Estate Planning for Non-Citizens

Overview

The federal gift and estate tax laws that apply to United States citizens are different from those for non-citizens (aliens). Further, there are different rules for **resident aliens** and **non-resident aliens**. Whether a non-citizen is a resident for transfer tax purposes depends on his "domicile." The domicile test considers several factors, including how long the non-citizen has been in the United States, how frequently he travels abroad, and especially his intent to remain in the country. (This test is different from the "green card" and "substantial presence" tests that are used to determine residence for income tax purposes.)

Description & Operation

- **Resident aliens** are subject to United States gift and estate taxes on their entire estates wherever situated.
- **Non-resident aliens**
  - Gift tax — Non-resident aliens are subject to gift tax on gifts of property situated in the United States and generally are not taxed on gifts they make of intangible property even though it may be considered located in the United States.
    - Intangible U.S. property includes U.S. bank accounts (provided the account is not connected with a U.S. trade or business), cash in U.S. brokerage accounts, bonds issued in the United States and stock in domestic corporations. The categorization of interests in partnerships or LLCs is less clear.
    - Estate Tax — Estate tax may apply to transfers of both tangible and intangible property situated or deemed situated in the United States upon a non-resident alien's death. However, certain intangible assets—such as stock in foreign corporations and proceeds for a policy insuring the life of a non-resident alien—are not considered to have a U.S. situs. Several European countries, Japan, Australia, and South Africa have tax treaties with the United States that govern where property is considered to be located.

Tax Implications

Non-citizens may be entitled to annual and lifetime gift tax exclusions and a credit on the applicable estate tax exclusion amount. The following tables summarize the amounts in 2018 that can be transferred gift and estate tax-free. It is important to consider not only the status of the transferor, but that of the transferee.

Gift Tax Considerations	To Citizen	To Resident or Non-Resident Alien
From Citizen or Resident Alien	• Spouse: Unlimited marital deduction • Non-Spouse: Annual exclusion – $15,000 Lifetime exclusion – $5,600,000	• Spouse: Annual exclusion – $152,000 Lifetime exclusion – $5,600,000 • Non-Spouse: Annual exclusion – $15,000 Lifetime exclusion – $5,600,000
From Non-Resident Alien (U.S. situs property)	• Spouse: Unlimited marital deduction • Non-Spouse: Annual exclusion – $15,000 Lifetime exclusion – N/A	• Spouse: Annual exclusion – $152,000 Lifetime exclusion – N/A • Non-Spouse: Annual exclusion – $15,000 Lifetime exclusion – N/A
Estate Tax Considerations	**To Citizen**	**To Resident or Non-Resident Alien**
From Citizen or Resident Alien	• Spouse: Unlimited marital deduction • Non-Spouse: Applicable exclusion – $5,600,000	• Spouse: Applicable exclusion – $5,600,000[1] • Non-Spouse: Applicable exclusion – $5,600,000
From Non-Resident Alien (U.S. situs property)	• Spouse: Unlimited marital deduction • Non-Spouse: Applicable exclusion – $60,000	• Spouse: Applicable exclusion – $60,000* • Non-Spouse: Applicable exclusion – $60,000

Qualified Domestic Trusts

The use of a Qualified Domestic Trust ("QDOT") may be appropriate for a married couple when one of the spouses is a non-citizen. A QDOT allows a decedent's estate to **defer estate tax** on property passing to a non-citizen spouse until the non-citizen spouse's death. Accordingly, it ensures that the QDOT property will eventually be subject to federal estate tax.

A QDOT must meet the following **requirements**:

- The executor must make an irrevocable election by attaching a statement to the estate tax return. The election cannot be made on any return filed more than one year after the due date (including extensions).
- The trust must a created under the laws of the United States, a state, the District of Columbia, or a foreign jurisdiction.
- The trust must require at least one of the trustees to be a U.S. citizen or domestic corporation.
- The U.S. trustee must be able to withhold tax from principal distributions to the noncitizen spouse.
- Property passing to the QDOT must separately qualify for the marital deduction under Internal Revenue Code §2056. This means that it must be included in the surviving spouse's estate.

1 Assets passing to a Qualified Domestic Trust are generally eligible for the unlimited marital deduction.

- A "small QDOT" (with assets of $2 million or less as of the date of the decedent's death) may not have more than 35% in real property located outside the United States as of the last day of its tax year.
- A "large QDOT" (with more than $2 million in assets) must have a "bank" as at least one of its trustees. A U.S. branch of a foreign bank may qualify if there is at least one U.S. co-trustee at all times. If the U.S. co-trustee is an individual, he/she must furnish a bond or security equal to 65% of the trust's value at the decedent's death.

Estate tax is imposed on distributions of principal made during the surviving spouse's lifetime and on the value of all property remaining in the trust on the surviving spouse's death. The tax is also imposed if a person other than a U.S. citizen or domestic corporation becomes a trustee of the trust, or if the trust otherwise ceases to meet requirements of a QDOT. There is an exception allowing for tax-exempt "hardship" distributions, i.e., in response to an immediate and substantial need relating to the health, education, maintenance, and support of the spouse or anyone the spouse is legally obligated to support.

The amount of estate tax is the additional amount that would have been due had the property been included in the decedent spouse's estate. The estate tax on QDOT distributions is due on the 15th day of the 4th month of the calendar year following the end of the calendar year in which the taxable event occurs.

The basis of property is adjusted to the date of death value. However, basis in a taxable distribution is adjusted upward to account for estate tax paid on the growth in value of the property occurring after the first spouse's death. For example, if property worth $1 million is placed in a QDOT and later paid to the surviving spouse when it has appreciated to $1.3 million upon distribution, it will be estate taxed at the increased value of $1.3 million. The recipient will receive a basis adjustment for the estate tax paid on the $300,000 increase in value between the date of death and the later distribution for a total basis of $1,300,000.

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