ESTATE PLANNING FOR NONCITIZENS WHO RESIDE IN THE UNITED STATES

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INTRODUCTION

The world is getting smaller. With accelerating globalization and the compression of travel and communications between countries, a growing number of our clients have international connections. Given the increasing flow of people and assets into the United States from abroad, it is important for domestic advisors, whether lawyers, accountants or financial consultants, to be aware of the issues and potential problems that confront clients with international connections. This area of estate planning, however, is particularly complicated because it involves the tax, property and succession laws of multiple jurisdictions, which often conflict with one another. The purpose of this discussion is to highlight some of the more prevalent issues in estate planning involving noncitizens who reside in the United States.

DISCUSSION

I. **Federal Estate and Gift Tax Rules for Noncitizens**. Whether an individual is subject to the U.S. estate and gift tax depends on a number of factors. Specifically, the individual's citizenship, residency and the situs (location) of his or her property. Because the U.S. imposes estate and gift tax on the basis of citizenship *or* residency, it is necessary to determine both for each client. While one's citizenship can be readily ascertained, one's residency can be ambiguous.

a. **Residency Status**. Section 7701(b) of the Internal Revenue Code sets forth an objective test for determining *U.S. income tax residency* based on the individual's status as a permanent resident (i.e. a green card holder) or the amount of time an individual was present in the U.S. during a given taxable year (known as the "substantial presence test"). The legal standard for determining *transfer tax residency*, however, "differs substantially from that for determining residency for income tax purposes."[1] Instead, residency for transfer tax purposes has both objective and subjective elements, namely physical presence (objective) coinciding with the requisite intention to remain

[1] Khan v. Commissioner, T.C. Memo 1998-22.

(subjective). Accordingly, a noncitizen who holds a green card will be subject to U.S. income tax, but may not be subject to U.S. estate or gift tax because he or she has no intent to remain permanently in the U.S. A few of the factors considered in determining a noncitizen's "subjective" intent to remain is the U.S. include:

i. Duration of stay in the U.S. and the frequency of travel between the U.S. and other countries;

ii. Reason for being in the U.S.;

iii. Size, location and nature of dwellings (i.e., house vs. apartment; resort town vs. city; own vs. rent); and

iv. Location of family, business interests, social memberships and valuables.

b. **Transfer Taxation of Noncitizens who are *not* U.S. Residents**. A complete review of the transfer taxation implications on individuals who are not U.S. citizens or residents ("Nonresident Aliens") is beyond the scope of this discussion. The following is a brief overview of the general concepts:

i. Nonresident Aliens are subject to federal estate and gift tax only on transfers of *U.S. situs assets*, such as real estate and tangible property located in the U.S.[2] Intangible property, such as stock in a domestic corporation, is not U.S. situs property for gift tax purposes, *but is U.S. situs property for estate tax purposes.*[3] Thus, a Nonresident Alien can transfer an unlimited amount of stock in domestic corporations during his or her lifetime, but at death any remaining domestic corporation stock in his or her estate may be subject to estate tax.

ii. Nonresident Aliens can make annual exclusion gifts, but if they are married to a Nonresident Alien, they cannot split gifts. Gifts between spouses are discussed in Paragraph d, below.

iii. Nonresident Aliens are entitled to a modest credit against the federal estate tax (currently a $13,000 tax credit, *equivalent to a $60,000 exemption*).[4]

iv. Nonresident Aliens are subject to generation skipping transfer tax on transfers to skip persons only if the transfers are subject to

[2] See I.R.C. §§2501, 2103.
[3] I.R.C. §2104(a).
[4] I.R.C. §2102.

federal estate or gift tax. Nonresident Aliens have a generation skipping transfer exemption of $1,000,000.[5]

v. Various treaties between the U.S. and other countries may alter the aforementioned property situs rules or allow Nonresident Aliens an increased credit or exemption for U.S. estate tax. Therefore, it is important to determine the existence and impact of any applicable treaty when advising Nonresident Aliens regarding transfer taxation. Currently, the U.S. has bilateral estate and gift tax treaties with seventeen countries.[6]

c. **Transfer Taxation of Noncitizens who are U.S. Residents**. Noncitizens who are U.S. residents ("Resident Aliens") are generally subject to the same transfer tax rules as U.S. citizens, *except for the rules relating to joint property and the marital deduction* (discussed in Subparagraph d below). In general, Resident Aliens are:

