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Estate and Gift Tax Planning for the Noncitizen Spouse

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Abstract: *Developing an estate plan for a married couple when one spouse is not a U.S. citizen requires the consideration of both tax and nontax issues. The issues particular to noncitizen planning require a thorough analysis of the couple's assets and objectives even for planners generally familiar with the estate tax. This article will examine the rules surrounding the use of the marital deduction if the spouse is not a U.S. citizen. Additionally, it will discuss several estate and gift planning options that may address the clients' needs and provide planning flexibility.*

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Prior to 1988, each U.S. citizen or resident was permitted to transfer assets during lifetime or upon death to a spouse without estate or gift tax consequences, regardless of the spouse's citizenship.[1] However, in reaction to the possibility that a noncitizen surviving spouse could return to his or her country of origin and avoid federal taxation of assets held outside of the United States, Congress enacted new rules denying the federal marital deduction when assets pass to noncitizen spouses unless certain requirements are satisfied.[2] Generally, the rules require the use of a qualified domestic trust (QDOT) or that the spouse become a U.S. citizen and thus be subject to taxation on worldwide property.[3]

Developing an estate plan for a married couple when one spouse is not a U.S. citizen requires the consideration of both tax and nontax issues. The issues particular to noncitizen planning require a thorough analysis of the couple's assets and objectives even for planners generally familiar with the estate tax. This article will examine the rules surrounding the use of the marital deduction if the spouse is not a U.S. citizen. Additionally, it will discuss several estate and gift planning options that may address the clients' needs and provide planning flexibility.[4] Please note that the article does not address the nonresident, noncitizen situation.

Federal Estate and Gift Taxation

The Internal Revenue Code (IRC) imposes a federal estate tax on the taxable estate of every decedent who is a citizen or resident of the United States.[5] While most of the rules apply to citizens and noncitizen residents alike, a number of rules are unique to planning for noncitizens.

Under the federal estate tax system, the gross estate of each citizen or resident includes his or her worldwide property.[6] The value of property, which passes from the decedent to a surviving spouse who is a U.S. citizen, is deducted, among other items, from the gross estate.[7] The tentative estate tax owed is determined by multiplying the taxable estate by the appropriate rate using the rate tables. For 2007–2009, the highest marginal estate tax rate is 45%.[8] Against the tax, a decedent's estate receives a credit.[9] For 2007 and 2008, this credit equals $780,080, equivalent to excluding the estate tax on a $2 million gross estate. This $2 million figure is sometimes referred to as the estate tax applicable exclusion amount.

To prevent estate tax revenue loss through lifetime transfers, the gift tax system imposes a tax on gratuitous transfers made during life.[10] As with the estate tax, the value of items passing to a surviving U.S. citizen spouse and qualifying charities may be deducted without limit from the gross gift amount. Further, each donor may exclude from gift tax treatment up to $12,000 (in 2007, as indexed for inflation) in gifts annually to each donee. The gift tax system uses the same rates and tables as the estate tax to calculate tax owed each year. Against the tentative gift tax, each donor receives a credit. For 2007 and years thereafter, this credit equals $345,800, the equivalent to the tax on the first $1 million of taxable gifts.

Under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) the estate and gift tax rates and exclusions will vary in coming years. In 2009, the estate tax exclusion will be $3.5 million. In 2010 the estate tax, but not the gift tax, will be repealed for one year. The existence of a "sunset" provision in the tax legislation means that, absent Congressional action, the repeal of the federal estate tax only will be effective for decedents dying in 2010. If the sunset provision remains in place, the federal estate tax will be reinstated based upon the tax law in effect in 2001. For decedents dying in 2011 or later, the reunified estate and gift exemption equivalent would then be $1 million (with a 55% maximum rate for gifts and bequests).

