Rethinking the U.S. Estate Tax on Nonresident Aliens

by Omer Harel

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The U.S. federal estate tax rates are among the highest in the world.[1] The current top estate tax rate following President Obama's tax reform is 35 percent, and it is scheduled to increase to 55 percent in 2013.[2] The amount that a nonresident alien can exempt from estate tax is fairly low, $60,000 of U.S.-situated assets. Consequently, estate tax exposure may be a significant concern for a foreign investor accustomed to paying minimal or no estate tax in his home country and who is interested in investing in U.S.-situated property.[3]

The surest way for an NRA to avoid U.S. estate tax exposure is to hold his U.S.-situated assets via a foreign corporation. However, there are significant disadvantages to this approach:

- if the NRA holds, via a foreign corporation, assets upon the disposition of which he is subject to tax in the United States (such as real property), the NRA is unable to benefit from the reduced long-term capital gains rate of 15 percent available to individuals;
- he is exposed to branch profits tax;
- in some instances, he will have higher ordinary income tax rates; and
- he will possibly incur additional foreign taxes due to using a foreign corporation to hold his U.S.-situated assets.

These consequences, which may significantly decrease the attractiveness of investing in the United States, did not receive a great deal of attention from lawmakers when it came to shaping the current estate tax regime for NRAs. It appears that Congress did not address these concerns during the enactment of the

[1] ACCF, ''New International Survey Shows U.S. Death Tax Rates Among Highest,'' *available at* http://www.accf.org/publications/118/new-international-survey-shows-us-death-tax-rates-among-highest; *see also* Jeffrey A. Schoenblum, *Multistate and Multinational Estate Planning*, Vol. 2, App. I (25th ed. 2008).

[2] IRC section 2001(c); *see also* RIA Checkpoint, *Complete Analysis of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, RIC Modernization, and Other Late 2010 Tax Provisions*, para. 107, *available at* https://checkpoint.riag.com.

[3] Charles Perkins, ''Foreign Ownership of U.S. Real Property,'' *available at* http://www.charlesperkinscpa.com/blog/57-foreign-ownership-of-us-real-property; Gideon Rothschild, ''What Foreign Buyers Need to Know Before Purchasing,'' *Real Estate Weekly*, *available at* http://findarticles.com/p/articles/mi_m3601/is_35_54/ai_n25405783/.

Obama tax reform, which effectively and discriminatorily repealed the estate tax in 2011-2012 for all but a few wealthy Americans and NRAs.[4]

This article evaluates the current NRA estate tax regime in light of both the 2008 economic crisis, which increased the importance of foreign investments in the United States, and the Obama tax reform. It concludes that there are reasons for shifting the current rules, including: no serious policy justification for imposing estate taxes on NRAs; the current regime discourages foreign investments in the United States; and the imposition of estate taxes on NRAs alters their behavior more than the imposition of estate taxes does on U.S. citizens or residents (herein referred to together as ''residents''). This article addresses the fairness argument, the central point presented in support of NRA estate tax retention providing that the estate tax is alive for residents. The fairness argument is unconvincing and even if accepted does not justify continuing the current system.

The following are a few critical points to keep in mind. First, this article does not address the complicated issue of expatriates. The conclusions of this article most likely do not apply to expatriates, given that their situations differ from those of other NRAs. References here to NRAs refer only to NRAs who are not expatriates. Second, an important variant is missing because of the following issue: Data suggest that the amount of revenue that the United States collects directly from NRAs because of the imposition of the estate tax is relatively low — approximately $53 million during 2009.[5] However, there is no existing data regarding revenues collected indirectly by the United States caused by the imposition of the estate tax on NRAs. An indirect collection occurs when some NRAs choose to invest in the United States and hold their U.S.-situated assets via a foreign corporation in order to avoid estate tax exposure and consequently pay higher income taxes or branch profits tax. Third, although the other two components of the federal wealth transfer tax system (the gift tax and the generation-skipping transfer tax) are not directly addressed here, the principles of the discussion are applicable to them as well.

[4]*See* discussion in Section III of this article.

[5]IRS, ''Nonresident Alien Estate Tax Returns with Non-Treaty Status: Gross Estate in the U.S., Outside the U.S., and Worldwide, and U.S. Gross Estate — by Tax Status and Size of U.S. Gross Estate''; and ''Nonresident Alien Estate Tax Returns with Treaty Status: Gross Estate in the U.S., Outside the U.S., and Worldwide, and U.S. Gross Estate — by Tax Status and Size of U.S. Gross Estate,'' *available at* http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96427,00.html.

I. U.S. Estate Tax

The United States generally taxes the estates of its citizens or residents[6] on a worldwide basis without regard to the situs of each particular asset.[7]

The actual tax liability of a resident's estate is generally computed in the following manner. First, the gross estate, which includes all property owned by the decedent at the time of his death, is computed.[8] Following the computation of the gross estate, deductions, including an unlimited marital deduction for transfers made to a citizen spouse, are subtracted from the gross estate in order to reach the taxable estate.[9] The rate schedule in IRC code section 2001(c) is applied to the taxable estate in order to determine the tentative estate tax. The tentative estate tax is then reduced by the unified credit and supplementary credits in order to arrive at the net estate tax.[10] After the Obama tax reform, the amount that the unified credit enables residents to exempt from estate tax is currently between $5 million and $10 million. Heirs usually receive fair market value basis in the property.[11]

II. U.S. Estate Tax Imposed on NRAs

The United States generally taxes estates of NRAs only on their assets that are situated in the U.S.[12] After the value of the assets situated in the United States is determined, to reach the NRA's taxable estate the estate is entitled to deductions similar to those available

[6]The complex issue of residency is not addressed in this article. However, a foreign non-U.S. citizen investor, who has never lived in the United States, will not be considered as a U.S. resident for estate tax purposes but as an NRA, and he will be taxed accordingly. *See* Diana S.C. Zeydel and Grace Chung, ''Estate Planning for Noncitizens and Nonresident Aliens: What Were Those Rules Again?'' 106 *J. Tax'n* 20 (2007).

[7]*Id.*; *see also* IRC sections 2001, 2031(a), and 2033.

[8]IRC sections 2031(a) and 2033 and Treas. reg. section 20.2033-1(a)(1). The language of IRC section 2033 may create ambiguities; therefore several interpretive issues are addressed in IRC sections 2034-2044. *See* Bittker and Lokken, *Federal Taxation of Income, Estates, and Gifts* (Thomson Reuters/WG&L, 2d/3rd ed. 1993-2003, updated June 2010), para. 125.1, *available at* https://www.checkpoint.riag.com.

[9]IRC sections 2051-2058. Because of the unlimited marital deduction available for transfers to a citizen spouse upon death, there is no estate tax if all the property of the decedent is transferred to a citizen spouse (IRC section 2056).

