TAXATION

CALIFORNIA
LAWYERS
ASSOCIATION

presents

2024 Estate and Gift Tax Conference

Panel 6: The Supercharger QDOT

Thursday, March 21, 2024

1:25pm - 2:10pm

Speakers: Cynthia Brittain

Conference Reference Materials

SUPERCHARGED QDOTS!
SHOULD YOU DRAFT IN A QDOT?

California Lawyers Association
ESTATE AND GIFT TAX CONFERENCE
March 21 - 22, 2024

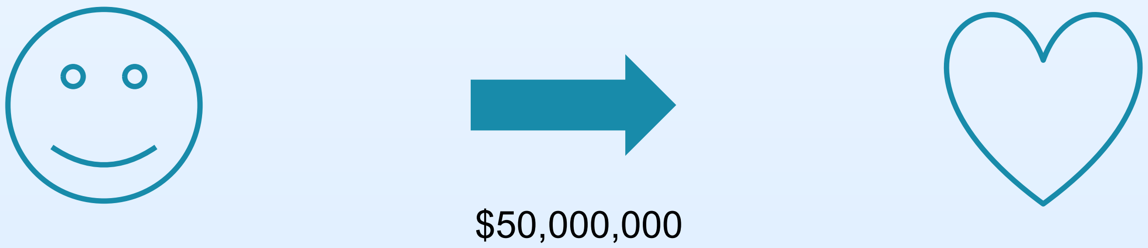
PRESENTER:
Cynthia D. Brittain, Partner
323-852-0030
cbrittain@karlinpeebles.com

Karlin & Peebles, LLP
5900 Wilshire Blvd., Suite 500
Los Angeles, CA 90036

KARLIN & PEEBLES, LLP
ATTORNEYS AT LAW

U.S. Citizens

- U.S. citizens can **give** between with an unlimited marital deduction – so no gift tax
- At death, a U.S. citizen can leave a U.S. citizen spouse everything **outright** without the imposition of estate tax.
- Plus, any transfer to a U.S. citizen spouse from a non U.S. citizen donor is U.S. gift or U.S. estate tax free…it's all about the donee.



U.S. Citizen Spouses – The Basics Between U.S. Citizens

Joint-Revocable Trust ($30,000,000)

CP/SP		CP/SP	
13,610,000	Excess in a Marital Trust QTIP $1,390000	Survivor's Trust	$15,000,000
Exempt Trust	QTIP" Trust		

Qualified Terminable Interest Property Trust will be taxable in surviving spouse's estate.

However, the tax is deferred resulting in higher cash flows to the Surviving Spouse.

Code Section 2056 (b)(7): Requirements For QTIP –

- Property passing from Decedent
- Qualifying income interest for life; (Section 2056(b)(5); Section 20.2056(b)-5(f))
- ➢ All income paid at least annually;
- ➢ Unproductive can be made productive by Surviving spouse;
- Income interest that terminates on remarriage does not qualify;
- No other beneficiaries (such as children) may have any rights in the trust;
- An irrevocable QTIP election must be made on the estate tax return;
- No person has the power to appoint except the Surviving spouse.

Note:
Foreign assets (real property, portfolio accounts, etc.) can be structured as a QTIP; foreign arrangements can be designed and receive acceptance as a QTIP or QDOT

General: Estate Taxation Of Non-U.S. Citizens

If U.S. domiciled:

- ESTATE TAX ON WORLDWIDE ASSETS; SAME EXEMPTION AS U.S. CITIZENS ($13,610,000)

If Non-U.S. domiciled:

- ESTATE TAX ON U.S. SITUSED ASSETS DEFINED BY THE CODE OR TREATY
- A VERY LIMITED EXEMPTION OF $60,000 or GREATER BY TAX TREATY
- THERE MAY BE BETTER PLANNING TOOLS HERE FOR NON-U.S. DOMICILED SPOUSES THAN U.S. CITIZENS…wait and see!
- For example, if two non-domiciled spouses with U.S. stock, if there is time for last minute planning the U.S. stock can be transferred U.S. gift tax free.