While citizens and resident aliens similarly are subject to the estate tax, two important distinctions relate to citizenship. First, direct gifts and direct bequests to a noncitizen spouse do not qualify for the unlimited marital deduction.[11] As part of this provision, gifts in trust that would otherwise qualify for a marital deduction (e.g., QTIP trusts) will not qualify when the spouse is not a citizen unless the trust meets certain other requirements (see following QDOT discussion). Second, the annual gift tax exclusion for gifts made to a noncitizen spouse is $125,000 (for 2007, as indexed for inflation) instead of the usual $12,000 per donee.[12] The unified credit is also available to offset the gift tax on the transfer of assets to a noncitizen spouse (e.g., in lieu of the marital gift tax deduction).

Notwithstanding the general rule that assets passing to a noncitizen spouse are not eligible for the unlimited marital deduction, in three circumstances the deduction will be allowed. First, the marital deduction is allowed if the property passing to the surviving spouse passes to a qualified domestic trust (QDOT).[13] Second, the marital deduction is allowed if the surviving spouse (1) becomes a U.S. citizen before the decedent's estate tax return is filed and (2) has maintained U.S. residency at all times after the decedent's death and until becoming a U.S. citizen.[14] Finally, the marital deduction is allowed for property passing directly to the surviving spouse if the surviving spouse irrevocably transfers such assets to a QDOT prior to the filing of the decedent's estate tax return.[15]

What Is a QDOT?

The majority of estate plans for married couples with adjusted gross estates greater than the applicable exclusion amount are designed to take advantage of the marital deduction and therefore defer estate taxes until the death of the surviving spouse. A QDOT is a statutorily defined trust allowing married couples with at least one noncitizen spouse to take advantage of the marital deduction opportunities available to married citizens. The QDOT, however, works differently from the typical marital trust.

While the QDOT postpones the estate tax until a subsequent taxable event occurs, the tax always remains that of the first decedent spouse. This effectively means that a surviving spouse's applicable exclusion amount cannot be used to shelter QDOT assets from estate tax. It also means that the QDOT tax, which is attributable to the taxable event, equals the estate tax that would have been imposed if the amount involved in the taxable event had been included in the decedent's estate and

had not been deducted. Furthermore, the applicable tax rate is the rate that was in effect on the decedent's death.

The QDOT design ensures that the property held by the QDOT will be subject to federal estate taxation upon distribution to a noncitizen spouse or at the death of the noncitizen spouse (i.e., he or she will not flee the United States with the assets and avoid taxation). A QDOT may be created by the deceased spouse's executor postdeath or by the noncitizen surviving spouse to hold property he or she received outright from the decedent.[16]

Two sets of rules apply to QDOTs with respect to the marital deduction. As a marital deduction trust, a QDOT must first meet the IRC provisions generally applicable to deductions made for gifts and bequests to a spouse. This may be accomplished with any of a number of trusts: (1) a qualified terminable interest property trust (QTIP), (2) a trust in which the assets will be paid to the noncitizen spouse's estate, or (3) a general power of appointment trust.[17]

In addition to the general marital deduction qualifications, a QDOT must meet four additional requirements specific to QDOTs.[18] First, at least one trustee of the trust must be an individual citizen of the United States or a domestic corporation.[19] Second, the trust must require that the trustee have the right to withhold any federal estate tax due on any trust distribution of principal.[20] Third, the trust must satisfy the requirements prescribed by regulations to ensure the collection of any tax imposed by IRC Sec. 2056A(b).[21] Finally, the executor must make an irrevocable election on the deceased spouse's federal estate tax return to qualify the property for the marital deduction.[22]

Additionally, the Code imposes certain security requirements on QDOTs to ensure the payment of estate taxes.[23] The Code divides QDOTs into two categories with different rules applying to each.

