Tax and Estate Planning for Nonresident Real Estate Owners

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This article discusses tax implications and estate planning considerations for Colorado nonresidents who own real estate in Colorado.

Colorado is blessed with tremendous scenery, activities, and opportunities. It's no surprise, then, that many non-Colorado residents own real estate here. Nonresident ownership is buttressed by Colorado's strong international economy, which generated over $1 billion in commerce with each of Canada and Mexico alone in 2018 and attracted over 800,000 non-immigrant business and vacation travelers that same year.[1] Nationally, investors from China, Canada, Mexico, India, Brazil, and Colombia—the top six jurisdictions for foreign investment—invested $20.7 billion from April 2019 to March 2020 in residential real estate.[2] Those foreign dollars find their way to Colorado along with significant sums from non-Colorado-based American investors. Colorado has no restriction on foreign ownership of real estate, extending to investment from within and outside the United States. Many nonresident visitors to Colorado become real estate investors. For those owners, important state and federal tax and estate planning concerns can arise. This article introduces those concerns, focusing on individuals, and then offers some practical solutions for resolving them. While similar rules apply to foreign entities, those are not the focus of this article.

Who Is a Nonresident?

As a threshold matter, one first needs to determine what it means to be a nonresident for state and federal tax purposes.

In Colorado, a nonresident for state tax purposes (hereinafter, "Colorado nonresident") is any individual who does not qualify as a resident for state tax purposes.[3] A resident for state tax purposes (hereinafter, "Colorado resident") is a person who either (1) has a residence in Colorado to which they intend to return when absent (as outlined in the "domicile test"[4]); or (2) maintains a permanent residence in Colorado and spends more than six months of the year in Colorado (as outlined in the "statutory residency rule"[5]). Intent is proven via a multifactor test that includes things like the location of family, business, vehicle registration, and voter registration, among other factors.[6] The statutory residency rule does not apply to certain active-duty military personnel.[7] Colorado has no estate, gift, inheritance, or generation-skipping transfer tax, so these tests only apply for Colorado income tax purposes.[8]

For federal income tax purposes, all US citizens and residents are taxed identically. A nonresident for federal income tax purposes (hereinafter, "income tax nonresident") is any noncitizen individual who is not a resident for federal income tax purposes.[9] A noncitizen is a resident for income tax purposes (hereinafter, "income tax resident") if the individual (1) has a permanent resident visa (i.e., a green card), (2) meets the "substantial presence test," or (3) elects resident treatment during an initial partial year of residency.[10] A noncitizen individual meets the substantial presence test when the individual is present in the United States for at least 183 days during a calendar year.[11] The 183-day calculation is a weighted average of the current year and the two previous years. The individual must count all days present in the United States, with few exceptions,[12] in the current year, one-third of those days in the first preceding year, and one-sixth of those days in the second preceding year.[13] The substantial presence test calculation must be made when the individual was present in the United States for at least 31 days in the current year.[14] In simple terms, if an individual is present in the United States for 122 days for each of three consecutive years, the individual will meet the substantial presence test.

Because a regular tourist visa allows an individual to be present in the United States for up to 183 days, and immigration status is irrelevant to the substantial presence test, even a noncitizen second-home owner vacationing in Colorado can meet the substantial presence test. The harsh result of federal income tax residency is that, like any citizen, the individual must pay tax in the United States on their worldwide income, must make extensive disclosures of foreign financial accounts and investments, and is subject to penalizing rules related to interests in certain foreign corporations and foreign trusts.[15]

Escape from the harsh tax result of meeting the substantial presence test is sometimes available. An individual who meets the substantial presence test may still qualify as an income tax nonresident if they either (1) were present in the United States for less than 183 days in the current year and can establish a closer connection to a foreign country ("closer connection exception"),[16] or (2) are a resident of both the United States and a foreign country, and an income tax treaty determines their residency is in the foreign country (often called a "treaty tie-breaker").[17] Claiming satisfaction of the closer connection exception is made on IRS Form 8840, filed each year that the individual's US tax return is filed. Relief under a treaty tie-breaker is claimed by filing a timely US tax return and attaching IRS Form 8833.

A noncitizen is treated as a resident for purposes of federal estate, gift, and generation-skipping transfer taxes (hereinafter, "transfer tax resident") if the individual is domiciled in the United States.[18] The federal domicile test is both objective and subjective. An individual is domiciled in the United States if they moved to the United States (objective test) with the intent to live here permanently (subjective test).[19] The individual's immigration status is not always dispositive, due to the subjective test, but it is an important factor.[20] Federal courts apply a multifactor test that is similar to the Colorado domicile test to determine whether a noncitizen had the subjective intent to remain in the United States permanently.[21] Perhaps obviously, a nonresident for federal transfer tax purposes

(hereinafter, "transfer tax nonresident") is anyone who is a noncitizen and not a resident.