Domiciled vs. Non-Domiciled (for exemption amount)

- Domiciled is a subjective test
  a. Living here, and
  b. With the intention of remaining here indefinitely
  c. Having a green card does not necessarily mean domicile, it is a factor.

- The test to determine whether an individual is domiciled in the United States is a facts and circumstances test that is particular to the individual in question. There are numerous cases that illustrate the application of this test by the courts. See *Estate of Kahn v. Commissioner*, T.C. Memo. 1998-22 (Pakistani citizen was U.S. resident); *Estate of Fokker v. Commissioner*, 10 T.C. 1225 (1948) (citizen of the Netherlands was U.S. resident); *Estate of Paquette v. Commissioner*, T.C. Memo. 1983-571 (Canadian citizen was not U.S. resident); *Forni v. Commissioner*, 22 T.C. 975 (1954) (Italian citizen was not U.S. resident); *Estate of Nienhuys v. Commissioner*, 17 T.C. 1149 (1952) (citizen of the Netherlands was not U.S. resident); *Estate of Jack ex rel Blair v. U.S.*, 54 Fed. Cl. 590 (Fed. Cl. 2002) (Canadian citizen was U.S. resident); *Cooper v. Reynolds*, 24 F.2d 150 (D. Wyo. 1927) (British citizen was U.S. resident).

Section 2056(d) and Transfers to Non-U.S. Citizen Spouse

ESTATE TAX – Assets cannot pass outright to a non-U.S. citizen spouse in unlimited amounts. The unlimited marital deduction does not apply to transfers to non-citizen spouses whether or not they are U.S. domiciled.

- A U.S. domiciled person is allowed the $13,610,000 exemption amount (that amount can pass outright to a non-U.S. citizen spouse without additional tax); however, if the Surviving Spouse is not a U.S. citizen, then the excess value cannot pass either outright or into the Surviving Spouse’s Survivor’s Trust U.S. estate tax free using the unlimited marital deduction.

REQUIRED:

- **A Qualified Domestic Trust (“QDOT”), or**
- **A relevant Estate or Estate and Gift Tax Treaty**

U.S. – U.K. Estate and Gift Tax Treaty

ESTATE TAX/INHERITANCE TAX – A couple may satisfy the definition of "domicile" under the tests in both the U.S. and the U.K. and be required to pay tax in both jurisdictions.

The U.S. – U.K. Estate and Gift Tax Treaty is designed to alleviate double taxation on gifts and estates of U.S. citizens and domiciliaries who are also U.K. domiciliaries.

- By allowing both countries to tax but requiring one to allow a credit against taxes paid in the other county.
- Depending on the asset, a country will have priority to tax, such as tax on real property, tangible personal property, and business assets located in that country.
- Depending on the assets, the Treaty may exempt assets from taxation. For example, a U.K. domiciliary will not be subject to U.S. estate tax on tangible personal property, cash, and U.S. corporate stock sitused in the U.S.
- The U.S.-U.K. provides a very different result than under general international estate tax principal (where U.S. stock is a U.S. asset for U.S. estate tax purposes).

Determination of Community or Separate Property

ESTATE OF CHARANIA v. SHULMAN, 2009 WL 2924091, at 1.

Who owns what for U.S. estate tax, especially in the international context?

ESTATE OF CHARANIA v. SHULMAN

Facts: The Decedent, Noordin M. Charania and his wife, Roshankhanu Dhanani married in Uganda in 1967. They were native Ugandans and at the time Uganda was under the hegemony of the United Kingdom. Therefore, both spouses were citizens of the United Kingdom. The Decedent worked as an agent for a Belgian Shipping Company.

In 1972, Idi Amin, the ruler of Uganda ordered the expulsions of all Ugandans of Asian Descent. Mr. Charania and Mrs. Dhanani fled to Belgium in October of 1972, intending to remain there indefinitely. Under Belgian law, a married couple can modify or change the matrimonial regime governing their property, but Mr. Charania and Mrs. Dhanani never entered into any agreement concerning the ownership of their property.

Having landed in Belgium with very little but growing their estate, Mr. Charania purchased 50,000 shares of Citicorp, an American financial services company, which converted into 125,000 shares of Citigroup stock. After a series of stock splits and stock dividends, the value of their shares grew to $11,790,000 at the time of Mr. Charania’s death.