[10]IRC sections 2001 and 2010. The computation presented is based on the assumption that no taxable gifts were made during the decedent's lifetime. (For the computation when taxable gifts were made, see Bittker and Lokken, *supra* note 8, at para. 132.3.)

[11]IRC section 1014; a different rule may apply for property received from a decedent who died in 2010 — the year in which there was no estate tax. *See* ''RIA Special Study: Estate and Gift Tax Relief in the 2010 Tax Relief Act,'' 56 *Federal Taxes Weekly Alert Newsletter* (2010), *available at* https://checkpoint.riag.com.

[12]IRC sections 2103, 2101, and 2106; this article does not address the issue of expatriates.

to a resident when computing the resident's taxable estate.[13] Some of these deductions (such as funeral expenses, administration expenses, indebtedness, and casualty losses) are available only in proportion to the value that the U.S.-situated property represents relative to the value of the entire worldwide estate of the NRA.[14] The estate of an NRA is not allowed a marital deduction on a transfer to a noncitizen spouse to ensure that the property does not evade U.S. estate taxation.[15] The same rate schedule that applies to residents is applied to the taxable estate of the NRA when computing the tentative tax.[16] The NRA estate is then allowed a unified credit of $13,000[17] in order to arrive at the final estate tax liability. Generally, the unified credit exempts the first $60,000 of the taxable estate from taxation. In some cases, because of an applicable estate tax treaty, the NRA is entitled to a higher credit and therefore the exemption amount is higher.[18] The United States currently has estate tax treaties with 16 countries (Australia, Austria, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, the Netherlands, Norway, South Africa, Switzerland, and the United Kingdom).

A. Situs Rules

As noted above, only the portion of the NRA's assets situated in the United States is subject to U.S. estate taxation. Therefore, the situs rules apply in order to determine whether a specific asset is subject to U.S. estate taxation. The situs rules can be highly complex, and a thorough discussion of them is beyond the scope of this article. However, the following is a brief description of the basic situs rules relevant to this article's topics.

Stock of a corporation that is owned by an NRA is property situated within the United States only if it was issued by a domestic corporation.[19] Stock of a foreign corporation is not defined as situated within the United States, even if the entirety of the foreign corporation's business assets and headquarters are located in the United States.[20] Therefore, using a foreign corporation to hold U.S.-situated assets is the most effective way for an NRA to avoid U.S. estate tax exposure.

Real property located in the United States is considered situated in it.[21]

Debt obligation situs rules are complex. Generally, an obligation of a U.S. debtor is not regarded as having a U.S. situs if the interest collected before the debtor's death was exempted from taxation under the portfolio interest exemption.[22] Bank deposits do not have a U.S. situs, provided that they are not connected with the active conduct of a trade or business.[23] This exemption for bank deposits reflects an established policy of encouraging NRAs to deposit money in American banks by assuring that the deposited amounts will not be taxed merely because of their technical presence in the United States.[24]

Partnership interest situs rules come with significant uncertainty.[25] The IRS ruled in Rev. Rul. 55-701, 1955-2 C.B. 836, that a partnership interest is located where the partnership business is carried out. However, the question of where the partnership business is carried out is one of facts and circumstances. Further, there are additional authorities that support a look-through to the partnership assets in order to determine whether they have a U.S. situs and therefore need to be

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[13]IRC section 2106.

[14]IRC section 2106(a)(1); Zeydel and Chung, *supra* note 6, at 26.

[15]IRC sections 2106(a)(3) and 2056(d). The estate of the NRA or the noncitizen spouse may, however, defer the estate tax liability as the estate of an NRA is allowed a marital deduction for a transfer to a qualifying domestic trust (QDT) made by the estate or the surviving spouse (IRC section 2056(d)(2)). A QDT is a trust meeting certain requirements, the most important of which is that at least one of the trustees is a U.S. citizen or a U.S. corporation, and that this trustee has a right to withhold an estate tax from each distribution made from the QDT (IRC section 2056A(a); *see also* Zeydel and Chung, *supra* note 6, at 22, 26; and Bittker and Lokken, *supra* note 8, at para. 134.2.4). Unlike the case of a regular marital deduction, the QDT does not necessarily enable the surviving spouse to defer the estate tax until her death, as the estate tax is imposed on any distribution from the QDT. Cynthia Blum, ''U.S. Transfer Taxation of Nonresident Aliens: Too Much or Too Little?'' 14 *U. Pa. J. Int'l Bus. L.* 469, 533 (1994).

[16]IRC section 2101(a), section 2001(c). Computation is based on the assumption that no taxable gifts were made by the NRA.

[17]IRC section 2102(b)(1).

[18]Under IRC section 2102(b)(3), an NRA may be allowed the same estate tax credit allowed for a resident, multiplied by the proportion of the worldwide estate situated in the United States. *See* Zeydel and Chung, *supra* note 6, at 26. The United States currently has 16 estate tax treaties in effect, not all of them entitle the NRA to the same credit. *See* Schoenblum, *supra* note 1, at Vol. 2, section 21.05[C].

[19]IRC section 2104(a).

[20]*See* Bittker and Lokken, *supra* note 8, at para. 134.2.3, stating that this is the applicable law unless there is a case of sham, such as a deathbed transfer of shares of a U.S. corporation to a foreign holding corporation. Generally, it seems that the possibility that the IRS will be able to effectively ignore the ownership of U.S.-situated assets by a foreign corporation is quite small. *See* Blum, *supra* note 15, at 479-480, footnotes 43-44 and the references cited therein.

[21]Treas. reg. section 20.2104-1(a)(1).

[22]IRC sections 2104(c), 2105(b), and 871(h).

[23]IRC sections 2105(b)(1) and 871(i).

[24]Bittker and Lokken, *supra* note 8, at para. 134.2.3, footnote 47 and the references mentioned therein.

[25]Schoenblum, *supra* note 1, at Vol. 2, section 20.05[l]; Zeydel and Chung, *supra* note 6, at 25; Richard M. Lipton and Patricia W. Mcdonald, ''Planning Can Minimize U.S. Taxation of Foreign Investment in U.S. Real Estate,'' 113 *J. Tax'n* 132, 143 (2010).

included in the NRA estate.[26] Thus, an NRA using a foreign partnership to invest in U.S.-situated assets subjects himself to U.S. estate tax exposure, particularly considering that partnership business location is based on facts and circumstances.

Beneficial interest in a trust situs is generally determined by the situs of the underlying assets.[27] Therefore, in general, the use of a foreign trust to hold U.S.-situated assets does not provide complete protection from estate tax exposure in the case of the death of an NRA beneficiary.

In conclusion, the simplest and surest way by which an NRA can avoid estate tax exposure is to hold U.S.-situated assets via a foreign corporation. This approach, however, has severe disadvantages which will be addressed further on.