Colorado Nonresident Income Tax

Owning real estate is a benefit and a burden. From an income tax perspective, Colorado wants its bite of the apple from real estate in one of at least two circumstances. First, if the property is being rented, the Colorado nonresident owner is required to pay income tax on the lease payments because the income is from a source within the state.[22] Second, when property is sold, Colorado imposes a withholding tax (discussed below) on certain sellers, which can include a Colorado nonresident owner.[23] If the Colorado nonresident owner is in the business of renting real estate, then carrying on that business in Colorado could also impose state-level income tax.[24]

A Colorado nonresident's income tax is calculated by multiplying their Colorado income tax (calculated as if they were a resident) by a fraction, the numerator of which is the Colorado adjusted gross income (i.e., the federal adjusted gross income from Colorado sources with certain adjustments) and the denominator of which is the individual's modified federal adjusted gross income (i.e., the federal gross income less allowable deductions).[25] Thus, a Colorado nonresident pays tax in Colorado on the fractional portion of their overall modified federal adjusted gross income that consists of Colorado-source income.

When the real estate owner is a partnership or limited liability company, or an S corporation, then each entity owner must pay tax on its share of the income of the partnership, limited liability company (taxed as a partnership), or S corporation (each a "pass-through entity") derived from Colorado sources, but subject to the entity-level taxation election discussed below.[26] Thus, where a pass-through entity holds title to Colorado real estate, the Colorado nonresident owners are required to pay tax in Colorado and file timely tax returns.

An entity-level tax may apply if a pass-through entity elects that treatment. Colorado recently enacted an election permitting such entities to be taxed like a corporation for Colorado income tax purposes under the SALT Parity Act.[27] While this election is determined at the entity level on Colorado-source income on Colorado Form DR 0106,[28] it has the effect of passing through a refundable Colorado income tax credit to each equity owner (including any Colorado nonresident owner, for that owner's share of Colorado-source income). For example, if two partners own a partnership equally, the partnership elects to be taxed at the entity level under the SALT Parity Act, and the partnership thus pays $50,000 in Colorado state income tax, the law permits the partners to each receive a credit against their individual Colorado state income tax equal to $25,000. This has the effect of bypassing the $10,000 limitation on the federal income tax deduction of state and local taxes (including income taxes), which is scheduled to sunset after December 31, 2025, unless made permanent by Congress.[29] This election came into effect for tax years beginning in 2022, but after September 1, 2023, the election may be retroactively extended to tax years beginning in 2018 through an amended entity return.[30]

Colorado Withholding Tax

Colorado's second bite comes upon the transfer of Colorado real estate. In that case, the tax is imposed on a slightly different class of individuals than mere Colorado nonresidents. If the transferor has a last known address outside of Colorado, then the person providing closing and settlement services must withhold 2% of the lesser of the sales price or the sales proceeds and pay those amounts to the Colorado Department of Revenue (Colorado withholding tax).[31] Closing and settlement services include "services which benefit the parties to the sale, lease, encumbrance, mortgage, or creation of a secured interest in and to real property and the receipt and disbursement of money in connection with any sale, lease, encumbrance, mortgage, or deed of trust."[32] Additionally, the withholding is required if the transferor is a corporation with no permanent place of business in Colorado.[33] Any foreign (i.e., non-Colorado) corporation that does not qualify to do business in Colorado and that does not maintain and staff a permanent office in Colorado is treated as not having a permanent place of business in Colorado.[34]

Certain exemptions to the Colorado withholding tax exist. If the sales price is not more than $100,000, the transfer is in a foreclosure process, or the transferor gives the transferee an affidavit of their Colorado residency, then the Colorado withholding tax is not required to be paid.[35]

The Colorado withholding tax can be sneaky in three ways. First, it is not directly tied to whether a taxpayer is a Colorado nonresident or income tax nonresident. Thus, an individual's income tax status is not necessarily determinative of whether the Colorado withholding tax applies.

