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ESTATE PLANNING FOR U.S. NON-CITIZENS & RESIDENTS

This Advisory discusses the estate tax benefits for those individuals who are not citizens of the United States and/or spouses of United States citizens who are not citizens of the United States. This Advisory is neither exhaustive nor tailored to your specific situation. You should discuss your situation with us or with your own attorney. Our representation is only undertaken through a written engagement letter and not by the distribution of this Advisory.

We live in a global society. Given the ease of communication, transportation, and travel, it is now not uncommon for people to live in multiple places during their lifetimes, including multiple countries. In fact, according to the 2010 census data, over 27% of California's residents are foreign born. This gives rise to special considerations for estate and tax planning given that international clients are not provided the same types of benefits and exemptions as U.S. citizens. International clients must plan carefully to maximize the benefits and exemptions that are available under U.S. law. Here are some factors to keep in mind.

U.S. Residents versus Non-Resident Aliens

For estate and gift tax purposes, the U.S. taxes the entire worldwide assets of its residents and citizens (U.S. persons). A person may be considered a U.S. resident for estate and gift tax purposes if he or she is living in the U.S. at the time of his or her death or at the time of making a gift. This may be the case even if that person is not officially a U.S. resident or citizen. This means, that if somebody enters the U.S., even for a brief period of time, but with no specific plans to leave, he or she may be deemed to be domiciled in the U.S. and subject to U.S. estate and gift taxes. A person may also be subject to income tax by the U.S., if that person is a permanent resident (holds a green card) or meets the IRS's criteria under the "substantial presence test." In fact, it may even be possible for someone to be considered a nonresident for estate tax purposes but a U.S. resident for income tax purposes or vice versa. A person that has assets situated in the United States, but is not a citizen and does not qualify as a resident will be subject to the rules placed on non-U.S. residents and non-U.S. citizens (non-U.S. persons).

What Does This Mean For Your Estate Tax Exemption?

U.S. persons are entitled to the maximum estate tax exemption, which currently is $5,430,000 for the year 2015 increasing to $5,450,000 in 2016 (this figure increases each year based on the rate of inflation). Any amounts over the exemption will be subject to estate tax at a rate up to 40%. In contrast, non-U.S. persons only receive a $13,000 unified transfer tax credit that may be used to offset both lifetime gift tax liabilities and the estate tax liability and must file

a U.S. estate tax return if their property located in the U.S. is valued at $60,000 or more. If the non-U.S. person is a citizen of a country that has an estate tax treaty with United States, then it is possible that the estate tax exemption may be higher. Currently, the U.S. has estate and gift tax treaties with the following countries: Australia, Austria, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, South Africa, Sweden, Switzerland and the United Kingdom. The allowed exemptions in each case vary and depend upon the terms of the treaty. It is also important to note that U.S. persons and non-U.S. persons may make gifts of $14,000 per done each year free of gift tax.

For any amount that a non-U.S. person's assets exceed the applicable exemption, that person will be subject to the same estate tax rates as a U.S. person, or up to 40%. It is important to note that there are some assets that are not considered to be situated in the United States for estate tax purposes. These assets include life insurance proceeds, U.S. bank accounts that are not used for a trade or business, CDs, stock in foreign corporations, retirement plans, and U.S. government and corporate bonds. What qualifies as the U.S. situs may also be defined differently for estate tax and gift tax purposes.

The Marital Deduction

One major area where U.S. residents are not treated the same as U.S. citizens regarding estate and gift taxation is the Marital Deduction. Under the Marital Deduction, a spouse may leave to the other spouse an unlimited bequest. This means that a spouse can leave to their other spouse extensive asset holdings valued at over the standard estate tax exemption amount without being penalized and subject to estate taxes. This is an especially useful tool given the concept of "portability", which allows a surviving spouse to use the deceased spouse's unused exemption amount and "port" it over to maximize the total exemption amount and ensure that no amount of either spouse's exemption is wasted. While a U.S. resident is treated as a U.S. person and may elect portability, the amount that they port over from the deceased spouse's leftover exemption may be less if the marital deduction is not available. In order to avoid this, with proper planning and written documentation, we employ a tool called the Qualified Domestic Trust (QDOT), which is discussed in more detail below. A non-U.S. person is generally not allowed to use portability, unless specifically provided for in a treaty.

If you are a non-U.S. person with assets situated in the United States or a U.S. resident that does not qualify for the marital deduction, careful estate planning must be done to limit your estate and gift tax exposure as much as possible.

Tools to Limit Estate Tax Exposure

Lifetime Gifts

While living, a U.S. spouse may gift up to $147,000 (for 2015 and indexed for inflation) each year to a non-U.S. spouse free of federal gift tax and without whittling down the U.S. spouse's lifetime exemption. Maximizing this annual gift is one way to shift assets from a U.S. spouse's estate to a non-U.S. spouse. Any gifts to a non-U.S. spouse that are larger than this amount, however, will be considered taxable gifts.

