• The United States imposes three distinct transfer taxes on the gratuitous transfer of property: the estate tax, the gift tax and the generation-skipping transfer tax.
  – The estate tax applies to transfers at death;
  – The gift tax applies to lifetime transfers; and
  – The generation-skipping transfer tax applies to transfers of property that effectively “skip” a generation, from the transferor to a person or persons at least two generations below that of the transferor.
U.S. Estate and Gift Taxation of Nonresident Aliens

• The U.S. transfer tax regime requires special planning for nonresident aliens who invest in the United States.
• The U.S. estate and gift tax rules for individuals look first to whether an individual is a U.S. citizen.
• If the individual is not a U.S. citizen, then the next inquiry is whether the individual is a resident of the United States, with residence in the transfer tax context being synonymous with being a U.S. domiciliary.
While U.S. citizens and residents are subject to worldwide estate and gift taxation on their gratuitous transfers, nonresidents (meaning here persons who are neither U.S. citizens nor U.S. domiciliaries) are only subject to the U.S. transfer tax system on property that is situated, or deemed situated in the United States.

In addition, nonresident aliens are generally not subject to U.S. gift tax on the transfer of intangible property (such as U.S. securities) regardless of where the property is situated or deemed situated.

Further, nonresidents are only subject to the Federal generation-skipping transfer tax with respect to transfers that are subject to the Federal estate or gift tax.
U.S. Estate and Gift Taxation of Nonresident Aliens – Residence

- **Residence for Federal Estate and Gift Tax Purposes**
  - While the determination of U.S. citizenship is generally very straightforward, the concept of residence differs for Federal income tax and Federal estate and gift tax purposes.
  - Federal income taxation focuses on citizenship or residency, with residency being predicated upon either having a “green card” (the permanent resident test) or based on meeting a mechanical test for determining substantial presence in the United States.
U.S. Estate and Gift Taxation of Nonresident Aliens – Residence

– In contrast, residence for Federal estate and gift tax purposes is predicated upon domicile. Accordingly, determining the domicile of an individual who is not a U.S. citizen is critical to the essential planning of his or her estate if U.S. property is involved.

– For Federal estate and gift tax purposes, “[a] person acquires domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom.”
U.S. Estate and Gift Taxation of Nonresident Aliens – Residence

• Although the intent of an individual is subjective, it is established by objective criteria such as his statements and conduct and by external facts and circumstances.

• Because they are prone to being self-serving, an individual’s statements concerning his or her domicile are generally accorded only a relatively small amount of weight.

• Therefore, courts generally will consider additional factors such as the location of an individual’s: (i) residential real property; (ii) social and religious affiliations; (iii) business activities; (iv) bank accounts; (v) personal property; (vi) jurisdiction for voting purposes; (vii) driver’s license; and (viii) registration of personal property, such as automobiles, boats and airplanes, as well as other factors that demonstrate that a particular jurisdiction has the most significant relationship to the individual.
Unlike the mechanical tests that are used to determine residence for income tax purposes, there is no clear, objective standard to ascertain whether an individual is domiciled in the United States.

Because there are different standards to determine the application of the Federal income tax laws and the Federal estate and gift tax laws, it is possible for an individual to be a resident of the United States for Federal income tax purposes but not a domiciliary of the United States for Federal estate and gift tax purposes, and vice versa.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

• **Federal Estate Taxation of Nonresident Aliens**
  – For Federal estate tax purposes, the value of the U.S. gross estate of a nonresident alien consists only of property (including property that is beneficially owned) that is situated, or deemed situated, in the United States at the time of his or her death.
  – Importantly, property situated outside the United States need not be disclosed to the Internal Revenue Service unless certain deductions or credits are claimed.
Tangible Personal Property

- The tangible personal property of a nonresident alien that is actually located in the United States has a U.S. situs and is subject to the Federal estate tax (as well as to the Fed. gift tax).
  - For this purpose, cash (meaning bills) is considered to be tangible personal property. Therefore, any cash in the United States, including cash in a safe deposit box in the nonresident’s name, is includible in the nonresident’s gross estate.
  - An important exception to the general rule that tangible personal property located in the United States is includible in a nonresident’s gross estate applies in the case of works of art on loan for exhibition in a non-profit art gallery or museum.
    - Such works of art are not deemed situated in the United States for Federal estate tax purposes.
Real Property