At his death, he paid tax on one-half of the Citigroup stock because Belgium applies a community property regime. Mr. Charania earned all his money in Belgium which purchased the Citigroup shares.

The IRS said that the Citigroup stock was Mr. Charania’s separate property and wanted to tax the full amount.

Analysis: ESTATE OF CHARANIA v. SHULMAN

- The Citigroup stock was U.S. sitused and subject to U.S. estate tax;
- The marital regime in Belgium applies community property;
- However, the IRS argued that the marital property regime of England applied and that the shares were Decedent's separate property;
- The dispute raised a conflicts of law question;
- Confusing the argument:
  - Both sides agreed that the ownership of property is controlled by the whole law of the decedent's domicile at the time of death.
  - The Parties further agreed that the Decedent in this case was domiciled in Belgium where he died;
  - Applying Belgium law, a Belgian court would look to the whole law of the country of the spouses' common nationality and both parties agreed that their common nationality was England.
- So framed, the question reduced to what marital property regime would an English court apply to determine the spouses' property rights in the Citigroup shares.
- The Estate argued that the domicile where the property was acquired should apply and since England followed the doctrine of mutability, the marital property regime where the spouses were domiciled when the property was acquired governs the question of ownership.
- The IRS argued that an English court would apply the doctrine of immutability. Under the doctrine of immutability, the marital property regime of the jurisdiction in which the spouses were domiciled at the time of their marriage governs all the personal property that they acquired thereafter, regardless of where they are living when the property is acquired or regardless of whether their domicile changes.
- The IRS further argued that because the spouses were domiciled in Uganda at the time of their marriage, and Uganda's marital property regime corresponded to that of England's martial property retime, the Citigroup shares were Decedent's separate property.

The Decision:

- Looking at an earlier case decided by the House of Lords in England, *De Nicols v Curlier*, [1900] A.C. 21 (H.L.)(appeal take from DC.), two French citizens married in France and moved to England where they become British subjects.
- The couple spent 34 years in England and amassed their wealth.
- However, the Court decided that entering into a marriage without a prenuptial agreement placed the spouses in the same legal position as if they had executed a contract that expressly adopted the community property regime of the French Civil Code. Once it attaches, it cannot be changed except by the spouses' express agreement to a different arrangement or by the occurrence of certain external factors (i.e., divorce);
- *De Nicols* is still good law in England and is the only English precedent on point.
- Therefore, the rule of immutability applied
- The Tax Court followed *De Nicols* as well and applied the rule of immutability.
- Therefore, the Citigroup stock was all Decedent's subject in total to U.S. estate tax, plus penalties.

Why is Estate of Charania important:

- We need to know who owns what when we are applying U.S. estate tax to a Decedent's taxable estate.
- What assets will we allocate to the Decedent versus the Surviving Spouse.
- Once we know that: We can turn to planning….

U.S. Citizen Spouse with Non-U.S. Citizen Spouse

Joint-Revocable Trust ($30,000,000)

CP/SP		CP/SP	
13,610,000	Excess in a Marital Trust QDOT $1,390000	Survivor's Trust	$15,000,000

Exempt Trust

QDOT
Similar to a QTIP but extra
Regulatory and Security requirements
Included in the Trust

Qualified Domestic Trusts

- The purpose of a QDOT is to ensure the assets transferred to the non-U.S. citizen spouse upon death of (non-U.S. domiciled/U.S. domiciled person/U.S. citizen) that would be subject to U.S. estate tax are eligible for a deferral until the death of the non-U.S. citizen spouse.

- This is the same principal as with the QTIP which we use all the time.

- It's about deferral…not escaping U.S. estate tax…maybe.