If the value of the QDOT exceeds $2 million, it is considered a large QDOT and either (a) must name a U.S. bank or trust company to act as trustee or (b) furnish a bond or letter of credit in the amount of 65% of the value of the QDOT.[24] If the value of the QDOT does not exceed $2 million, it is considered a small QDOT and does not have to satisfy these security arrangements if the value of any real estate located outside of the United States does not exceed 35% of the value of the trust. The $2 million threshold applies as of the date of death or the alternate valuation date, if applicable. It excludes debt and under certain circumstances the personal residence of the surviving spouse.[25]

Triggering Estate Taxation

An estate tax will be imposed on a QDOT in the following three circumstances: (1) upon a distribution of principal to the noncitizen spouse during his or her lifetime, (2) in the event that the QDOT fails to continue to meet any of the QDOT requirements, including security arrangements, and (3) upon the death of the surviving spouse.[26] The amount of estate tax imposed on the principal distribution or against the entire QDOT equals the amount of federal estate tax that would have been imposed if the property had been included in the decedent's estate.[27] In other words, the property is taxed as if it had never qualified for a marital deduction.

However, there are several exceptions to the imposition of an estate tax. First, distributions of income from a QDOT to a noncitizen spouse are not subject to estate tax. The trust instrument and applicable state law determine if a distribution is classified as income.[28]

Second, an estate tax will not be imposed on distributions of principal from a QDOT in the event of hardship.[29] Hardship is defined as an immediate and substantial financial need relating to the spouse's health, maintenance, education or support, or the health, maintenance, education or support of any person that the spouse is legally obligated to support.[30] A hardship does not exist if funds are reasonably available from other sources such as publicly traded stocks and securities.[31]

Finally, the estate tax exposure will cease to exist if the surviving spouse becomes a U.S. citizen at any time, provided either that the spouse maintained U.S. residency at all times following the decedent's death or that no taxable distributions were made from the QDOT before the spouse became a U.S. citizen.[32] The Code permits this exception because U.S. citizenship permits the federal government to tax worldwide property, absent any tax treaty between the United States and the other jurisdiction.

Even if the surviving spouse becomes a U.S. citizen, federal income, estate and gift taxes may still be imposed

if the surviving spouse later loses his or her U.S. citizenship (e.g., becomes an expatriate).[33] Section 2107 provides that the estate tax will be imposed on the estate of any decedent nonresident whose death occurs while subject to expatriate income tax under Sec. 877. In turn, Sec. 877 will apply to any nonresident noncitizen who expatriated within 10 years and who has average five-year net income above $131,000 (in 2006, as indexed) or net worth above $2 million (not indexed).[34]

General Estate Planning Considerations

Most married couples establish estate plans that will delay paying an estate tax until the death of the surviving spouse. As seen, however, in order for couples with a noncitizen surviving spouse to take advantage of the marital deduction, they must either use a QDOT, or the surviving spouse must become a U.S. citizen before the filing of the citizen spouse's estate tax return. Generally, because of the certainty that the deduction will be available, the QDOT plan is thought to be the better short-term solution. In some circumstances, though, a QDOT may not be appropriate.

For example, a QDOT may not be the appropriate planning vehicle if the estate is not substantial. That is, if the decedent's gross estate is less than his or her estate tax exemption equivalent, then no marital deduction will be necessary to avoid estate tax. Further, a QDOT may not be appropriate if the surviving spouse does not intend to remain a U.S. resident after the death of the spouse. In this case, the value of direct ownership of the assets may outweigh the estate tax costs of such a transfer.

To evaluate the propriety of the QDOT in a particular estate plan, it will be necessary to first determine the value of the taxable estate of the first spouse to die. The estate of every U.S. citizen or resident includes all property that he or she owns at the time of death either outright or with another individual.

Generally, property owned jointly (e.g., joint tenants with right of survivorship or tenants by the entirety) by spouses is assumed to be owned one-half by each spouse. If the surviving spouse is not a U.S. citizen, however, the entire value of the jointly titled property is included in the estate of the deceased spouse unless the executor can prove that the noncitizen spouse furnished consideration.[35] In contrast, community property laws operate normally even where a noncitizen spouse is involved—each spouse owns one-half of the couple's community property so one-half of community property assets avoids estate taxation upon the death of the first spouse.

