

Tax and Estate Planning for Brazilians with U.S. Assets and/or U.S. Heirs



Brazilian-American
Chamber of Commerce of Florida
EST. 1981

UTUMI
ADVOGADOS

 **Bilzin Sumberg**

Webinar Presenters

Speakers



Hal J. Webb

Head of International
Private Client
Wealth Team,
Bilzin Sumberg
hwebb@bilzin.com



**Ana Claudia Akie
Utumi**

Founding Partner, Utumi
Advogados
Ana.Utumi@utumilaw.com

Moderator



William Heuseler

Managing Director, Banco
Itau International
William.Heuseler@itau.us

Event Sponsors



Brazilian-American
Chamber of Commerce of Florida
EST. 1981



Brazilian-American
Chamber of Commerce of Florida
EST. 1981



Current Scenario

- It is common for Brazilian HNW families to have assets located in the U.S. (financial investments, real estate, shares of U.S. companies, etc.)
- In addition, these families often have members that are U.S. citizens or U.S. taxpayers
- It is also common to find Brazilian families that decide to move residence to the U.S. permanently or temporarily
- Analyzing the tax implications of holding assets in the U.S., of having U.S. tax residents as heirs, or of moving to the U.S. is essential to avoid excessive tax payments in Brazil and/or in the U.S.

Topics to be Discussed

- Brazil and U.S. tax issues for Brazilians with U.S. assets and/or U.S. heirs
- Planning using revocable or irrevocable trusts, including use of corporate settlor
- U.S. pre-immigration tax and estate planning

Brazil-U.S. Relationship

- **U.S. and Brazil do not have treaty to avoid double taxation**
 - ✓ No reduction of withholding tax on dividends
 - ✓ No recharacterization of gain for foreign tax credit
- **There is an exchange of information treaty and FATCA IGA in place**
 - ✓ Exchange of financial information since 2015
 - ✓ In 2019, Brazilian authorities received information about 64,000 bank accounts

Overview of U.S. Gift Tax and Estate Tax Systems for NRAs



U.S. Gift Tax - Nonresident Aliens

- **Nonresident aliens are subject to gift tax on gifts of real property and tangible personal property situated in the U.S.**
 - ✓ Annual exclusion and marital deduction apply
 - ✓ Gifts of intangible personal property are exempt
 - ✓ Cash is tangible personal property (issue if money being gifted is located in the U.S.)
 - ✓ Cash or property situated without the United States should not be required to be used to purchase property situated within the United States
 - ✓ Jointly held real estate is a gift tax trap for the unwary
 - ✓ Community property issues



U.S. Estate Tax - Nonresident Aliens

- Same as U.S. citizen, except that only property "situated within the U.S." is subject to tax, and only \$60,000 of property is excluded
- Community property issues
- Examples of U.S. situs property



Brazilian Implications of Holding U.S. Assets

- **Taxation of foreign income obtained by Brazilian residents**

- ✓ General rule: Individual Income Tax (IRPF) at 27.5%
- ✓ Financial investments and capital gains: Income tax on Gains (IR/Gains) between 15% to 22.5%, depending on the amount of gains (15% up to BRL 5MM per year)
 - Foreign exchange gains taxable if investments performed with funds obtained in Brazil
- ✓ Taxation on cash basis – “availability”
 - Whenever the income or gain is made available to the individual
 - No CFC for individuals – use of foreign company to hold assets may allow postponement of taxation, but profits are subject to IRPF/27.5%
 - ✓ Concerns on substance/business purposes analysis



Brazilian Gift and Estate Tax (ITCMD)

- ITCMD is a State tax levied on gifts and estate transfer
- Rates vary from 4% to 8%, depending on the State
 - ✓ São Paulo – 4%
 - ✓ Rio de Janeiro – progressive rates up to 8%
- Court disputes on constitutionality of ITCMD on transfer of foreign assets upon death
 - ✓ Several families are disputing this taxation under Court