- **This discussion is how to minimize the U.S. estate tax on transfers to non-U.S. citizens who may be U.S. domiciled or living in another country.**

QDOT Requirements – Assets pass directly to the QDOT Marital Deduction Requirement

Typically: QTIP Requirements, plus

- Statutory Requirements, and
- Security Requirements

Statutory Regulations – REQUIRED

- At least one trustee is a U.S. citizen with a U.S. tax home or a capitalized U.S domestic corporation (such as a PTC).
- Require that no distribution "other than income" be made for the trust unless the U.S. Trustee has the right to withhold any QDOT tax on the distribution from the QDOT. **This must be in the instrument**.
- Make the election on the timely filed U.S. estate tax return
- Maintain the QDOT in a U.S. state or D.C.

➢ Section 2056(a)(3) allows within the definition of trusts, "other arrangements which have substantially the same effect as trust," even foreign arrangements.

Security Regulations – REQUIRED

- Revenue Procedure 96-54 sets out the model language to satisfy the Security Regulations requirements
  - There are different security regulations depending on whether the trust is a "small QDOT" or "large QDOT"

Example: If the fair market value of the assets passing to the QDOT is in excess of $2 million then (A) at least one Trustee must be a U.S. Bank; (B) the Trustee must furnish a bond; or (C) the Trustee must furnish an irrevocable letter of credit.

Taxation of QDOTs – Generally

The 40% QDOT Tax Imposed On:

- Certain distributions from the QDOT during the lifetime of the Surviving spouse (**i.e., capital gains because usually not considered part of the trust's "distributable net income"**); and
- The remaining value of property in the QDOT at Surviving Spouse's date of death.

Exceptions:

- Income from a QDOT to the non-citizen surviving spouse **is not subject to the QDOT tax** imposed under §2056(b)(1)(i); § 2056(A)(c)(2), § 2056(A)(e)
    a. Income has the same meaning as it has in §643(b).
        i. Income determined in accordance with the terms of the governing trust and applicable law
        ii. The Trustee, acting in good faith, can allocate capital gains to income
        iii. While income under §643(b) does not include capital gains or other items allocated to corpus under local law, capital gains can be considered income.

Income Can Avail Itself to Deductions; the QDOT Tax is fixed at 40%

Taxation of QDOTs – Under "New" 643 Regulations

The regulations under Section 643 provide greater distribution power for QDOT beneficiaries, as it provides substantial flexibility since it looks solely to the terms of the governing instrument and applicable law. (IRC Section 643)

- **<u>Adjustment Power:</u>** Capital Gains included in Distributable Net Income ("DNI") – Gains from the sale and exchange of capital assets are included in DNI to the extent they are pursuant to the terms of the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of discretion by the fiduciary (in accordance with a power granted to the fiduciary by applicable local law or by the governing instrument if not prohibited by applicable local law. (Reg. Section 1.643(a)-3(b))

- **<u>However</u>:** Trust provisions that depart fundamentally from tradition principles of income and principal will not be recognized. For example, if a trust instrument directs that all the trust income be distributed to the income beneficiary yet defines income as ordinary dividends and interest as principal. As such, the trust will not be considered one that under its governing instrument requires income to be distributed currently.

- **<u>Further:</u>** A state statute that permits a trustee to make adjustments between income and principal to fulfil the trustee's duty of impartiality between the income and remainder beneficiaries is a reasonable apportionment in the trust.

Taxation of QTIPS – Under "New" Reg. Sec. 643

- <u>**Unitrust Distributions**</u>. As a safe harbor, if a state statute provides that "income" is a Unitrust amount of no less than 3% and no more than 5% of the FMV of the trust assets, that "income allocation" will be a reasonable apportionment of the total returns of the trust. (Under California's Uniform Fiduciary Income and Principals Act, such is defined.)
- **In Kind Distributions of Property in Satisfaction of Required Income Distributions.** In a Unitrust or adjustment situation, however, where the trustee makes a distribution to the income beneficiary in excess of the trust's ordinary income based on the trust's total return, the trustee may decide not to liquidate assets, but instead make a distribution of trust property to the income beneficiary in satisfaction of the additional amount required to be distributed to the income beneficiary.
- **Treasury Regs. Section 20.2056(b)-5(f)(1) and 1.2523(e)-1(f)(1), (QTIPS)** specify that the requirement that a spouse be entitled to all the income from a QTIP will be met if the spouse is entitled to income as defined by state statute that provides for the reasonable apportionment between the income and remainder beneficiaries.
- **Thus, a trust that provides for the spouse to receive a unitrust amount of no less than 3% and no more than 5% of the annual FMV of the trust will be considered to require all trust income to be distributed to the spouse, assuming the other statutory and regulatory requirements are met will qualify for the marital deduction.**
- **A similar result will be available for trusts administered under an adjustment provision.**

Look for states that have adopted the uniform principal and income act.