Once the couple's net worth has been identified, the next step is to determine whether a QDOT should be used (whether created by the decedent spouse or later by the executor or surviving spouse). The ability to use the marital deduction and thus defer estate tax payments until the death of the noncitizen spouse may be advantageous for larger estates comprised primarily of illiquid assets. Similarly, a QDOT may be appropriate if the estate assets will not grow substantially after the first spouse's death.[36]

A QDOT should also be considered if the noncitizen spouse plans to become a U.S. citizen in the future. If a plan calls for a QDOT, consideration should be given to providing estate tax liquidity at the surviving noncitizen spouse's death. Alternatively, depending upon the size of the estate and the couple's objectives, choosing to pay the applicable estate taxes at the decedent's death may be a viable estate planning option.

This latter choice—to pay some estate tax upon the death of the first spouse—may be economically advantageous. This is particularly true if the estate assets are anticipated to achieve significant growth in the estate of the surviving spouse. In these situations, it may be better to overfund the credit shelter trust and pay estate taxes at the first death, thereby reducing the estate tax exposure upon the surviving spouse's death. However, while paying taxes at the first death may be financially advantageous in some situations, this approach is generally not followed. This may be because, in addition to the possibility of estate tax repeal, it is emotionally difficult to have the surviving spouse part with assets voluntarily (i.e., pay estate taxes) at a time when he or she may be most vulnerable.

Beneficiary Planning for Life Insurance, Annuities, and Retirement Plans

Considerable planning flexibility exists when choosing the designated beneficiary of a life insurance policy, annuity contract or retirement plan. The beneficiary of these assets could be a QDOT created by the spouse to take advantage of the marital deduction and defer estate

taxes. Alternatively, the noncitizen spouse could be named as the beneficiary of these assets.

If the noncitizen spouse is named as the beneficiary of these assets, he or she has several options regarding taxation: (1) disclaim the assets and allow them to pass to the contingent beneficiary, (2) maintain the assets in his or her individual name and pay any applicable estate taxes, (3) roll the assets over into a QDOT created by the surviving spouse, or (4) in the case of an annuity, pay the required estate taxes on the corpus (i.e., principal) distribution of each nonassignable annuity payment received (e.g., 403(b) payment).

Life Insurance

Life insurance, if structured properly, can be an excellent vehicle to provide for survivor income needs. In most circumstances, the insured spouse names his or her spouse as the beneficiary of an insurance policy without giving the choice too much thought. However, designating a noncitizen spouse beneficiary involves additional considerations.

In these situations, where the insured owns his or her own policy, the insured spouse must determine if he or she wants to take advantage of the marital deduction by naming a QDOT as the beneficiary or to name the noncitizen spouse as the beneficiary (and to allow for postmortem planning).

If a QDOT is named as the beneficiary of an insurance policy on the life of the citizen spouse, the proceeds will qualify for the marital deduction, thus deferring estate taxation. The trust would provide income to the surviving spouse during his or her lifetime and could provide for distributions of trust principal for his or her health, education, maintenance, and support or for any reason if an independent trustee is used. Income generated by the death proceeds and distributed from the trust to the surviving spouse would not be subject to estate taxation.

However, if principal, except for hardship purposes, is distributed to the surviving spouse during his or her lifetime or if any remains in the trust upon his or her death, such amount will be subject to estate taxation. Therefore, naming a QDOT as the beneficiary of a life insurance policy merely defers the estate taxation of the proceeds.

Alternatively, the surviving spouse could be named as the primary beneficiary of an insurance policy on the citizen spouse's life. This option provides considerable postmortem estate planning flexibility. For example, if the estate has sufficient liquid assets to satisfy estate taxes, the surviving spouse may choose to receive the death proceeds outright or disclaim the assets so that they pass to the contingent beneficiary. If, however, the estate does not have sufficient liquid assets, the surviving spouse could transfer the proceeds to a QDOT created by the surviving spouse and qualify for the marital deduction.