Second, the Colorado withholding tax applies to any "Colorado real property interest," a term that has a broad meaning that is not always apparent or intuitive.[36] A "Colorado real property interest" is an "interest in real property" located in Colorado, and the term "interest in real property" in turn borrows the definition of that term in the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) found in the Internal Revenue Code § 897.[37] The FIRPTA definition of an interest in real property is broad-reaching and includes fee ownership and co-ownership of land, leaseholds, options to acquire land, and options to acquire leaseholds of land, improvements thereon, time shares, life estates, remainders, and reversions, the right (directly or indirectly) to share in the appreciation of, or gross profits from, real property, plus the personal property on any real property.[38] The FIRPTA regulations clarify that "real property" refers to the land, improvements, personal property associated with the land, and unserved natural produces of the land (such as crops, timber, mines, wells, and other natural deposits).[39] As if this list was not broad enough, as discussed below, FIRPTA also reaches indirect interests in real property.

The FIRPTA regulations are clear that local law (i.e., Colorado real property law) does not control the definition of "real property" for FIRPTA and, thus, by extension for Colorado withholding tax purposes.[40] Not every interest relating to real property counts. An interest held solely as a creditor is not an interest in real property.[41] But if the debt is structured in a way that grants the holder a direct or indirect interest in the appreciation or profits from the real property, including an interest rate tied to an index that

reflects real property appreciation, the debt is not held solely as a creditor.[42] Payments on the production of mineral interests can also create an interest in real property subject to Colorado withholding tax.[43] While production payments are typically treated as if they are an interest held as a creditor, they become an interest in real property when they entitle the holder to share in the appreciation of the property.[44]

Indirect ownership of real property through an entity, trust, or estate is also exposed to FIRPTA and Colorado withholding tax. A partner's proportionate interest in the profits or capital of a partnership (for federal income tax purposes) and a beneficiary's proportionate interest in an estate or trust that holds an interest in real property can itself be an interest in real property.[45] Additionally, stock in a corporation (taxed as a C corporation for federal income tax purposes) can be treated as an interest in real property if the corporation is a "United States Real Property Holding Corporation."[46] Such a corporation is any domestic corporation in which the fair market value of the corporation's US real property interests equals at least 50% of the fair market value of its interests in real property located inside or outside of the United States (other than solely as a creditor), and other property held in a trade or business.[47] An example would be a single-purpose corporation formed to hold a rental property in the United States. A nonresident for Colorado withholding tax purposes who transfers stock in such a corporation thus does not escape the Colorado withholding tax because of the long reach of the FIRPTA definitions that the Colorado law incorporates.

Third, Colorado disregarded entities (such as a single-member LLC that has not elected to be taxed as a corporation) with owners who are subject to Colorado withholding tax do not shield the transfer from the Colorado withholding tax.[48]

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Federal Income Tax Issues

Not to be outdone, the United States wants similar bites of the income tax apple on Colorado real property owned by income tax nonresidents. The federal tax, however, may be imposed on the American payor, not on the income tax nonresident who is the payee. Thus, as a default rule, payments of rent, royalties, dividends, and other annual or periodic payments (so-called fixed, determinable, annual, periodic income, or "FDAP") made to income tax nonresidents are subject to a 30% withholding tax on the gross amount of those payments.[49] The payor (i.e., a lessee) is liable for withholding and paying the tax.[50] In the real property context, this means that an income tax nonresident lessor is subject to tax on the gross rental payment and is not allowed to take deductions absent an exception to the default rule.

Two significant exceptions to FDAP tax exist for real property owners. First, an income tax nonresident may elect to treat FDAP from real property (i.e., rental or royalty income) as effectively connected with the conduct of a trade or business (so-called effectively connected income, or "ECI").[51] ECI is taxed on a net basis, after application of available deductions.[52] The election is made by providing the payor an IRS Form W-8ECI and filing annual income tax returns to report the ECI.[53] If the income tax nonresident is a resident of a country that has an income tax treaty with the United States, the treaty very likely includes a similar election to treat FDAP from real property as ECI.[54]

Second, an income tax nonresident can also avoid withholding on FDAP derived from Colorado real property by structuring the investment as "portfolio interest" debt rather than ownership of an interest in real property located in Colorado.[55] Portfolio interest is interest paid on an obligation in registered form that is not effectively connected with the conduct of a US trade or business.[56] An obligation is in registered form if (1) the obligation is registered as to principal and stated interest with the issuer and transfer of the obligation may occur only upon surrender of the instrument and issuance of a new instrument; (2) the right to principal and stated interest can only be transferred through a book entry system that the issuer maintains (regardless of whether a physical instrument was issued); or (3) the obligation is registered as to principal and stated interest with the issuer and the obligation can only be transferred in either the method in (1) or (2).[57] In addition, the payor must also receive an IRS W-8BEN from the payee.[58] Certain interest that includes interest rate kickers attached to the performance

of the real property does not qualify.[59] Portfolio interest also does not include interest paid by a corporation to a shareholder holding more than 10% of the voting power in the corporation or paid by a partnership to a partner holding more than 10% of the capital or profits interests in the partnership.[60]