- Real property is deemed situated where it is located. Because the Internal Revenue Code and the Treasury Regulations thereunder do not define real property, one must look to the law of the jurisdiction where the property is located to determine whether it is characterized as real property.
  - Generally, real property includes improvements, fixtures, crops, timber and mineral interests.
  - Security interests in real property, such as mortgages, are usually considered debts and not real property for Federal estate tax purposes, and the rules (discussed below) for debt obligations apply to them.
Importantly, where a nonresident mortgages his U.S. real property on a non-recourse basis and, thereby, has no personal liability for the indebtedness, only the equity value of the real property is includible in his U.S. gross estate.

On the other hand, if the mortgage is a recourse mortgage (i.e., it is the personal obligation of the nonresident and is enforceable against him or his estate), the total fair market value of the U.S. real property is includible in the nonresident’s estate.

- In the latter case, only a portion of a mortgage is deductible, and then only if the personal representative of the nonresident discloses the value of the nonresident’s worldwide assets on the Federal estate tax return.
- Frequently, such full disclosure will not be desirable, and, accordingly, where possible, it is preferable if the mortgage on the nonresident’s U.S. real property is non-recourse.
– Certain types of mortgages which are peculiar to certain jurisdictions may be considered real property.
– Generally, leases are not considered real property.
– A condominium will generally be considered real property.
– In contrast, a cooperative apartment will generally be considered intangible personal property because it consists of an interest in the shares of a U.S. corporation, plus a proprietary lease.
Because U.S. real property is deemed situated in the United States, nonresident investors frequently use non-U.S. corporations to acquire title to real property located in the United States.

If a nonresident investor already owns real property in the United States, it may be possible for him to transform it into non-U.S. intangible personal property by transferring it to a foreign (non-U.S.) corporation in consideration for the shares of the corporation.

In this manner, the nonresident investor may be able to avoid having the property deemed situated in the United States for Federal estate tax purposes.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

- Although such a transformation may be possible from a Federal estate tax standpoint, it may trigger certain adverse income tax consequences under the Foreign Investment in Real Property Tax Act of 1980 (“FIRPTA”), and such consequences require careful analysis.
- A nonresident’s acquisition, directly or indirectly, of certain interests in U.S. property or business enterprises through a corporation or other entity may be subject to separate nontax reporting requirements with the U.S. Commerce Department and the U.S. Department of Agriculture, depending upon the circumstances.
• **Intangible Personal Property**
  – The estate taxation of a nonresident alien’s intangible personal property can be complex and depends on the type of property involved.
  – Generally, intangible personal property, the written evidence of which is not treated as property itself (such as cash bills), is deemed situated within the United States if it is issued by, or enforceable against, a U.S. person.
  • However, there are several exceptions to this general rule.
• **Stock in a U.S. Corporation and a Foreign Corporation**
  – Shares of stock issued by a U.S. corporation and owned (or deemed beneficially owned by a nonresident alien at his death) are deemed situated in the United States.
  – Conversely, shares of stock issued by a foreign corporation and owned (or deemed beneficially owned) by a nonresident alien at his death are not deemed situated in the United States.
  – The location of the share certificate evidencing ownership of stock is irrelevant to the taxability of such shares for Federal estate tax purposes.
  – Furthermore, the use of agency arrangements or nominees will not alter the tax consequences.
In order to be certain that a foreign corporation will eliminate exposure to Federal estate taxation, it is essential that the corporation have a business activity and be a *bona fide* corporation (as opposed to a nominee of the owner) that does the following:

- observes all the usual corporate formalities, including having officers and directors, holding regular corporate meetings, adopting formal corporate resolutions, and authorizing and ratifying important actions that are undertaken by the corporation;
- maintains a corporate bank account;
- is the legal and beneficial owner of the property; and
- performs functions so as to avoid characterization as a passive, sham corporation, set up merely as a blind to deter creditors.
In addition, it is essential that the corporation be recognized as a corporation under the tax laws of the United States.

- For example, some foreign entities organized for business purposes, such as *stiftungs* (foundations), are not necessarily considered corporations for Federal estate tax purposes.
– United States Treasury Regulations under section 7701 of the Internal Revenue Code permit the owners of certain “business entities” that are not automatically classified as corporations to elect to be treated as an association taxable as a corporation or a partnership (if it has two or more members), or to be disregarded (if it has a single member) for Federal tax purposes.