III. Tax Reforms: Before and After

Before President George W. Bush's tax reform,[28] the exemption amount for residents was $675,000[29] and the maximum estate tax rate was 55 percent. The Bush tax reform substantially increased the exemption amount in stages after 2001. The exemption amount increased to $3.5 million for residents who died during 2009. The exemption amount for NRAs remained unchanged at $60,000.[30] Also, the Bush tax reform reduced the estate tax rates in stages until it reached 45 percent for estates of decedents dying in 2007-2009. This reduction applies to both residents and NRAs.[31] The Bush tax reform completely repealed the estate tax for decedents dying in 2010 (including NRAs).[32] The Bush tax reform was subject to a sunset provision and was scheduled to expire in 2011. Under the sunset provision, the top estate tax rate was intended to increase back to 55 percent for decedents dying in 2011 with a $1 million exemption amount planned for residents.

The Obama tax reform[33] revived the estate tax in 2011-2012.[34] However, it did so in an exceedingly modest way for residents. The exemption for residents was increased to $5 million per individual and to $10 million in cases of married couples. The married couple exemption was due to a new provision enabling surviving spouses to use the exemption amount not used by the predeceased spouse who passed away after 2010.[35] The exemption amount for NRAs has remained unchanged ($60,000).[36] The Obama tax reform also lowered the top estate tax rate for both residents and NRAs to 35 percent.[37]

The Obama tax reform essentially used the Bush tax reform's sunset provision by extending it until December 31, 2012. Therefore, providing no additional amendments, the top estate tax rate in 2013 and in subsequent years will be 55 percent and the exemption for residents will be $1 million.

The outcome of the Obama tax reform is essentially a repeal of the estate tax for everyone in 2011-2012, apart from NRAs and a small group of wealthy Americans.

IV. Problems With Current Situation

A. Background

The issue of imposing U.S. estate tax on NRAs received limited attention from commentators following the enactment of the 1988 Technical and Miscellaneous Revenue Act.[38] The TAMRA legislation repealed the reduced rate schedule applicable to NRAs and subjected them to the same rate schedule as residents, while keeping the exemption amount of $60,000

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[26] Zeydel and Chung, *supra* note 6, at 25, and the case mentioned therein (*Sanchez v. Bowers*, 13 AFTR 1074, 70 F2d 715 (CA-2, 1934)). A proposal made by the tax section of the California Bar that clarifies the current situation by treating a partnership interest the same as stock of corporation, so that a partnership interest would have a U.S. situs only if it was issued by a domestic partnership, was never adopted. *See* Richard A. Cassell, Michael J.A. Karlin, Carlyn S. McCaffrey, and William P. Streng, ''U.S. Estate Planning for Nonresident Aliens Who Own Partnership Interests,'' *Tax Notes Int'l,* Aug. 11, 2003, p. 563, *Doc 2003-14517*, or *2003 WTD 154-13*.

[27] Bittker and Lokken, *supra* note 8, at para. 134.2.3; Zeydel and Chung, *supra* note 6, at 25; for a moderately different approach, see Schoenblum, *supra* note 1, at Vol. 2, section 20.05[J].

[28] The Economic Growth and Tax Relief Reconciliation Act of 2001, P.L. 107-16 (2001).

[29] This is in addition to the unlimited marital deduction for a transfer to a citizen spouse (IRC section 2056).

[30] The exemption amount may be higher if the NRA is from a country that has an estate tax treaty in effect with the United States.

[31] P.L. 107-16, section 511 (2001).

[32] P.L. 107-16, section 501 (2001), codified in IRC section 2210 as in force during 2010.

[33] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, P.L. 111-132 (2010).

[34] P.L. 111-132, section 301 (2010). The estate tax was revived also for 2010, by providing estates of decedents dying during 2010 the choice between being taxed under the new rules applicable for decedents dying in 2011-2012 with a full step-up in basis, or no taxation while benefiting from a limited step-up in basis under the Economic Growth and Tax Relief Reconciliation Act provisions.

[35] P.L. 111-132, sections 302 and 303, as codified in IRC section 2010(c). The estate of the predeceased spouse benefits from an unlimited marital deduction for the transfer to the surviving spouse. Therefore, the unified credit is not used to exempt amounts from taxation that are transferred to the surviving spouse, and the exemption amount is not reduced because of the transfer to the surviving spouse.

[36] This amount may be increased by a treaty.

[37] IRC section 2001(c) as amended by P.L. 111-132, section 302 (2010).

[38] P.L. 100-647 (1988).

available to them the same.[39] This act was set in motion in part to gain equity in the treatment of U.S. and foreign decedents, and in particular by the need to eliminate a situation in which a resident of a treaty country benefited from both the lower rates and a portion of the unified credit applicable to residents.[40]

TAMRA brought several criticisms. For example, some commentators argued that the situation TAMRA tried to address — NRAs from treaty countries benefiting from both lower rates and higher credit — is particularly narrow since the United States has estate tax treaties with only 16 countries and Congress could potentially tailor a provision to address these concerns, hence depicting TAMRA as discriminatory.[41] A second example is that the TAMRA changes are discouraging investments in the U.S. because of the adverse income tax consequences of using a corporate form and other legislative changes such as the introduction of the branch profits tax.[42] One highly respected commentator argued, however, that imposing estate taxes on NRAs is justified, based on fairness, although she suggested increasing the exemption amount for NRAs.[43]

Section IV.B of this article explains the problems with the current situation and why the NRA estate tax should be repealed or, at the very least, significantly modified, without regard to current estate tax regime continuance for residents. It also addresses commentators' arguments for NRA estate tax modification following the enactment of TAMRA and demonstrates that these arguments are more forceful today. Section IV.C addresses several justifications for retaining the NRA estate tax and explains why there is no justification for continuance of the current situation.

B. Repealing or Modifying NRA Estate Tax

1. Deterrent Effect

The current NRA estate tax deters individual foreign investors and most likely discourages them from investing in the United States. This appears true because NRAs are fearful of being subject to the estate tax or because the costs of avoiding this tax by holding assets via a foreign corporation are too high. The costs, which seriously decrease the profitability of the investment, include potential for higher income taxes, branch profits tax exposure, and multiple tiers of tax that these holding structures may create that result in higher foreign taxes. These consequences are extremely harsh regarding real property upon the disposition of which the United States taxes NRAs.[44] When an NRA holds real estate directly, he may be able to benefit from the lower rate of 15 percent for long-term capital gains; however, the NRA is unable to do so when holding the assets via a foreign corporation.[45]

Given that thousands of Israelis have invested in U.S. real estate since the 2008 economic crisis,[46] the following example (of a typical Israeli) demonstrates the effect that using an Israeli holding corporation might have on the profitability of investment in U.S. real estate. In this example we assume that the Israeli investor is planning to buy the real property, rent it for a few years, and dispose of it.[47] If the Israeli investor acquires the property directly using a limited liability company,[48] he would pay a maximum of 35 percent federal income taxes on his rental profits.[49] The Israeli investor will receive a credit in Israel for the paid federal income taxes. He also may incur additional taxes in Israel in order to pay total taxes according to his

[39]William W. Bell and David B. Shoemaker, ''TAMRA Increases Estate Tax Rates of Nonresident Aliens,'' 6 *J. Partnership Tax'n* 79, 79-80 (1989).