Estate Planning



Brazilian-American
Chamber of Commerce of Florida
EST. 1981

UTUMI
ADVOGADOS

 **Bilzin Sumberg**

"Domestic Trust" and "Foreign Trust" Defined

- **Domestic Trust:**
 - ✓ Court Test: A court within the U.S. is able to exercise primary supervision over the administration of the trust; AND
 - ✓ Control Test: One or more U.S. persons have the authority to control all substantial decisions of the trust.
- **Foreign Trust:** all other trusts (NRA with only one substantial power causes the trust to be a foreign trust)



"Grantor Trust" and "Nongrantor Trust" Defined

- Trusts are classified as foreign or domestic, and grantor or nongrantor
- A trust is a grantor trust to the extent a person (normally the grantor) is treated as the owner of the assets of the trust for U.S. income tax purposes
- A trust is a nongrantor trust to the extent it is not a grantor trust
 - ✓ A trust can be part grantor and part nongrantor
 - ✓ A trust can't convert from nongrantor to grantor if NRA is the grantor



Grantor Trust for NRA Transferor

- **A trust is a grantor trust (with a foreign person as the grantor and treated as the owner of the assets of the trust for federal income tax purposes) to the extent:**
 - ✓ The grantor has the power to revest absolutely in himself title to the trust property provided that such power is exercisable solely by the grantor without the approval or consent of any other person or with the approval or consent of a related or subordinate party who is subservient to the grantor (incapacity issue)
 - ✓ The only amounts distributable from such portion (whether income or corpus) of the trust during the lifetime of the grantor are distributable to the grantor or the spouse of the grantor (issues related to power to timing of restrictions, power to add beneficiaries, power to terminate the trust, powers of appointment, etc.)

U.S. Income Taxation of Trusts and Beneficiaries

- **Grantor Trust**

- ✓ Person treated as owner of assets is subject to U.S. income tax on current income (grantor trust does not have accumulated income)

- **Nongrantor Trust**

- ✓ Trust subject to U.S. income tax except that beneficiaries are taxed on receipt of distributions of income and income required to be distributed (whether or not actually distributed)

- **Foreign vs. Domestic**

- ✓ Accumulation Distributions from foreign trust subject to throwback rules – U.S. income tax and interest charge
- ✓ Accumulated income loses character

- **CFCs; PFICs; non-CFC, non-PFIC**



Brazilian Remarks on Trusts

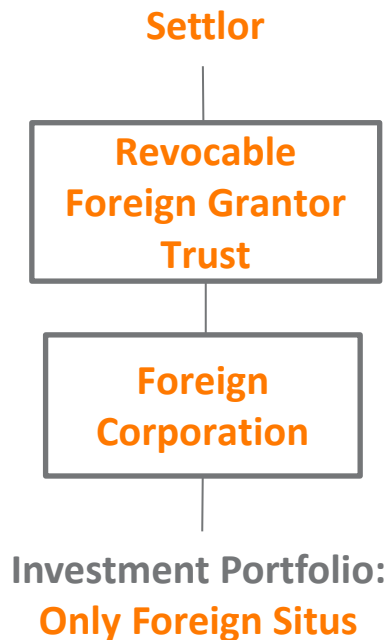
- Trusts are NOT tax planning for Brazilian residents
- There is no legislation about trusts, but rather some opinions issued by Federal tax authorities
- Any trusts holding Brazilian assets may easily be disregarded by a Brazilian judge
 - ✓ So, holding Brazilian assets under a trust is not efficient if there are family members residing in Brazil
- Obligation to declare trusts to Brazilian Central Bank
 - ✓ Beneficiaries must declare
 - ✓ If not vested yet – Settlor declares instead