Two other planning options should be considered where proceeds will benefit a noncitizen spouse. Where a noncitizen spouse is named the owner and beneficiary of an insurance policy on the life of the citizen spouse, the death benefit generally will not be subject to estate tax in the insured's estate.[37] The proceeds do not have to pass to a QDOT because they do not need to qualify for the marital deduction. Similarly, where an irrevocable trust for the primary benefit of the noncitizen spouse is the owner and beneficiary of an insurance policy on the life of the citizen spouse, the death proceeds do not have to qualify for the marital deduction because the death benefit generally will be excluded from the insured's estate. These two alternatives will often be preferable to qualifying for the marital deduction by creating or funding a QDOT or obtaining U.S. citizenship.

Annuities and Pensions

Nonassignable assets such as annuities and qualified pensions will be treated as passing to the surviving spouse in the form of a QDOT if the surviving spouse agrees to be bound by the provisions of Treasury Regulation Secs. 20.2056A-4(c)(2) and (3).[38] This regulation provides that the surviving spouse must elect to meet the requirements of the tax payment option or the rollover option. The tax payment option requires the surviving spouse to pay the estate tax associated with the principal portion of any annuity payment received.

In contrast, the rollover option requires the surviving spouse to roll over the principal portion of any annuity payment received to a QDOT created by the decedent, executor, or surviving spouse. Each of these options requires the surviving spouse to sign an agreement with the IRS. Failure to comply with the agreement could

result in an estate tax being imposed on the entire remaining present value of the annuity or other nonassignable asset.[39] The amount of principal included in each annuity payment is calculated by a four-step formula provided by the regulations.[40]

IRAs and 401(k)s

Under the final regulations, choosing to name a QDOT as the beneficiary of an IRA, 401(k), or other defined-contribution plan gives the participant spouse the ability to take minimum required distributions over the joint life expectancy of the participant and the spouse.[41] Thus, distributions to the citizen/resident spouse during his or her lifetime may be the same regardless of whether the beneficiary is a QDOT trust or the noncitizen spouse. However, there are several other income and estate tax consequences upon the participant's death to consider.

First, the QDOT, if structured as a qualified terminable interest property (QTIP) trust, would not qualify for the marital deduction unless all of the plan or IRA income is distributed by the trust annually. A distribution of all plan income annually would result in a substantial loss of potential income tax deferral.[42] Second, principal that is distributed from the retirement plan to the QDOT may be subject to income tax at the trust's income tax rate.[43] Therefore, trust income, to the extent it exceeds $10,450 (in 2007), will be taxable at the 35% marginal rate.

If the surviving spouse were in a lower marginal income tax bracket, it would be disadvantageous for income tax purposes to name the QDOT as the beneficiary of a retirement plan. Finally, upon the surviving spouse's death, the heirs would not be able to continue the income tax deferral over their lifetime (e.g., stretch IRA). All of these factors affect the income tax deferral of an IRA, 401(k), or other defined-contribution plan. If the surviving noncitizen spouse is named as the beneficiary of a qualified plan or IRA, the surviving spouse has two options to have the assets qualify for the marital deduction: (1) roll the assets into an individual retirement trust that qualifies as a QDOT (e.g., QDOT IRA trust),[44] or (2) assign the plan to a QDOT created by the surviving spouse. Both of these options require careful consideration due to the lack of IRS guidance in this area.

Rolling the assets to a QDOT IRA trust provides several estate and income tax benefits. An IRA can be in the form of a trust or a custodial account.[45] A QDOT IRA trust is basically an IRA held in the form of a trust with QDOT provisions. The IRS will not issue a ruling regarding this type of IRA; therefore, it is recommended that the trustee use the Model Trust Account Form 5305 and include QDOT provisions.