Taxation of QDOTs – Under "New" 643 Regulations

- **<u>In Kind Unitrust Distributions under a QDOT</u>.** **Treasury regulation section 20.2056(A) – 5(c)(2)** explicitly provides that distributions to a spouse as the income beneficiary of a QDOT made "in conformance with applicable law that defines the terms income to be satisfied by such an amount), or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries, will be considered distribution of trust income, if the applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the trust, and satisfies section 1.643(b)-1 (i.e., reasonable apportionment, allowed by the trust instrument and applicable law, and does not stray too far from fundamental principals).

- **SUPERCHARGE! Thus, no 40% QDOT tax of a unitrust amount or an adjustment under the Uniform Principal and Income Act or the California Fiduciary Principal and Income Act.**

- **<u>Income Taxation of the QDOT Beneficiary</u>. See next example of in-kind taxation with/without Section 643(e) election.**

- **However, for QDOTS, where there has likely been a basis step-up, this is not a big issue.**

- **If the non-U.S. Citizen Spouse is also non-U.S. domiciled, then the capital gains on domestic stock will not be realized under IRC Section 871…so in kind distributions of stock can be made systematically with no QDOT 40% tax.**

Taxation of QDOTs – Section 643(e) Election

Example

A trust has DNI of $3,000 comprised of ordinary income. The trustee distributes to beneficiary appreciated capital property that has an adjusted basis of $1,000 and a fair market value of $2,500.

If a Section 643(e) election is made, the beneficiary will have a basis of $2,500 in the property and, pursuant to Section 662(a)(2), will be treated as receiving $2,500 of DNI, thereby recognizing ordinary income of $2,500. The trust will have a distribution deduction of $2,500 but will now recognize $1,500 of capital gain.

If no Section 643(e) is made, the beneficiary will have a basis of $1,000 in the property but will recognize ordinary income of only $1,000 (the DNI deemed distributed to him). Due to the trustee not making the election, the beneficiary benefits by having $1,500 of ordinary income converted into potential capital gain. On the other hand, the trust will have a distribution deduction of only $1,000, thereby converting the $1,500 of capital gain which would have been recognized if the election had been made into $1,500 of ordinary income, the cost of which may be borne by the remainder beneficiaries.

Optimal QDOT Design – You can have more than 1

QDOT Income Only	QDOT Growth No-Income

QDOT
Income Only

Income only

If the assets are income producing this model is better because less is subject to U.S. estate tax; but you can allocate capital gain to income, also

*Depends on the estate of the surviving spouse.

QDOT
Growth No-Income

5% unitrust = 5% of trust's FMV (total value of trust) is distributable as income, possibly no U.S. tax (no QDOT tax or capital gains tax)

But if drafted as income-only, this trust wouldn't distribute anything with more being subject to estate tax.

DRAFTING IS CRITICAL.

Optimal QDOT Design – As discussed

1. If the QDOT makes a distribution of non-taxable income to a non-U.S. spouse who's domiciled outside of the U.S., those amounts will not be subject to U.S. estate tax later.

2. If a U.S. tax treaty is in place such income distribution from the trust may be subject to U.S. income tax at lower treaty rates.

3. Proper QDOT design requires analyzing how income and value will be earned or generated.

QDOT Twist – Property Passing Outright to Spouse

- If the Decedent directs his or her property to pass into a QDOT, then the QDOT must satisfy the QTIP qualified lifetime income requirements.

- However, if the property passes outright to the Surviving spouse, then there is no QDOT in place.   What should we do?

- Property passing to a Surviving spouse will be treated as passing to the Surviving spouse in a QDOT: As long as the assets are transferred or irrevocably assigned to the QDOT on or before the due date of estate tax return.

QDOT Twist – WOWZA!

