Guide to US Federal Estate Tax

US Federal Estate Tax

US Federal Estate Tax can arise in Irish estates, even if the level of US assets held is relatively modest. The US levies Federal Estate Tax on all of the assets of the deceased if he was a US citizen, or held a US passport or green card on the date of death (once the value of the estate exceeds a set threshold; US$5,450,000 in 2016).

Other persons come within the charge to US tax if they hold assets located in the US (such as shares in US multinationals) with a value of US$60,000 or more. In recent years an increasing number of Irish estates have had to deal with US Estate Tax simply because the deceased held US shares, either because he worked for a US company and received employee shares, or because a US company was regarded as a good investment. In many such cases the deceased would have been unaware of any US tax exposure.

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

The top rate of federal estate tax applicable in the US is 40%.

Ireland US Double Taxation Agreement

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

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

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

In some cases banks in the US will seek a tax clearance certificate from the IRS in regard to US bank accounts. Under the Ireland US Double Taxation Treaty for Inheritance tax bank accounts are treated as being located in the State of domicile of the deceased (and this is reflected in the IRS Manual). Therefore where an individual dies domiciled in Ireland any US bank accounts held by the individual at the date of death will be treated as an Irish asset and not a US asset. Therefore the IRS will not issue a tax clearance certificate for an non US asset. It may be necessary to write to the bank setting out the provisions of the Ireland US DTA to secure the transfer the funds to the deceased personal representatives.

Current Regime for US Federal Estate Tax

Following an element of turbulence in the area of federal estate tax rates and thresholds the current top rate of tax is 40%, with an estate exemption of US$5,450,000 (in 2016) for US citizens and US$60,000 for non resident aliens.

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

The top rate of US Federal Estate Tax was reduced from 45% to 35% for deaths occurring after 31 December 2009. This rate was maintained until the end of 2012 For US citizens and US resident individuals the exemption amount was increased from US$3.5m in 2009 to US$5.120m in 2012. The threshold for non resident aliens remained unchanged at US$60,000.

Special rules were introduced for estates of individuals who died in 2010. The executors of an estate could opt for CGT treatment (i.e taking a stepped up version of the deceased's base cost which passes to the beneficiary) or opt for paying Federal Estate Tax under the new 2010 rules. The election for the CGT treatment had to be made before 17 January 2012 to ensure that estate tax treatment would not apply.

US Tax Compliance

The US Federal Estate Tax return and tax are normally due within 9 months of the date of death of the deceased.

If a return is filed late, and/or the tax liability is paid late, interest and penalties will be charged by the IRS. Taxpayers can apply for a 6 month "pay and file" extension but this extension must be applied for within 9 months of the date of death. This extension will prevent the estate from penalties but interest will still be charged on the late payment of tax.

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

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

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

FATCA

In 2012, Ireland entered into an information sharing agreement with the United States. The Intergovernmental Agreement is based on US legislation known as the "Foreign Account Tax Compliance Act" or "FATCA". The purpose of the Agreement is to enable the US government to identify US taxpayers who hold assets offshore. Once the offshore assets are identified, the IRS can crosscheck the tax returns for the individual to ascertain if US tax is being operated on income or gains arising from such assets.

From a federal estate tax perspective, there is no direct effect on the individuals who own the accounts but the IRS will be aware of the details of any relevant accounts.

Conclusion

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

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

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

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

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