable estates in the U.S.[92] No estate tax treaty exists between the U.S. and Mexico.[93]

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83. *See Gift Tax for Nonresidents not Citizens of the United States*, IRS, (Apr. 2, 2021), https://www.irs.gov/businesses/small-businesses-self-employed/gift-tax-for-nonresidents-not-citizens-of-the-united-states [https://perma.cc/23AW-EERU].

84. *See id.*

85. *See* I.R.C. § 2512(a).

86. *See Taxation of Nonresident Aliens*, *supra* note 75.

87. *See* Davies v. Comm'r, 40 T.C. 525, 530 (1963).

88. *Id.* at 525–26.

89. *Id.* at 530.

90. Treas. Reg. § 25.2511-3(a)(3).

91. *See id.* §§ 20.2103-1, 20.2107-1(a), 25.2501(a), 25.2511-1(a)-(f), 25.2511-3(a).

92. I.R.C. § 2101(a).

93. *See International Tax Treaty: Mexico*, JDSUPRA (Nov. 12, 2020), http://www.jdsupra.com/legalnews/international-tax-treaty-mexico-66757 [https://perma.cc/83KJ-BY2N].

b. General Rules

i. Limited Unified Credit

NRAs are entitled to a unified credit of $13,000, which essentially permits an NRA to transfer $60,000 worth of property.[94] Compare this to the $11.7 million that U.S. citizens or RAs are permitted to transfer free of estate tax.[95] The estate tax rates for NRAs are the same as for U.S. citizens and RAs (at a top graduated rate of 40%).[96]

ii. Transfers to Spouse

NRAs are entitled to an unlimited exclusion for gifts to U.S. citizen spouses.[97] However, an NRA is subject to the requirements of Section 2056(5)(A), the qualified domestic trust (QDOT) requirements, if the NRA's spouse is also an NRA, which is quite likely.[98]

iii. Charitable Gifts

Charitable gifts by NRAs are limited.[99] Only gifts to the U.S. or a political subdivision thereof, a domestic (U.S.) corporate charity, or a U.S. charitable trust would qualify for the deduction.[100] Contrast this with Section 2055(a)(2), which allows RAs to make gifts to foreign charities.[101] Additionally, the charitable deduction may only be made if the entire worldwide estate of the decedent is shown on the estate tax return.[102]

iv. Basis of Acquired Property

Generally, a transferee receives a stepped-up basis.[103] Note, however, that stock in a foreign personal holding company will not be entitled to a basis step-up.[104]

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94. I.R.C. § 2102(b).
95. *Estate Tax*, IRS https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax (Sept. 15, 2021) [https://perma.cc/VA5L-8JXA].
96. *Taxation of Nonresident Aliens*, *supra* note 75.
97. I.R.C. § 2106(a)(3).
98. *Id.* § 2056(5)(A).
99. *Id.* § 2106(a)(2).
100. *Id.*
101. *Id.* § 2055(a)(2).
102. *Id.*
103. *Id.* § 1014(a).
104. *Id.* § 1014.

v. What Is U.S. Situs Property?

- U.S. real property;
- Domestic corporate stock;
- U.S. debt obligations;
- U.S. currency located in the U.S.;
- Tangible personal property located in U.S. (this generally does not include works of art on loan); and
- Sections 2035–2038 transfers if property was U.S. situs property at time of transfer.[105]

vi. What Is Not U.S. Situs Property?

- Foreign real property;
- Stock in foreign corporate stock;
- U.S. currency located outside of the U.S.;
- Tangible personal property located outside of the U.S.; and
- Life insurance proceeds on the life of a NRA decedent, owned by the NRA, and issued by a U.S. insurance company.[106]

vii. Major Exception to U.S. Situs Property

The following property is not U.S. situs property under the general rules of Section 2104(c): (a) amounts on deposit at a bank or insurance company that are described under Section 871(i)(3); (b) deposits with a foreign branch of a domestic corporation or partnership, if the branch is engaged in the commercial banking business; (c) "portfolio interest" debt obligations under Section 871(h); and (d) certain original issue discount obligations.[107] Note, the estate tax exceptions intend to coincide with the income tax "portfolio interest" exemptions.[108]

viii. Certain Other Deductions

Deductions for expenses and debts under I.R.C. Section 2053 and I.R.C. Section 2054 are deductible in proportion to the U.S. gross estate to the total estate.[109] Because NRAs are required to disclose their entire worldwide estates to take advantage of these deductions, like the charitable deduction, they are often not taken.[110]

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105. *Id.* §§ 2104, 2035–38.
106. *Id.* §§ 2104(a); 2105.
107. *Id.* §§ 2105(b), 2104(c), 871(i)(3)(h).
108. *Id.* § 2105.
109. *Id.* § 2106(a)(1).
110. *Id.* §§ 2053, 2054; *Taxation of Nonresident Aliens*, *supra* note 75.

3. Generation-Skipping Transfer Tax

Generally, NRAs are subject to the generation-skipping transfer tax only to the extent the transfer is subject to gift or estate tax.[111] Thus, if the underlying transfer did not cause the imposition of gift or estate tax, the generation-skipping transfer tax should not apply.[112] Note, however, NRAs are eligible for the entire GST exemption (currently $11.7 million), despite NRAs having smaller estate tax exemption amounts.[113]

IV. RESIDENT ALIENS (RESIDENT/NON-U.S. CITIZEN)

A. Income Tax Issues

Generally, RAs are taxed on their worldwide income exactly like U.S. citizens.[114]

B. Transfer Tax Issues

1. Gift Tax

a. Statutory Guidance

RAs are generally subject to gift tax on transfers in a similar manner as U.S. citizens.[115]

b. Rules

i. Unified Credit

RAs are entitled to the same unified credit against gift taxation as U.S. citizens.[116]

ii. Annual Exclusion Gifts

RAs are entitled to the $15,000 exclusion for annual exclusion gifts and the unlimited exclusions for educational and medical expenses.[117]

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111. *Id.* § 2631.
112. *Id.* § 2663; Treas. Reg. § 26.2663.
113. I.R.C. § 2663; Treas. Reg. § 26.2663.
114. I.R.C. § 2663; Treas. Reg. § 26.2663.
115. I.R.C. § 2501(a).
116. *Id.*
117. *Id.* §§ 2503(b), (e).

iii. Gifts to Spouse

RAs are entitled to an unlimited exclusion for gifts to U.S. citizen spouses and a $100,000 annual exclusion for gifts to non-citizen spouses (adjusted annually for inflation).[118]

iv. Charitable Gifts

Generally, RAs may make unlimited gifts to qualified charities.[119] Note the more expanded definition of charity, which applies to RAs as compared to NRAs.[120]

v. Basis of Acquired Property

Generally, the transferee will receive property at the transferor's basis.[121]

2. Estate Tax

a. Statutory Guidance

RAs are subject to estate tax on their worldwide assets, just as U.S. citizens are.[122] Generally, except for the marital deduction, RAs are taxed similarly to U.S. citizens for estate tax purposes.[123]

b. General Rules

i. Unified Credit

RAs are entitled to the same unified credit as U.S. citizens are.[124]

ii. Transfers to Spouse

RAs are entitled to an unlimited exclusion for gifts to U.S. citizen spouses.[125] An RA is subject to the QDOT requirements of 2056(5)(A) if the RA's spouse is not a U.S. citizen.[126]

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118. *See* Treas. Reg. § 2523(i).
119. I.R.C. § 2522(a).
120. *Id.*
121. *Id.* § 1015.
122. *Id.* § 2001.
123. *Id.*
124. *Id.* § 2056(5)(A).
125. *Id.* § 2056; Treas. Reg. § 25.2505.1.
126. *See infra* Section IV.B.5.f.

iii. Charitable Gifts

RAs are entitled to the same charitable deduction as U.S. citizens.[127]

iv. Basis of Acquired Property

Generally, the transferee will receive a stepped-up basis.[128]

3. Generation-Skipping Transfer Tax

RAs are subject to the generation-skipping transfer tax in the same manner as U.S. citizens.[129]

4. Marital Deduction Issues

a. Surviving Spouse Is RA or NRA

The marital deduction is not allowed for the decedent's surviving spouse if they are an RA or NRA.[130] If the surviving spouse is a U.S. citizen, regardless of domicile, the marital deduction is allowed.[131]

b. Exceptions

If the surviving spouse is an RA or NRA, the marital deduction is allowed only if: (i) the spouse becomes a citizen before filing the federal estate tax return; or (ii) the property passes to a QDOT that meets the requirements described below.[132]

c. Section 2013 Credit

If the deceased spouse's estate pays estate tax on property that otherwise would have qualified for the marital deduction, and the surviving spouse dies in the U.S. and is subject to estate taxation on the same property, the estate will receive a credit for the tax paid in the first estate.[133] There are no time

127. *Taxation of Nonresident Aliens*, *supra* note 75.

128. I.R.C. § 1014.

129. Emily M. Lanza, *The Federal Estate, Gift, and Generation-Skipping Transfer Taxes*, CONG. RSCH. SERV. 1, 4, (June 5, 2014), https://sgp.fas.org/crs/misc/95-416.pdf [https://perma.cc/WJ9Q-L4CY].

130. John L. Wong, *How to Avoid U.S. Gift and Estate Taxes When Becoming a U.S. Resident Alien or U.S. Citizen*, MOD. WEALTH L. (Sept. 23, 2016), https://modernwealthlaw.com/avoid-us-gift-estate-tax-us-resident-alien/ [https://perma.cc/L5BH-ZF4Z].

131. *Id.*

132. *See infra* Section IV.B.5.f.