The QDOT

As previously mentioned, the QDOT is a tool that allows property to pass to a non-US spouse (a spouse who is not a U.S. citizen) and take advantage of the marital deduction. In order to be valid, a QDOT must generally comply with the following requirements:

1. The trust must be "ordinary"

2. The trust must have at least one US (individual or corporate) trustee

3. Distributions are not allowed unless the U.S. trustee has the right to withhold tax imposed on the distribution

4. The trust is subject to and maintained under the laws of a U.S. state or the District of Columbia

5. The estate representative must make an election to apply the QDOT upon the passing of the first spouse

6. The trust must qualify for the marital deduction under the provisions of IRC Section 2056

Any distributions that are made from the QDOT to the non-U.S. spouse, except for income and hardship purposes, will be subject to U.S. estate tax. Once the non-U.S. spouse passes, then the remaining assets in the trust will be subject to the U.S. estate tax at that time. If properly setup, the surviving non-U.S. spouse may also elect portability and apply any remaining unused exemption of the deceased spouse against any potential estate tax liability. It should be noted, however, that the unused exemption may be re-determined and whittled away as distributions are made from the QDOT. There may also be certain limitations on a non-U.S.

spouse's ability to preserve the unused exemption if the non-U.S. spouse later remarries. The QDOT is a complex tool that is subject to specific regulations and must be evaluated on a case-by-case basis to determine whether it is appropriate.

Taking Title as Community Property versus Joint Tenants

If a U.S. spouse and a non-U.S. spouse hold title to property as joint tenants with right of survivorship, the "contribution rule" will be applied to determine the value of the asset that will be included in the gross estate of the U.S. spouse. Under the contribution rule, the entire value of the jointly held property may be included in the U.S. spouse's gross estate except for any portion that can be shown to have been contributed by the non-U.S. spouse or on behalf of the non-U.S. spouse as a gift by a third party bequest, devise or inheritance. It may also be that the jointly-held property to be considered a taxable gift between spouses upon the creation and termination of the joint tenancy depending on certain factors which include:

- the amount contributed to the purchase by each spouse
- the interest each spouse retained upon selling or disposing of the property
- the citizenship of each spouse
- whether or not the amount of the gift is more than the amount that can be transferred to a non-U.S. spouse tax free each year

If the spouses live in a community property state and take title to assets as community property, then both spouses are deemed to have supplied half of the consideration for the purchase of the asset. In such instances, the community property rule supersedes the contribution rule and the above analysis does not apply. Thus, community property is generally the preferred method for taking title in these situations if available.

Become a Citizen

Finally, the non-U.S. spouse may decide to apply for U.S. citizenship. In order to qualify for the unlimited marital deduction, however, certain steps must be taken to ensure that the citizenship application is approved in a timely manner and before the estate tax return is due for the deceased spouse. Careful evaluation of the option is necessary, including benefits of the country where the spouse is a citizen.

Here is a condensed summary of the exemptions and credits that may apply:

	U.S. Person	Non-U.S. Person
Estate Tax Exemption Amount	$5,430,000 per person[1]	$60,000 per person ($13,000 unified transfer tax credit)
Top Estate and Gift Tax Rate	40%	40%
Lifetime Gift Tax Exemption Amount	$5,430,000 per person[2]	$0
Annual Gift Tax Exclusion Amount	$14,000 per donee[3]	$14,000 per donee[4]
Gift Splitting Between Spouses	Yes, if both spouses are U.S. persons	No
Marital Deduction for Lifetime Gifts	Unlimited if recipient spouse a U.S. citizen	$147,000 per year if recipient spouse non-U.S. citizen
Marital Deduction for Testamentary Bequests	Unlimited if recipient spouse a U.S. citizen	$0, if recipient spouse is a non-U.S. citizen, unless assets are held in a QDOT
Gift Tax Exclusion for Direct Medical & Education Expense	Yes	Yes
Portability [5]	Yes	No

In summary, this discussion is intended to provide more information on options available to a spouse who is not a citizen or for non-U.S. persons in general but the list is not exhaustive. Each situation requires careful examination and planning based on the specific circumstances and unique details. If you have any questions about the above, please contact a legal or tax professional or the attorneys at Buynak, Fauver, Archbald & Spray, LLP, for more information.

As always, you should be sure that additional legislation has not been enacted or that court decisions have been rendered that would change the above advisements. This Advisory is neither exhaustive nor is it tailored to your specific situation and should not be considered legal advice. We look forward to being of service to you.

[1] Indexed for inflation.
[2] Indexed for inflation
[3] Indexed for inflation.
[4] Indexed for inflation.
[5] Portability provides a surviving spouse with the opportunity to use the last deceased spouse's unused estate tax exemption amount.

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This Advisory is one of a series of business, estate planning and tax advisories prepared by the attorneys at Buynak, Fauver, Archbald & Spray, LLP. Should you have further questions regarding the information provided in this Advisory, please contact the author listed above.

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