[40]H.R. Rep. No. 795, 100th Cong., 2d Sess. 594 (''H.R. Report''); William W. Bell and David B. Shoemaker, ''Foreign Direct Investment in U.S. Real Estate: The Screws Tighten,'' 8 *J. Partnership Tax'n* 258, footnote 38 (1991); Blum, *supra* note 15, at footnote 2.

[41]Blum, *supra* note 15, at footnote 3 and the references cited therein; *see* in particular ''U.S. Trade Relationships with the Soviet Union and Eastern Europe, the Implications of 'Europe 1992' on American Direct Investment, and Foreign Investment in the United States: Hearings Before the House Comm. on Ways and Means,'' 101st Cong., 2d Sess. 57 (1990).

[42]Bell and Shoemaker, TAMRA, *supra* note 39, noting at 87-88 that ''this country's policy of encouraging foreign investment in U.S. real estate has largely been reversed in this decade'' and ''Congress does not fully appreciate the relationship between the NRA's income tax position and his estate tax position. TAMRA forces the NRA into a corporate investment structure without recognizing that TRA '86 made the corporate investment structure intolerable from the NRA's income tax perspective.''

[43]Blum, *supra* note 15, at 471, 505-508, 520, 550-553, 561, 563.

[44]IRC section 897(a).

[45]IRC section 1(h), sections 11, 871(b), and 882(a); *see* Lipton and Mcdonald, *supra* note 25, at 137, 143; *see also* Steven L. Cantor and Tracey B. Leibowitz, ''Structuring Foreign Investment in U.S. Real Property,'' *available at* http://www.realtor.org/intupdt.nsf/Pages/StructuringForeignInvestmentinU.S.Real Property.

[46]*See* Adi Ben-Israel, ''Phenomenon: thousands of Israelis acquire homes in the United States at rock bottom prices; detached with pool in Florida is sold for $80,000'' (Aug. 17, 2009), *available at* http://www.globes.co.il/news/article.aspx?did=1000490240.

[47]For the sake of simplicity, this article ignores state income tax rates and the issue of depreciation recapture.

[48]Although the treatment of the LLC under Israeli law is highly problematic, the Israel Tax Authority did, in effect, agree in some cases to recognize the LLC as a passthrough entity and enable the owner to report the LLC's income as if it was his personal income. *See* Income Tax Procedure 5/2004 — International Tax Division, section 5.2.2, Apr. 19, 2004.

[49]IRC section 1, section 871(b), (d). We assume that an election under section 871(d) to treat the rental income as income connected with U.S. business was made.

marginal tax rate, which could reach 45 percent.[50] Also, when he disposes of the property, he will be taxed at long-term capital gain rates, which are 15 percent today in the United States. The Israeli investor will likely receive a credit for these taxes in Israel and will have to incur additional taxes in Israel, in order to pay a total of 20 to 25 percent on his capital gains (the tax rates in Israel for capital gains).

Assuming that the Israeli investor holds his interest in the U.S. LLC (which holds the U.S. real estate) via an Israeli corporation, the corporation will pay up to 35 percent federal income taxes on its rental profits[51] and pay branch profits taxes of 12.5 percent, assuming that the investor wants to repatriate the money to Israel before the disposition of the property.[52] Because the 43.125 percent total U.S. tax is much higher than the Israeli corporate tax rate, the Israeli corporation will not incur additional taxes in Israel.[53] However, if the Israeli corporation distributes the 56.875 percent of the profits that reached Israel, an additional Israeli tax of 25 percent will be levied on the 56.875 percent so distributed. The total tax liability will be 57.34 percent. Also, when disposing of the property, the Israeli corporation will not be able to benefit from the long-term capital gain rates. Assuming that all the property is disposed of immediately to avoid branch profits tax, the total tax liability in the United States might remain at 35 percent upon its disposition. Moreover, when the profits are distributed to the Israeli shareholder as a dividend, there will be an additional Israeli tax of 25 percent on the 65 percent distributed.[54] The maximum total tax liability on the sale proceeds would be 51.25 percent.[55]

Although thousands of individual Israeli investors have invested considerably[56] in the United States since 2008, most likely other investors would also have invested in the United States if there were no estate tax. Though of course the United States should not initiate tax policy decisions based on consequences to Israeli investors alone, one can infer from the above example that the need to hold assets via a corporation will likely add costs to investing in U.S. real estate and may prevent additional investments. These costs to the extent attributable to increased U.S. taxes are incurred by any foreign investor, regardless of his country of origin. Further, the United States considers superfluous any costs a foreign investor incurs that the United States does not benefit from (such as additional foreign taxes and foreign attorney fees) as the costs decrease the attractiveness of investment while generating no revenues for the United States.

Several of these arguments arose following the enactment of TAMRA.[57] A number of commentators noted that it is as if during the enactment of TAMRA, Congress never truly considered the relationship between NRAs' income tax position and their estate tax position.[58]

The arguments presented here appear to have additional strength today than they did post-TAMRA enactment for multiple reasons. First, the long-term capital gains tax rates during the years following the enactment of TAMRA were a great deal higher than today's 15 percent rate.[59] Therefore, the cost to the NRA of avoiding estate tax exposure by using a foreign holding corporation is much higher today than it was after the enactment of TAMRA. Further, the U.S. market, in particular the real estate industry, took a huge hit during the global financial crisis. Therefore, the U.S. in general, and the real estate industry in particular, need foreign investments now more than ever. It is no longer the 1980s — a decade when foreign ownership of U.S. property was perceived as a threat to the American economy.[60] The NRA estate tax is simply an unnecessary barrier to investments in the United

[50]Income Tax Ordinance [Revised], section 121, 200; Convention Between the Government of the United States of America and the Government of the State of Israel With Respect to Taxes on Income, Nov. 20, 1975, article 26 (''Israel-U.S. income tax treaty'').

[51]We assume that an election under section 882(d) to treat the rental income as income connected with U.S. business was made.

[52]Israel-U.S. income tax treaty, article 14-A(a); IRC section 884(a), (e). The branch profits tax could be avoided if the Israeli investor would retain the money in the United States, until the disposition of the property, since a foreign corporation is generally not subject to branch profits tax upon complete termination of its U.S. trade or business (Treas. reg. section 1.884-2T(a)(1)).

[53]Income Tax Ordinance [Revised], sections 126 and 200; Israel-U.S. income tax treaty, article 26.

