# The Transfer Certificate: the teeth in the US estate tax bite

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## Abstract

Individuals living outside of the USA who have inherited a US Asset from a non-US Person are often faced with the challenge of obtaining a Transfer Certificate in order to acquire title to the inherited US Asset. The process for obtaining a Transfer Certificate is arduous and often quite expensive. This article provides an overview of the purpose of a Transfer Certificate and the process for obtaining one. The article also suggests planning techniques for the legitimate avoidance or streamlining of the process or for acquiring a Transfer Certificate.

## Introduction

Many individuals who live outside of the USA with no US connections but for investments in American corporations wonder how the US government will enforce the collection of US estate tax imposed on these assets at death. Much to their surprise—or more specifically, the surprise of the beneficiaries who are left to navigate the inherited US tax mess—the institutions holding the US investments will not transfer such assets until they receive a Transfer Certificate from the US Internal Revenue Service. For the majority of these individuals, this begins the long, arduous process of getting right with the taxing arm of the US government.

This article begins with a brief overview of the US estate tax regime detailing when a US Person and a non-US Person have exposure to US estate tax. It then discusses who is liable for the payment of US estate tax assessed against the estate of a decedent and the limitations that such liability imposes on the transfer of the US Assets of the estate. Next, it provides an overview of the procedure to obtain a Transfer Certificate, which provides clearance to the holding institutions to transfer US situs assets, and the additional requirement of a Medallion Signature Guarantee (MSG) for the transfer of securities. Finally, the article proposes strategies to expedite—or altogether avoid—the process for obtaining a Transfer Certificate.

## The US estate tax regime

### *Overview of the US wealth transfer tax regime for US Persons and non-US Persons*

The initial steps in determining whether a client will need to navigate the US wealth transfer tax regime is to figure out (i) if the client is a US Person; (ii) if not a US Person, does the client own any US Assets; and (iii) does the value of the client's assets exceed the applicable exclusion from US transfer tax.

The USA has a wealth transfer tax regime, which includes estate and gift taxes and generation-skipping transfer tax. This article will focus solely on the estate tax.

A US citizen or US domicile (a 'U.S. Person') is subject to estate tax, regardless of the location of such property in the world, to the extent the total value (less certain deductions) exceeds USD 5,490,000 ('U.S. Exclusion Amount'), which is

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reduced dollar for gratuitous transfers during life.[1] To the extent that the total value of the lifetime gifts and assets held at death exceeds the US Exclusion Amount, the excess amount is taxed at 40 per cent.[2]

A non-US Person is subject to a estate tax against the gross value of his or her assets located in the USA.[3] Assets located in the USA generally include shares of stock issued by US companies; US real estate; tangible property located in the USA; and currency (meaning physical money) but not deposits on account at a US bank (collectively 'U.S. Assets').[4] It is noteworthy that US portfolio debt obligations such as government or corporate bonds are excluded. It is also important to remember that the transfer during life of intangible property, such as the gift of shares of stock issued by a US company and debt obligations, is not subject to US gift tax.[5]

Each non-US Person also has an estate tax exclusion of USD 60,000, which applies to gratuitous transfers at death.[6] In some instances, a US tax treaty may apply that permits a higher exclusion amount against estate tax.[7] To the extent that the total value of the US Assets held at death exceeds the applicable exclusion amount, the excess amount is taxed at a graduated rate from 26 per cent up to a maximum tax rate of 40 per cent on the gross value of US Assets over USD 1,000,000.[8]

If the client will have an estate tax liability, the next step is to determine who is responsible for the payment of the tax under US law.

### *Liability for the payment of US estate tax*

Unlike many countries that impose an inheritance tax—the payment of which is typically the responsibility of the recipients—the USA attaches a lien for estate tax against the assets held by the decedent as of the date of death. This occurs regardless of whether the property comes into possession of the qualified executor or administrator of the decedent's estate.[9] Therefore, if the assets of the decedent transfer directly to beneficiaries outside of the probate estate, such as through a transfer-on-death beneficiary designation, these assets are still subject to estate tax.

