

Usufruct tax implications for US taxpayers

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While usufructs are a valuable succession-planning tool in Latin America, they may result in undesirable tax consequences when involving US persons. Therefore, proper planning should be done for usufruct structures involving US beneficiaries.

In some Latin American countries, it is common for a parent – a non-resident alien (“NRA”) – to gift property to their US children through a usufruct. The usufructuary parent can transfer rights to a property for a period limited to the life of their US child, while retaining title to the property during their own lifetime. The use of usufruct arrangements for NRAs with US children makes the classification of the usufruct for US tax purposes very relevant.

What exactly is usufruct?

A usufruct grants, by contractual arrangement, the right of use or enjoyment of property from one person to another for a specified period. The usufructuary is the person who has the right to use the property and is generally entitled to income from the property.

Provisions of a usufruct arrangement vary. When it comes to ownership of non-US entities via usufruct, the terms need to be properly analysed to determine what US reporting requirements apply.

We plan usufruct structures with you and support you in meeting your reporting obligations.

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The Internal Revenue Service has issued private letter rulings (“PLRs”) that characterise a usufruct as a trust for US income tax purposes. In one such

ruling (PLR 9121035) the usufructuary had administrative powers over the assets subject to the usufruct (similar to a trustee).

Under the premise that a usufruct is a trust for US tax purposes, assets transferred to a beneficiary upon the death of the person creating the usufruct may result in the beneficiary receiving a fair market value tax basis in the property received, in accordance with US estate tax principles.

Observe reporting requirements for usufruct regulations

Without the appropriate understanding of a usufruct arrangement, property held in a usufruct can result in non-compliance with US reporting requirements for US taxpayers. US persons receiving or holding title to usufruct property located outside the US or from a non-US person may have several US information reporting requirements, including forms 8938 and 3520. In addition, if a US person holds a usufruct account at a foreign financial institution, the US person is required to report the account on form Fincen 114 (“FBAR”).

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