Because the withholding tax on FDAP does not apply to portfolio interest, an income tax nonresident who is the lender on portfolio interest debt secured by Colorado real property can eliminate US income tax on the payment of the interest. The interest payments would also escape Colorado income tax if the note was secured by Colorado real property.[61] Therefore, a strategic income tax nonresident who does not want to pay income tax in the United States on real property loans may achieve that goal by structuring the loan as a portfolio interest debt. The income tax nonresident may still be taxable on the interest in their resident jurisdiction.

FIRPTA Withholding Tax

In addition to the Colorado withholding tax, the federal government wants its share of the gains on an income tax nonresident's sale of an interest in real property under FIRPTA. With limited exceptions, FIRPTA requires the buyer of an interest in real property to withhold and pay to the IRS 15% of the amount realized unless the seller provides a certification that the seller is not an income tax nonresident (a "non-foreign certification").[62] Because the class of individuals who can sign a non-foreign certification is different from those exempted from the Colorado withholding tax, a seller could be exposed to one or both of the withholding taxes.

An income tax nonresident who does not meet the substantial presence test is generally not required to pay the 30% FDAP tax on US-source capital gains.[63] However, in the case of a US real property interest under FIRPTA, this capital gain exclusion has been eliminated for all income tax nonresidents by treating such gain as ECI.[64] FIRPTA withholding acts as a prepayment of this tax on deemed ECI, which may be refunded if it exceeds the actual tax on the gain recognized.[65] Further, the FIRPTA withholding tax may be reduced to 10% if the property being sold is acquired by the buyer to be used as a residence, and for which the gross sales price does not exceed $1 million.[66]

As discussed above, FIRPTA applies to all interests in real property located in the United States, not just Colorado. Thus, FIRPTA reaches direct and indirect ownership of an interest in real property, including interests in partnerships, trusts, estate, and US real property holding corporations.

Federal Gift and Estate Tax

Transfer tax nonresidents are subject to federal gift tax on all gifts of US-located tangible assets and to federal estate tax on US-located tangible and intangible assets.[67] Colorado real property falls squarely within the scope of both the federal gift tax and the federal estate tax. The exceptions to these rules are limited in scope in the case of the transfer tax nonresident. Federal gift tax does not apply to the first $18,000 of value of a direct gift per recipient, or $185,000 if the direct gift is to a noncitizen spouse.[68] Federal estate tax does not apply to the first $60,000 in value of the assets located in the United States, and no exception applies for bequests to a noncitizen spouse unless the bequest is made to a qualified domestic trust (which defers the estate tax hit until the trust distributes principal or the surviving spouse dies).[69]

Therefore, ownership of Colorado real property potentially exposes a transfer tax nonresident to federal gift tax and federal estate tax. The application of either can be surprising. For example, if spouses acquire a Colorado residence and each spouse holds an undivided one-half interest in the property, where one spouse provided most or all of the consideration, a gift has been made to the other spouse that could expose a transfer tax nonresident to federal gift tax. Likewise, the death of a spouse holding property as joint tenants with right of survivorship can expose the deceased spouse's share of the real property to federal estate tax if the surviving spouse is not a US citizen.

The maximum federal gift tax and federal estate tax rate of 40% is imposed on the value of the transferred assets that exceeds the exemption amounts listed above.[70] Thus, the estate of a transfer tax nonresident that includes a condo in Snowmass worth $2.06 million that does not pass at death to a US citizen spouse could be subject to a roughly $800,000 federal estate tax.

A few important exceptions to these transfer taxes exist. First, because federal gift tax applies only to tangible assets located in the United States, it does not apply to intangibles, including stock in a corporation.[71] Second, stock in a foreign corporation is not treated as property located within the United States for federal estate tax purposes, even if the corporation owns US-located property.[72] Third, the gift or ownership of portfolio interest debt is not subject to either federal gift tax or federal estate tax.[73]

Therefore, despite the threat of federal gift tax and federal estate tax for a transfer tax nonresident's ownership of Colorado real property, each tax can become inapplicable with careful planning.