Uncertain Tax Scenario on Trusts – Contributions and Distributions

- **Transfer of assets into a trust**
 - ✓ May be deemed as donation
 - ✓ Subject to ITCMD and settlor must write-off transferred assets of his Statement of Assets (part of the Income Tax Return)
 - Revocable trust – possible to defend that there was no donation and that this write-off is not necessary
 - ✓ Tax authorities' Consultation Answer no. 309/2018
 - Transfer of assets to a non-resident as donation is subject to withholding tax at 15% (25% if beneficiary resides in tax haven jurisdiction)
- **Distributions from a trust directly to beneficiaries residing in Brazil**
 - ✓ Deemed ordinary income – RFB Consultation Answer no. 41/2020



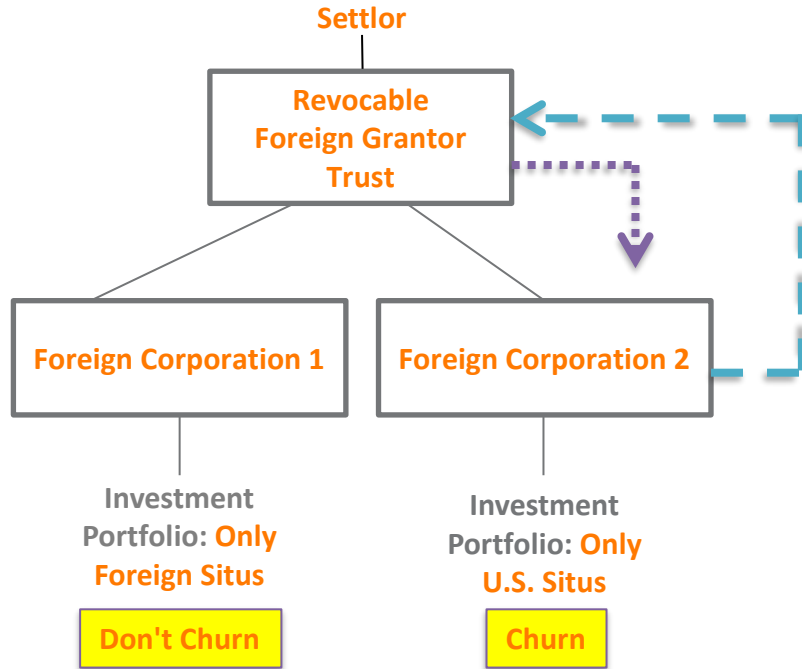
Planning Option #1: No U.S. Situs Assets



- Upon death of Settlor, trust automatically receives step-up in basis in shares of FC (if trust structured properly)
- No automatic step-up of FC's basis in Investment Portfolio
- Check-the-box election made by FC effective prior to death
- FC can invest in U.S. equity markets via foreign funds
- May not need FC; portfolio could be owned by trust if never U.S. situs assets
- From Brazilian standpoint: possible to defend that, in case of revocable trusts, the ownership of assets still belongs to the Settlor to avoid ITCMD and WHT



Planning Option #2: Separate Corporations for U.S. Situs and Foreign Situs



- FC1 holds only foreign situs assets and FC2 holds only U.S. situs assets
- Churn (and consider cleansing) FC2, not FC1
- Check-the-box election made by FC1 effective prior to death of settlor
- Check-the-box election made by FC2 effective at least 2 days after death of settlor
- May not need FC1; portfolio could be owned by trust if never U.S. situs assets



Certain Planning Issues

- **Incapacity Issue for Revocable Trusts**

- ✓ Meaning and significance of incapacity
- ✓ To preserve grantor trust treatment in the event the grantor becomes incapacitated, the power to revoke or other power to "revest" must be exercisable by a guardian or other person who has unrestricted authority to exercise such power on the grantor's behalf while the grantor is incapacitated
- ✓ Consider same planning for POA over income for step-up in basis

- **Funding issues**

- ✓ Community property
- ✓ Indirect and nominee transferors
- ✓ Transfers of U.S. situs property