i. Subject to federal gift tax on lifetime transfers of his or her *worldwide assets*;[7]

ii. Subject to federal estate tax on his or her *worldwide assets*;[8]

iii. Entitled to the same federal estate and gift tax exemption amounts as a U.S. citizen.[9]

iv. Entitled to the same federal generation skipping transfer tax exemption as a U.S. citizen;[10] and

v. Allowed to make annual exclusion gifts and split gifts with his or her spouse, as long as his or her spouse is a Resident Alien or U.S. citizen.[11]

d. **Transfer Tax Issues Involving a Noncitizen Spouse**. The marital deduction, which permits a donor or decedent spouse to transfer an unlimited amount of property to his or her spouse, is not generally available where the donee-spouse is a noncitizen. Presumably, the rationale for this rule is the U.S. government's fear that the surviving noncitizen spouse will leave the U.S. with property that has never been subject to U.S. transfer tax. As a result, where a decedent is survived by a noncitizen spouse there is limited ability to defer the estate tax until the subsequent death.

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[5] Treas. Reg. §26.2663-2(a).
[6] Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, The Netherlands, Norway, South Africa, Switzerland and the United Kingdom.
[7] I.R.C. §2001(a).
[8] I.R.C. §2031(a).
[9] I.R.C. §§2010(a), 2505(a).
[10] I.R.C. §2631(a).
[11] I.R.C. §§2503(b)(1), 2513(a)(1).

i. Gifts to a Noncitizen Spouse. The gift tax marital deduction does not apply to gifts to a noncitizen spouse.[12] Section 2523(i)(2), however, increases the annual exclusion amount for gifts to noncitizen spouses that would otherwise qualify for the marital deduction up to $139,000 in 2012 (indexed for inflation; $143,000 in 2013).

ii. Estate Tax Marital Deduction. The estate tax marital deduction generally does not apply to property passing to a decedent's noncitizen spouse, resulting in estate tax being imposed on everything over the applicable exclusion amount passing to the noncitizen spouse. There are, however, two ways for bequests to noncitizen spouses to qualify for the marital deduction: (1) the noncitizen spouse must become a U.S. citizen before the date for filing the estate tax return (including extensions), while remaining a resident of the U.S. between the date of death becoming a U.S. citizen; or (2) the property being left to the noncitizen spouse must be placed in a "qualified domestic trust" ("QDOT") before the due date of the decedent's federal estate tax return on which the decedent's executor makes a QDOT election.[13]

iii. QDOT requirements. The decedent's estate plan, or the noncitizen spouse him or herself may create the QDOT to hold the property passing to the noncitizen spouse.[14] In addition, a non-QDOT trust created for the noncitizen spouse by the decedent may be reformed under local law to qualify as a QDOT under Section 2056(d) of the Internal Revenue Code.[15] If the reformation takes place pursuant to the provisions of the trust agreement, the reformation must be complete by the time the federal estate tax return is filed.[16] If the reformation is completed through a court proceeding, the proceeding need only be commenced by the date that the federal estate tax return is filed.[17] Regardless of how the QDOT is established, it must meet the requirements of Sections 2056(d) and 2056A(a)(1), which include:

1. At least one trustee must be a U.S. citizen or a domestic corporation;

[12] I.R.C. §2523.
[13] I.R.C. §2056(d).
[14] Treas. Reg. §20.2056A-2(b)(2).
[15] Treas. Reg. §20.2056A-4(a).
[16] Treas. Reg. §20.2056A-4(a)(1).
[17] Treas. Reg. §20.2056A-4(a)(2).

2. Other than the trust's income, no distribution may be made from the trust unless the U.S. trustee has the right to withhold transfer tax on the distribution;

3. All of the trust's income must be payable to the noncitizen spouse annually;

4. An election must be made on the decedent's federal estate tax return;

5. The trust must comply with "such requirements as the Secretary may by regulations prescribe to ensure the collection of any tax imposed."[18]

6. If the trust's assets exceed $2 Million for federal estate tax purposes, determined without reduction for any indebtedness with respect to the assets, then at all times during the term of the QDOT, the trust must either:

   a. Have at least one trustee that is a U.S. bank; or

   b. The U.S. trustee must furnish a bond or letter of credit in favor of the Internal Revenue Service equal to sixty-five percent of the fair market value of the trust (determined without regard to indebtedness) as of the date of the decedent's death.

