

# New Dimensions in Estate & Trust Planning

*A Newsletter to Benefit Clients & Friends  
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## ESTATE PLANNING FOR THE NON-CITIZEN SPOUSE

*by Richard L. Ferris, Esq.*

### **Preserving your Marital Deduction through a Qualified Domestic Trust**

If your spouse is a United States citizen, you can give him or her as much as you want without paying gift or estate taxes. Gifts or bequests to a citizen spouse qualify for the *marital deduction* – an estate and gift tax deduction available only to married couples. The marital deduction allows married couples to transfer assets to each other free of gift taxes during their lives and it defers the payment of estate taxes by either spouse until both spouses have died.

### **What if my spouse is not a U.S. Citizen?**

First the bad news: Your spouse may not qualify for the marital deduction if he or she is not a citizen. Without the marital deduction, there may be gift taxes on gifts to your non-citizen spouse during your life; then, at your death, estate taxes, payable within nine (9)

months of your death, will be due by your surviving non-citizen spouse.

### **Why is my Non-Citizen spouse treated differently?**

In 1988, Congress ended the marital deduction for non-citizen spouses because it feared that they would return to their countries of origin with the wealth that the marital deduction enabled them to inherit tax-free. Upon their deaths, their wealth would be beyond the reach of the Internal Revenue Service. In other words, Congress realized that allowing the marital deduction for non-citizen spouses created a loophole through which a couple's wealth could escape tax-free.

### **Is there anyway for me to postpone my Estate Tax if my spouse is not a U.S. Citizen?**

Now for the good news: Congress realized that most non-citizen spouses are not going to

leave the country to escape gift and estate taxes. Therefore, it added a provision to the Internal Revenue Code to restore the marital deduction for bequests made to a “Qualified Domestic Trust” – a trust designed to ensure that the Internal Revenue Service actually will be able to collect the estate tax. The Qualified Domestic Trust provision restores the marital deduction if you, in your will or Revocable Living Trust, give or bequest assets to your trustee who is governed by the following trust instructions:

- *All income* of the Marital Trust must be distributed to your spouse, who must, in turn, pay income taxes on these distributions.
- If *any principal* is paid to your spouse, estate taxes must be paid on each distribution of principal. When your spouse dies, estate taxes must also be paid on any principal that remains in the Marital Trust at the time of your spouse’s death.

Assets transferred to the Marital Trust that includes these instructions will qualify for the marital deduction if (1) your trustee makes a special election on your estate tax return to claim the marital deduction and (2) the trust ensures the ultimate collection of estate taxes by adding the following requirements:

- **The United States Trustee Requirement:** The trust must have at least one trustee who is a United States corporation or a resident citizen. (An adult child or other relative may serve as your trustee).
- **The Withholding Requirement:** The trust instructions must give the United States trustee the right to withhold an estate tax from each distribution of principal to your non-citizen spouse.

Under IRS rules, the QDOT Trust must also meet one of the following requirements:

- **The Bank Trustee Requirement:** At least one of the United States Trustees must be a bank.
- **The Bond Requirement:** If the United States trustee is an individual, he or she must furnish a bond or security equal to 65% of the value of assets in the trust.
- **The Foreign Real Property Requirement:** Trusts of \$2 million or less may simply require that no more than 35% of the trust assets, valued as of the last day of the trust’s taxable year, consist of real property located outside of the United States and that no other trust property is located outside the United States.

#### **When will the assets in my Qualified Domestic Trust be taxed?**

Your Qualified Domestic Trust will defer estate taxes until the death of your non-citizen spouse unless he or she receives principal from the trust. Any principal paid out of the trust will be subject to estate taxes as they are paid unless the Non-citizen spouse can prove “hardship” as defined under IRS rules.

#### **What if my spouse becomes a U.S. Citizen?**

Under certain circumstances, the restrictions created by your trust will be removed if your spouse becomes a citizen. If your trust allows it, your trustee may distribute principal to your spouse once he or she becomes a citizen without paying an estate tax.

#### **Conclusion**

A Qualified Domestic Trust does not avoid estate taxes forever. It merely defers them until your spouse’s death. You will need to use other estate planning techniques if you want to reduce estate taxes or eliminate them entirely. To evaluate the propriety of the QDOT in your estate plan, it is a MUST that you seek professional legal and tax advice from a highly skilled estate planning attorney in this area.

There are a myriad of planning considerations in Non U.S. Citizen Estate Planning situations:

- 1.) Should a QDOT Trust be used?
- 2.) How much property should be owned jointly?
- 3.) Who is the proper beneficiary of my Life Insurance, IRA, 401(k), annuities?
- 4.) How can a Life Insurance Trust (ILIT) be used to resolve many Non-Citizen Estate Planning issues?

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### *About the Author*

**RICHARD L. FERRIS, Senior Partner**, began his legal career in 1972 with the Ohio Attorney General's Office, Tax Section. Dick founded Ferris & Associates in 1993, a Williamsburg, VA, law firm whose practice is limited to estate and trust planning, probate and estate administration and business formation and planning.

Dick earned his B.S. Degree from the University of Dayton; Law Degree from Ohio Northern University; LL.M. (Masters of Law in Taxation) from Boston University; and his CLU (Chartered Life Underwriter), ChFC (Chartered Financial Consultant), and Masters of Science in Financial Services Degrees from the American College.

He has authored many articles on Estate Planning, including publication in the Virginia State Bar's *Trusts and Estates*. In addition, Dick is a frequent speaker before civic, social, and professional groups. He has co-authored three books on Estate and Trust Planning: **LEGACY—Plan, Protect and Preserve Your Estate**, **GENERATIONS—Planning Your Legacy and LOVE, MONEY, CONTROL—Reinventing Estate Planning**.

Dick is a member of the Virginia, Ohio, and District of Columbia Bars, as well as a member of the National Network of Estate Planning Attorneys. He is admitted to practice before the U.S. Tax Court

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