• A “business entity” is defined as an organization or other contractual arrangement that qualifies as an “entity” for Federal tax purposes, but is not treated as a trust (or subject to other special treatment).

• Trusts are not eligible to elect to be treated as corporations or partnerships (or to be disregarded) for Federal tax purposes.
If a foreign corporation is used to hold property situated or deemed situated in the United States, it is preferable for the foreign corporation to acquire the property directly, if possible.

On the other hand, if the property is transferred by a nonresident alien to a wholly owned foreign corporation in consideration for the corporation’s issuance of shares of stock of that corporation, the ability to shield the underlying property from Federal estate tax is less certain and the Internal Revenue Service will likely scrutinize whether the transfer to the foreign corporation constituted a bona fide sale for full and adequate consideration in money or money’s worth.
In addition, the Internal Revenue Service has privately ruled that American Depositary Receipts (“ADRs”) should not be includible in the gross estate of a nonresident alien.

- Despite being registered and issued generally by U.S. banks, ADRs represent shares of stock of foreign corporations and should be treated as such for Federal estate tax purposes.
• **Debt Obligations**
  – The situs rule for debt obligations is similar to the situs rule for stock in a corporation.
  – Thus, debt obligations of a U.S. person or of a U.S. governmental entity which are owned (or deemed owned) by a nonresident alien decedent are deemed property situated in the United States “whether the written evidence of the debt obligation is treated as being the property itself or whether the decedent was engaged in a business in the United States at the time of his death.”
  – Thus, debt obligations of a U.S. person or of a U.S. governmental entity are subject to Federal estate tax unless an exception applies.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

• The following exceptions apply to the general rule regarding the U.S. situs of debt obligations of a U.S. person or a U.S. government agency:

  **Bank Deposits**
  • U.S. bank deposits generating interest income that is exempt from Federal income tax to a nonresident alien are not subject to Federal estate tax.
  • Interest earned on a nonresident’s deposits with banks and savings and loan associations (or similar institutions) is exempt from Federal income tax, provided it is not effectively connected with a U.S. trade or business.
• Although the rule that U.S. bank deposits are not subject to Federal estate tax is generally clear with regard to U.S. bank deposits held by a nonresident, the Internal Revenue Service takes the position that if funds are held in special deposits by a U.S. bank in a custodial capacity or in deposits held at U.S. brokerage firms or other financial institutions which are not considered banks, they are not exempt from the Federal estate tax.
  – Clearly, any form of special deposit should be avoided if the circumstances do not warrant its use.
  – In addition, cash stored in a bank’s safety deposit box is not within the bank deposits exception.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

- **Portfolio Interest Debt Instruments**
  - Debt obligations, the interest on which qualifies as “portfolio interest,” are excludable from the gross estate of a nonresident decedent.
  - To qualify as a debt instrument which generates portfolio interest and consequently will be treated as non-U.S. situs property, an obligation must have been issued after July 18, 1984, and the obligation generally must be in registered form, as opposed to bearer form (although there are exceptions to the “registered form” requirement).
• **Other Exclusions for Debt Instruments**
  - *Certain short-term debt instruments.*
    • These are interest bearing obligations and obligations issued at a discount with a maturity date of 183 days or less from the date of original issuance, which are exempt from withholding tax for Federal income tax purposes, and are not effectively connected with the conduct of a U.S. trade or business.
  - *Foreign Branch Bank Deposits.* Deposits with a foreign branch of a domestic corporation or partnership engaged in the commercial banking business are treated as foreign situs property.
  - *U.S. Branch Bank Deposits.* Similarly, deposits with a U.S. branch of a foreign bank conducting business in the United States should also be treated as U.S. situs property.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

• **Life Insurance**
  – Insurance proceeds payable by a U.S. insurance company on the life of a nonresident insured owner of the policy are deemed property situated outside the United States.
  