The payment of estate tax is the responsibility of an executor who is qualified and acting in the USA ('Executor'). If no Executor is appointed, then:

> any person in actual or constructive possession of any property of the decedent is required to pay the entire tax to the extent of the value of the property in his or her possession (the 'Possessor').[10]

While it is the responsibility of the Executor (or if none, the Possessor) to pay the estate tax, the Executor is not personally liable unless the Executor makes distributions to beneficiaries prior to paying the estate tax. If the assets in the estate are insufficient to pay the estate tax liability and the Executor (or Possessor) has made distributions from the estate, then the Executor (or Possessor) is personally liable for the estate tax that remains due to the extent of the distributions made.[11] For a non-resident estate where no Executor is appointed, the institution holding the US Assets, as a Possessor, is responsible for the payment of, and potentially liable for, the estate tax levied against the estate.

## The Transfer Certificate

Once a lien is imposed on an estate as discussed above, the Internal Revenue Service ('IRS') may

1 IRC ss 2010, 2505. The US Exclusion Amount is indexed annually for inflation.

2 IRC ss 2001, 2502. In addition to the US Exclusion Amount, certain lifetime gifts made by a US Person are excluded from US gift tax such as gifts to a US citizen spouse that qualify for the marital deduction, gifts to individuals, companies or trusts that do not to exceed USD 14,000 in any one year (this amount is indexed annually for inflation), and certain transfers for educational or medical expenses. See IRC ss 2503 and 2523.

3 IRC s2103.

4 IRC ss 2104, 2105, Treas Reg ss 20.2104-1, 20.2015-1.

5 IRC ss 2501(a)(2), 2511(b).

6 IRC ss 2102, 2505. This amount is not indexed for inflation.

7 For a list of US Gift and Estate Tax Treaties, see <https://www.irs.gov/businesses/small-businesses-self-employed/estate-gift-tax-treaties-international>.

8 IRC (n 3).

9 IRC s 6324(a)(1).

10 Treas Reg s 20.2002-1; See also IRC ss 2002, 6324(a)(2); Treas Reg s 301.6324-1(a)(1).

11 ibid.

issue a certificate of discharge of any or all of the property subject to the lien upon satisfaction of the estate tax due.[12]

For the estate of a non-resident decedent (aka an estate without a Executor appointed in the US), this type of certificate is called a 'Transfer Certificate'. The primary purpose of the Transfer Certificate is to permit the transfer of property free from the lien.[13] To that end, the Transfer Certificate identifies each asset for which the estate tax lien has been satisfied, thereby permitting the Possessor to transfer those identified assets without assuming liability for unpaid estate tax.[14] Most institutions that hold US Assets that were owned by the decedent require the Transfer Certificate before they will transfer US Assets to the appropriate recipients in order to eliminate their exposure to personal liability as a Possessor for unpaid estate tax.

If there is no estate tax due because the estate of a non-US Person is under the exclusion amount of USD 60,000, then a Transfer Certificate is not required. Also exempt from the Transfer Certificate are estates with a US Executor.[15]

## How to obtain a Transfer Certificate

If the financial institution in possession of the US Assets requires a Transfer Certificate before it will transfer assets, then the foreign Executor of the estate must file an estate tax return with the IRS.

### Form 706

If the decedent was a US Person who resided outside of the USA, then the executor must file a Form 706 US Estate (and Generation-Skipping Transfer) Tax Return regardless of whether the decedent owes estate tax. If there was no Executor appointed in the US, then any person in actual or constructive possession of any property of the decedent is considered an executor and must file a return.[16]

### Form 706-NA

If the decedent was a non-US Person who resided outside of the USA and the total value of the decedent's US Assets exceeds USD 60,000, then the Executor must file a Form 706-NA US Estate Tax Return—Estate of Non-resident not a Citizen of the USA. [17] This is the case even if there is an applicable estate tax treaty that provides the decedent with a higher estate tax exemption threshold such that there is no estate tax liability.