[54]Income Tax Ordinance [Revised], section 125B.

[55]The total tax liability upon a disposition of the property might be reduced through the use of an Israeli family corporation, which income is attributed directly to one of its shareholders (Income Tax Ordinance [Revised], section 64A). The ultimate problem with using the Israeli family corporation is that most likely the Israel-U.S. income tax treaty is not applicable to the corporation as it is not taxed in Israel as a corporation

(Footnote continued in next column.)

(Israel-U.S. income tax treaty, article 2(1)(f)(ii)). Therefore, the branch profits tax on the earnings repatriated to Israel may be 30 percent.

[56]In the first half of 2010, Israeli investors invested $440 million in U.S. real estate, according to statistics published by the Israel-U.S. Chamber of Commerce. *See* Yael Grontman, ''Israeli Investors captured the second place in U.S. Real Estate Investments'' (Dec. 19, 2010), *available at* http://www.globes.co.il/news/article.aspx?did=1000609435.

[57]Bell and Shoemaker, TAMRA, *supra* note 39, at 87-88.

[58]*Id*.

[59]Tax Foundation, *Federal Capital Gains Tax Rates 1988-2011*, *available at* http://www.taxfoundation.org/files/fedcapgains taxrates-20080527.pdf.

[60]For a brief explanation regarding the contribution and importance of foreign investments to the U.S. economy, see Mark J.

(Footnote continued on next page.)

States. In that respect, even opponents of the repeal have agreed that a repeal of the estate tax for NRAs might only be justified because of an urgent need to promote investments by foreigners in the United States.[61] In any case, Congress should at a minimum evaluate the desirability of retaining the NRA estate tax in light of the extra costs to the NRA that originate from using foreign corporations to hold U.S.-situated assets.

The situation becomes all the more absurd regarding assets that when held via a foreign corporation do not have adverse U.S. income tax consequences. An example of this is stock in a publicly traded U.S. corporation. The United States generally does not tax the gains on the sale of such stock and withholds taxes from dividends to foreign investors at the same rates for individuals and corporations. The U.S. does not receive the additional costs paid by the foreign investor. The consequences of forcing a foreign investor to use a foreign holding corporation are that:

- it creates a trap for the unwary individual[62]; and
- it makes the investment in the stock of these U.S. corporations less profitable. This is due to the extra costs of forming a corporation and the negative income tax consequences that the foreign investor might experience in his home country. However, from a U.S. perspective, these extra costs are superfluous as they generate no revenues for the United States.

Thus, even if the NRA estate tax was retained, the situs rules regarding these assets ought to be changed as the opponents to repeal have suggested.[63] In this way NRAs would not be subject to U.S. estate tax while holding these assets.

2. Bias

The imposition of estate tax on an NRA creates biases that the imposition of estate tax on a resident does not. Because the NRA is not taxed in the United States on a worldwide basis, he can take his money and invest it somewhere else to avoid U.S. estate taxation. Therefore, the current situation in which an NRA acquires an exemption amount to a little over 0.5 percent[64] of what a resident receives does not make sense from an economic policy perspective. An additional bias that the NRA estate tax creates is understandable if you consider that most deaths are not sudden. Assume that an NRA with significant U.S.-situated assets invested in the United States when he was young is now approaching 70. This NRA could potentially sell his U.S.-situated assets, take the money back to his home country, and avoid estate tax exposure.[65] It is therefore incomprehensible why it is in the interest of the U.S. to retain this bias; the United States should not encourage successful foreign investors to take their money out of the United States. Further, if the successful foreign investor kept his money in the United States, there would be a much higher chance that his heirs would continue to invest and perhaps expand their U.S. investments. The chances that heirs will begin investing in the United States without an existing investment mechanism put in place for them are less likely.

3. Weak Policy Arguments

The major policy arguments for levying estate taxes on residents are not applicable or have significantly less force regarding NRAs. The rationale for reducing large concentrations of wealth is clearly not applicable to NRAs as only a relatively small portion of their assets is typically situated in the United States. Even if it is a large portion, it is likely that these well-advised, wealthy foreign investors will hold their U.S.-situated assets via a foreign holding corporation. An additional argument used for justifying the imposition of estate tax on residents is that the government was a silent partner in the accumulation of their wealth. In this case it is clear that the U.S. government did not contribute to the NRAs' wealth accumulation regarding the money that they brought from their home country. Therefore, the NRA estate tax could be more easily justified if it was only a tax on the appreciation in the U.S.-situated assets.[66] Other arguments such as inhibiting heirs from engaging in productive activity[67] do not apply to NRAs given that, as noted above, the U.S. estate tax is unlikely to apply to most assets transferred to them.

Wolff, ''Congressional Unilateral Tax Treaty Overrides: The 'Latter in Time Doctrine' is Out of Time!'' 9 *Fla. Tax Rev.* 699, 751-752 (2009).

[61] Blum, *supra* note 15, at 563.

[62] This was the view of some regarding the whole estate tax regime for NRAs. *See* Blum, *supra* note 15, at 476 and footnote 28, citing Staff of the Joint Committee on Taxation, Background and Issues Relating to the Taxation of Foreign Investment in the United States 84 (1990). This claim seems particularly strong regarding publicly traded stock, as unlike assets such as real estate, people do not consult attorneys and accountants before stock purchases, and there are no negative U.S. income tax consequences if the NRA holds them via a foreign holding corporation.

[63] Blum, *supra* note 15, at 524-525.

[64] $60,000 in comparison to $10 million available to residents with married couple status after the Obama tax reform. See discussion in Section III of this article.

[65] *See* the suggested strategy of not holding any U.S.-situated assets at the time of death in order to avoid U.S. estate tax exposure. Jane Peebles and Michael Karlin, ''Nonresident Alien Estate Planning,'' *Lexsee 2009 Emerging Issues* 4542, see text after reference to footnote 53.

[66] This refers to the Canadian approach regarding residents and NRAs. *See* guides available at Canada Revenue Agency website (http://www.cra-arc.gc.ca): Guide T4011, *Preparing Returns for Deceased Persons*, at 21; Guide T4037, *Capital Gains*, at 26.

[67] Reginald Mombrun, ''Let's Protect Our Economy and Democracy from Paris Hilton: The Case for Keeping the Estate Tax,'' 33 *Ohio N.U.L. Rev.* 61, 86 (2007).

It has been argued that justifications for imposing estate taxes on residents apply to imposing estate taxes on NRAs. An example is that the goal of a progressive redistribution of wealth is applicable to NRAs.[68] However, levying estate taxes on NRAs will distribute little (given that most NRAs' assets are not situated in the United States) while negatively affecting efficiency and decreasing desirability of investing in the United States. This is also a general justification for imposing almost any tax on people who have the means to pay. This is insufficient to justify imposing estate tax on NRAs. This tax also reduces the amount of money that NRAs' home countries receive. These countries are typically less wealthy than the United States and, therefore, from a global perspective, the tax can be considered as regressive rather than progressive.