Estate Planning

In the thick soup of tax issues that a nonresident's ownership of Colorado real property can create, it is often easy to forget two important estate planning matters. First, the chance of an individual becoming incapacitated during their lifetime is high. Some studies have found, for example, that one in nine individuals age 65 or older has Alzheimer's disease, and one in three seniors dies from Alzheimer's.[74] Of course, many other ailments can cause incapacity. Given these realities, it is important for estate planners to consider what would happen if the Colorado real property owner becomes incapacitated in any location.

If an individual becomes incapacitated while directly owning Colorado real property, there may be no clear way to manage the property without a conservatorship. This is because title companies are frequently reluctant to accept powers of attorney that are not specific to the real property, especially those powers of attorney that may not be executed under Colorado law or while present in Colorado. Banks are often equally reluctant to accept powers of attorney. Thus, while an agent under a power of attorney may have the ability to lease property, they may not always have the ability to acquire, refinance, or extend credit through a bank or sell the property through a transaction that includes a title company.[75] Owning the property

in joint names does not necessarily solve this issue, because both owners would be needed to engage in these types of transactions.

While a very specific power of attorney can solve the conservatorship riddle, it would not necessarily prevent probate of a nonresident's directly owned property. And while holding property as joint tenants or executing a beneficiary deed can solve the probate riddle, it does not on its own solve the conservatorship riddle.

Due to these competing issues, the usual fix is to have the nonresident own the property through a trust or an entity. For example, if a nonresident owns a second home in Winter Park through a revocable trust, upon the nonresident's incapacity the trustee could manage the property and the property would pass based on the terms of the trust at the nonresident's death. No conservatorship and no probate are needed in that case. Likewise, though slightly more complex, if the second home is held in an LLC or corporation, with a revocable trust as the ultimate entity owner, similar results occur because the trust could control the entity or the entity documents could include management provisions that control for incapacity and death.[76]

Planning Options for Nonresidents

Although planning for these many considerations can be challenging, practitioners have effective options. Taking the incapacity and death issues into account, for Colorado nonresidents who are income and transfer tax residents, owning the Colorado real property through a trust or entity is usually the best option. Although the trust or entity may be exposed to Colorado income tax and the Colorado withholding tax, individual estate planning for incapacity and death are often the primary considerations from a Colorado perspective for such individuals.

If the individual is an income and transfer tax nonresident, federal tax issues often become a major consideration. In that regard, trade-offs are required between income tax and transfer tax planning. In general, the more control the individual retains over the Colorado real property, the greater exposure they have to federal income tax and transfer taxes. Three options are explored below: direct ownership, ownership through a foreign corporation, and portfolio debt lending.

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Direct Ownership

The simplest option is to acquire title to the Colorado real property directly. This could be in the form of a revocable trust or even a US entity, such as an LLC. While incapacity and estate planning considerations are covered in this plan, the benefits of its simplicity are equally its undoing for federal income and transfer tax purposes.

The individual would be exposed to the full scope of US and Colorado income tax issues discussed above: FDAP withholding tax, FIRPTA withholding tax, capital gains on the sale of the real property, and Colorado withholding tax. Additionally, the direct ownership, or control of the revocable trust or entity interests, would expose the individual to US transfer taxes, absent a transfer tax treaty to the contrary. Direct gifts of interests in the real property could be exposed to federal gift tax, even if the real property is owned in an entity, unless the entity ownership has the effect of converting the ownership interest to intangible personal property for federal gift tax purposes.[77] Additionally, direct ownership of Colorado real property would expose a transfer tax nonresident decedent owner to federal estate tax.

Foreign Corporation Ownership

Alternatively, the revocable trust or the individual could hold their interest in Colorado real property through a foreign corporation. The "check-the-box" regulations discuss which types of foreign entities are treated as corporations for US tax purposes,[78] and thus the revocable trust or individual could select an entity that is appropriate in their home jurisdiction and treated as a corporation in the United States. In this case, the acquiring foreign corporation would shield the individual from federal estate tax and gifts of shares in the foreign corporation would be excluded from federal gift tax.

When a foreign corporation owns US real property directly, it is exposed to FIRPTA, as well as Colorado withholding tax for Colorado-located real property. This can be a heavy burden. In addition, without appropriate elections (discussed above), rental income would be FDAP to the foreign corporation. Another tax can apply to a foreign corporation's gains from US real property (branch profits tax).[79] Essentially, branch profits tax approximates a dividend tax (which would be FDAP) as though the foreign corporation had received a dividend payment. Thus, this transfer tax protective structure comes with income tax burdens.