7. If the trust's assets are $2 Million or less for federal estate tax purposes, determined without reduction for any indebtedness with respect to the assets, the trust document must prohibit investment of more than thirty-five percent of the trust's annual fair market value (determined on the last day of the taxable year) in offshore real estate.[19] If this requirement is not met, the trust must satisfy one of the requirements imposed on trusts whose trust's assets exceed $2 Million (as discussed in the preceding Paragraph 6).

iv. Taxation of QDOTs. QDOT property is subject to federal estate tax at the following events, with the amount of tax being generally equal to the amount of federal estate tax that would have been paid by the decedent's estate if the remaining principal in the QDOT had been includible in his or her estate[20]:

[18] I.R.C. §2056A(a)(3).
[19] Treas. Reg. §20.2056A-2(ii).
[20] I.R.C. §2056A(b)(1).

1. Death of the surviving noncitizen spouse;

2. Termination of the qualified status of the QDOT;

3. Any distribution from the QDOT during the surviving noncitizen spouse's lifetime, except for mandatory distributions of income and distributions of trust principal on account of hardship.[21]

v. Jointly owned property. Special rules apply to interests in joint property where either or both spouses are not U.S. citizens.

1. *Gift tax*: In general, a joint tenancy or tenancy by the entirety in real property will not be considered a taxable gift to the co-tenant noncitizen spouse at the creation of the tenancy.[22] At the tenancy's termination, however, a gift is deemed to have been made to the extent that the share that the co-tenant noncitizen spouse receives exceeds his or her proportionate contribution to the tenancy.[23] With respect to joint tenancies in personal property, there is no marital deduction on the transfer and the donor is deemed to have made a gift of one-half the value of the jointly held property to the noncitizen spouse.[24]

2. *Estate tax*: The qualified joint interest rule of Section 2040(b) does not apply where either or both spouses are not U.S. citizens.[25] This means that if at least one spouse is a noncitizen, the couple's jointly owned property with right of survivorship is not treated as though each spouse contributed equally to its cost.[26] Instead, the entire value of the jointly owned property is included in the first-to-die's estate, unless the executor submits facts to demonstrate that the property was not entirely acquired by the decedent.[27]

II. **Nontax Issues for Noncitizens who are U.S. Residents**.

a. International Effectiveness of Estate Planning Documents. A person's domicile at the time of his or her death generally governs the administration of the decedent's estate.[28] In addition, North Carolina law governs the succession of property

[21] I.R.C. §2056A(b)(3).
[22] I.R.C. §2523; Treas. Reg. §25.2523(i)(2(b)(1).
[23] Treas. Reg. §25.2523(i)(2(b)(2).
[24] I.R.C. §2523(i).
[25] I.R.C. §2040(b).
[26] I.R.C. §2056(d)(1)(B).
[27] I.R.C. §2040(a).
[28] N.C. Gen. Stat. §2-3-1.

owned by a decedent that was located in North Carolina at the time of his or her death.[29] Accordingly:

i. A noncitizen or nonresident that either resides in North Carolina or owns property in North Carolina should ensure that his or her estate planning documents are valid under North Carolina law.

ii. When a person, regardless of his or her citizenship or residency status, owns property *located outside of the U.S.*, his or her North Carolina estate planning documents *may not* be recognized by the foreign jurisdiction or even control the disposition in the foreign property. As a result, legal counsel should be consulted in the foreign jurisdiction at issue to determine what documents in addition to the North Carolina estate planning documents are necessary to dispose of the foreign property consistent with the client's overall estate plan.

iii. If the client has a Will (or equivalent) in a foreign jurisdiction designed to control the succession of such property, the U.S. Will and other estate planning documents need to be coordinated with the foreign jurisdiction's documents and they should be clear that they do not supersede or revoke one another. Thus, the wording of the revocation clause that typically appears at the beginning of a Will should be carefully drafted to avoid superseding the estate plan prepared in the foreign jurisdiction with respect to foreign property.

iv. Although trusts are common in the American legal system, many foreign legal systems do not recognize trusts. Accordingly, if a trust is used as part of a client's estate plan with international connections, consideration needs to be given regarding how the foreign country will treat the trust arrangement.

b. Choosing Fiduciaries. Even where clients are not engaging in international estate planning, advisors should be aware of the administrative and federal tax implications in naming a non-U.S. citizen as a fiduciary.