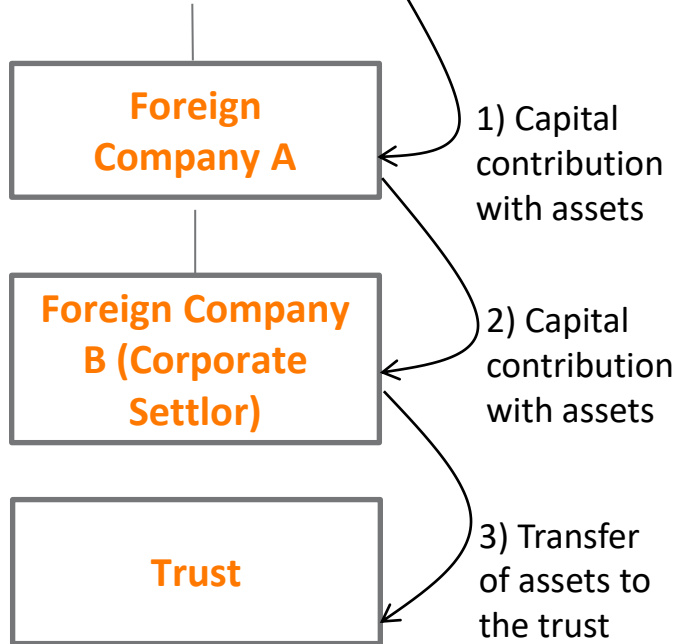
- **Trustee:**

- ✓ Who should/could serve as trustee?
- ✓ Who should/could have the power to remove and replace the trustee?



Company as Settlor/Transferor

Brazilian Individual



• Brazilian aspects

- ✓ Corporate settlor may help to avoid adverse tax consequences upon trust set up
- ✓ For Brazilian tax purposes
 - Investment in a foreign company
 - Assets transferred as capital contribution
 - Maintenance of the acquisition cost of the assets in the Statement of Assets
- ✓ Taxation of estate transfer upon death of the Brazilian individual and not upon setting up the trust
- ✓ Distributions from the trust through Foreign companies A and B
 - May be treated as capital reduction
 - Taxation as capital gains on foreign exchange gains



Company as Settlor/Transferor

- **Company as settlor, transferor or powerholder**
 - ✓ When a company makes a gratuitous transfer to a trust, who is the grantor? Treas. Regs. Sec. 1.671-2(e)(4): "If a partnership or a corporation makes a gratuitous transfer to a trust that is not for a business purpose of the partnership or corporation but is for the personal purposes of one or more of the partners or shareholders, the gratuitous transfer will be treated as a constructive distribution to such partners or shareholders under federal tax principles and the partners or the shareholders will be treated as the grantors of the trust."
 - ✓ Grantor Trust Issue: If UBO of the company is the grantor, who has the powers required to be classified as a grantor trust (e.g., power to revoke) -- the company or the UBO?

Company as Settlor/Transferor

- **Company as settlor, transferor or powerholder (continued)**

- ✓ Distributions to a U.S. person: If a U.S. person receives a purported gift or bequest from a partnership (domestic or foreign) or a foreign corporation (e.g., a transfer of property other than for fair market value to a person who is not an owner of the company), the purported gift or bequest must be included in the gross income of the U.S. person
 - If a U.S. person receives a distribution from a trust to which a partnership or foreign corporation has made a gratuitous transfer, the U.S. person is treated as receiving a purported gift from that company (PFIC issues if a foreign corporation)
 - For purposes of the purported gift rule, a transferor that is a wholly owned business entity is treated as a corporation even if the company elected to be treated as a disregarded entity
 - Consider use of domestic single-member LLC instead of a partnership or a foreign corporation (certain risks and reporting)
 - Certain exceptions apply



Jurisdiction and Classification

- U.S. vs. non-U.S. governing law and trustee
- Potential benefits of U.S. governing law and/or trustee
- Potential disadvantages of U.S. governing law and/or trustee
- Methods of creating and maintaining foreign trust status even if trust is governed by U.S. law and has a U.S. person as trustee
- Other considerations