There are several benefits to creating a QDOT IRA trust. First, because the trust is created by the surviving spouse, there is no requirement that all plan or IRA income be distributed to the trust annually. Therefore, the surviving spouse may limit distributions from the plan to minimum required distributions and maintain the income tax deferral provided by the plan. Second, the use of a QDOT IRA trust permits the surviving spouse to take distributions based upon the Uniform Table, thereby potentially maximizing income tax deferral over more than one generation.

However, estate liquidity issues must be addressed in order to "stretch" the QDOT IRA trust over the next generation. The only potential drawback to creating a QDOT IRA trust is locating a U.S. bank or trust company that is willing to serve as trustee of this type of trust.

Alternatively, the surviving spouse could assign the plan assets to a QDOT created by the surviving spouse. The QDOT created by the surviving spouse should be a grantor trust so that the surviving spouse is considered the owner of all of the trust's assets for income tax purposes.

This approach also permits the surviving spouse to name a new designated beneficiary and take advantage of the Uniform Table, thereby maximizing income tax deferral. However, there exists a lack of clarity as to the identity of the designated beneficiary under this approach. If the surviving spouse were considered to be the designated beneficiary, then distributions to the surviving spouse would be based upon his or her life expectancy only. If, however, another individual (e.g., child) is considered to be the designated beneficiary, then distributions could be based upon the joint life expectancy of the surviving spouse and the beneficiary.

The identification of the designated beneficiary is important as it determines whether the plan assets must be distributed upon the surviving spouse's death over

the remaining life expectancy of the spouse or can be continued over the remaining life expectancy of the beneficiary. The benefit of this approach over the QDOT IRA trust is that when minimum required distributions include principal (e.g., later in the spouse's lifetime), the principal distributions to the QDOT can be held by the QDOT and not distributed to the surviving spouse, thus avoiding estate taxation during the surviving spouse's lifetime. In contrast, principal distributions from a QDOT IRA trust will be made directly to the surviving spouse and will therefore be subject to estate taxes.

Estate Tax Liquidity

Although the use of a QDOT created by the spouse, executor, or surviving spouse takes advantage of the marital deduction, it merely postpones the estate taxation of the trust assets. Estate taxes may be imposed during the surviving spouse's lifetime if trust principal is distributed to the surviving spouse. Additionally, any remaining proceeds held in the trust upon the surviving spouse's death will be subject to estate taxation.

Irrevocable life insurance trusts have traditionally been an integral part of many estate plans. In the case of a noncitizen spouse, these trusts can offer significant estate and gift planning opportunities. Depending upon the estate plan, an irrevocable trust could be funded to provide liquidity upon the death of the first spouse (i.e., citizen spouse), upon the death of the second spouse (using a QDOT), or under both circumstances if postmortem planning is anticipated.

Providing estate tax liquidity at the death of the citizen spouse would enable the estate to overfund the credit shelter trust and therefore avoid estate taxation upon the death of the noncitizen spouse. Alternatively, where a QDOT will be used, an irrevocable trust could be funded to provide liquidity upon the surviving spouse's death through the use of survivorship life insurance. A combination approach may allow the most planning flexibility. An irrevocable trust or trusts funded with insurance on the life of the citizen spouse and survivorship insurance could provide supplemental benefits to the surviving spouse without the restrictions required by a QDOT and address estate liquidity issues upon the death of the surviving spouse (i.e., noncitizen spouse). Irrevocable trusts may help provide liquidity in these circumstances as the following example illustrates.