The processing time for an estate tax return is six to nine months barring an audit by the IRS, which could drastically extend that time. The process could be further prolonged if the estate claims relief from estate tax by virtue of the fact that another country imposed transfer tax on the same property. In this case, the Executor must wait until payment is made to that country and file a Form 706-CE (Certificate of Payment of Foreign Death Tax) signed by the relevant taxing authority of that country certifying the amount of tax paid to that country. The processing time for the estate tax return can be a major issue for beneficiaries of the US Assets. Before the institution holding the assets receives clearance from the IRS, the estate beneficiaries do not have access to the assets and cannot manage the investments or diversify the stock portfolio to protect against market risk.

Often times, executors or beneficiaries of the estate of the non-US Person do not realize that they need to file a Form 706-NA until the filing deadline has long passed, which is nine months after the date of death

12 IRC s 6325; Treas Reg ss 20.6325-1(a), 301.6325-1(c).

13 Treas Reg s 301.6325-1(c)(1).

14 ibid.

15 Treas Reg s 20.6325-1(b)–(c). The IRS has also stated that a Transfer Certificate is not required for property of a non-US Person decedent who died in 2010 and whose Executor made the IRC s 1022 Election. Internal Revenue Bulletin: 2011-35.

16 IRC s 2203.

17 IRC s 6018(a)(2). For purposes of determining the value of the US Assets of the estate, if the transfer of the estate is subject to the tax imposed by IRC s 2107(a) (relating to expatriation to avoid tax), any amounts includible in the decedent's gross estate under s 2107(b) are to be added to the value on the date of his death of that part of his gross estate situated in the US Treas Reg s 20.6018-1(b).

of the decedent, which in turn causes penalties and interest charges to accrue for late filing and payment.

### *No requirement to file a US estate tax return*

Although a Transfer Certificate for an estate of non-US Person is not required under the Treasury Regulations where the value of US Assets do not exceed USD 60,000, in the event the financial institution require one, there is a process through which one can be requested.[18] The executor must submit the following items, with English translation, to the Department of the Treasury[19]:

- The decedent's last will and testament along with any codicils.
- Each death tax or inheritance tax return and any corrective statements filed with taxing authorities.
- The decedent's death certificate.
- An affidavit made under oath before a notary public or other comparable local official stating the following information:
  - The decedent's date and country of birth.
  - The date of the decedent's naturalization as a US citizen, or a statement that the decedent was never a naturalized US citizen.
  - A list of the decedent's US Assets including the date of death values, and account numbers for any US bank or investment accounts.
  - The decedent's citizenship and residence at the date of death.
  - Whether any of the decedent's US bank accounts were used in connection with a trade or business in the USA.

The processing time for the affidavit and supporting documents is 90 days.[20]

Once the client has tackled the estate tax return and received a Transfer Certificate, the client may encounter an additional obstacle to transfer the asset, known as an MSG, if the asset is a US security.

## The MSG: an additional requirement to the Transfer Certificate

### *What is an MSG?*

If the decedent holds securities (eg stocks, bonds, mutual funds, savings bonds) in a US company, the executor will likely have to work with the transfer agent (eg Computershare) in order to transfer the securities to the appropriate recipient. Often is the case that the transfer agent, in addition to the otherwise applicable Transfer Certificate, will require the executor to obtain an MSG on the transfer instrument before it will transfer the securities.

The MSG is a guarantee by a financial institution (the 'Guarantor') that the signature is genuine, the signer is the appropriate person to endorse the securities, and the signer has the legal capacity to sign.[21] While the main purpose of the MSG is to protect shareholders against the unauthorized transfer of securities, it also protects the transfer agents who accept the guarantee because if the transfer agent wrongfully changes the registered owner of the security in reliance on the MSG, it can sue the Guarantor for any loss resulting from the breach of warranty.