i. *Executor.* Nonresidents of North Carolina are precluded from serving as personal representative of a decedent's estate unless a resident process agent is appointed.[30] In addition, if the Will does not include a provision waiving the requirement that the personal representative post a bond, a bond will be required unless the

[29] Id.
[30] N.C. Gen. Stat. §2-4-2(4). North Carolina AOC Form E-500 is used to appoint a resident process agent.

nonresident personal representative is serving as co-executor with a North Carolina resident.[31]

ii. *Trustee*. A trust may inadvertently become a "foreign trust" if the trustee is not a U.S. citizen.[32] Under the Internal Revenue Code, a trust is treated as a "foreign trust" if (i) no U.S. court is able to exercise primary jurisdiction over the administration of the trust, or (ii) if a non-U.S. citizen has the authority to control any substantial decision of the trust (the "Control Test").[33] Thus, a domestic trust can inadvertently become a foreign trust, subject to foreign trust reporting requirements (Form 3520 and Form 3520-A) and tax consequences,[34] if the trust designates a non-U.S. citizen as trustee, which would arguably cause the trust to fail the Control Test. The Treasury Regulations do, however, provide a twelve month safe harbor to cure the inadvertent migration of a domestic trust to a foreign trust where the "death, incapacity, resignation, change in residency or other change with respect to a person that has a power to make a substantial decision of the trust" would cause the trust to fail the Control Test.[35] As a result, if a client names a non-U.S. citizen as a fiduciary under a trust, they should do so only after being made aware of the issues that may arise if that person serves as trustee.

III. **Renunciation of Citizenship and Termination of Long-Term Residency**. In general, an individual who renounces his or her U.S. citizenship, or any long-term resident[36] who terminates his or her U.S. residency may be subject to expatriation taxes under Sections 877A and 2801.[37] Additionally, Section 2801 imposes a transfer tax on U.S. citizens who receive gifts and bequests received from an expatriate.

a. Persons subject to the tax. The expatriation tax applies to a "covered expatriate," which is defined as an individual:

i. Whose average net annual income tax for the five taxable years preceding expatriation exceeds $124,000 (indexed for inflation, $151,000 for 2012 expatriations);

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[31] N.C. Gen. Stat. §28A-8-1(b).
[32] I.R.C. §6048
[33] I.R.C. §§7701(a)(30)(E) and 7701(a)(31)(B); see also Treas. Reg. §301.7701-7.
[34] I.R.C. §6048.
[35] Treas. Reg. §301.7701-7(d)(2)(ii).
[36] An individual (other than a U.S. citizen) is a long-term resident if he or she is a lawful permanent U.S. resident in at least eight out of the fifteen tax years ending in the tax year of expatriation. I.R.C. §877(e)(2).
[37] Enacted by Section 301 of the Heroes Earnings Assistance and Relief Tax Act of 2008 ("Heroes Act"). As a result of the Heroes Act, the special transfer tax situs rules in §§ 2107, 2501(a)(3) and (5) do not apply to individuals expatriating after June 16, 2008.

ii. Whose net worth is $2 million or more on the date of expatriation; or

iii. Who fails to certify that he or she has complied with all U.S. federal tax obligations for the five preceding tax years preceding expatriation.[38]

b. Tax computation. Generally, Section 877A imposes a mark-to-market exit tax on the expatriate's worldwide property. Essentially, this means that income tax is assessed on the net unrealized gain in the expatriate's worldwide property as if such property had been sold for fair market value on the day before the expatriation. "Property" includes any interest in property that would be taxable as part of the covered expatriate's gross estate for federal estate tax purposes as if he or she died the day before the expatriation.[39] A lifetime exclusion amount applies to reduce the amount of expatriation tax owed.[40] For instance, an individual who expatriates in 2012 will recognize a net gain only to the extent that it exceeds $651,000.

c. Deferral election. The expatriate may elect to defer the mark-to-market tax until the expatriate actually disposes of the property or dies. However, such deferral is irrevocable, carries an interest charge, and the expatriate must provide some form of security for payment (i.e., bond or letter of credit).

d. Exceptions for certain property. The mark-to-market regime applies to all of the covered expatriate's property, *except*:

i. Deferred compensation items (i.e. simplified employee pensions[41] and simplified retirement accounts[42]);[43]

ii. Specific tax deferred accounts (i.e. individual retirement plans[44] and Section 529 plans); and

iii. Interests in a non-grantor trust of which the covered expatriate was a beneficiary on the day before expatriation.