It may be tempting to think about contributing preexisting Colorado real property to a foreign corporation structure to gain the transfer

tax benefits. It is true that holding shares in a foreign corporation rather than Colorado real property directly would shelter the Colorado real property from federal estate tax at the shareholder's death. However, it comes at an income tax cost. A transfer of an interest in the Colorado real property is a deemed sale of the property to the foreign corporation, triggering capital gains on any appreciation, as well as FIRPTA withholding tax and Colorado withholding tax.[80]

To avoid the branch profits tax issues of a foreign corporation and to potentially avoid the gain recognition on transfers to foreign corporations, some practitioners suggest using a foreign partnership. Significant uncertainties around their treatment for transfer tax purposes might dissuade the more cautious adviser. While some authority indicates the IRS may view the partnership interest as intangible personal property located where the partnership is administered and not where the partnership property is located,[81] other authority has come to the opposite conclusion.[82] Even if the federal estate tax protection of a foreign partnership were clear, the income tax result of a transfer of Colorado real property to a foreign partnership is unclear and the individual's interest in the partnership would continue to be subject to FIRPTA withholding tax and Colorado withholding tax.[83]

Sometimes, to eliminate the branch profits tax issues and to ensure federal estate tax protection, a transfer tax nonresident will form a tiered structure consisting of a foreign corporation that owns a domestic corporation subsidiary. The domestic corporation then owns the Colorado real property. Though payment of dividends from the domestic corporation to the foreign corporation are taxable in the United States as FDAP, some income tax treaties reduce the dividend tax rate to as low as 5%,[84] making the cost of expatriating funds earned from the Colorado real property to the foreign corporation relatively inexpensive.

Portfolio Debt Lending

As an alternative or complementary strategy, the transfer tax nonresident could avoid owning an interest in Colorado real property entirely. In that case, and to still have exposure to the real estate market, the individual could be a lender on a portfolio debt that is secured by Colorado real property. While the portfolio debt rules would prevent interest from being tied to the value of the underlying real property, the interest rate could still vary as long as the measuring stick for the interest is not property owned by the debtor or a related party.[85] This gives the parties significant flexibility in structuring the debt. The borrower could be an irrevocable trust, the property of which is excluded from the gross estate of the lender for federal estate tax purposes, but that is a US trust that would not be subject to FIRPTA withholding tax.

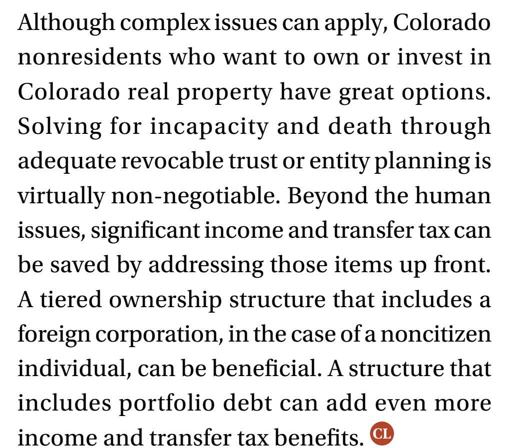
The portfolio debt option, of course, raises the same estate planning concerns as the direct ownership options. Thus, the lender ideally would be a revocable trust or an entity with adequate controls in the case of incapacity or death.

If the loan is made to a corporate or partnership owner of the Colorado real property, care must be taken to avoid the 10% owner rules discussed above. Because equity ownership in the corporation or partnership is subject to attribution rules that would cause certain family members' shares or interests to be treated as the shares or interests of the lender, when family members own the corporation or partnership, special attention to these rules is required.[86]

Assuming the loan can qualify as portfolio debt, significant income and transfer tax benefits occur. There is no federal estate tax exposure for the note, even if its security is Colorado real property. A gift of an interest in the note is not subject to federal gift tax because it is intangible personal property.[87] Interest payments are not subject to federal or Colorado income tax, and payment on the note is not subject to FIRPTA withholding tax or Colorado withholding tax.

When the transfer tax nonresident has family members who are US residents, portfolio interest debt can be a great tool. In that case, the transfer tax nonresident could fund a US irrevocable trust with intangible property and then lend additional funds to the trust on a portfolio debt note. The trust can then invest in real property in Colorado. Any appreciation from the real property investment that exceeds the face amount of the note is trapped in the irrevocable trust for the benefit of family. Properly structured, the irrevocable trust can afford its beneficiaries protection from federal estate tax at their deaths and protection from the claims of their creditors.