### *How to obtain an MSG*

A person can obtain an MSG from a US or Canadian financial institution that participates in one of three MSG programmes.[22] In order to reduce their exposure to liability, however, financial institutions generally require a previous banking relationship with the person requesting the MSG and that person must appear at the financial institution to sign the MSG. This can be particularly burdensome to people who

18 Treas Reg s 301.6325-1(c)(2).
19 The address is: Department of the Treasury, Internal Revenue Service, STOP 824G, Cincinnati, OH 45999.
20 See <https://www.irs.gov/businesses/small-businesses-self-employed/transfer-certificate-filing-requirements-for-non-u-s-citizens>.
21 Uniform Commercial Code s 8-306. Effect of Guaranteeing Signature, Indorsement, or Instruction.
22 See 31 CFR 306.45.

live outside of North America and do not bank with US institutions.

Although each financial institution has its own guidelines for issuing an MSG, generally the person requesting the MSG must provide proper identification, evidence of authority to endorse the security (ie the Letters of Authority of the administrator of the estate), proof of possession of the security, a certified copy of the Death Certificate, and proof that estate tax in not due (aka a Transfer Certificate).

For non-US Persons who do not have a relationship with a financial institution located in the USA or Canada, it may be possible to obtain an MSG at a branch of a USA or Canadian bank with whom they have a relationship. Alternatively, the executor should contact his or her local financial institution to determine if that institution has relationship with a US or Canadian MSG Program member. If finding a local institution is proving difficult, there are also services in some countries that will assist the executor in obtaining a Medallion Guarantee for a fee.[23]

An additional issue arises if the value of the security being transferred is significant. There are different coverage levels for an MSG, which is signified by a letter prefix on the MSG stamp that corresponds with the dollar value insured by the Guarantor.[24] The executor must find a Guarantor who has correct stamp to cover the full amount of the security being transferred. If the security consists of stock, it may be possible to transfer the stock in multiple transactions; however, the executor should obtain approval from the transfer agent before proceeding.

## Planning tips for non-US Persons during life

When formulating an estate plan for a client who is a non-US Person and owns US Assets, the goal is to structure the ownership of the assets in a non-US manner so as to reduce the client's exposure to US wealth transfer tax and alleviate the hassle of obtaining a transfer certificate and an MSG. With all of these tips, it is important that the client consult with advisors in the taxing jurisdictions applicable to the client in order to ensure that the planning structure does not create an unfavourable tax in those jurisdictions.

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### *Divestment of US investments*

As discussed above, if the client's financial advisor makes investments in the shares of a company that is incorporated in the USA, those shares will be subject to US estate tax. Further, investments in mutual funds created in the USA (eg funds invested in a mutual fund incorporated in a US state) are considered a US Asset subject to US estate tax, even if the fund does not hold US shares.

If the client owns US securities, the client should consider either exiting the US market or gifting the US investments during life. If gifting is not an option and the client wishes to maintain US investments, the client should explore an investment strategy whereby the client holds US investments indirectly through non-US-based structures such as non-US mutual funds or non-US ETFs, which reduces the exposure to US estate tax.

### *US Will*

If the client wishes to retain stock in a particular US company, the simplest method to eliminate the Transfer Certificate requirement and to ease the burden of the MSG is for the client to execute a US Will, which governs the disposition of his or her US

23 See <http://www.stai.org/medallions_outside_the_us.php>.

24 The coverage levels and associated prefixes are as follows: A: USD 1,000,000; B: USD 750,000; C: USD 500,000; D: USD 250,000; E: USD 100,000; F: USD 100,000 (Credit Unions-per transaction); X: USD 2,000,000; Y: USD 5,000,000; Z: USD 10,000,000. See <http://www.colonialstock.com/Medallion-Signature-Guarantee.htm>.

Assets and appoints a US Executor. An Executor eliminates the need for a Transfer Certificate because the Executor assumes the liability for unpaid estate tax in the event of the impermissible transfer of assets. The Executor will still have to file a Form 706 or a Form 706-NA and pay estate tax if the value of all of the US Assets exceeds USD 60,000, assuming there is no applicable tax treaty.