133. I.R.C. § 2013.

limits for this deduction.[134]

5. QDOT Requirements

a. U.S. Trustee

The trust instrument must require that at least one trustee be a U.S. citizen.[135]

b. Distribution Restrictions

No distributions other than income may be made from the trust unless a trustee who is an individual U.S. citizen or domestic corporation has the right to withhold from such distribution the tax imposed by Section 2056A(b).[136]

c. Many Treasury Regulation Requirements

In order to ensure the collection of the 2056A tax, the trust must meet numerous requirements imposed by the regulations.[137]

d. QDOTs with More Than $2 Million

QDOTs with more than $2 million must provide for: (i) the appointment of a U.S. bank as trustee; (ii) the posting of a bond by the trustee in an amount equal to 65% of the value of the trust; or (iii) the furnishing an irrevocable letter of credit issued by a U.S. bank and in an amount equal to 65% of the value of the trust.[138]

e. Election

An election must be made by the decedent's executor.[139]

f. QDOT Tax Treatments

Distributions from the QDOT to the surviving spouse are generally subject to estate tax at the decedent spouse's rate; however, the following distributions are not subject to this tax: (i) income distributions to the surviving spouse; (ii) income distributions to the surviving spouse based

134. *See id.* § 2013(a).
135. *See* Treas. Reg. § 20.2056A-2(a).
136. *Id.*; *see* I.R.C. § 2056A(b).
137. Treas. Reg. § 20.2056A-2; I.R.C. § 2056A.
138. Treas. Reg. § 20.2056A-2(d).
139. I.R.C. § 2056A.

upon hardship; or (iii) income distributions to reimburse the surviving spouse for any income tax on income generated by the QDOT and taxable to the surviving spouse.[140]

If a QDOT fails to meet its requirements, the estate tax is imposed on the value of the trust upon its failure date.[141]

If the alien's surviving spouse becomes a U.S. citizen after the decedent spouse's death, the QDOT rules will no longer apply to distributions to the surviving spouse.[142]

V. SUBSTANTIVE U.S. TAX RULES APPLICABLE TO FOREIGN TRUSTS AND FOREIGN GRANTORS

A. U.S. Trust Versus Foreign Trust

A trust is a U.S. trust if it satisfies both the "court test" and the "control test."[143] The trust is a foreign trust by default if it fails either.[144]

1. Court Test

A trust meets the court test if: (a) a U.S. court has authority to render orders or judgments concerning administration; (b) a U.S. court has authority to determine all issues regarding administration substantially; and (c) the trust does not contain an automatic migration clause.[145]

2. Control Test

A trust meets the control test if a non-U.S. person can veto a "substantial decision."[146] Substantial decisions include, but are not limited to, the following: (a) the timing or amount of distributions; (b) selection of a beneficiary; (c) allocation of receipts between income and principal; (d) whether to terminate a trust; (e) whether to sue or defend the trust; (f) whether to remove or add a trustee; and (g) investment decisions.[147]

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140. *Id.* § 2056A(b)(3).
141. *See id.*
142. *Id.* § 2056A(b)(12).
143. Treas. Reg. § 7701(a)(30)(E).
144. *Id.* § 7701(a)(31)(B).
145. *Id.* §§ 301.7701-7(c)(3), (4).
146. *Id.* § 301.7701-7(d)(1)(ii).
147. *Id.*

B. U.S. Settlors of Foreign Trusts

1. Grantor Trust Status Generally

A U.S. person who transfers property to a foreign trust with a U.S. beneficiary remains the income tax owner of the property.[148] There are at least four relevant inquiries in determining the applicability of whether a trust is a grantor trust for U.S. income tax purposes: (a) whether there is a U.S. transferor; (b) whether there has been a transfer of property within the meaning of Section 679; (c) whether the transferee trust is domestic or foreign; and (d) whether the trust has any U.S. beneficiaries.[149]

a. U.S. Transferor

A foreign person who transfers property to a foreign trust and becomes a U.S. citizen or resident within five years of such transfer will be treated as a U.S. transferor with respect to the portion of the trust that, as of the date of immigration, is attributable to such prior transfer.[150]

b. Transfer of Property

In general, Section 679 does not apply to transfers because of the transferor's death, nor does it apply to any sale or exchange for fair market value consideration.[151] For purposes of determining whether the transferor of property to the trust received fair market value in exchange for such property, certain debt will be disregarded.[152] Specifically, debt owed (or as may be provided in regulations, guaranteed) by the trust, by any grantor, owner, or beneficiary of the trust, or by certain persons related to a grantor, owner, or beneficiary will not be taken into account.[153] Under this rule, even if the U.S. transferor moves property to a foreign trust (with U.S. beneficiaries) in exchange for the trust's fair market value debt instrument, the transferor will be treated as the owner of the portion of the trust attributable to such property under Section 679.[154]

148. I.R.C. § 679.
149. *See id.*
150. *Id.* § 679(a)(4).
151. *Id.* § 679(a)(2).
152. *Id.* § 679(a)(3).
153. *Id.* § 679(a)(3)(c).
154. *Id.* § 679(a)(3)(b).

c. Foreign Trust

If a U.S. person transfers property to a domestic trust, which subsequently becomes a foreign trust during the transferor's lifetime, such person will be treated under Sections 679 and 6048 of the I.R.C. (information reporting) as having transferred to a foreign trust an amount equal to the portion of such trust that, as of the date of such redomiciliation, is attributable to such prior transfer.[155]

d. U.S. Beneficiary

A trust will be treated as having a U.S. beneficiary for any given taxable year of the transferor unless,

> (1) under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a U.S. person, and (2) if the trust were terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of a U.S. person.[156]

Under Section 679(c)(3), if a foreign beneficiary of a foreign trust subsequently becomes a U.S. citizen or resident, Section 679 will apply to prior transfers by a U.S. person to the trust only to the extent they were made within five years of such immigration.[157]

2. Trap for the Unwary or Planning Tool: Foreign Trust or Grantor Trust Toggle Switch?

Under I.R.C. Section 679, it is possible (in fact, likely) to create a foreign trust that is a grantor trust for U.S. income tax purposes.[158] However, what happens if the trust is no longer a foreign trust?[159] Unless the trust qualifies as a grantor trust under Section 671–679 of the I.R.C., the trust becomes a U.S. non-grantor trust.[160]

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155. *Id.* § 679(a)(5).
156. *Id.* § 679(c)(1).
157. *Id.* § 679(c)(3).
158. *See id.* § 679(a).
159. *See id.*; author's original thought.
160. I.R.C. § 679(a).

C. U.S. Trusts with Foreign Beneficiaries

1. Basic Rules

I.R.C. Sections 661 and 662 contain the basic rules governing income taxation of U.S. complex trusts and apply to NRAs.[161]

a. Distributable Net Income

Trusts deduct amounts properly paid to the beneficiary up to distributable net income (DNI).[162] Distributions are generally treated as consisting of pro-rata shares of each type of income constituting DNI.[163] Beneficiaries who receive a distribution report equivalent to the income on their tax return; as a result, the income distributed by U.S. trust to an NRA beneficiary will only be taxable if the income received from the trust would have been taxable if earned by the NRA directly.[164]

b. FDAP Income

FDAP income is generally taxable at 30%; however, the U.S./Mexico Treaty substantially reduced this.[165]

c. Portfolio Interest Exception

As a result of the portfolio interest exception under Section 871(h) and the exemption for bank deposits under Section 878, very little U.S.-source interest income is taxable when received by an NRA.[166]

d. Capital Gain

Most capital gains are not taxable.[167]

e. Effectively Connected Income

ECI is taxable at graduated rates.[168]

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161. *See id.* §§ 661–62.
162. *Id.* § 662(a)(1).
163. Johnson v. United States, 76 Cl. Ct. 360, 363–64 (1932).
164. *See* I.R.C. § 662(a)(1).
165. *See infra* Exhibit A.
166. I.R.C. §§ 871(h), 878.
167. *Id.* § 871.
168. *Id.* § 871(b).

f. FIRTPA

FIRPTA issues (subject to treaty modifications) apply to real estate.[169]

2. Trustee Has Certain Withholding Obligations

Generally, the trustee must withhold 30% of any income distribution to a foreign beneficiary and pay the withheld income taxes to the United States Treasury each year.[170] In many cases, however, a dual tax treaty provision will apply to reduce the withholding rate to something less than 30%, and in some cases, 0%.[171] Additionally, if a treaty provision applies, the foreign beneficiary may be permitted a credit for U.S. taxes paid in the beneficiary's reporting country.[172]

D. U.S. Beneficiaries of Foreign Trusts: Foreign Grantor Trust

1. General Rule

The grantor trust rules only apply if they result in a U.S. person being treated as the trust's grantor.[173]

2. Exceptions Allowing Foreign Grantor Trust

Two exceptions allow foreign grantor trust treatment for foreign trusts: (a) trusts that are revocable by the foreign grantor, and (b) trusts that during the foreign grantor's lifetime can only make distributions to the grantor or the spouse of the grantor.[174]

3. ECI/FDAP Income

Generally, the foreign grantor is taxed only on ECI and FDAP income (subject to the treaty modifications), and tax-free accumulations are possible.[175] However, if U.S. situs assets are owned, they will be includible in the estate of an NRA.[176]

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169. Jonathan Hobbs, *FIRPTA Rules Impact U.S. Real Estate Transactions*, TAX ADVISOR (Apr. 1, 2015), https://www.thetaxadvisor.com/issues/2015/apr/tax-clinic-11.html [https://perma.cc/5JT9-AFJE].

170. I.R.C. § 871(a).

171. *Id.* § 871(m)(6); *see Claiming Tax Treaty Benefits*, IRS, https://www.irs.gov/individuals/international-taxpayers/claiming-tax-treaty-benefits (Sept. 29, 2021) [https://perma.cc/KA36-TJQ2].

172. *See* I.R.C. § 871(m)(6).

173. I.R.C. § 672(f).

174. *Id.* § 672(f)(2)(A).

175. *Effectively Connected Income (ECI)*, IRS, https://www.irs.gov/individuals/international-taxpayers/effectively-connected-income-eci (Sept. 15, 2021) [https://perma.cc/D2MT-PALW].