• In contrast, if a nonresident alien owns a life insurance policy issued by a U.S. insurance company on the life of another person, the value of that policy is includible in the nonresident owner’s estate.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

• **Partnership Interests**
  – To lessen the impact of income taxation, partnerships and entities treated as partnerships for Federal tax purposes are sometimes used by nonresidents as investment vehicles for property situated in the United States.
  • Caution is necessary, however, because to the extent that a nonresident makes an investment in a U.S. partnership through a foreign corporation, branch profits tax exposure may arise.
  • Branch profits tax exposure may be avoided, however, by making the investment through a U.S. corporation which in turn is owned by a foreign corporation.
The law regarding the situs of a partnership interest for Federal estate tax purposes varies depending upon whether, under the applicable local law, a partnership qualifies as a separate and distinct legal entity and whether the partnership survives the death of one of its partners.

- If the partnership is not recognized as a legal entity or terminates upon the death of the partner, the situs of the decedent’s partnership interest is the location of the underlying partnership assets.
- In contrast, if the partnership is both recognized as a separate legal entity and survives the death of its partners, the situs may be determined either by reference to the domicile of the deceased partner or by reference to where the business of the partnership is conducted.
- Despite judicial authority for the former position (i.e., determining situs by reference to the domicile of the deceased partner), the Service primarily focuses on where the business of the partnership is conducted.
Limited liability companies are increasingly used as business structures.
- If a limited liability company has at least two members, it may be treated for U.S. tax purposes as a partnership.
- If a domestic limited liability company has only one member and the check-the-box election for treatment as a corporation has not been made, it is disregarded as an entity.

For foreign limited liability companies, the U.S. federal tax treatment of the entity depends upon whether each member of the entity has limited liability.
- If each member has limited liability, it is treated as an association and may be taxable as a corporation.
- If any member does not have limited liability, it is treated as a partnership.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

- **Trust Interests**
  - There are two threshold requirements for a trust interest to be includible in a nonresident decedent’s gross estate for Federal estate tax purposes:
    - (1) the trust must be a valid trust on the nonresident decedent’s date of death; and
    - (2) his interest in the trust must be indefeasibly vested in such manner as would cause estate tax inclusion if he were a U.S. citizen or resident (domiciliary) pursuant to Sections 2033 through 2046 of the Internal Revenue Code.
  - If these two preliminary requirements are met, then an analysis of the rules of Sections 2104 and 2105 of the Code, which sections classify property as having a situs within and without the United States, is necessary to determine whether the nonresident alien decedent’s interest in the trust is includible in his gross estate for FET purposes.
• **i. Nonresident is the Beneficiary of the Trust.**
  
  – Since an interest must be indefeasibly vested, a mere expectation that a person will receive property is insufficient to trigger Federal estate taxation.

  – If a nonresident decedent is the beneficiary of a non-U.S. trust and has a general testamentary power of appointment over the trust property (pursuant to Section 2041 of the Code) which consists of U.S. situs property (such as shares of stock in a U.S. corporation), such U.S. situs property will be includible in the nonresident’s U.S. gross estate.
• **ii. Nonresident is the Settlor of the Trust.**
  – A nonresident alien decedent will be subject to U.S. estate tax inclusion where the nonresident settles a trust consisting of U.S. situs property either at the time that the property is transferred to the trust, or at the time of the decedent’s death, and retains strings so as to cause estate tax inclusion under Sections 2035-2038 or 2042 of the Internal Revenue Code.
• ***General Considerations.***
  
  – The above results are consistent with principles of estate taxation for U.S. citizens or residents (domiciliaries).

  – These principles provide for the inclusion of trust property in the decedent’s gross estate where he holds powers over the economic benefits of the trust either as a beneficiary (holding a general power of appointment over trust property) or as a settlor (holding other powers over the trust property).

  – Thus, if a nonresident alien decedent holds certain proscribed powers over, or interests in, a trust (whether foreign or domestic) pursuant to any of sections 2035 through 2038, 2041 and 2042 of the Code, the trust’s property will be included in his U.S. gross estate if it is U.S. situs property on either the date of the transfer or the date of death.

  – The situs of such property held by the trust is determined based upon the rules set forth in Sections 2104 and 2105 of the Code.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

- **Estate Tax Consequences When Property is Transferred with Strings**
  - Under section 2104(b) of the Code, a transfer of property (in trust or otherwise) situated in the United States either at the time of transfer or at the time of the transferor’s death causes the property to be includible in the transferor’s gross estate for Federal estate tax purposes if the “string provisions,” namely sections 2035 through 2038 and 2042 of the Code, apply.
  - The principles used to determine whether property is situated within the U.S. for Federal estate tax purposes also apply here.
    - Therefore, shares of stock of a domestic (U.S.) corporation which were directly transferred to a revocable trust would be ensnared by this rule notwithstanding that for purposes of the Federal gift tax, such shares were deemed to be situated outside the United States.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

– The string provisions also affect property situated in the United States that a nonresident gratuitously transfers to a foreign trust.