It has also been argued that the United States assists NRAs in retaining their wealth, which justifies levying the estate tax.[69] This rationale may be applicable to NRAs as well. However, the author argues that:

- since retaining wealth is relatively simple today, it is incomprehensible why the U.S. chooses to, in effect, punish the heirs of an NRA who invests his money in the United States;
- the United States itself obviously does not follow this rationale since it does not impose estate taxes on NRAs who merely have a bank account in the United States, and because regarding some assets (such as stock of a U.S. publicly traded corporation) the NRA can escape the estate tax without adverse income tax consequences in the United States[70];
- if the above stated rationale was underlying the NRA estate tax, no estate tax should be imposed if shown that the NRA lost money on his investment in the United States; and
- the assistance that NRAs receive in retaining their wealth is much less help than residents receive, as typically, a smaller portion of their assets is situated in the United States, and because they usually hold U.S.-situated assets for a shorter period of time than residents do.

Also, NRAs do not receive many additional benefits from the U.S. government that residents do receive. Therefore, if an NRA must pay estate taxes, they should be much lower than the taxes residents pay.

4. Increasingly Discriminatory

The estate taxes imposed on NRAs have become extremely discriminating following the Obama tax reform. When TAMRA was enacted, some commentators said the previous higher exemption amount given to residents (which was justified because residents are taxed on a worldwide basis[71] while NRAs are only taxed on the portion of their assets situated in the United States) is in effect discriminatory. The exemption amount for NRAs after TAMRA was $60,000, the same as it is today. The exemption amount for residents, however, was $600,000.[72] Even commentators who supported retaining the estate taxes imposed on NRAs suggested increasing the exemption amount for NRAs from 10 percent to 50 percent of the exemption amount to which residents are entitled to.[73]

As noted above,[74] after the Obama tax reform the exemption amount that NRAs became entitled to is 0.6 percent of what a resident is entitled to ($60,000 as opposed to up to $10 million). The Obama tax reform essentially eliminated the estate tax for all but a small group of wealthy Americans and all NRAs. This is clearly discriminatory[75] and cannot be justified considering that the case for imposing estate taxes on residents is much stronger, and the massive biases that the imposition of estate taxes on NRAs places on investing decisions in comparison with the imposition of estate taxes on residents. The arguments that the U.S. estate taxes discriminate against NRAs appear to be more persuasive following the Obama tax reform. In some cases, the new NRA estate tax regime may be in violation of the nondiscrimination clause of many U.S. income tax treaties.[76] Perhaps the NRAs' exemption

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[68]Blum, *supra* note 15, at 505.

[69]*Id*.

[70]*See* discussion above.

[71]H.R. Report, *supra* note 40, at 594. As can be inferred from the text in H.R. Report, only the situation of NRAs from treaty countries was analyzed and compared to the situation of residents.

[72]For the exemption amount that was available to NRAs, see Bell and Shoemaker, TAMRA, *supra* note 39, at 79-80. This amount could have been increased if the NRA was from a treaty country. For the exemption amount available to residents in the past, see Barry W. Johnson, *Estate Tax Returns, 1986-1988*, at 32, *available at* http://www.irs.gov/pub/irs-soi/86-88estr.pdf.

[73]Blum, *supra* note 15, at 550.

[74]*See* discussion in Section III of this article.

[75]In an early case, the district court rejected a claim of an NRA that the higher exemption amount available to residents is discriminatory and in violation of U.S. treaty obligations, since an NRA with only a small portion of his assets situated within the United States pays a small amount of federal taxes and therefore ''by and large'' there is no discrimination (*Watson v. Hoey*, 59 F. Supp. 197, 199 (1943); for a critical analysis of the *Hoey* test as too restrictive for NRAs, see Sandford H. Goldberg and Peter A. Glicklich, ''Treaty Based Non-Discrimination: Now You See It Now You Don't,'' 1 *Fla. Tax Rev.* 51, 66). However, it seems almost impossible to assert that with the huge difference in exemption amounts created by the Obama tax reform, there is ''by and large'' no discrimination today.

[76]The nondiscrimination article in income tax treaties usually applies to taxes of every kind, and therefore also covers estate taxes. (*See* U.S. Model Income Tax Convention of November 15, 2006, article 24.7 (''U.S. model'').) The U.S. position is most likely that the different treatment of NRAs is *never* a violation of

(Footnote continued on next page.)

amount was not increased because they cannot vote, as argued by some commentators after the enactment of TAMRA.[77]

5. Lack of Benefit

The NRA will not necessarily be able to benefit from the step-up in basis in his home country, particularly when his home country does not impose estate taxes. Therefore, the imposition of an estate tax on NRAs can result in double taxation. For example, the Israeli Tax Authority ruled that heirs of an Israeli decedent who paid U.S. estate taxes cannot enjoy a step-up in basis in Israel or receive a credit for the estate taxes paid to the U.S. government. The Israeli Tax Authority ruled that the estate taxes paid will only be added to the original basis of the decedent in the property transferred to the heirs in order to determine the heirs' basis.[78]

6. Random Nature of Estate Tax

The estate tax imposed on NRAs is an exceptionally random tax. A core element for a tax to be considered good is that it is certain and not arbitrary. However, the estate tax imposed on NRAs is exceptionally random as its applicability depends on whether the NRA manages to dispose of his U.S.-situated assets before he dies.[79]

C. Retaining Estate Tax Imposed on NRAs

1. Repeal Is Inequitable

The repeal of this tax while retaining the estate tax imposed on residents is inequitable and American voters may see it as clearly discriminatory. This was the primary argument for retaining the estate tax imposed on NRAs.[80] The author believes:

- That such a repeal is not inequitable as:
  - — there is a much stronger case for imposing estate tax on residents[81];
  - — residents are always able to benefit from the step-up in basis; and
  - — the imposition of estate taxes on NRAs, particularly on those who are not subject to higher estate taxes in their home countries, distorts behavior in ways that estate taxes imposed on residents do not.
- That today's economic climate calls for an urgent need to attract foreign investors. A repeal therefore will most likely be viewed more favorably than it would have been during the 1980s or 1990s, decades when foreign ownership of U.S. assets was generally perceived by Americans as a threat to the U.S. economy.
- That because the Obama tax reform eliminated the estate tax for all residents in 2011-2012 (apart from a small group of wealthy Americans), it seems unlikely that repealing it for NRAs will be viewed as inequitable.