176. G. Warren Whitaker & Dina Kapur Sanna, *U.S. Tax Planning for Non-U.S. Persons, Assets and Trusts-An Introductory Outline*, DAY PITNEY LLP, 1, 2, (2019) https://www.daypitney.com/~/media/files

4. Basis "Step-up" on Death

Trust provisions might need to be modified to comply with Section 1014(b).[177]

5. Section 901(b)(5)

If Section 672(f) denies grantor trust status to a foreign trust, but the grantor is nevertheless subject to foreign taxes on the trust's income (i.e., because the grantor is treated as the owner of the trust's assets under the grantor's country's grantor trust-type rules), the U.S. beneficiaries who are taxed on distributions will be entitled to a foreign tax credit corresponding to the foreign taxes previously paid by the grantor.[178]

6. Recipient of Distributions

Subject to certain reporting requirements, a U.S. beneficiary of a foreign grantor trust who receives distributions during the trust term is not subject to U.S. taxes.[179]

E. U.S. Beneficiaries of Foreign Trusts: Foreign Non-Grantor Trust

1. Taxation of Accumulation Distributions from Foreign Non-Grantor Trusts

The U.S. tax law applicable to foreign non-grantor trusts contains complicated rules for the taxation of trust distributions that represent accumulations of undistributed net income (UNI) (i.e., distributions from a "complex trust").[180] These "throwback rules" are designed to approximate and capture the incremental amount of U.S. tax (if any) that would have been collected if the UNI (income accumulated by the trust) and later distribution to a U.S. beneficiary had instead been distributed when earned.[181] The throwback rules generally seek to treat a beneficiary as having received the UNI in the year in which it was earned by the trust (under a complex formula).[182] The beneficiary may be required to pay a throwback tax and an

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/insights/publications/2019/us-tax-planning-for-nonus-persons-assets-and-trusts--an-introductory-outline 2019.pdf [https://perma.cc/L56J-6FZX].

177. I.R.C. § 1014(b).

178. *Id.* § 901(b)(5).

179. *Id.* § 901(m).

180. *See U.S. Taxation and information reporting for foreign trusts and their U.S. owners and U.S. beneficiaries*, DELOITTE, 1–7, (2014) https://www2.deloitte.com/content/dam/Deloitte/us/Documents/Tax/us-tax-foreign-trusts-final-021315.pdf [https://perma.cc/X9FB-BE67].

181. *See id.*

182. *See id.*

interest charge on the deferral.[183] The throwback rules will not apply to amounts accumulated when the trust was a foreign grantor trust.[184]

Contrary to the general rule, capital gains are included in the DNI—or amounts that must be distributed currently in order to avoid accumulation distribution status in later years—of any foreign trust, even if such gains are allocated to corpus under local law or the terms of the trust instrument.[185] Because accumulation distributions do not retain their character in the hands of the recipient beneficiary, beneficiaries of foreign non-grantor trusts are taxed at ordinary income rates on distributions of accumulated capital gains.[186]

The exemption from the throwback rules for amounts accumulated prior to the beneficiary's twenty-first birthday that formerly applied to domestic trusts does not apply to foreign trusts.[187]

Distributions in satisfaction of a gift or bequest of a specific sum of money or specific property that is paid and credited all at once or in not more than three installments is not an accumulation distribution (unless the gift or bequest can be paid or credited only from the income of the estate or trust).[188]

2. Throwback Rule Minimization Techniques

Distribute DNI annually (within sixty-five days of year-end) to avoid the creation of UNI.[189]

Invest trust assets in tax-exempt bonds that produce tax-exempt income, which is not included in DNI, cannot produce UNI even if accumulated.[190]

Distribute UNI (which must be distributed before trust principal) to a foreign subtrust that permits the trustee absolute discretion to distribute to multiple beneficiaries (so that no one beneficiary has the sole right to trust distributions), preferably one or more of whom is a non-U.S. beneficiary.[191] This delays the throwback rule if and until a distribution is made to a U.S. beneficiary.[192]

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183. *See id.*
184. *See id.*
185. *See id.*
186. *See id.*
187. Charles F. Schultz III, *Foreign trust DNI, UNI, and the throwback rules: Important tax planning strategies*, TAX ADVISOR (Oct. 5, 2017), https://www.thetaxadviser.com/newsletters/2017/oct/foreign-trust-dni-uni-throwback-rules.html [https://perma.cc/UPW6-EY2Q].
188. Treas. Reg. § 1-665(b)-1A(c)(1); *see also* I.R.C. § 663(a)(1).
189. Schultz III, *supra* note 187.
190. *Id.*
191. *Id.*
192. *Id.*

Do not sell property within the trust that would realize a capital gain.[193] If a capital gain is realized, ensure that the capital gain is distributed in the year of realization.[194]

Consider offshore private placement insurance or offshore private placement annuity.[195] Income and investment returns within the policy, death benefit proceeds, withdrawals of premium up to basis, and certain policy loans are tax-free and do not generate DNI or UNI.[196]

A loan to a U.S. beneficiary from the trust generally does not minimize the tax, as the loan is deemed a distribution to the beneficiary of the full amount of the loan even if the loan is later repaid unless the loan meets the requirements of a qualified obligation.[197]

F. Reporting and Disclosure Requirements

1. Settlor

a. Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

A U.S. person who creates a foreign trust or otherwise transfers money or property to a foreign trust must report such an event on Form 3520.[198] Form 3520 is due on the date the reporting party's income tax return is due, including extensions.[199] The penalty for failure to file is equal to the greater of $10,000 or 35% of the amount transferred, 35% of the gross value of distributions received from a foreign trust, or 5% of the gross value of the foreign trust's assets treated as owned by a U.S. person under the grantor trust rules.[200] If noncompliance continues ninety days after the IRS notice, additional $10,000 penalties accrue every thirty days thereafter.[201] It is important to note that a reasonable cause exception exists.[202]

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193. Beverly Bird, *Do I Have to Pay Taxes on the Sale of a Home in a Trust?* ZACKS, https://finance.zacks.com/pay-taxes-sale-home-trust-7676.html (last visited Oct. 23, 2021) [https://perma.cc/YK6E-RTEX].

194. *See id.*

195. *See Private Placement Life Insurance or Annuities*, VIE INT'L, https://www.vieinternational.com/solutions/private-placement-life-insurance-or-annuities#:~:text=Vie%20International%20has%20been%20a%20leader%20in%20the,for%20trust%2C%20investment%2C%20tax%20and%20asset%20protection%20purposes (last visited Oct. 22, 2021) [https://perma.cc/RUG6-8N3D].

196. *Instructions for Form 1041 and Schedules A, B, G, J, and K-1 (2020)*, IRS, https://www.irs.gov/instructions/i1041 (Jan. 22, 2021) [https://perma.cc/4K83-6LWU].

197. I.R.C. § 643(i)(1).

198. *See 2020 Instructions for Form 3520-A*, DEP'T TREASURY INTERNAL REVENUE SERV., https://www.irs.gov/pub/irs-pdf/i3520a.pdf, 1–7 (last visited Sept. 25, 2021) [https://perma.cc/PGY3-2DX3].

199. *Instructions for Form 3520 (2020)*, IRS, https://www.irs.gov/instructions/i3520 (Jan. 12, 2021) [https://perma.cc/U3N7-KTZK].

200. *Id.*; I.R.C. § 6677.

201. I.R.C. § 6677.

202. *Id.* § 6677(a).

b. Form 3520-A: Annual Information Return of Foreign Trust with a U.S. Owner

A U.S. person who is taxable as the owner of a foreign trust under any of the grantor trust rules (Sections 671–79) must ensure that the trustee files an annual return on Form 3520-A.[203] Although the filing requirement is imposed on the trustee, the penalty for failure to file is imposed on the U.S. grantor.[204] Such penalty equals 5% of the trust assets treated as owned by the U.S. grantor, with additional $10,000 penalties every thirty days for continuing failure after notice from the IRS.[205]

c. Form 709: U.S. Gift (and Generation-Skipping Transfer) Tax Return

Even if a transfer to a trust is incomplete for gift tax purposes (which will be the case regarding an asset protection trust, for example, when the grantor retains a special power of appointment), the transferor must nonetheless file a Form 709 to advise the IRS of the incomplete gift.[206] Disclosure of all relevant facts, including a copy of the trust document, is required.[207] This form is a calendar year form due April 15, following the year of the transfer.[208] The penalty for failure to file is based on the amount of tax required to be shown on the return, which will be zero in the case of an incomplete gift.[209]

2. Trustee or Executor

a. Form 3520-A: Annual Information Return of Foreign Trust with a U.S. Owner

The trustee of a foreign grantor trust with a U.S. grantor must file Form 3520-A annually with the Philadelphia Service Center.[210] The form generally must be filed by March 15 (unless such deadline is extended under Form 7004).[211]

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203. *See id.* § 671–79; *2020 Form 3520-A*, *Annual Information Return of Foreign Trust With a U.S. Owner*, IRS (2020), irs.gov/pub/irs-pdf/f3520a.pdf [https://perma.cc/HA73-CM5R].

204. *Instructions for Form 3520-A (2020)*, IRS, https://www.irs.gov/instructions/i3520a (Jan. 12, 2021) [https://perma.cc/2KFR-9PUV].

205. *Id.*

206. *See* Treas. Reg. §§ 25.2511-2(c).

207. *Instructions for Form 709 (2020)*, IRS, https://www.irs.gov/instructions/i709#idm140535813989056 (Jan. 12, 2021) [https://perma.cc/M4EA-RJ9Y].

208. *Id.*

209. *Id.*

210. *Instructions for Form 3520-A (2020)*, *supra* note 204.