For the aforementioned exceptions, the covered expatriate is not taxed at the time of expatriation. Instead, a thirty percent withholding tax applies to payments or distributions from the excepted property/property interest.

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[38] §§877A(g)(1)(A), 877(a)(2).
[39] Whether property is included in the gross estate is determined without regard to §§ 2010 through 2016. Furthermore, a covered expatriate is deemed to own his or her beneficial interest in each trust. See Notice 2009-85.
[40] The lifetime exclusion amount is 600,000, increased by a cost of living adjustment each year.
[41] Within the meaning of Section 408(k).
[42] Within the meaning of Section 408(p).
[43] See Notice 2009-85, Section 5.B. for a full list of eligible deferred compensation items.
[44] As defined in §7701(a)(37)

e. Gifts and bequests from an expatriate under Section 2801. Section 2801 imposes a transfer tax on the person who receives a gift or bequest from a covered expatriate. The amount of the tax is determined by multiplying the value of the covered gift or bequest by the greater of: (i) the highest estate tax rate specified in 2001(c) as in effect on the date of receipt; or (ii) the highest gift tax rate specified in 2502(a) as in effect on the date of receipt. The tax imposed is reduced by the amount of any gift or estate tax paid to a foreign country with respect to the covered gift or bequest.

IV. Common Estate Planning Scenarios Involving Noncitizens.

a. One spouse is a U.S. citizen, one spouse is a Resident Alien. Where a married couple with a potentially taxable estate resides in the U.S. and one spouse is a U.S. citizen and the other spouse is Resident Alien (i.e., domiciled in the U.S. and intends to remain in the U.S. permanently), the following estate planning techniques should be considered:

i. Both spouses should execute U.S. estate planning documents.

ii. The U.S. citizen's estate planning documents should provide for a QDOT for the benefit of the noncitizen spouse. The noncitizen spouse's estate planning documents do not need to provide for a QDOT for the benefit of the citizen spouse.

b. One spouse is a U.S. citizen, one spouse is a Nonresident Alien. Where a married couple with a potentially taxable estate resides in the U.S. and one spouse is a U.S. citizen and the other spouse is Nonresident Alien (i.e., may be domiciled in the U.S. but does *not* intend to remain in the U.S. permanently), the following estate planning techniques should be considered:

i. Both spouses should execute U.S. estate planning documents and consider the need for documents in the applicable foreign jurisdiction.

ii. The U.S. citizen's estate planning documents should provide for a QDOT for the benefit of the noncitizen spouse. The noncitizen spouse's estate planning documents do not need to provide for a QDOT for the benefit of the citizen spouse.

iii. The noncitizen spouse, who can generally transfer during life or at death unlimited *non*-U.S. situs assets, should consider making lifetime transfers of domestic corporation stock, which is generally subject to estate taxation if held in the noncitizen's estate at death, but is not subject to gift tax during life.

iv. The noncitizen spouse should avoid owning U.S. situs assets such as U.S. real estate to avoid federal estate tax being imposed on

such property at his or her death. Note: currently only a $60,000 federal transfer tax exemption applies to Nonresident Aliens, unless a treaty provides otherwise. Accordingly, if the Nonresident's U.S. situs assets will potentially exceed the exemption amount, the client should consider how the projected taxes will be paid if the estate is illiquid.

c. Both spouses are Resident Aliens. Where a married couple with a potentially taxable estate resides in the U.S. and both spouses are Resident Aliens (i.e., domiciled in the U.S. and intend to remain in the U.S. permanently), the following estate planning techniques should be considered:

i. Both spouses should execute U.S. estate planning documents and consider the need for documents in the applicable foreign jurisdiction.

ii. Both spouses' estate planning documents should provide for a QDOT for the benefit of the other spouse.

iii. Consider making use of the increased annual exclusion amount for gifts to noncitizen spouses (indexed for inflation; $143,000 in 2013) to equalize their respective estates.

d. Client works in the U.S., but is a Nonresident Alien. Where a non-U.S. citizen works in the U.S. but does not intend to remain in the U.S. permanently, the following estate planning techniques should be considered:

i. Determine the existence and impact of any treaty between the U.S. and the Nonresident's home country.

ii. Avoid ownership of U.S. situs assets.