> Assume D (a U.S. citizen) dies in 2007 while married to S and with a gross estate of $10,000,000. D's will provides for $2 million in assets to go to a credit shelter trust and assets of $8 million to be paid to a QDOT. D's estate will not result in a tax payable because (1) the transfer to the QDOT qualifies for an estate tax marital deduction, and (2) D's estate tax credit of $780,800 (equivalent to a $2 million exemption) equals the tentative estate tax on the remaining $2 million. During S's life, S receives a distribution each year of income from the QDOT. These distributions are not subject to estate tax. In 2012, S requests a distribution of $1 million of principal from the QDOT. The estate tax on the distribution equals $450,000. This is the amount of tax that would have been payable had the $1 million been taxable in D's estate. The trustee withholds the $450,000 to pay the estate tax and distributes $550,000 to S. In 2015, S dies. The QDOT comprises $7 million (all principal). A tax of $3,150,000 is imposed on the trust. This is the amount of tax that would have been payable had the $7 million been taxable in D's estate. The trustee pays the estate tax and distributes the remaining $3,850,000 to the trust's contingent beneficiaries, the children of D and S.[46]

In this example, the ability of the QDOT trustee to make the necessary estate tax payments of $450,000 and $3,850,000 will depend, in part, on the liquidity of trust assets. If the property is not easily made liquid, payment of the tax—and therefore the making of the distributions—may be difficult. However, where an irrevocable life insurance trust (ILIT) is able to buy illiquid property from the QDOT, the QDOT will have a ready source of cash from which to make the estate tax payments.

Conclusion

Using the marital deduction is an integral component of most estate plans. However, this benefit is not available if the surviving spouse is not a U.S. citizen unless the estate plan includes a QDOT or the surviving spouse becomes a U.S. citizen. An understanding of the

QDOT requirements and the ability to apply these rules to a client's particular situation is essential when transferring wealth to a noncitizen spouse. ■

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(1) For purposes of this material, the term "citizen" and "citizenship" refer to U.S. citizen and U.S. citizenship, respectively.
(2) Technical and Miscellaneous Revenue Act of 1988, H.R. No. 795, 100th Cong., 2nd Sess. 592 (1988).
(3) Treas. Reg. Section 20.2056A–1(c). For cases involving noncitizen nonresidents from a country with which the United States has an estate and gift tax treaty that is inconsistent with the QDOT rules, the estate (or the donor) may avail itself either of the statutory rules of §2056A (QDOT) or the marital deduction allowed under the treaty.
(4) Although it also applies to both citizen and noncitizen residents, the generation skipping transfer tax is beyond the scope of this material.
(5) IRC § 2001(a).
(6) The question of residence at death is beyond the scope of this material. Generally, however, residency is determined under a system different than that used for federal income tax. Where the income tax system uses a quantitative formula based on days of physical presence in the United States, the estate tax determination is based on domicile and intent. A surviving spouse is a resident only if the spouse is a resident under Chapter 11 of the IRC. See Treas. Reg. §20.0-1(b)(1).
(7) IRC § 2056(a) and (d).
(8) This rate applies, in 2007-2009, for taxable gifts and estates that exceed $1,500,000.
(9) IRC § 2010.
(10) IRC §2501.
(11) These provisions attempt to prevent assets from leaving U.S. jurisdiction at the death of the citizen spouse. Without special restrictions, a noncitizen spouse could leave the country with a bequest or gift—such assets could be taken beyond the reach of the U.S. taxing authority.
(12) IRC § 2523(i).
(13) IRC § 2056A.
(14) IRC § 2056(d)(4).
(15) IRC § 2056(d)(2)(B).
(16) Treas. Reg. § 2056A-2(b)(2).
(17) Treas. Reg. §20.2056A-2(b)(1). A QDOT may also be formed if the noncitizen spouse is the only noncharitable beneficiary of a charitable remainder trust (§2056(b)(8)). See power of appointment trust at §2056(b)(5), QTIP at §2056(b)(7), and estate trust at Treas. Reg. §20.2056(c)-2(b)(1)(i)-(iii).
(18) IRC § 2056A(a).
(19) IRC § 2056A(a)(1)(A).
(20) IRC § 2056A(a)(1)(B).
(21) IRC § 2056A(a)(2).
(22) IRC § 2056A(a)(3).
(23) Treas. Reg. § 20.2056A-2(d)(1).
(24) The Treas. Regs. provide a sample bond at §20.2056A(d)(1)(i)(B) and a sample letter of credit at (d)(1)(i)(C). The value of property for purposes of calculating the $2 million threshold is not reduced for any indebtedness associated with it, as for example, real estate with a mortgage.
(25) Treas. Reg. § 20.2056A-2(d)(1).
(26) IRC § 2056A(b)(1). A payment of the estate tax by the QDOT will be considered a distribution for these purposes. As a result, the estate tax payment itself is subject to estate tax.
(27) IRC § 2056A(b)(2)(A). The formula requires the trustee to calculate the decedent's estate tax with and without the QDOT property (or distribution), subtracting the latter from the former. The applicable rates are those in effect on the date of the first decedent's death (see Treas. Reg. §20.2056A-6(a)). The difference represents the amount of tax owed by the QDOT trustee. The tax withheld is also considered a tax-triggering distribution.
(28) IRC §§ 2056A(c)(2) and 643(b).
(29) IRC §§ 2056A(b)(3)(B).
(30) Treas. Reg. § 20.2056A-5(c)(1).