211. *Id.*

b. Foreign Grantor Trust Owner Statement

The trustee must furnish a Foreign Grantor Trust Owner Statement (page 3 of Form 3520-A) to the U.S. grantor of the trust while the trustee files Form 3520-A.[212]

c. Appointment of U.S. Agent for Tax Reporting Purposes

The IRS has authority to unilaterally determine the income of a foreign grantor trust to be included on the U.S. grantor's tax return if the trustee of a foreign trust fails to authorize a U.S. person to act as its limited agent for purposes of applying Sections 7602, 7603, and 7604 (relating to the examination of records and the service and enforcement of a summons for the examination of such records).[213] The IRS has provided sample language in the instructions to Form 3520-A.[214] In addition, the name, address, and taxpayer identification number of the agent must be set forth on the trust's Form 3520-A and the grantor's Form 3520, and a copy of the authorization of the agent document must be attached to the Form 3520-A that is filed with the IRS.[215]

d. Foreign Trust Beneficiary Statement

A U.S. beneficiary of a foreign trust must provide the IRS with information regarding the proper tax treatment of any distributions from the trust occurring after August 20, 1996.[216] In this regard, the trustee of a foreign trust must furnish, as applicable, a Foreign Grantor Trust Beneficiary Statement (page five of Form 3520-A) or a Foreign Non-grantor Trust Beneficiary Statement to any U.S. beneficiary who received a distribution from the trust during the year.[217] The information to be included in a Foreign Non-grantor Trust Beneficiary Statement is set forth in the instructions to Form 3520-A.[218] The Statements must be furnished at the same time that the trustee files Form 3520-A.[219]

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212. *Id.*; *2020 Form 3520-A*, *supra* note 203.
213. I.R.C. §§ 7602–04.
214. *Instructions for Form 3520-A (2020)*, *supra* note 204.
215. *Id.*
216. *Id.*
217. *2020 Form 3520-A*, *supra* note 203; *Instructions for Form 3520-A (2020)*, *supra* note 204.
218. *2020 Form 3520-A*, *supra* note 203; *Instructions for Form 3520-A (2020)*, *supra* note 204.
219. *Instructions for Form 3520-A (2020)*, *supra* note 204.

e. Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

In the case of a transfer to a foreign trust by reason of the death of a U.S. person occurring after August 20, 1996, the executor of the decedent's estate must report such transfer on Form 3520.[220] In addition, the executor of the estate of a U.S. person who died after August 20, 1996, must report the death of such person if the decedent was treated as the owner of any portion of a foreign trust under the grantor trust rules or if any portion of a foreign trust was included in the decedent's gross estate.[221] Although the instructions to Form 3520 do not address this point, Form 3520 probably should be filed by the due date (including extensions) of the decedent's final income tax return in this situation.[222] Form 3520 is to be filed with the IRS.[223] The penalty for noncompliance is equal to 35% of the reportable amount, with additional $10,000 penalties every 30 days for continuing failure after notice from the IRS.[224]

f. Form 1041: U.S. Income Tax Return for Estates and Trusts

Current regulations provide that the trustee of a foreign trust that is a grantor trust for U.S. income tax purposes must file a statement (a grantor trust information letter) attached to Form 1041 to report the income of the trust.[225] The form and attached letter generally must be filed by April 15 each year.[226]

g. Form 1040-NR: U.S. Nonresident Alien Income Tax Return

The trustee of a foreign trust that is not a grantor trust for U.S. income tax purposes but has U.S.-source income must file a Form 1040-NR if the U.S. tax attributable to such income was not withheld at its source by the payor.[227] Because Form 1040-NR is designed to report income attributable to nonresident alien individuals, as opposed to nonresident trusts, the trustee must make appropriate adjustments on the form.[228] The IRS reportedly is developing a new form (Form 1041-NR) to be used by foreign trusts for tax

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220. *Id.*
221. *Id.*
222. Author's original thought.
223. *Instructions for Form 3520 (2020)*, *supra* note 199.
224. *Id.*
225. *Instructions for Form 1041 and Schedules A, B, G, J, and K-1 (2020)*, *supra* note 196.
226. *Id.*
227. *See Instructions for Form 1040*, DEP'T TREASURY INTERNAL REVENUE SERV., 16–17 (2020), https://www.irs.gov/pub/irs-pdf/i1040nr.pdf [https://perma.cc/6QK6-N8P9].
228. *Instructions for Form 1040-NR (2020)*, IRS, https://www.irs.gov/instructions/i1040nr (Feb. 9, 2021) [https://perma.cc/6DKA-G8VN].

reporting purposes.[229]

Form 1040-NR generally must be filed by June 15 each year (or by April 15, if the trust has a U.S. office).[230] The penalty for failure to file is generally 5% of the amount of tax required to be shown on the return, with an additional 5% penalty for each month or partial month during which such failure continues (usually up to a maximum penalty of 25%).[231] The penalty for failure to pay any tax required to be shown on the return within twenty-one days of notice and demand, therefore (ten business days in the case of an amount over $100,000) is generally equal to 0.5% of the amount of such tax, with an additional 0.5% penalty for each month or partial month during which such failure continues (up to a maximum penalty of 25%).[232]

3. Beneficiaries

a. Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

A U.S. beneficiary of a foreign trust must provide information to the IRS regarding distributions from a foreign trust.[233] The penalty for failure to file is equal to 35% of the distribution amount, with additional $10,000 penalties every thirty days for continuing failure after notice from the IRS.[234] Failure to provide adequate information to determine the proper tax treatment of a distribution may also result in treatment of the distribution as an accumulation distribution.[235] The beneficiary can avoid such default treatment by attaching either a Foreign Grantor Trust Beneficiary Statement or a Foreign Non-Grantor Trust Beneficiary Statement (see above), as appropriate, to Form 3520.[236]

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229. Lawrence H. McNamara, *New Foreign Trust Tax Form Project: 1041NR*, TAX ADVISOR (Sept. 1, 2007), thetaxadvisor.com/issues/2007/sep/newforegintrusttaxform-project-1041nr.html [https://perma.cc/ZA33-C5C3].

230. *Instructions for Form 1040-NR (2020)*, *supra* note 228.

231. *Collection Procedural Questions*, IRS, https://www.irs.gov/faqs/irs-procedures/collection-procedural-questions (Nov. 4, 2021) [https://perma.cc/YD8J-R7P8].

232. *Id.*

233. *Foreign Trust Reporting Requirements and Tax Consequences*, IRS, http://www.irs.gov/businesses/international-businesses/foreign-trust-reporting-requirements-and-tax-consequences (July 6, 2021) [https://perma.cc/RNH4-HEEG].

234. John Nuckolls, *Foreign Trust Reporting: Beware of Late-filing Penalties*, TAX ADVISOR (May 14, 2020), https://www.thetaxadvisor.com/issues/2020/may/foreign-trust-reporting-late-filing-penalties.html [https://perma.cc/JK5Z-B5DN].

235. McNamara, *supra* note 229.

236. Nuckolls, *supra* note 234.

VI. MEXICAN TAX AND ESTATE PLANNING ISSUES

A. Resident Individuals for Tax Purposes in Mexico

1. Tax Residency in Mexico

a. Dwelling Place in Mexico

Under the Mexican Federal Fiscal Code (MFFC), an individual is considered a resident in Mexico for tax purposes when the individual has established their dwelling home in Mexico.[237]

There is no legal definition regarding what should be understood as a dwelling home, but in practice, it includes any physical space where a taxpayer could be located on a regular basis; it is irrelevant whether the taxpayer owns it.[238] MFFC regulations set forth that an individual will not be considered to have established the individual dwelling home in Mexico if the individual lives temporarily in a property used for touristic purposes and the individual's center of vital interest is not located in Mexico.[239]

b. Tie-breaking Rule

When an individual has a dwelling home in Mexico and another abroad, they will be considered a resident in Mexico for tax purposes, provided that their "center of vital interests" is in Mexico.[240] For these purposes, under the MFFC, the center of vital interest is deemed to be in Mexico if in a calendar year, an individual has more than 50% of the individual's total income arising from Mexican-sourced income or if the center of the individual's professional activities is in Mexico.[241]

c. Mexican Citizens

Mexican citizens are presumed to be Mexican tax residents unless otherwise proven.[242]

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237. *Article 9: Those Who Are Considered Residents in National Territory*, BASE ADUANERA DIGIT. ONLINE, https://bado.mx/articles/1038/codigo-fiscal-de-la-federacion/article-9-those-who-are-considered-residents-in-national/ (last visited Sept. 30, 2021) [https://perma.cc/3SL2-5YUC].

238. *See Article 10: What Is Considered Fiscal Address*, BASE ADUANERA DIGIT. ONLINE, https://bado.mx/articles/1035/codigo-fiscal-de-la-federacion/article-10-what-is-considered-fiscal-address/ (last visited Sept 30, 2021) [https://perma.cc/ADC4-JEKR].

239. *Mexico - Information on Residency for Tax Purposes*, CENT. ADMIN. AUDI & TAXPAYER ASSISTANCE, 1, 3, https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/Mexico-Residency.pdf (last visited Sept. 30, 2021) [https://perma.cc/65UC-PQQE].

240. *Id.*

241. *Id.*

242. *Id.*

Please note that, unlike the USA, once a Mexican citizen files a notice of their change of tax residence to another country, the Mexican citizen will no longer be compelled to pay income tax in Mexico unless the Mexican citizen receives a Mexican source of income.[243]

d. Change of Residence

Effective as of 2022, when a Mexican tax resident changes their residence to a jurisdiction abroad where the Mexican tax resident's income is subject to a preferential tax regime, if no tax is paid or the income tax paid abroad is less than 75% of the tax that would be payable in Mexico, such individual will still be considered a resident in Mexico for the year in which the change was made and for the subsequent five years.[244] This rule will not be applicable when Mexico has an information exchange agreement signed with such jurisdiction and an international treaty that enables the mutual administrative assistance on notices and collection of taxes.[245]

In order to change their tax residence, taxpayers in Mexico will need to prove that they previously acquired tax residence in another jurisdiction.

2. Income on Worldwide Earnings

Under Mexican Income Tax Law (MITL), individuals that are residents of Mexico for tax purposes pay income tax on all income they receive in the tax year despite its source; consequently, Mexican tax residents pay income tax on their worldwide income.[246]

Provided certain requirements are met, taxpayers are allowed to credit in Mexico the income tax paid directly or withheld abroad in connection to the foreign source of income.[247]

3. General Overview on the Taxation of Foreign Structures

Until December 31, 2019, Mexican tax residents who generated income through a foreign legal arrangement (i.e., trust or Canadian limited partnership) or a foreign entity (i.e., L.L.C.) were compelled to determine if

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243. *See Mexico-Thinking Beyond Borders*, KPMG GLOB. (Aug. 1, 2016), https://home.kpmg/xx/en/home/insights/2015/07/mexico-thinking-beyond-borders.html [https://perma.cc/44ZX-PVRP].