It is important that the client's US Will can be admitted for probate in a state within the USA that will take jurisdiction over the client's assets. For real property, it is relatively simple to determine which state has jurisdiction as it is generally the state in which the real property is located. For intangible property, it may be more difficult to determine which state has jurisdiction and one should consult with an attorney of each relevant state.[25]

The advantage of this method is that Executor does not have to wait until the IRS has issued a Transfer Certificate (six to nine months or longer if there is an audit) to assume control of the US Assets. This allows the Executor to manage the assets to reduce exposure to fluctuations in the market and in exchange rates. The Executor is also free to make partial distributions to the beneficiary to the extent that the assets held by the Executor exceed the amount required to cover the estate tax exposure.

### Foreign entities

A foreign corporation is another way a client could also hold US stock. As discussed above, shares of stock held by a non-US Person are subject to estate tax only if they are issued by a US corporation.[26] Further, if the corporation continues to operate after the death of the client, the shares of the foreign corporation can be transferred pursuant to the client's wishes without requiring a Transfer Certificate for the underlying US Asset. While the foreign corporation is initially appealing, many clients find that corporate ownership is not a viable option for them due to income tax consequences and reporting obligations imposed by their home country.

A US tax treaty may also provide solutions depending on how it defines US Assets. For example, under the US–Australian Estate Tax Treaty, a partnership is deemed to be situated in the place where the business of the partnership is carried on, such that US singular investments held through an appropriately structured Australian partnership should not be subject to estate tax upon the death of a partner.[27] Clients should seek advice from his or her solicitor as to whether there is treaty relief available.

### US Irrevocable Trust

The client could also create a US irrevocable trust of which the client's spouse and children are the beneficiaries (the 'Irrevocable Trust') to hold US Assets. If the Irrevocable Trust is structured correctly so that the client does not retain control over the trust assets, such assets will not be included in the client's US taxable estate. The Irrevocable Trust could serve as a vehicle through which the client could make US investments, and, to the extent the Irrevocable Trust continues after the client's death, there is no need to transfer the US Assets thereby making a Transfer Certificate unnecessary.

For people without US familial connections, an Irrevocable Trust may not be an option because the majority of the trustees as well as any other persons or entities that hold a special office must be US citizens or US tax residents in order to maintain the designation of a US 'domestic' trust. If finding

25 As a way of example of the complexities one may face when trying to find a court to take jurisdiction over the estate, under Ohio Revised Code s 2107.11, stock is deemed to be located in the place where the instrument evidencing the stock is located or if there is no such instrument then where the debtor resides. In one case involving a foreign estate whose sole asset was stock issued by an Ohio corporation, the Ohio probate court for the county in which the stock certificate was located refused to take jurisdiction because the headquarters of the corporation that issued the stock was located in another county in Ohio. Ultimately, the county in which the corporation was headquartered accepted jurisdiction of the estate after the stock certificate was transferred to a bank, who was later appointed Executor of the estate, and who held the certificate at its branch located in that county.

26 IRC (n 5).

27 art III, (1)(g). Convention between the Government of the Commonwealth of Australia and the Government of the USA for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes and Estates of Deceased Persons.

a US individual to act as trustee is not an option, the client could also appoint a US institution as trustee. Additionally, the client could appoint a US individual as a special officer who has the authority to remove and replace the trustee and change the governing law of the trust in the event that the Irrevocable Trust becomes overly burdensome. Clients should discuss with his or her solicitor the tax implications of this structure in his or her country of residence, specifically in relation to the foreign income tax and gift tax rules.

***Ann M. Seller's*** *work focuses primarily on estate planning and probate administration. As part of her practice, Ann concentrates on international aspects of estate planning, including: the creation of wills and trusts for multinational families, estate and gift tax issues that arise with the ownership of cross-border property, and advising clients about the US Expatriation Tax. Ann is a member of the Society of Trust and Estate Practitioners (STEP). E-mail: aseller@kplaw.com; website: www.kplaw.com.*