• If a nonresident alien retains the right to alter, amend or revoke such a trust, the value of the property remains includible in his U.S. gross estate.

• Therefore, if the property is tangible personal property (such as cash), it should be removed from the United States before being contributed to the trust and should not be located in the United States at the time of the nonresident grantor’s death.
U.S. real property presents different problems because it is not transportable and different Federal income tax rules may apply.

- It is usually difficult to transfer such property without Federal income tax consequences because of the application of FIRPTA.
- For example, if such property had appreciated in value, generally, even the transfer of such property to a foreign corporation wholly owned by the nonresident would trigger a tax on its appreciation.
- If there were no appreciation in value, however, such real property could be contributed to a foreign corporation in exchange for stock in such corporation without any tax being incurred as a result of the transfer.
Likewise, if it is not desirable to sell the stock of a U.S. corporation, such stock could be contributed to a foreign corporation in exchange for the foreign corporation’s stock.

Where property is contributed for stock, the transaction needs to be carefully structured so as to fall within the exception to the application of Sections 2035, 2036 and 2038 for a “bona fide sale for an adequate and full consideration in money or money’s worth” in order to avoid estate tax inclusion under Section 2104(b).
• **Jointly Held Property**

  - Generally, under Code section 2040(a), if property is held by a decedent and other persons as joint tenants with the right of survivorship, the value of the jointly held property included in the estate of the first joint tenant to die is based on the amount of consideration the deceased joint tenant originally provided to acquire such property and to pay for subsequent capital improvements thereon.

  - There is in effect a “tracing rule.” Thus, upon the death of a joint tenant, an appropriate percentage of the value of the jointly held property as of the date of the decedent’s death (or alternate valuation date) will be included in the decedent’s gross estate.
Notwithstanding the general rule of Code section 2040(a), under Code section 2040(b), if a decedent and the surviving spouse are the only joint tenants of the property, one-half of the value of the property will be includible in the deceased spouse’s gross estate. Thus, for such “qualified joint interests,” the decedent’s interest in jointly held property can be determined without resort to a complicated tracing rule.

Code section 2040(b), however, does not apply if the surviving spouse is not a citizen of the United States at the time of the decedent’s death. Accordingly, in such cases, the decedent’s estate must employ the general “tracing rule” of Code section 2040(a) to determine the amount includible in the deceased spouse’s estate.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

• **Credits**
  – The applicability of credits depends on the type of property that is included in the nonresident’s gross estate and is frequently limited.

  **i. The Applicable Exclusion Amount.**
  – A nonresident is allowed a “credit” against the Federal estate tax of $13,000. This credit is the equivalent of an exclusion of $60,000, and therefore pales in comparison to the applicable exclusion amount of $5,490,000 that is allowed to U.S. citizens and residents in 2017.
• **Credits cont’d**
  – Treaties, where applicable, may increase the amount of exclusion to which a nonresident decedent is entitled.
  – In many instances, residents of treaty jurisdictions may prefer the lower fixed dollar amount of the credit available to nonresidents under the Code ($13,000) because, in order to take advantage of the credit allowed under a treaty, the nonresident’s estate must disclose the full nature and value of the worldwide assets of the nonresident decedent.
  • A nonresident (or his legal representative) generally will wish to avoid such complete disclosure.
ii. **No Portability of the Deceased Spousal Unused Exclusion ("DSUE") Amount.**

- An executor of the estate of a nonresident decedent who was not a citizen of the United States at the time of death may **not** elect portability on behalf of that decedent.

- In addition, the estate of a nonresident surviving spouse who was not a citizen of the United States at the time of such surviving spouse’s death shall **not** take into account the DSUE amount of any deceased spouse of such surviving spouse except to the extent allowed under any applicable treaty obligation of the United States.
• Credits cont’d
  
  iii. Credit for Tax on Prior Transfers.
  – There is a credit for Federal estate taxes paid on property passing to the nonresident within ten years prior to and two years after the death of the nonresident. However, the amount of the credit is limited to an amount of tax paid by the transferor’s estate that is attributable to the property passing to the nonresident transferee.
  – A further limitation on the amount of the available credit is that it is reduced by 20 percent for each two-year period that passes following the death of the transferor.
  • Consequently, if the transferor predeceases the transferee by ten years, no credit is available.
iv. Other Credits.