2. International Practice

There is an international practice to impose estate taxes on NRAs, and they generate revenues. These arguments are convincing. However, since the U.S. estate tax rates are among the highest in the world, and because a large number of countries do not impose estate

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this article as NRAs are not subject to a tax on a worldwide basis (U.S. model, article 24.1). The U.S.'s position that NRAs are never in a comparable situation to residents — unacceptable as it in effect — provides the U.S. with a license to discriminate against NRAs at whim. (It also is inconsistent with the view in *Hoey*, with the U.S. policy to grant in some cases involving NRAs from a country with which the United States has an estate tax treaty a proportionate credit (*see supra* note 18), and with the U.S.'s method of allowing certain deductions only in proportion to the value that the U.S.-situated property represents relative to the value of the whole NRA worldwide estate.) The European Court of Justice position appears different and does not support the U.S.'s view that residents and NRAs are never in a comparable situation. (*See, e.g.*, *Prunus* (C-384-09), at para. 80 [2010]; *see also Schumacker* (C-279/93), at paras. 33-37 [1995] E.C.R. I-225.) However, regarding most of the U.S. income tax treaties, it continues to appear that there is no violation of the nondiscrimination article. This is because:

- in some of the treaties, the other countries specifically agreed to the notion that a U.S. citizen taxed on a worldwide basis is not in the same situation as their national who is not taxed in the United States on a worldwide basis (*see, e.g.*, Luxembourg-U.S. income tax treaty, Apr. 3, 1996, at article 26(1));
- in other treaties the nondiscrimination article applies only to nationals of one country who are also residents of the other (*see, e.g.*, Philippines-U.S. income tax treaty, Oct. 1, 1976, at article 24(1)); and
- other treaties do not contain a provision that expressly extends the applicability of the nondiscrimination article to taxes of any kind, making it questionable whether this article also applies to estate taxes (*see, e.g.*, P.R.C.-U.S. income tax treaty, Apr. 30, 1984).

However, at least in one of the U.S. tax treaties, none of the described situations applies, and therefore, it appears that in light of the *Hoey* court ''by and large'' test (*supra* note 75, at 199) and the ECJ view, there may be a violation of the treaty (Ukraine-U.S. income tax treaty, Mar. 4, 1994, at article 25(1)). For a thorough discussion regarding the negative impact of the U.S. violations of tax treaties, see Wolff, *supra* note 60. However, even if there is no violation of an income tax treaty, this does not make the enormous difference in exemption amounts available to residents and NRAs nondiscriminatory.

[77]Bell and Shoemaker, TAMRA, *supra* note 39, at 87.

[78]*See* Tax Decision 25/07 summary (published Feb. 9, 2009), *available at* http://www.shaam.gov.il/tmmisuyint.

[79]As recommended by Peebles and Karlin, *supra* note 65, at the text after reference to footnote 53.

[80]Blum, *supra* note 15, at 471, 505-508, 520, 561, and 563.

[81]*See* discussion above in Section IV.B of this article.

taxes at all,[82] U.S. estate taxes negatively affect the attractiveness of investments in the United States. Also, it is unclear how much revenue the United States generates from the estate taxes imposed on NRAs[83] as opposed to how much money it loses in revenues because of lost investments. All that is known is that the revenue the United States generates directly from the estate tax imposed on NRAs is miniscule.[84] The author is not aware of the exact amount of revenue the U.S. estate tax generates indirectly due to foreign corporation holdings of U.S.-situated assets for those NRAs avoiding estate tax exposure and consequently paying higher income taxes. What is clear is that every dollar that the U.S. estate tax causes an NRA to spend that the United States does not receive (such as extra foreign taxes, attorney fees paid to attorneys abroad, fees for registering a foreign corporation) is a waste from the U.S. perspective as it lessens attractiveness of investment in U.S.-situated assets.

Further, a repeal of the NRA estate tax will not necessarily result in a loss of current revenues. This is because for some assets such as real property, the United States will tax the gain on their appreciation, which it currently does not as heirs enjoy a step-up in basis.

3. Negative Effects

The repeal would have negative effects in the international arena. It has been argued that repealing the estate tax imposed on NRAs will negatively affect American citizens abroad, reduce U.S. leverage in estate tax treaty negotiations, affect U.S. ability to obtain information about assets of U.S. residents situated abroad, and become a voluntary relinquishment of revenues.[85] These arguments are not convincing.

The United States has estate tax treaties in place with only 16 countries while the imposition of U.S. estate tax seemingly alters the conduct of investors from more than 160 countries. These estate tax treaties are rarely amended; most estate tax treaties have not been modified since the 1980s.[86] Also, almost no new estate tax treaty has entered into force over the course of the last 20 years,[87] rendering the leverage argument weak at best.

Second, it is unclear as to how valuable the information received due to the imposition of the NRA estate tax is and whether the United States is unable to obtain this information otherwise.[88]

Third, to prevent the revocation of current U.S. estate tax treaties and the potential negative effects on American citizens with assets situated abroad, Congress could simply repeal the estate tax on NRAs and enact a provision allowing the IRS to impose estate taxes on residents of countries with which the IRS has not achieved satisfactory agreements regarding the treatment of U.S. citizens' estates.[89]

Fourth, these arguments are irrelevant regarding countries that do not impose estate tax. In these instances, Congress may simply exempt from estate taxes NRAs from countries that do not impose estate taxes on U.S. residents.[90]

And last, regarding the voluntary relinquishment argument, if the NRA estate tax is repealed, there is a chance that additional countries will follow the U.S. lead regarding taxation issues and cancel such taxes as well. The United States, which currently gives tax credits to its residents for foreign death taxes paid,[91] might benefit from such a movement.

V. Proposals for Changes

The NRA estate tax is an unnecessary barrier to trade as it makes investment in the United States by individuals far less attractive and there is not a strong enough policy justifying its retention. Also, such a tax alters behavior in ways that the estate tax imposed on residents does not. Further, the tax is exceptionally random and therefore at least one of the following changes needs to occur.

A. Complete Repeal

The estate tax imposed on NRAs should be repealed entirely.[92] This seems to be the best solution, especially in light of the urgent need to attract foreign investors to the United States. Adopting such a proposal will enable foreign investors to enjoy long-term capital gain

[82] *Supra* note 1.

[83] As discussed in the introduction of this article, the amounts of additional revenues that the United States collects because foreign individuals invest through foreign corporations in order to insulate themselves from U.S. estate tax exposure are unclear as there is no data regarding this matter.

[84] The United States generated directly $53 million in revenue from the NRA estate tax during 2009; *see* discussion in the introduction of this article.

[85] Blum, *supra* note 15, at 511-519.

[86] Peebles and Karlin, *supra* note 65 (see the text between references to footnotes 40-42).

[87] *Id.*

[88] It was suggested that the IRS may be able to collect this information even without imposing estate tax on NRAs, even though such imposition facilitates the collection. *See* Blum, *supra* note 15, at 515-519.