Conclusion



Although complex issues can apply, Colorado nonresidents who want to own or invest in Colorado real property have great options. Solving for incapacity and death through adequate revocable trust or entity planning is virtually non-negotiable. Beyond the human issues, significant income and transfer tax can be saved by addressing those items up front. A tiered ownership structure that includes a foreign corporation, in the case of a noncitizen individual, can be beneficial. A structure that includes portfolio debt can add even more income and transfer tax benefits. CL

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NOTES

1. 2020 State Economic Data for Engaging in International Real Estate, National Association of Realtors Research Group, Tables 9 and 12, https://cdn.nar.realtor/sites/default/files/documents/2020-state-by-state-international-business-reports-co-05-29-2020.pdf.

2. 2020 International Transactions in U.S. Residential Real Estate, National Association of Realtors Research Group, https://www.nar.realtor/research-and-statistics/research-reports/international-transactions-in-u-s-residential-real-estate.

3. CRS § 39-22-103(8)(c).

4. 1 CCR § 201-2-39-22-103(8)(a)(2)(a)(i).

5. CRS § 39-22-103(8).

6. 1 CCR § 201-2-39-22-103(8)(a)(2)(c).

7. 1 CCR § 201-2-39-22-103(8)(b)(1).

8. *See, e.g.*, CRS §§ 39-23.5-102 and -103 (tying the Colorado estate tax to the federal credit for state estate tax, which credit was repealed as of 2005).

9. IRC § 7701(b)(1).

10. IRC § 7701(b)(1)(A).

11. Treas. Reg. § 301.7701(b)-1(c)(1).

12. *See, e.g.*, Treas. Reg. § 301.7701(b)-3(a) (identifying certain days that an individual is not deemed present in the United States).

13. Treas. Reg. § 301.7701(b)-1(c)(1).

14. Treas. Reg. § 301.7701(b)-1(c)(3).

15. *See, e.g.*, IRC §§ 61, 667(d), 951, 1291, and 6038 (listing some of the income tax rules for income tax residents).

16. Treas. Reg. § 301.7701(b)-2(a).

17. *See* US Dep't of Treasury, United States Model Income Tax Treaty, Art. 4(3) (2016).

18. Treas. Reg. §§ 20.0-1(b)(1) and 25.2501-1(b).

19. Treas. Reg. § 20.0-1(b)(1); *Mitchell v. United States*, 88 U.S. 350, 353 (1874); *Est. of Nienhuys v. Comm'r*, 17 T.C. 1149, 1159 (1952).

20. *See Est. of Khan v. Comm'r*, 75 T.C.M. 1597 (1998). *See also* Rev. Rul. 80-209, 1980-2 C.B. 248 (holding that an individual in the country illegally could still establish domicile in the United States).

21. *See Est. of Nienhuys*, 17 T.C. at 1159.

22. CRS §§ 39-22-109(2)(a)(I) and -601(1).

23. *See* CRS § 39-22-604.5(1).

24. CRS § 39-22-109(2)(a)(II).

25. *See* CRS § 39-22-109(1).

26. CRS §§ 39-22-109(2)(a)(III), (VI); -203(1)(a); and -343(1)(a).

27. *See* Colorado HB 21-1327, enacted on June 23, 2021, as amended by Colorado SB 22-124, enacted on May 16, 2022, adding CRS §§ 39-22-343 to -346.

28. CRS § 39-22-343. *See also* https://tax.colorado.gov/2021-partnership-s-corporation-forms.

29. IRC § 164(b)(6).

30. *See* CRS § 39-22-343.

31. CRS § 39-22-604.5(1).

32. CRS § 39-22-604.5(6)(b).

33. CRS § 39-22-604.5(1).

34. *Id.*

35. CRS § 39-22-604.5(2).

36. *See* CRS § 39-22-604.5(1).

37. CRS § 39-22-604.5(6)(c).

38. IRC § 897(c)(1)(A)(i), (c)(6); Treas. Reg. § 1.897-1(d)(2)(i).

39. Treas. Reg. § 1.897-1(b).

40. Treas. Reg. § 1.897-1(b)(1).

41. Treas. Reg. § 1.897-1(d).

42. Treas. Reg. § 1.897-1(d)(3)(i)(D).

43. Treas. Reg. § 1.897-1(d)(2)(i).

44. *Id. See also* IRC § 636(a) (defining the tax treatment of production payments on mineral interests for federal income tax purposes).

45. *See* Treas. Reg. § 1.897-1(e)(1).

46. IRC § 897(c)(2).

47. Treas. Reg. § 1.897-2(b)(1).

48. *Cf.* Treas. Reg. § 1.897-1(e)(1) (requiring proportionate ownership of entity interest in real property).