244. *Id.*

245. *Id.*

246. *Id.*

247. *Mexico-Corporate-Tax Credits and Incentives*, PWC (July 21, 2021), https://taxsummaries.pwc.com/mexico/corporate/tax-credits-and-incentives#:~:text=%20Corporate%20-%20Tax%20credits%20and%20incentives%20,Tax%20Law%20provides%20a%2030%25%20tax...%20More%20 [https://perma.cc/WV9V-XEPK].

said income was subject to the preferential tax regime provisions.[248] For these purposes, income was deemed as subject to controlled foreign company (CFC) rules when: (i) the tax paid abroad was lower than 75% of the tax that will be payable in Mexico (i.e., a rate below 22.5% for entities and 26.25% for individuals); or (ii) the entities or legal arrangements were tax transparent in the jurisdiction where they were incorporated.[249]

Taxpayers subject to this new regime should pay the corresponding income tax annually and should file an informative return reporting this income.[250] Not filing the informative return is considered a tax felony.[251] Taxpayers could determine their taxable income using a different currency than the Mexican peso, which could entail some benefits because the foreign exchange of cash or debt instruments is taxed as interest even if not realized.[252]

Several exceptions applied to the CFC regime, such as not having control, which means not having binding powers to decide when to make distributions.[253] If there was a lack of control, taxpayers could defer the tax until the distribution was received.[254]

As of 2020, a new tax regime was included for Mexican residents with income arising from tax transparent foreign entities and foreign legal arrangements (whether tax transparent or not).[255] In this regard, under Article 4-B of the MITL, all income generated through these entities or figures is deemed as income of the taxpayers and is subject to the general regime (not CFC provisions) when generated, even if not distributed.[256]

Taxpayers subject to this new regime should pay the corresponding income tax annually and should file an informative return reporting this income.[257] One relevant item is that foreign exchange is considered and taxed as interest, unlike the CFC rules under the general regime.[258] For purposes of Article 4-B of the MITL, there are no exceptions, such as lack of control.[259]

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248. *See* Guillermo Aguayo et al., *Suspension of periods and legal terms for certain tax procedures*, WHITE & CASE (May 2020), https://www.whitecase.com/sites/default/files/2020-05/suspension-periods-and-legal-terms-certain-tax-procedures-eng.pdf [https://perma.cc/3UB6-GKZF].

249. *Controlled Foreign Company (CFC) Rules*, OECD, https://qdd.oecd.org/subject.aspx?Subject=CFC (last visited Sept. 27, 2021) [https://perma.cc/53HX-YGU5].

250. *Mexico-Thinking Beyond Borders*, *supra* note 243.

251. *See Tax Compliance Guide: Disclosure of Reportable Schemes*, RITCH MUELLER 1, 6 (Dec. 2020), https://ritch.com.mx/storage/uploads/articles/535/en/RivWuOXi5lGTq0VhxIPPb607P0m3zq9xWxbST8C1.pdf [https://perma.cc/LJ6U-MT9Q].

252. *Mexico-Income Tax*, KPMG GLOB. (June 9, 2016), https://home.kpmg/xx/en/home/insights/2011/12/mexico-income-tax.html#:~:text=Residents%20%20%20Taxable%20income%20bracket%20%20,%20%2010.88%20%208%20more%20rows%20 [https://perma.cc/PMF6-GEN9].

253. *See Controlled Foreign Company (CFC) Rules*, *supra* note 249.

254. *Id.*

255. Aguayo et al., *supra* note 248.

256. *Id.*

257. *Mexico-Thinking Beyond Borders*, *supra* note 243.

258. *Id.*

259. *See* Aguayo et al., *supra* note 248.

The CFC provisions will now be applicable only to income generated through tax-transparent entities (companies with legal personalities).[260] Taxpayers subject to this new regime should pay the corresponding income tax annually and should file an informative return reporting this income.[261] Not filing the informative return is a tax felony.[262]

The control exception was revisited, and under the amended provision a Mexican resident will have effective control over a nonresident entity, if the resident:

> (a) due to its participation, has more than 50% of the voting rights or value of the shares of the foreign entity, or could veto the decisions of the entity;
> (b) due to any agreement or title, has rights to more than 50% of the entity's assets or profits in case of a capital redemption or liquidation;
> (c) due to a combination of the above, owns more than 50% of the abovementioned rights in the entity;
> (d) files consolidated financial statements with the non-resident entity; or
> (e) may make unilateral decisions, directly or indirectly, at shareholders' or board meetings.[263]

For these purposes, related parties are considered.[264]

B. Nonresident Individuals for Tax Purposes in Mexico

1. Mexican Source Income

Under the MITL, nonresident individuals without a permanent establishment (PE) in Mexico will pay income tax in Mexico only on Mexican-source income.[265]

For these purposes, the MITL set forth different types of income and the rules to determine when such are considered Mexican-sourced and therefore

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260. Jorge San Martin & Elsa Sanchez-Urtiz, *INSIGHT: Mexico's 2020 Tax Reform-Focus on Income Tax, VAT and Federal Tax Code*, BLOOMBERG L. (Feb. 19, 2020, 2:01 AM), https://news.blooMberglaw.com/litigation/insight-mexicos-2020-tax-reform-focus-on-income-tax-vat-and-federal-tax-code?context=article-related [https://perma.cc/X57K-MV9R].

261. *See Mexico: Individual-Taxes on personal income*, PWC, https://taxsummaries.pwc.com/mexico/individual/taxes-on-personal-income (July 23, 2021) [https://perma.cc/S8RS-LVS4].

262. *See* I.R.C. § 7201.

263. *See Final 2020 Tax Reform Package Approved by Senate*, DELOITTE GLOB. (Nov. 1, 2019), https://www.taxathand.com/article/12522/Mexico/2019/Final-2020-tax-reform-package-approved-by-Senate [https://perma.cc/T8CY-NKJK].

264. *See* San Martin & Sanchez-Urtiz, *supra* note 260.

265. *See United States-Mexico Income Tax Convention*, IRS, 1, 8–9 (Jan. 1, 1994), https://www.irs.gov/pub/irs-trty/mexico.pdf [https://perma.cc/8UP8-ZDZS].

taxable in Mexico.[266] The types of income comprised in the MITL include, among others, income derived from salaries, personal independent services, leasing immovable property, leasing of movable property, sale of fixed assets, sale of shares, dividends and other profit distributions, interests, financial leasing, royalties and technical assistance, construction and installation services, prizes, artistic and sports activities and intermediation.[267]

Derived from the above, a foreign resident without a PE will be taxed in Mexico when the following requirements are met: (i) the specific item of income is expressly considered as taxable, and (ii) the hypotheses for having a Mexican source of wealth are fulfilled.[268]

Please note that the rules for determining when income has a Mexican source of wealth vary depending on the nature of the income.[269]

The MITL provides for the tax to be paid through withholding made by the payer if such is a Mexican tax resident or nonresident with a PE.[270] For these purposes, any other way of fulfilling obligations diverse from payment will be treated as payment for tax purposes.[271]

The MITL further provides that if the payer of the item of income assumes or absorbs the taxes on account of the nonresident, such amount will be considered a taxable income for the nonresident.[272]

2. Exemption for Nonresidents Staying Less Than 183 Days

a. Length of Stay

For purposes of determining the tax residence or the existence of a PE, the MITL does not refer to the length of days spent by a nonresident in Mexico.[273]

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266. *See id.*; *see also Mexico: Corporate-Income Determination*, PWC, https://taxsummaries.pwc.com/mexico/corporate/income-determination (Oct. 22, 2021) [https://perma.cc/95PR-88CZ].

267. *See United States-Mexico Income Tax Convention*, *supra* note 265.

268. *See Taxation of Expats Living in Mexico*, ESCAPE ARTIST (Mar. 1, 2021), https://www.escapeartist.com/blog/taxation-of-expats-living-in-mexico/ [https://perma.cc/4HN9-5X78].

269. *Publication 514: Foreign Tax Credit for Individuals (2020)*, DEP'T TREASURY INTERNAL REVENUE SERV., 1, 1–2 (Feb 25, 2021), https://www.irs.gov/pub/irs-pdf/p514.pdf [https://perma.cc/N8XC-F9DS].

270. Christine Ballard, *2020 Mexico Tax Reform Overview: Key Changes for you and Your Business*, MOSS ADAMS, L.L.P. (Mar. 16, 2021), https://www.mossadams.com/articles/2020/03/2020-mexico-tax-reform-overview [https://perma.cc/RAL6-YMRZ].

271. *Id.*

272. *See Mexico: Corporate-Income Determination*, *supra* note 266.

273. *See Mexico: Corporate – Corporate Residence*, PWC, https://taxsummaries.pwc.com/mexico/corporate/corporate-residence (Oct. 22, 2021) [https://perma.cc/LL4P-PTW6].

b. Exemption

Regarding only Mexican-source income arising from salaries or independent services, a nonresident staying less than 183 days in Mexico might be exempted from income tax on Mexican-source income if: (1) the payments are made by a foreign tax resident with no PE in Mexico; and (2) the service provided has no connection with any establishment of the foreign resident.[274]

3. Taxes on the Gains and Income

a. Real Estate Transfer by Foreign Tax Resident

Regarding the sale of real estate, the MITL provides that the source of wealth of the income will be Mexican-sourced when said property is located within the country.[275] In such cases, generally, a 25% withholding tax to the gross income obtained by the foreign resident, without any deductions, is applicable.[276] The tax will be withheld by the acquirer, provided such is a Mexican resident or a foreign resident with a PE in Mexico; otherwise, the taxpayer must pay the corresponding tax by filing a tax return before the tax authorities within fifteen days following the reception of the income.[277]

i. 35% Withholding Rate

Taxpayers can elect to be taxed at a 35% rate over the gain, provided they fulfill the following requirements: (i) have a representative in Mexico who is a resident of Mexico for tax purposes or a foreign resident with a PE in Mexico, who will maintain available to the tax authorities the supporting documentation related to the tax payments on account of the taxpayer for five years after the tax return is filed; and (ii) the transfer of land is recorded in a notarial instrument or deed.[278]

ii. Gain Calculation

The gain is calculated as the difference between the updated acquisition cost of the real estate and the consideration received from the transferees.[279]

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274. *Id.* (explaining length of time is not regarded for considering permanent establishment).

275. *See id.*

276. *See id.*

277. *See Mexico: Corporate-Income Determination*, *supra* note 266.

278. *See Mexico-Corporate-Withholding Taxes*, PWC, https://taxsummaries.pwc.com/mexico/corporate/withholding-taxes (July 21, 2021) [https://perma.cc/DT44-29UU].