- No credit is allowed to the estate of a nonresident for death taxes paid to foreign governments.
- In addition, it should be noted that the state death tax credit that used to be available on a fractional basis to nonresident alien decedents under Section 2011 has been replaced by a deduction under Section 2058.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

• **Deductions**
  – In addition, the availability of deductions from the gross estate of a nonresident alien is similarly limited.
  – Deductions attributable to property situated outside the United States are not available, and certain deductions attributable to property situated within the United States are available on a proportionate basis.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

- **QDOTs**
  - In order to qualify for the marital deduction, all property, whether probate or non-probate, passing to a non-U.S. citizen surviving spouse must be placed in or irrevocably assigned to a QDOT on or before the extended due date of the Federal estate tax return, with the outside limit for such transfers being one year after the time prescribed by law, including extensions, for filing the Federal estate tax return.
  - A QDOT may be created by a decedent, his or her executor or surviving spouse.
• **Marital deduction.**
  
  – Federal tax law provides an unlimited marital deduction to the estate of a nonresident (dying after November 10, 1988) who leaves his property situated, or deemed situated in the United States to a U.S. citizen surviving spouse, provided that the usual statutory requirements to ensure that the property will be taxable at the death of the surviving spouse are met.
  
  – In contrast, transfers of such U.S. property from a nonresident to his non-U.S. citizen spouse will qualify for the marital deduction only if the property is also transferred to a Qualified Domestic Trust (“QDOT”) for the benefit of the surviving spouse.
  
  – Similarly, a marital deduction with respect to the estate tax is allowed to the estate of a U.S. citizen or resident (domiciliary) for transfers to his non-U.S. citizen spouse only if the property transferred is held in a QDOT for the benefit of the spouse.
QDOT Requirements -- In order for a trust to be a QDOT, the following requirements must be met:

- The trust must require that at least one trustee be an individual U.S. citizen or U.S. corporation;
- The trust instrument must provide the U.S. trustee with the right to withhold the estate tax imposed on any distribution of principal from the trust;
- The trust must comply with such regulations as are promulgated to ensure the collection of any estate tax imposed on the trust;
- The executor of the decedent must make an irrevocable election with respect to the trust on the decedent’s Federal estate tax return, which must be filed within one year of the due date for the return, including extensions; and
- The trust must be organized as a trust or, in foreign jurisdictions which do not recognize trusts, must have substantially the same effect as a trust.
Property passing to a QDOT must qualify as qualified terminable interest property under Section 2056(b)(7) or otherwise qualify for the marital deduction under section 2056.

If a trust does not meet the requirements for a QDOT, as set forth above, but would have qualified for the marital deduction in all other respects, the time for determining whether a trust will qualify as a QDOT may be extended if a reformation proceeding is commenced prior to the due date for filing the estate tax return.

- In that event, the determination of whether the trust qualifies as a QDOT will be made at the conclusion of the reformation proceedings.
The purpose of the security requirement set forth above is generally to ensure that an estate tax (the “deferred estate tax”) is paid at the earlier of the following occurrences:

- (a) upon distribution of trust principal before the surviving spouse’s death (except in the case of hardship), in which case the deferred estate tax would apply to the value of the principal distributed, or
- (b) upon the death of the surviving spouse, in which case the deferred estate tax would apply to the value of the principal remaining in the trust as of the surviving spouse’s death.

The imposition of the deferred estate tax would be accelerated, however, if there were no U.S. citizen or domestic corporation acting as a trustee of the trust or if the trust were to cease to meet the regulatory requirements to ensure the collection of tax.

If the trust were thus disqualified, the estate tax would apply to the value of the principal remaining in the trust at that time.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

- The amount of the deferred estate tax imposed is designed to equal the additional estate tax that would have been due had the value of the principal of the trust subject to the deferred estate tax been included in the decedent spouse’s gross estate. The deferred estate tax imposed on the QDOT would be treated as an estate tax paid with respect to the decedent’s estate.
Significantly, all trust distributions of income to the non-U.S. citizen surviving spouse are exempt from the estate tax.