(31) For purposes of this exception, sources that are not considered reasonably available include closely held business interests, real estate, and tangible personal property.
(32) IRC § 2056A(b)(12).
(33) IRC § 2107. This section references income tax § 877, which provides for a 10-year look-back period for expatriate noncitizens.
(34) The American Jobs Creation Act (AJCA) of 2004 amended § 877, which provides for an alternative federal income tax regime for certain expatriated individuals. It eliminated the subjective tax-avoidance criteria in favor of objective criteria (in the form of the average five-year net income and net worth tests). The AJCA provides that individuals will continue to be treated as U.S. citizens or long-term residents for U.S. tax purposes even after the 10-year period until they have notified the Secretary of the Department of State or of Homeland Security of expatriation or termination of residency. The implementation date of this provision is retroactive and applies to expatriations occurring after June 3, 2004. For more information on expatriation, see IRS Form 8854, Initial and Annual Expatriation Information Statement. See also www.irs.gov/businesses/small/international/article/0, id=97245,00.htm.
(35) IRC § 2056(d)(1)(B).
(36) As, for example, where the decedent spouse's income contributes significantly to the couple's projected estate tax problem.
(37) The proceeds will be includible if the deceased insured had retained or given away within three years of death any incidents of ownership in the policy. See § 2042 and § 2035.
(38) The gift of a property interest when the annuity is created does not result in a gift tax because a gift tax marital deduction is available. While normally a gift tax marital deduction will not be available for transfers to a noncitizen spouse, § 2523(i) permits such a deduction in the case of spousal joint-and-survivor annuities. The section provides, in part:

> This subsection [prohibiting a gift tax marital deduction] shall not apply to any transfer resulting from the acquisition of rights under a joint and survivor annuity described in (f)(6) [i.e., under any annuity in which the donor spouse and the noncitizen donee spouse are the only persons who have the right to receive any payments under the annuity while either is alive].

(39) Treas. Reg. § 20.2056A-4(c)(1).
(40) Treas. Reg. § 20.2056A-4(c)(4).
(41) Treas. Reg. § 1.401(a)(9)-1.
(42) "Income" for these purposes is not simply the amount distributed from the account (e.g., a required minimum distribution). In Rev. Rul. 2006-26, 2006-22 I.R.B. 939, the IRS provides a safe-harbor definition for "income" that will meet the marital deduction standards. The QDOT must provide a formula for income that will provide the surviving spouse with either (1) the IRA (or plan account's) internal investment income, or (2) a unitrust percentage between 3 and 5 based on the account value.
(43) The trust may, however, receive a distribution deduction for distributions of trust principal, in which case the beneficiary (i.e., the noncitizen spouse) would bear the income tax burden of distributed benefits.
(44) Natalie B. Choate, *Life and Death Planning for Retirement Benefits,* 5th ed. (2003): 193.
(45) IRC §§ 408(a) and (h).
(46) The estate tax calculations assume a flat 45% federal estate tax rate.