Step-Up In Basis for Assets in Trust: Relevant Law

Step-up in basis applies to all trust assets which are included in the gross estate of the decedent and all other assets held in a trust described in the following sections:

- Sec. 1014(b)(2): Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before death **to revoke the trust**
- Sec. 1014(b)(3): Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before death **to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust**



Step-Up in Basis for Assets in Trust: Provisions in Trust Documents

- Impact: Step-up in basis is in the shares of the company, not underlying assets
- Goals: End up with a step-up in basis in the underlying assets, no retained earnings as of the date of death and no estate tax (planning may be required -- e.g., check-the-box election)
- In addition to power to revoke or amend (or other similar powers), provide power of appointment over income or right to income for life
 - ✓ Make sure power is not limited by local law; and
 - ✓ Make sure power does not have to be exercised by the settlor in a fiduciary manner
- Consider whether the settlor continues to have the appropriate powers during incapacity

Pre-Immigration Planning



Brazilian-American
Chamber of Commerce of Florida
EST. 1981

UTUMI
ADVOGADOS

 **Bilzin Sumberg**

Why is Pre-Immigration Tax Planning Important?

- Moving to the United States has significant U.S. tax implications
- No automatic basis step-up upon entry
- Pre-immigration tax planning (income and transfer) is critical for individuals and families temporarily or permanently relocating to the United States
- Three principal categories of U.S. tax considerations:
 - ✓ U.S. federal income tax considerations;
 - ✓ U.S. federal estate tax, gift tax, and generation-skipping transfer tax considerations; and
 - ✓ State and local income (and, potentially, other) tax considerations



Main Objectives

- Minimize taxes in U.S., home country, and other relevant countries
- Create global estate plan
- Coordinate tax planning and estate plan with non-tax issues
 - ✓ Timing for move to the U.S. and termination of residence in home country
 - ✓ Immigration visa planning
 - ✓ Tax residence and place of domicile of family members
 - ✓ Family relationships
 - ✓ Expenses and other cash flow needs of family members
 - ✓ Wealth management (asset allocation; access to investments, income tax, etc.)
 - ✓ Location of assets
 - ✓ Access to (and control over) assets
 - ✓ Power to make investment decisions
 - ✓ Reporting requirements in the U.S. and other jurisdictions
 - ✓ Asset protection
 - ✓ Other non-tax issues



Brazilian Tax Considerations

- As the U.S. pre-immigration plan normally includes setting up a trust while the Family is still a Brazilian resident, it is important to care about Brazilian tax issues as explained
- A Brazilian citizen may become non-resident
 - ✓ Definite exit communication
 - ✓ (+) Definite exit tax return
 - ✓ (+) Appointment of an attorney-in-fact, who becomes responsible for any tax contingencies that authorities may identify
 - ✓ (+) Request of tax clearance certificate
- No rule to establish how long a non-resident Brazilian may stay in Brazil without reacquiring tax residency
 - ✓ 183-day rule does not apply to Brazilian citizens
 - ✓ Authorities normally make substance/purposes analysis
 - Risk of being considered Brazilian tax resident by keeping a home in Brazil



U.S. Planning Ideas to Consider

- Accelerate income and gain, and defer deductions and losses
- Step-up basis (historic cost) for appreciated assets
 - ✓ Check-the-box election planning
 - ✓ Sale or restructuring prior to U.S. residency starting date
- Evaluate business interests and other assets to reduce global income tax on income and profit from sale (consider potential for foreign tax credits)
- Make gifts outright and to irrevocable trusts
- U.S. and home country estate planning (create wills and revocable trusts)
- U.S. and home country estate/inheritance tax planning (create trusts and companies to provide discounts on values and limit tax on future increase in value)
- Post-nuptial agreement

Thank You



Brazilian-American
Chamber of Commerce of Florida
EST. 1981

UTUMI
ADVOGADOS

 **Bilzin Sumberg**