In addition, estate tax-free distributions of principal are permitted in the case of hardship.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

- Certain treaties, as well as the U.S. Treasury Department’s Model Estate and Gift Tax Treaty, recognize some form of marital deduction.
  - However, the marital deduction rules vary from treaty to treaty. Therefore, it is essential to review the appropriate treaty provisions to ascertain the marital deduction rules that apply.
- In the case of the estate of a surviving nonresident spouse who is the beneficiary of a QDOT, the estate may choose either the statutory deduction under the QDOT provisions of the Code or the marital deduction allowed under the applicable tax treaty, but not both.
• **Charitable Deductions**
  – Bequests, legacies, devises or transfers from a nonresident to the United States or any political subdivision thereof, or to any charitable corporation organized in the United States and established and operated for religious, scientific or educational purposes, or to a trustee or fraternal organization for charitable purposes within the United States, are allowed as a charitable deduction.
  – If charitable transfers qualify, the entire deduction is allowed and no apportionment is required, but the personal representative must disclose the value of the decedent’s worldwide gross estate in order to claim the charitable deduction.
U.S. Estate and Gift Taxation of Nonresident Aliens – Estate Tax

- **Deductions for Funeral and Administration Expenses, Claims Against the Estate, Indebtedness, Taxes and Losses**
  - Section 2053 of the Code allows deductions for funeral and administration expenses, claims against the estate, indebtedness in respect of property which is includible in the U.S. gross estate, and taxes.
  - In addition, Section 2054 allows deductions for losses.
  - Further, under Section 2058, a deduction is available for state death taxes. Each of these Code sections are subject to their own limitations, including in the case of claims and administration expenses, regulations under Section 2053 that were recently finalized that are applicable to decedents dying on or after October 20, 2009.
Importantly, in order for a nonresident’s estate to take any deduction under Section 2053 or 2054, the nonresident’s entire estate must be disclosed to the Internal Revenue Service, and the decedent’s personal representative may not wish to disclose this information.

- Consequently, the personal representative may decide to forego the deduction for Federal estate tax purposes.
- Therefore, it may be advisable for the estate planner to include in any nonresident’s will disposing of U.S. property a provision which authorizes the fiduciary to forego any such U.S. deductions, and additional provisions that expressly exonerate the fiduciary from liability for failing to take such deductions.
U.S. Estate and Gift Taxation of Nonresident Aliens – Gift Tax

• Federal Gift Taxation of Nonresident Aliens
  – What is Subject to Gift Tax?
    • A gift is a gratuitous transfer of a property interest. A gift can take a variety of forms, such as an outright gift, a forgiveness of a debt, an assignment of property, a constructive gift or the establishment and funding of a trust.
U.S. Estate and Gift Taxation of Nonresident Aliens – Gift Tax

- **General NRA Gift Tax Principles**
  - A nonresident is subject to the Federal gift tax only on transfers (direct or indirect, by trust or otherwise) of real or tangible personal property situated in the United States.
  - In contrast, transfers of intangible property by nonresidents, such as shares of stock of domestic corporations or debts of a U.S. person or entity, are specifically excluded from the gift tax unless the donor is a nonresident who expatriated from the United States and meets certain statutory requirements.
Accordingly, in determining the Federal gift tax for a nonresident (and assuming that an expatriation situation does not apply), the only issues that need to be addressed are:

- (1) whether the gift consists of real or tangible personal property and, if so,
- (2) whether it is situated in the United States.

As with the estate tax, real or tangible property is situated in the United States only if it is physically located in the United States.
Because no gift tax applies to gifts of debt obligations of U.S. persons or stock of U.S. corporations, a nonresident may wish to make gifts of this type of property, especially since they would be subject to the Federal estate tax if held at death.

In addition, if a nonresident wishes to make a gift of tangible personal property which is located in the United States, he should remove it from the United States before making the gift to avoid the Federal gift tax.