279. *See How to Figure Long-Term Capital Gains Tax*, H&R BLOCK, https://www.hrblock.com/tax-center/income/investments/how-to-figure-capital-gains-tax/ (last visited Oct. 1, 2021) [https://perma.cc/59KL-A3BH].

b. REITs

Foreign tax residents that acquire certificates in a Mexican real estate investment trust (REIT) (also known as FIBRA) qualify for tax-free treatment on the sale of these instruments provided that the certificates are traded to third parties through the Mexican Stock Exchange or a recognized foreign market, but the rules changed under the 2020 Act.[280]

c. Shares of Mexican Company

i. Transfer of Shares

The transfer of shares or securities is subject to withholding tax in Mexico at a rate of 25% on the consideration, with no deductions, if either (1) the person who issued the shares or securities is a Mexican tax resident, or (2) regarding foreign shares, if more than 50% of the accounting value of the shares or securities are directly or indirectly related to Mexican real estate.[281]

The following transactions are also taxed as a transfer of Mexican shares: execution of a usufruct or the right to use such shares is constituted; or any right to receive yields over such shares is transferred.[282]

ii. Foreign Tax Residents

Foreign tax residents can choose to be subject to a withholding tax at a rate of 35% on the net capital gain obtained on the transfer of the shares, securities, and interests if they comply with all the following requirements: (1) they appoint a Mexican tax resident as their legal representative for the transaction; (2) they do not reside in a preferential tax regime for Mexican tax purposes; and (3) they file an audited tax report on the transaction's tax implications with the Mexican tax authorities, prepared by an authorized certified public accountant.[283]

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280. *See Global REIT Survey 2016 Mexico-FIBRAS*, EUR. PUB. REAL EST. ASS'N (2016), https://www.epra.com/media/EPRA_REIT_2016_GLOBAL_1481196802652.pdf [https://perma.cc/96DZ-SXB5].

281. *See Mexico: Corporate-Income Determination*, *supra* note 266.

282. *See Flash: Mexican Tax Reform Initiative For 2022*, KPMG, https://home.kpmg/mx/es/home/tendencias/2021/09/flash-mexican-tax-reform-initiative-for-2022.html (last visited Oct. 1, 2021) [https://perma.cc/24PJ-E3R7].

283. *See Mexico: Corporate-Withholding Taxes*, *supra* note 278.

iii. Transfer of Public Shares

Foreign tax residents are subject to withholding tax on the transfer of Mexican shares placed with the general investing public on the Mexican Stock Exchange.[284] The withholding tax will be 10% on the gain. For these purposes, the intermediary will determine the gain of each transaction and will withhold the tax.[285] However, when the taxpayer is a resident of a treaty country, the transfer will be tax-exempt, as long as the taxpayer provides to the intermediary a statement under oath declaring its resident status and its tax identification number.[286] If this information is not provided, the 10% WTH is applicable.[287]

C. Donation, Inheritance, and Bequest

1. Definition

The MITL does not contain a definition of a donation, inheritance, or bequest; therefore, the definitions in the Mexican Federal Civil Code (MFCC) are applicable.[288]

2. Definitions Under MFCC

The following are the terms as defined under the MFCC: "[d]onation" is an agreement by means of which a person transfers to a third party, gratuitously, part or all of his current goods; "[i]nheritance" is the transmission of all the goods and rights (not extinguished by death) of a deceased person at the moment of the deceased person's death; and a "[b]equest" is the act of transferring specific goods, property of the deceased, to a third person by means of a will.[289]

3. Wills

In Mexico, a will must comply with the local regulations applicable to the state where it is granted.[290] For the case of Mexico City, in general terms, the following rules are applicable:

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284. *See id.*
285. *See id.*
286. *See id.*
287. *Id.*
288. *See* Codigo Civil Federal, [CC], art. 2332, 1281, 1392, 1395, Diario Oficial a la Federacion [DOF] 14-05-28, ultimas reformas DOF 24-12-2013 (Mex.).
289. *Id.*
290. STEPHEN ZAMORA ET AL., MEXICAN LAW, 500 (Oxford Scholarship Online, 2005).

a. A will is a personal act, that shall be granted freely and that may be revoked (i.e. by a new will).[291]
b. A will shall be granted before a notary public (or a Mexican consul if granted abroad).[292]
c. The notary public will issue the will in the terms required by the testator.[293]
d. The testator shall sign the will before the notary public.[294]
e. Under certain circumstances, witnesses may be required.[295]

4. Donation Agreement

Donation agreements must be written and executed before a notary public by the donor and the donee to be valid.[296]

5. Fideicomiso

The 1917 Mexican Constitution banned foreign ownership of any land within Mexico's Restricted Zone (any land located within sixty miles of any national border and thirty miles of its coastline).[297] Until the 1970s, only Mexican citizens or Mexican corporations whose corporate documents prohibit stock ownership by non-Mexican citizens could own land in the Restricted Zone.[298] Nowadays, to own land in the Restricted Zone, however, foreign individuals must own such land through a "fideicomiso."[299] A fideicomiso may last for up to fifty years, which can be extended.[300]

A fideicomiso is a contractual arrangement under Mexico's statutory civil law, inspired by the common law trust.[301] The structure of a Mexican fideicomiso for owning property in the restricted zone is as follows: (1) a Mexican bank holds title to the real estate, and (2) a foreign individual or a foreign company are named as beneficiaries, with the rights to sell, improve, and dispose of the property.[302]

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291. Codigo Civil Federal [CC], art. 1295 (Mex).
292. *See* ZAMORA ET AL., *supra* note 290.
293. *Id.*
294. *Id.* at 501–02.
295. *Id.*
296. *See id.* at 511.
297. Constitution Politica de los Estados Unidos Mexicanos [CP], art. 27 § I Diario Oficial de la Federación [DOF] 05-02-1917 (Mex).
298. *See* Michael Boreale, *Beachfront Property in Arizona?: Loosening Restriction on Foreign Acquisition of Mexican Real Estate and the Implications for Arizona Investors*, 22 ARIZ. J. INT'L & COMP. L. 389, 396–97 (2005).
299. *Id.* at 396.
300. Ley Para Promover la Inversion Mexicana y Vigilar la Inversion Extranjera [LIE], art. 13, Diario de la Federacion [DOF] (Mex.).
301. Boreale, *supra* note 298, at 396 n. 63–65.
302. *Id.* at 392.

For many years, the IRS took the position that ownership of a fideicomiso was a foreign trust that had to be reported on Form 3520 and Form 3520-A.[303] In 2012, however, the IRS issued a private letter ruling that fideicomisos are not trusts but nominee arrangements in which a nominee holds title to the asset for its true owner.[304] The IRS followed with Revenue Ruling 2013-14, stating that a fideicomiso is not a foreign trust.[305]

D. Death, Inheritance, and Gift Tax

1. No Specific Death, Inheritance, or Gift Tax

There is no specific death, inheritance, or gift tax in Mexico ("Mexican Transfer Tax") that is analogous to the transfer tax system of the United States.[306]

2. Donations, Inheritance, and Bequest Considered as Income in Mexico

Although there is not a Mexican Transfer Tax, donations, inheritances, and bequests are considered "income" in Mexico and are subject to income tax in the recipient's hands, absent an exemption under the MITL.[307]

3. Resident Individuals

a. Exemptions from Income Tax

Individuals who are residents of Mexico for tax purposes are exempted from the income earned from the following: (1) inheritance and bequests; to the extent such income is properly informed to the Mexican Tax Authorities; (2) donations from spouses or straight-line ascendants; and (3) donations from straight-line descendants to the extent the goods received are not subsequently transferred to another straight-line descendant.[308]

b. Reporting Required

Income that Mexican tax resident individuals receive from inheritance, bequests, and donations (when applicable) in a given tax year must be reported to the tax authorities in their annual tax return.[309]

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303. *See* I.R.S. Priv. Ltr. Rul. 201245003 (Nov. 9, 2012).
304. *Id.*
305. Rev. Rul. 2013–14, 2013–16 I.R.B. 1267.
306. *Compare* 26 C.F.R. §§ 20.2055-2, 20.2055-3 *with* Codigo Civil Federal [CC], art. 2382–83 (laws concerning gifts in Mexico).
307. Ley del Impuesto Sobre la Renta [LIR], art. 93, Diario de la Federación [DOF] (Mex.).
308. *Id.* art. 93 §§ XXII–XXIII.
309. *Id.* art. 76.

Income received by resident individuals from donations shall be reported to the tax authorities when all donations (including prizes and loans) received in a tax year exceed 600,000 Mexican Pesos.[310]

In addition, since the tax authorities take very formalistic approaches in audits, the taxpayer must have the proper documentation to evidence that the income received arises from a donation, bequest, or inheritance.[311] In this regard, the taxpayer must keep the donation agreement executed before the Mexican Notary Public or the proper documentation of the succession.[312]

4. Nonresident Individual Receipt of Donation, Inheritance, or Bequest

Unlike individuals who are tax residents in Mexico, individuals who are tax residents abroad are subject to taxation in Mexico when they receive Mexican-sourced income from a donation, inheritance, or bequest of the following assets: (a) shares issued by an entity that is a resident in Mexico or by an entity whose value is derived from greater than 50% of Mexican real estate; and (b) real estate located in Mexican territory.[313]

5. Donation Exception

Properly structured donations of the abovementioned goods from a spouse or straight-line ascendant are exempt from this tax.[314] Nevertheless, donations made from a descendent to a straight-line ascendant are not exempted.[315]

6. Tax Rates

In any other case of donation or inheritance/bequest of this type of shares or real estate, the nonresident acquirer shall pay income tax in Mexico by applying a 25% tax rate over the appraisal value of the good.[316] This tax shall be paid through a Mexican Notary Public (when the transaction is executed before one) or directly by the nonresident.[317]

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310. *Id.*
311. *Id.*
312. *Id.*
313. *Id.* art. 144.
314. *Id.* art. 93 § XXII.
315. *See id.* art. 93 (listing available exemptions).
316. *Id.* art. 158.
317. *Id.*