iii. Execute U.S. estate planning documents with respect to U.S. situs assets, and consult with counsel in the foreign jurisdiction for the preparation of coordinated foreign estate planning documents.

e. Gifts to U.S. citizens from overseas. Where a U.S. citizen is the potential recipient of a gift from a Nonresident Alien, the following should be considered:

i. Given that the gift tax does not generally apply to a Nonresident Alien's gifts of property located outside of the U.S., only gifts of real estate or tangible personal property located in the U.S. is subject to gift tax.

ii. The U.S. recipient must report any gift (or bequest) received in any tax year if the aggregate gifts from the Nonresident Alien exceed

$100,000 on IRS Form 3520.[45] In the case of a gift from a foreign corporation or partnership, if the aggregate gifts from such foreign entity exceed $10,000 (indexed for inflation, $15,102 in 2013) the U.S. recipient must report the gift.

V. **Conclusion**. Estate planning involving noncitizens who reside in the U.S. is fraught with rules and exceptions. There are a number of federal transfer tax and succession planning pitfalls to be aware of when advising clients with international connections, but proper advice regarding the myriad issues can greatly enhance the tax efficiency and administration of the a Noncitizen's estate.

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[45] I.R.C. §6039F; Notice 97-34. Note: Transfers made pursuant to Section 2503(e)(2) (payments made directly to an educational institution or medical provider for medical expenses) are exempted from the reporting requirement.

Estate Planning for Noncitizens who Reside in the United States

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Residency Status

- Claude, a corporate executive, is a citizen of Sweden, but works in North Carolina, where he has lived with his wife Bertha for four years. Claude continues to own a home in Sweden.
  - Which of Claude's assets will be subject to U.S. transfer tax?
    - It depends on Claude's residency status.
    - U.S. citizen – worldwide assets
    - Resident alien – worldwide assets
    - Nonresident alien – U.S. situs assets only

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Residency Status (cont.)

- Not the same as income tax residency.
- Two part analysis:
  - Objective: physical presence in the U.S.
  - Subjective: no present intention to leave the U.S. – a facts & circumstances analysis.
    - Length of stay
    - Reason for being in the U.S.
    - Frequency of travel out of the U.S.
    - Size, nature and location of dwellings
    - Location of family, business, valuables

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Residency Status (cont.)

- For Claude, it is appropriate to ask:
  - Does he intend to stay in the U.S. or retire to Sweden or elsewhere?
  - How often does he travel back to Sweden?
  - Home or apartment?
  - Is Bertha a U.S. citizen?
  - Is family in the U.S.?
  - Location of financial interests in Sweden?

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Rules Applicable to Nonresident Aliens

- Individuals who are not U.S. citizens or residents are Nonresident Aliens.
- Subject to U.S. estate and gift taxation only on U.S. situs assets.
  - U.S. Situs assets include real estate and tangible property located in the U.S.
  - Intangible property is generally not U.S. situs.
    - Caution: Stock in U.S. corporations
- Limited to a $60,000 exemption for estate tax purposes (unless modified by treaty).

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Rules Applicable to Nonresident Aliens (cont.)

- GST exemption of $1,000,000.
- May make annual exclusion gifts.
- Cannot gift split.

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Rules Applicable to Nonresident Aliens (cont.)

- Assume that Claude, the Swedish citizen from Slide 2, dies in 2012, but is a Nonresident Alien for U.S. transfer tax purposes. He owned Swedish real estate valued at $1,000,000 and U.S. situs property consisting of a $500,000 home/personal property and $500,000 in U.S. stock.
  - Claude's U.S. estate will be valued at $1,000,000, with only a $60,000 exemption, resulting in over $300,000 in federal estate tax.
  - None of Claude's property located in Sweden will be subject to federal estate tax.

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Rules Applicable to Resident Aliens

- Resident Aliens are generally subject to the same transfer tax rules as U.S. citizens.
- *Worldwide* assets are subject to federal estate and gift tax.
- Entitled to the same federal estate, gift and GST tax exemptions as U.S. citizens.
- May make annual exclusion gifts.
- May split gifts, as long as spouse is a Resident Alien or U.S. citizen.

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Rules Applicable to Resident Aliens (cont.)

- Assume that Claude, the Swedish citizen from Slide 2, dies in 2012, but is a Resident Alien for U.S. transfer tax purposes. He owned Swedish real estate valued at $1,000,000 and U.S. situs property consisting of a $500,000 home/personal property and $500,000 in U.S. stock.
  - Claude's U.S. estate will be valued at $2,000,000, but will be entitled to a $5,120,000 exemption, resulting in no federal estate tax.