- In this way, he will avoid both the Federal gift tax and the “gross up” consequence if the Federal estate tax applies to his estate.
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• If a nonresident wishes to make a gift of real or tangible personal property located in the United States but is unable or unwilling to remove the same from the United States, it is unlikely that he would be able to avoid taxation by transferring the property to a foreign corporation and, thereafter, transferring the shares of the foreign corporation.
• Importantly, even if the donor removes the property from the United States to transfer it gratuitously, he should not retain rights or powers that, under sections 2035 through 2038, 2041 and 2042 of the Code, make the property includible in his gross estate if situated in the United States at the time of his death.
If a nonresident purchases tangible personal property while visiting the United States, it is clearly advisable from the nonresident’s standpoint to hold off making any gifts of such property until after he has left the United States to avoid the Federal gift tax.

Moreover, when a nonresident transfers funds to a donee who is located in the United States, as an extra layer of precaution (although technically not required), the nonresident should avoid using checks drawn on U.S. banks and wire transfers into the United States.
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- **Computation of the Gift Tax**
  - The Federal gift tax is a cumulative tax that is determined by computing a tentative tax on taxable gifts made during the applicable period, plus taxable gifts made subsequent to June 6, 1932. The tentative tax applicable to the prior gifts is then subtracted to determine the actual tax.
  - **i. Annual Exclusion.** The annual exclusion of $14,000 per donee for gifts in 2017 is available to a nonresident. In order to qualify, the gift must be of a present interest in property.
    - Significantly, nonresident spouses are unable to split gifts to effectively double the annual exclusion.
    - In addition, the annual exclusion amount for gifts by a spouse to a non-U.S. citizen spouse is increased to $100,000, subject to indexing (with this amount at $149,000 for 2017).
• **ii. Gift Tax Exclusion for the Direct Payment of Tuition or Medical Care.** A donor (including a nonresident) is permitted to exclude from taxable gifts amounts paid on behalf of an individual as tuition to a qualifying educational organization for the education or training of such individual, or amounts paid on behalf of an individual to any person who provides medical care with respect to such individual as payment for such medical care. The payments of these expenses by a donor must be made directly to the educational institution or provider of medical services.

• **iii. Federal Gift Tax Rates.** The Federal gift tax schedule of rates for nonresidents is the same as the unified estate and gift tax rate schedule for U.S. citizens and residents. However, in contrast to the $13,000 credit available to nonresidents for estate tax purposes, no credit against gift tax is available to nonresidents.
iv. Marital Deduction.

- A nonresident is eligible for a marital deduction for a gift of U.S. situs property to his U.S. citizen spouse.
- However, whether the donor is a U.S. citizen, a U.S. domiciliary or a nonresident alien, no marital deduction is allowed at all for gifts to or for the benefit of a non-U.S. citizen spouse.

  » As partial compensation for the complete loss of a marital deduction, the annual exclusion amount allowable for any gifts to a non-U.S. citizen spouse under Section 2503(b) of the Code is increased to $100,000, indexed for inflation.

- For 2017, the indexed amount is $149,000.
• **v. Charitable Deduction.** Charitable deductions by a nonresident are limited to gifts made to U.S. charitable corporations in the United States, any state, or any political subdivision of the United States, domestic veterans organizations and trusts, funds, foundations, fraternal orders or lodges for use within the United States.

• **vi. Joint Gifts by Spouses.** Gift-splitting by spouses to third parties under section 2513 of the Code is permitted only if both spouses are U.S. citizens or residents (domiciliaries).

• **vii. Treaties.** Treaties may vary the application of the Federal gift tax provisions.
U.S. Estate and Gift Taxation of Nonresident Aliens – GST Tax

- **Generation-Skipping Transfer Tax Rules Applicable to Nonresident Aliens**
  - Special generation-skipping transfer tax ("GST tax") rules apply to transfers by nonresident aliens that “skip” a generation.
  - The generation-skipping transfer, or “GST” tax, is currently a flat 40% tax imposed on transfers to “skip persons,” a term which includes family members more than one generation, and unrelated persons more than 37½ years, younger than the donor.
  - The purpose of this tax is to ensure that property will be subject to full transfer taxation at each generational level.
  - This tax is imposed in addition to the gift tax or estate tax.
Under current law, the “GST exemption” permits a donor to transfer a total of $5,490,000 to skip persons free of GST tax. The GST exemption is a one-time, cumulative exemption from taxation.

According to Reg. § 26.2663-2(a), this expanded GST exemption amount also applies to nonresident alien transferors.

Significantly, with respect to nonresident aliens, transfers which are not subject to the Federal gift or estate tax (such as transfers of non-U.S. situs property by a nonresident alien) are not subject to the GST tax.