7. Other Taxes

The acquisition of real estate (either land and/or constructions) is subject to real estate transfer tax, payable by the acquirer upon the acquisition.[318] Since this is a local tax, the location of the property will determine the applicable rate; however, the rate varies between 2 to 6% over the higher of the following values: (i) consideration paid; (ii) cadastral value of the property; or (iii) appraisal value.[319]

The acquisition of real estate in Mexico due to a donation or an inheritance is not taxed for value added tax purposes.[320]

E. Mexican Marital Property Regime

When parties marry in Mexico, they must declare that they are being married either: (a) with all goods and property in common (all goods held as "community property") or (b) under the regime of ("separación de bienes") separate property.[321] Property held under the separate property regime is fully managed and administered by each respective spouse owner.[322] Property held under the community property regime is administered jointly; however, spouses may also enter into a "conjugal partnership" whereby the property may be managed differently, under the terms of the agreement.[323]

VII. PLANNING TECHNIQUES AND CONSIDERATIONS

A. Preliminary Planning Considerations

1. Coordination of Advisors

One of the most important considerations when representing individuals with cross-border issues, whether they are a U.S. citizen or resident with children residing in Mexico or a Mexican citizen or resident with children in the U.S., is proper coordination with counsel and advisors on both sides of the border.[324] This coordination includes, but is not limited to, lawyers, financial advisors, accountants, and insurance professionals.[325] Competent

318. *Id.*
319. *Id.* art. 160.
320. *See id.*
321. *Id.* art. 187–88.
322. Codigo Civil Federal [CC], art. 178.
323. *See id.* art. 207.
324. *See id.* art. 178.
325. *See* J. Truman Bidwell, Jr. & Ettere A. Santucci, *Opinions of Counsel in Cross-Border Financial Transactions*, STRAFFORD 1, 13–14 (2017), http://media.Straffordpub.com/products/opinions-of-counsel-in-cross-border-financial-transactions-2017-09-20/presentation.pdf [https://perma.cc/6KFK-ZWPM].

and qualified counsel is paramount to good representation.[326]

2. Non-Tax Considerations

a. Matrimonial Property Considerations

An advisor must be cognizant of the marital property characteristics of the assets subject to the planning.[327] Generally, an individual's personal property rights are governed by the law where the individual is domiciled.[328] For real property located in Texas or Mexico, the law of the land will apply despite the owner's domicile.[329] However, when obtained, the community or separate property character will control upon the individual's death.[330]

b. Immigration Considerations and Issues

It is also important for advisors to understand the current immigration status of the client. Is it a U.S. client who is considering expatriation to Mexico?[331] How about a Mexican national considering immigrating to the U.S.?[332] These planning issues are critical to the planning techniques proposed.[333]

B. Individual Planning: For Whom Are We Planning?

1. Domicile of Donor/Testator

Prior to beginning the planning process, it is important to explore the donor's domicile and/or tax residency.[334]

2. Domicile of Donee/Beneficiary

It is equally important to determine the domicile or tax residence of the recipient of the donation or bequest.[335]

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326. *Id.*
327. *See* TEX. FAM. CODE ANN. § 3.102.
328. *See* TEX. PROP. CODE ANN. § 42.002.
329. Boreale, *supra* note 298, at 389–90.
330. *See id.* at 391.
331. *See* Jorge A. Vargas, *Mexico's Foreign Investment Regulations of 1998,* 23 HOUS. J. INT'L L. 1, 3 (2000).
332. Author's original thought; *4.61.12 Foreign Investment In Real Property Tax Act*, IRS, https://www.irs.gov/irm/part4/irm_04-061-012 (May 24, 2019) [https://perma.cc/5JKU-KT48].
333. *See* Manuel F. Pasero, *Foreign Investment in Mexico's Real Estate: An Introduction to Legal Aspects of Real Estate Transactions*, 35 SAN DIEGO L.R. 783, 803 (1998).
334. Codigo Civil Federal [CC], art. 30.
335. *See id.*

C. Asset Planning: For What Are We Planning?

1. Situs of Assets: Mexico or U.S.?

A full understanding of the nature of the assets to be transferred and where they are situated, or located, in Mexico or the U.S. is very important from a planning perspective.[336]

2. Tangible or Intangible Assets?

A proper understanding of the nature of the assets as being tangible or intangible is important for the process.[337]

D. Planning Techniques

1. Mexican Citizen (Non-U.S. Resident) with U.S. Beneficiaries

a. U.S. Tax Issues/Planning

i. Gifts/Bequests of Intangible Property

Gifts of intangible property are remarkably powerful transfer tools, as they are not subject to U.S. gift or estate tax.[338] However, care must be taken when considering the gift or estate tax consequence of the gift—note that U.S. corporate stock is included in the estate of the Mexican NRA but may be gifted on a gift tax-free basis.[339]

ii. Gifts/Bequests of Intangible Property to Dynasty Trusts

As the GST tax does not apply to gifts of intangibles because it is not considered a "gift" for U.S. transfer tax purposes, the use of dynasty trusts in proper jurisdictions, such as Delaware or Alaska, should strongly be considered.[340]

iii. Gifts/Bequest of Tangible Personal Property

Gifts of tangible personal property in the U.S. are subject to U.S. gift tax; thus, gifts of tangible personal property, such as jewelry or art, should

336. *See id.*
337. Andrea M. Matwyshyn, *Imagining the Intangible*, 34 DEL. J. CORP. L. 965, 975 (2009).
338. *See Gift Tax*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/gift-tax (Apr. 2, 2021) [https://perma.cc/HYU6-RDV4].
339. *See id.*
340. *See Dynasty Trusts and the Rule Against Perpetuities*, 116 HARV. L.R. 2588, 2589 (2003).

not be made in the U.S.[341]

iv. Gifts/Bequests of U.S. Real Property

U.S. real property is included in the estate of the Mexican NRA and would also be subject to gift tax if given to the U.S. beneficiary.[342]

b. Mexican Tax Issues/Planning

i. Donation, Inheritance, or Bequests of Shares in Mexican Entity or of Mexican Real Property

Careful consideration must be used when planning for transfers of Mexican entity interests and Mexican real estate passing to a non-Mexican tax resident as a flat 25% income tax based on the value of the transferred asset is imposed on non-exempt transfers.[343]

ii. Donations Exemption for Shares in Mexican Entity or Mexican Real Estate

Mexican NRAs should strongly consider gifting (i.e., donating) these interests to their non-Mexican tax resident descendants, as such a transfer is an exempt transfer, and if structured correctly, should pass free of Mexican income tax to the donee.[344]

c. Miscellaneous Planning Issues

i. Ancillary Planning Documents

If the Mexican NRA spends significant time in the U.S., they should execute appropriate ancillary planning documents, such as a power of attorney for financial matters and a medical power of attorney.[345]

ii. Revocable Trust Planning

Although a probated Mexican will is generally admissible in Texas, the favored planning tool is a revocable management trust.[346]

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341. *Gift Tax*, *supra* note 338.
342. *Id.*
343. *See* Pasero, *supra* note 333, at 800.
344. *Id.* at 802.
345. *See* Vargas, *supra* note 331, at 28.
346. *See* TEX. EST. CODE ANN. § 502.001.

- Fund Trust: The trust takes the place of a will, and if funded properly, passes assets privately to the grantor's intended beneficiaries;
- Privacy: With many clients, both Mexican and U.S., the privacy features of the revocable management trust are very important;
- Patriot Act/Know Your Client Issues: A revocable management trust is a better vehicle for transferring securities upon the death of Mexican NRA rather than individual account with "pay on death" clause because of Patriot Act issues.
- Note Regarding Wills/Intestacy: Although the Texas Estates Code will recognize a properly-probated will in Mexico, a will that has not been probated must comply with the Texas Estates Code, which might be difficult. If the will does not comply, the property will pass subject to the laws of intestacy. Texas law applies to real property located in Texas, however generally the law of Mexico would apply to the succession of personal property.[347]

iii. Real Property Issues

Ownership of U.S. real property by a Mexican NRA individual can pose multiple adverse issues that the individual (and often times the individual's counsel) is rarely aware of.[348]

- Outright Ownership: Outright ownership of real property is included in taxable estate of a Mexican NRA. Considering the $60,000 estate tax exemption for Mexican NRAs, this can pose a significant estate tax issue;
- Foreign Corporation Ownership: Many consider ownership of real property through a foreign corporation; however, this type of ownership can have adverse income tax consequences and should be closely reviewed;
- FIRPTA Issues: Upon sale of real property, generally FIRPTA requires a 10% retention of amount realized;
- Revocable Trust Ownership: Revocable trust passes property outside of probate; however, property will be included in taxable estate of Mexican NRA;
- Irrevocable Trust Ownership: Irrevocable trust ownership is an option; however, a Mexican NRA should pay reasonable rent to the trust for usage;

347. *Id.* §§ 1301.204, 1301.057, 502.001.

348. *See Estate Tax for Nonresidents not Citizens of the United States*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax-for-nonresidents-not-citizens-of-the-united-states (Aug. 5, 2021) [https://perma.cc/2VE6-Q23K].

- Consider Ownership Effect on Tax Residency: Real property ownership can cause tax residency issues if not managed appropriately;
- Marital Property Character Must Be Carefully Considered: For example, if a Mexican NRA purchases U.S. real estate with her separate property and later decides to put her husband on the deed, there can be U.S. gift tax consequences.[349]

iv. Foreign Trust Consideration

Consider creation of foreign grantor trust for certain non-U.S. assets.[350]

v. Pre-Immigration Planning

- Step-Up Basis of Assets: Because a step-up adjustment in basis to fair market value is generally not allowed upon immigration to the United States, it may behoove the Mexican NRA to attempt to adjust their basis in assets prior to immigration.[351] A taxable reorganization or sale to a family member may accomplish this goal.[352]
- Accelerate Income: Careful consideration should be made to determine if it would be beneficial for the Mexican NRA to accelerate income on a pre-immigration basis.[353] The exercise of stock options and acceleration of receipt of deferred compensation programs are prime examples of income acceleration vehicles that may be utilized to maximize the pre-immigration tax matters.[354]
- Postponement of Deductions and Losses: As discussed above, Mexican NRAs have restricted deductions under the Code.[355] In the event a Mexican NRA is anticipating an immigration position, postponement of such deduction and losses until the NRA becomes

349. *Id.*; *see Foreign Account Tax Compliance Act (FATCA)*, IRS, https://www.irs.gov/businesses/corporations/foreign-account-tax-compliance-act-fatca (July 6, 2021) [https://perma.cc/K79U-5YMQ]; EST. § 502.002; TEX. FAM. CODE ANN. § 3.101.