[89] Blum, *supra* note 15, at 517. In light of the U.S.'s political power, it is unlikely that other countries will act toward the United States as the United States acted toward Sweden when cancelling the Sweden-U.S estate tax treaty after Sweden repealed its inheritance tax. *See* "Treasury Announces End to Sweden-U.S. Estate and Gift Tax Treaty," *Doc 2007-14363* or *2007 WTD 117-22*.

[90] As suggested by Blum, *supra* note 15, at 515. The arguments that Blum raises against such a move are unconvincing.

[91] IRC section 2014.

[92] As noted above, the conclusions of this article, including this one, most likely do not apply to expatriates.

rates upon the disposition of real property without being exposed to estate taxes. Also, this repeal will help stimulate the real estate market, which suffered significantly because of the 2008 economic crisis. Such a move will be more effective in stimulating the real estate industry than the cancellation of the 1980 Foreign Investment in Real Property Tax Act,[93] as the taxes paid in the United States for disposing real property are taxes that the individual would likely incur in any event. Therefore they have a lower potential for deterring foreign investment.

B. Partial Repeal

The estate tax imposed on NRAs should be repealed for residents of countries that do not impose estate taxes on Americans. This is justified by the notion of reciprocity and the limited ability these NRAs have to benefit from the step-up in basis. Also, behavior distortion among these NRAs seems more apparent as they are probably not subject to estate taxes at all.[94] Finally, the justifications for retaining the estate tax imposed on NRAs regarding the negative international effect of the repeal do not apply to the imposition of estate taxes on these particular NRAs.

C. Canadian Approach

The United States should move toward the Canadian approach of taxing only unrealized gains of NRAs.[95] Taxing NRAs only on unrealized gains has several advantages:

- The justification for imposing it is much stronger (for example, the U.S. contribution to the accumulation of wealth).
- The imposition of such a tax will not distort behavior in a way that the current NRA estate tax distorts behavior. For example, taxation of unrealized gains is less likely to deter foreign investments, because NRAs are taxed on their gains in every country anyway. Also, the imposition of taxes only on unrealized gains will eliminate the incentive to sell U.S.-situated property when NRAs are facing death.
- The applicability of the tax will not depend on whether the NRA managed to divest his U.S.-situated assets before his death. The fact that imposition of estate tax on NRAs depends on whether the NRA managed to ''get out'' in time creates inequity among foreign investors.
- The NRAs will be able to obtain credit for such taxes in their home countries — as these are taxes imposed on income.

One argument against this change is that residents of other countries that impose estate taxes will not be able to receive credit for such taxes.[96] However, this disadvantage can be overcome by enabling the estate of an NRA to elect between taxation of unrealized gains and the current estate tax regime for NRAs.

D. Exemption Amount

The exemption amount of NRAs should become derivative of the exemption amount available to residents. As noted above, the exemption amount for NRAs is in effect 0.6 percent of the exemption amount available to residents. This clearly discriminates against foreigners and is an unwise move from an economic policy standpoint as the estate tax imposed on NRAs has a greater potential of preventing investments in the United States and also alters investor behavior more. Even the 10 percent of the residents' exemption amount that was available to NRAs after the TAMRA has been regarded as too little by several commentators.[97] The unified credit available to NRAs that determines the exemption amount should be derivative of the exemption amount available to residents.[98] A reasonable number is 30 percent, which will not be clearly discriminatory and will take into account that NRAs are taxed on only a portion of their assets. This would also ensure that the estate tax imposed on NRAs does not become discriminatory just because political pressures cause Congress to increase the exemption amount available to residents.

E. Lower Rates

The estate tax rates should be lowered for NRAs. Because the justifications for imposing estate tax on

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[93]As suggested by several commentators. *See* Doron Narotzky, ''FIRPTA — Can and How Should the Current Crisis be Used for Change?'' 36 *Mich. Tax Law.* 26 (2010).

[94]Most countries that impose estate taxes do not completely exempt NRAs from estate tax. *See* Schoenblum, Vol. 2, chapter 20.14[E] and App. I. Therefore, exempting residents of countries who do not impose estate taxes on American residents in effect exempts residents of countries who do not impose estate taxes at all. These residents are those whose behavior is most likely to be distorted because of the imposition of estate tax as they can simply insulate themselves from estate tax exposure by not investing in the United States.

[95]As suggested by Bell and Shoemaker, *Direct Investment*, *supra* note 40, at 268. Their primary argument was that estate taxation of an NRA's capital investment, without regard to appreciation of the assets, is an almost insurmountable disincentive to foreign direct investment in U.S. real estate. The author agrees with the Bell and Shoemaker argument. From an NRA's point of view, this can be viewed as a confiscation. There are additional good reasons to adopt the Bell and Shoemaker proposal presented here.

[96]Blum, *supra* note 15, at 557.

[97]*Id*. at 550-551.

[98]Offers to increase the amount of credit available for NRAs were made after the enactment of the TAMRA as well. *Id.* at 550-551. However, as history has demonstrated, a mere increase is insufficient to prevent the estate tax on NRAs from becoming discriminatory. Therefore, IRC section 2102(b)(1), which determines the amount of the unified credit available to NRAs, should be amended so that this amount is a derivative of the amount of credit to which residents are entitled to under IRC section 2010.

NRAs are weaker than the justifications are for residents, and the NRA estate tax reduces the attractiveness of individual foreign investments in the United States, it is completely justifiable to reduce the estate tax rates for NRAs.

F. Change the Situs Rules

The situs rules should be changed. The United States should create certainty regarding the location of a partnership interest. Also, it should change the situs rules so that stock of publicly traded U.S. corporations will be deemed to be situated outside the United States. The change of the situs rule regarding stock of publicly traded U.S. corporations is necessary because:

- the current situation is a classic trap for the unwary since, unlike real estate investment, stock purchase is quick and usually without attorney consultation; and
- holding publicly traded U.S. corporation stock via a foreign holding company does not create adverse U.S. income tax consequences for the investor but it does add costs that the United States does not benefit from.

VI. Conclusion

The U.S. estate tax imposed on NRAs today is an inefficient tax without serious policy justifications and it distorts behavior in ways that the estate tax imposed on residents does not. Also, this tax decreases the attractiveness of investments in the United States from the NRAs' perspective as it forces NRAs to invest in U.S.-situated assets using a foreign corporation. This insulates them from estate tax exposure and subjects them to additional costs and higher taxes that the U.S. Treasury does not necessarily benefit from. The fairness arguments that were presented to support the retention of the NRA estate tax are not persuasive as NRAs owe much lower ''debt'' to the U.S. government than residents and, unlike residents, are sometimes unable to fully benefit from the step-up in basis. Further, after the Obama tax reform — which basically repealed the estate tax for almost all residents in 2011-2012 — the current regime has become extremely discriminatory and might in some instances violate U.S. income tax treaties.

Now that the United States (in particular the real estate industry) needs foreign investments more than ever, it is the right time to rethink this tax and repeal it or drastically modify it so that it will not deter foreign investors. ◆