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Transfers to a Noncitizen Spouse

- The unlimited marital deduction is generally not available if the transferee-spouse is a noncitizen. Exceptions:
  - Gifts: The annual exclusion amount is increased for gifts to noncitizen spouses.
    - 2012 = 139,000; 2013 = $143,000
  - Estate:
    - Noncitizen becomes a U.S. citizen; or
    - Property passes to a qualified domestic trust ("QDOT").

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Transfers to a Noncitizen Spouse (cont.)

- QDOT requirements:
  - At least one U.S. trustee.
  - Trust income payable to the surviving spouse annually.
  - QDOT election on decedent's estate tax return.
  - The U.S. trustee must have the right to withhold transfer tax on trust distributions.
  - If assets passing to QDOT exceed $2 million:
    - At least one trustee must be a U.S. bank, or
    - The U.S. trustee must furnish a bond of letter of credit.

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Transfers to a Noncitizen Spouse (cont.)

- QDOT:
  - May be established by:
    - The decedent,
    - The surviving noncitizen spouse, or
    - If the property is left in a non-QDOT trust, by reforming the trust.
  - The QDOT generally must be established by the time the decedent's estate tax return is filed.
    - Exception: If the trust is reformed by a court proceeding, the proceeding need only be commenced by the date the estate tax return is filed.

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Transfers to a Noncitizen Spouse

- Assume that Claude, a U.S. citizen, dies in 2012 leaving $5.12 million dollars to a family trust for the benefit of Bertha and his children, and the remaining $5 million *outright* to his wife, Bertha, a non-U.S. citizen.
  - Will Claude's estate be subject to estate tax?
    - Yes, unless Bertha timely becomes a U.S. citizen or establishes a QDOT.

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Nontax Issues for Resident Aliens

- Claude, a U.S. citizen and resident, dies owning real estate in Sweden. Will Claude's North Carolina Will control the disposition of his Swedish real estate?
  - Seek the advice of counsel in the foreign jurisdiction whenever a client owns property outside of the U.S.
  - Coordinate U.S. estate planning documents with foreign estate planning documents to avoid conflicts of law issues, or inadvertently revoking a document.

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Nontax Issues for Resident Aliens

- Naming a non-U.S. citizen as a fiduciary?
  - Foreign executor? Resident process agent/bond
  - Foreign trustee?
  - If a non-U.S. citizen has the authority to control any "substantial decision" of a trust, the trust is considered a "foreign trust," subject to foreign trust income tax and reporting requirements.
    - 12 month safe harbor to correct an inadvertent conversion.

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Common Estate Planning Scenarios

- U.S. citizen married to a Resident Alien.
  - The citizen-spouse's estate plan should provide for a QDOT in favor of the Resident Alien spouse.
  - Consider the practicality of increased annual exclusion gifts ($139,000 in 2012) to the Resident Alien spouse.

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Common Estate Planning Scenarios (cont.)

- U.S. citizen married to Nonresident Alien.
  - The citizen-spouse's estate plan should provide for a QDOT in favor of the Nonresident Alien spouse.
  - The Nonresident Alien should not acquire U.S. situs assets.
  - The Nonresident Alien should consider gifting non-U.S. situs assets, which are not subject to federal gift tax.
  - The Nonresident Alien spouse should consider making lifetime transfers of domestic corporate stock.

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Common Estate Planning Scenarios (cont.)

- Both spouses are Resident Aliens.
  - Both spouses should provide for QDOTs for the survivor of them.
  - Consider the practicality of increased annual exclusion gifts ($139,000 in 2012) to equalize their respective estates.

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Common Estate Planning Scenarios (cont.)

- Non-U.S. citizen works in the U.S. but is a Nonresident Alien.
  - Determine whether a treaty applies.
  - Avoid ownership of U.S. situs assets.
  - Execute U.S. estate planning documents with respect to any U.S. situs property.

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Common Estate Planning Scenarios (cont.)

- Gifts to U.S. citizens from Nonresident Aliens.
  - Avoid gifts of U.S. situs assets.
  - Report gifts received from a Nonresident Alien if the aggregate gifts from such donor exceed $100,000 in the given taxable year.
    - IRS Form 3520.