350. *Foreign Trust Reporting Requirements and Tax Consequences*, IRS, https://www.irs.gov/businesses/international-businesses/foreign-trust-reporting-requirements-and-tax-consequences#:~:text=%20Foreign%20Trust%20Reporting%20Requirements%20and%20Tax%20Consequences,foreign%20trust%20-%20In%20general%2C%20a...%20More%20 (July 6, 2021) [https://perma.cc/46CK-ESGM].

351. Rolando Garcia, *Tax Planning for High-Net-Worth Individuals Immigrating to the United States*, TAX ADVISOR (Apr. 1, 2016), https://www.thetaxadviser.com/issues/2016/apr/planning-for-high-net-worth-individuals-immigrating-to-US.html#:~:text=However%2C%20Lady%20Liberty%20does%20not%20warn%20of%20the,This%20item%20articulates%20some%20considerations%20for%20those%20taxpayers [https://perma.cc/S6C2-PXSL].

352. *See id.*

353. *See id.*

354. Jeffrey M. Colon, *Double-Dipping: The Cross-Border Taxation of Stock Options*, 35 RUTGERS L.J. 171, 185–86, 199, 223–24 (2003).

355. *See supra* Section III.B.2.b.viii.

an RA and can therefore offset the deductions and losses might be beneficial.[356]

- Evaluation of Corporate Holdings and Avoidance of Anti-Deferral Tax Regimes: The corporate anti-deferral regimes of the Internal Revenue Code can have severe tax consequences on shareholders.[357] Once the Mexican NRA becomes an RA or U.S. citizen, the Mexican NRA may immediately become subject to one of the corporate anti-deferral regimes.[358] With proper pre-immigration planning, the ownership interest that would cause one to be affected by the regime can be avoided prior to immigration with transfers of corporate shares to other NRAs.[359] Because of the catchall "constructive ownership" rules of the anti-deferral regimes, such transfers should be carefully scrutinized prior to each transfer.[360]
- Planning for U.S. Beneficiaries: A gift by an NRA of intangible property not situsedin the U.S. to the NRA's heirs located in the U.S. is an extraordinarily powerful estate planning tool.[361] First, because the gift is of intangibles not situsedin the U.S., the gift should not attract U.S. gift taxation.[362] Second, because the generation skipping tax does not apply to transfers that are not considered gifts for U.S. tax purposes (i.e., gifts of foreign intangibles), transfers to dynastic trusts established in jurisdictions that have abolished the rule against perpetuities, either foreign or domestic, will not only escape gift taxation on the transfer but should not be included in the taxable estate of the U.S. beneficiary.[363] Lastly, as the gift is from a third person, the trust could be established as a "spendthrift" trust and avoid the reach of most creditors.[364]

356. *See supra* Section III.B.2.b.viii.
357. I.R.S. Notice 2020-39, 2020-26 I.R.B. 984.
358. *See* I.R.C. § 951A; I.R.S. Notice 2020-39.
359. *See* I.R.C. §§ 7701(a)1–30.
360. *See How to Figure Long-Term Capital Gains Tax*, *supra* note 279.
361. *See* I.R.C. § 958(b).
362. *See* I.R.S. Priv. Ltr. Rul. 8210055 (Dec. 10, 1981).
363. *Id.*; Treas. Reg. § 25.2511-3(a)(1) (amended 1973).
364. C.R. McCorkle, Ann, *Validity of Spendthrift Trusts*, 34 A.L.R. 1335 § 2 (1954).

2. Planning for U.S. Resident: Mexican Citizen (Mexican RA) and U.S. Citizen with Mexican Tax Resident Beneficiaries

a. U.S. Tax Issues/Planning

i. Subject to U.S. Gift/Estate Tax

The worldwide assets of the Mexican RA/U.S. citizen are subject to U.S. gift and estate tax.[365] Therefore, traditional planning techniques to reduce and minimize transfer tax exposure should be explored and considered.[366]

ii. Make Use of Exemption Planning

The rather generous estate and gift tax exemption of $11.7 million per person (in 2021, indexed to inflation) should be maximized.[367]

iii. Marital Planning: Spouse Is U.S. Citizen

If the spouse of the Mexican RA is a U.S. citizen, the U.S. marital deduction applies, and traditional marital trust/QTIP planning may be used.[368]

iv. Marital Planning: Spouse Is Not a U.S. Citizen

If the spouse of the Mexican RA is not a U.S. citizen, the U.S. marital deduction does not apply, and a QDOT planning should be considered.[369]

v. Consider Annual Exclusion Gift to Non-citizen Spouse

The Mexican RA should consider making gifts of the special "spousal" annual exclusion amount of $159,000 to the Mexican RA's non-citizen spouse.[370]

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365. *See* I.R.C. §§ 2001, 2010(a), 2501(a)(1), 2106(a)(1).

366. *See A Guide to International Estate Planning for Cross-Border Families*, THUN FIN. (2019), https://thunfinancial.com/home/american-expat-financial-advice-research-articles/international-estate-planning-cross-border-families/ [https://perma.cc/T2PG-XH4Y].

367. *See* I.R.S. Rev. Proc. 2020-46, 2020-45 I.R.B. 995.

368. *See* Treas. Reg. § 20.2056(b)-7 (amended 2004).

369. *See supra* Section IV.B.5; I.R.C. § 2056A.

370. *See Instructions for Form 709 (2020)*, *supra* note 207.

b. Mexican Tax Issues/Planning

i. Donation, Inheritance, or Bequests of Shares in Mexican Entity or of Mexican Real Property

Careful consideration must be used when planning for transfers of Mexican entity interests and Mexican real estate passing to a non-Mexican tax resident because a flat 25% income tax (based on the value of the transferred asset) is imposed on non-exempt transfers.[371]

ii. Donations Exemption for Shares in Mexican Entity or Mexican Real Estate

Mexican RAs should strongly consider gifting these interests to their non-Mexican tax resident descendants, as such a transfer is an exempt transfer and if structured correctly, should pass free of Mexican income tax to the donee.[372]

iii. Bequests to Mexican Tax Residents

Although inherited assets are generally exempted from income in Mexico under the MITL, careful consideration with Mexican counsel should be applied in structuring the vehicle (i.e., a trust) to receive the inheritance.[373]

iv. Donation/Gift to Mexican Tax Resident

Careful consideration should be given to gifts from a U.S. citizen or Mexican RA, as donations from a straight-line ascendant or descendant are exempt from Mexican income tax, provided some requirements are met.[374]

c. Miscellaneous Planning Issues

i. Careful Consideration Relating to Wills

It is generally recommended that Mexican RAs and U.S. individuals with property in Mexico have a separate Mexican will to dispose of the Mexican property.[375] This will should be carefully drafted to identify the

371. *See supra* Section VI.B.3.a.
372. *See supra* Section VI.B.3.a.
373. *See supra* Section VI.B.3.a.
374. *See supra* Section VI.B.3.a.
375. *See* Thomas Lloyd, *Who Will Inherit Property That I Own in Mexico?*, TOP MEX. REAL EST. (Mar. 10, 2018), https://www.topmexicorealestate.com/blog/2018/10/who-will-inherit-property-mexico/ [https://perma.cc/JBB8-GAHN].

property being transferred.[376]

ii. Marital/Gift Tax Exclusion

The marital deduction exclusion of $159,000 is a powerful technique for transferring assets to the Mexican RA spouse.[377] The technique can be effectively used to equalize estates and distributions from a QDOT taxed at the deceased spouse's rates.[378]

iii. Pay Estate Tax

In certain situations, the payment of estate tax would appear to be the best option upon the decedent's death.[379] Although a QDOT allows for distributions of income, if the taxable estate would not produce income or the surviving spouse is very young and not likely to stay in the U.S., payment of tax might be the best alternative.[380]

Exhibit "A"

Country of Residence of Payee				Dividends			Copyright Royalties	
Name	Code	Interest Paid by U.S. Obligors General	Interest Paid to Banks	Paid by U.S. Corporations — General	Qualifying for Direct Dividend Rate	Capital Gains	Motion Pictures and Television	Other
Mexico	MX	10	[a] 4.9	[b] 10	[b, c] 5	[d] 0	10	10

a. The rate is 4.9% for interest derived from (1) loans granted by banks and insurance companies and (2) bonds or securities that are regularly and substantially traded on a recognized securities market; the rate is 10% for interest not described in the preceding sentence and paid (i) by banks or (ii) by the buyer of machinery and equipment to the seller due to a sale on credit.[381]

376. *See id.*

377. *See Frequently Asked Questions on Gift Taxes for Nonresidents not Citizens of the United States*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/frequently-asked-questions-on-gift-taxes-for-nonresidents-not-citizens-of-the-united-states (Sept. 15, 2021) [https://perma.cc/A7XV-NR].

378. *See id.*

379. *See* I.R.C. §§ 2056(d)(2), 2056A(b)(1)(B).

380. *See* I.R.C. § 2056A(b)(12).

381. Second Protocol Amending Convention Between U.S. & Mex., IRS 1–10 (Nov. 2002), https://www.treasury.gov/resource-center/tax-policy/treaties/documents/mexico.pdf. [https://perma.cc/976F-6E4U].

b. No U.S. tax is imposed on a dividend paid by a U.S. corporation that received at least 80% of its gross income from an active foreign business for the 3-year period before the dividend is declared.[382]
c. The 5% rate applies if the recipient is a corporation owning at least 10% of the shares of the payer.[383]
d. Capital gains on Mexican shares could be exempted provided the seller owned at least 25% of the shares for at least a 12-month period prior to the sale. Otherwise, domestic rates will apply (25% WHT on the consideration or 35% on the net gain provided some requirements are met).[384]

In all cases the exemption or reduction in rate does not apply if the recipient has a permanent establishment in the United States and the property giving rise to the income is effectively connected with this permanent establishment.[385]

382. *Id.*
383. *Id.*
384. *Id.*
385. *Id.*