49. IRC §§ 871(a) and 1441(a).

50. IRC § 1441(a).

51. IRC § 871(d).

52. *See* IRC § 864(c).

53. *See* Treas. Reg. § 1.1441-4(a)(2)(i); Instructions for IRS Form W-8ECI.

54. *See* US Dep't of Treasury, *supra* note 17, Art. 6(5).

55. *See* IRC § 871(h).

56. *See* IRC § 871(h)(2); Treas. Reg. § 1.871-14(a), (c).

57. *See* Treas. Reg. §§ 5f.103-1(c) and 1.871-14(c)(1)(i).

58. *See* Treas. Reg. § 1.871-14(c)(1)(ii)(C), -14(c)(2).

59. *See* IRC § 871(h)(4)(A).

60. *See* IRC § 871(h)(3).

61. *See, e.g.*, 1 CCR § 201-1-39-22-109(3)(a)(iv) (providing that "interest income from a loan secured by real or tangible property located in Colorado is not Colorado-source income").

62. *See* IRC § 1445(a); Treas. Reg. § 1.1445-2(b)(1), (2).

63. IRC § 871(a)(2).

64. *See* IRC § 897(a).

65. *See* Treas. Reg. § 1.1445-1(f).

66. IRC § 1445(c)(4).

67. *See* IRC §§ 2101(a), 2106(a), and 2501(a)(2).

68. *See* IRC §§ 2504(b) and 2523(i).

69. *See e.g.* IRC §§ 2102(b) (setting the federal estate tax credit at $13,000, which equates to $60,000 in property value), 2056(d) (denying a marital deduction for bequests to noncitizen spouses unless made to a QDOT), and 2056A (establishing the rules for QDOTs).

70. IRC §§ 2001(c) and 2502(a).

71. *See* IRC § 2501(a)(2); Treas. Reg. § 25.2511-3(b).

72. *See* Treas. Reg. § 20.2105-1(f).

73. *See, e.g.*, IRC § 2105(b)(3) (exempting portfolio interest debt from estate tax); PLR 8210055 (Dec. 10, 1981) (stating that debt obligations are intangible property not subject to gift tax for noncitizen nonresidents of the United States).

74. Alzheimer's Association, *2023 Alzheimer's Disease Facts and Figures*, https://www.alz.org/media/Documents/alzheimers-facts-and-figures.pdf.

75. *See* CRS § 15-14-727 for the general powers granted to an agent over real property under a Colorado durable power of attorney.

76. *See, e.g.*, Nelson et al., "Revocable Trusts for Changing Times," 38 *ABA Probate & Property* (Oct. 2021) (explaining in detail how these revocable trusts are typically structured), http://www.rimonlaw.com/wp-content/uploads/2021/09/pp-35-05-septoct21-authorpdfs-nelson-sass-plum.pdf.

77. *See* IRC § 2501(a)(2).

78. *See* Treas. Reg. § 301.7701-2(b), -3(b) (defining which foreign entities are corporations by default and which can elect that status).

79. *See* IRC § 884.

80. *See* IRC §§ 367(a), 897(a)(1), and 1445(a).

81. *See, e.g., Blodgett v. Silberman*, 277 U.S. 1, 12 (1928) (holding that a limited partnership interest was "a chose in action, and an intangible" to a Connecticut decedent, not subject to New York estate tax even though the partnership owned New York real property). *But see* Rev. Rul. 55-701, 1955-1 C.B. 465 (holding an interest in a New York partnership was intangible personal property located in the jurisdiction where the partnership carries on its business).

82. *See Sanchez v. Bowers*, 70 F.2d 715, 717–18 (2d Cir. 1934) (holding that an interest in a Cuban partnership was an interest in the underlying assets because the partnership terminated upon the decedent's death).

83. *See, e.g.*, IRC § 721(c) (granting Treasury broad authority to adopt regulations to address contributions to foreign partnerships).

84. *See, e.g.*, U.S.-Mex. Tax Convention, Art. 10 (reducing dividends withholding tax to 5% when paid to a corporate shareholder with at least 10% of the voting shares).

85. *See, e.g.*, IRC § 871(h)(4)(A)(i), (C)(v) (permitting interest tied to stock that is actively traded); PLR 200933002 (May 9, 2009) (holding that interest paid on notes that was tied to an actively traded fund could qualify as portfolio interest).

86. *See* IRC § 871(h)(3)(C); Treas. Reg. § 1.871-14(g)(2)(ii).

87. *See* Treas. Reg. § 25.2511-3(a)(1), (b).