- If the property to be held in the QDOT is property transferred by the Surviving spouse, **then the QDOT need not qualify for the Marital Deduction requirements of § 2056(b)(5)**.

- The Surviving spouse does not have to be a beneficiary.

- If the Surviving spouse is not a beneficiary, then no required annual distribution of income.

- This option can maximize distribution to trust beneficiaries who are likely children of a much younger age…which will provide time to distribute assets under optimized drafting and investing.

- This rule applies only if all the trust property has been transferred or assigned to the trust by the Surviving spouse.

- The Self-Settled QDOT must still include the statutory and security regulations requirements.

- If any assets were transferred to the trust by the Deceased spouse, then the trust must include provisions for the marital deduction under § 2056.

QDOT Twist – IMPORTANT!

- **Under the regulations, property assigned or transferred to a QDOT pursuant to § 2056(d)(2)(B), is treated as passing from the decedent in a QDOT *solely for purposes of § 2056(d)(2)(A). For all other purposes (e.g., income, gift, estate, and generation-skipping taxes), <u>the surviving spouse is treated as the transferor of the property to the QDOT.</u>***

- *Advanced Note:*

➢ *When transferring into the QDOT…it may be important for the Surviving Spouse to keep a limited power of appointment to avoid the remainder interest possibly being treated as a remainder interest gift. This is generally when the Surviving spouse retains an interest that is not a "qualified interest," meaning her children beneficiaries, or she is and they are right after…the gift would be the remainder interest*

➢ *However, if the Surviving Spouse is a non-U.S. citizen, non-U.S. domiciled individual, then the transfer of intangible property would likely not be subject to U.S. gift tax….as gifts of U.S. intangible property such as U.S. or foreign stock, maybe U.S. partnership interest, notes, etc., are not subject to U.S. gift tax.*

IRC Section 2501(a)(2).

Self-Settled ("SS") QDOT – The Surviving Spouse as Transferor

- Non estate includable: SS-QDOT - with Surviving spouse as beneficiary
- Non estate includable: SS-QDOT - without Surviving spouse as beneficiary

1. With Surviving spouse as beneficiary: The SS QDOT must meet 2056(b)(5) QTIP requirements.

2. Statutory Requirements Only: QDOT without Surviving spouse as beneficiary
   - U.S. trustee as U.S. citizen with U.S. tax home or capitalized domestic corporation
   - No distribution from QDOT w/o approval of U.S. trustee must be in the trust instrument
   - U.S. trustee has the right to withhold QDOT tax
   - Nothing "other than income" may be made from the trust unless the U.S. trustee has the right to withhold the QDOT tax on the distribution from the QDOT

The Foreign QDOT

- The QDOT can be a foreign trust.
- If the QDOT is a foreign trust, then U.S. capital gains and certain income generated inside the trust is not taxed.
- If the Surviving spouse is foreign, then it is possible to distribute out in kind property that is likely not taxed either. The QDOT grows U.S. income tax free and is distributed out QDOT tax free.
- While a requirement for a QDOT is that the trust be sitused in the U.S., (the "court test" satisfied), the foreign beneficiary could retain one or more substantial decision-making powers (the "control test" failed).

QDOT As Foreign Trust – If Foreign Beneficiary

- The use of a foreign trust could be significantly advantageous.
- Capital gains are includible in income (within the Distributable Net Income Calculation) – helpful to clear out income with QDOT Tax.
- The advantage of establishing a QDOT by the Surviving spouse includes that the SS QDOT may be structured as a foreign grantor trust as to the SS or a Foreign non-grantor trust.
- Since the Surviving spouse is a non-U.S. resident alien, only certain U.S.-sourced income will be taxable, capital gains escape tax altogether.
- If the trust is structured as a foreign non-grantor trust, care must be taken if there are U.S. beneficiaries…to avoid the throwback tax.

Gift Transfers to Non-U.S. Citizens Spouse

GIFT TAX – Assets cannot pass to a non-U.S. citizen spouse in unlimited amounts. The unlimited marital deduction does not apply to gift transfers to non-citizen/domiciled person spouses.

- A U.S. citizen/domiciled person: While a U.S. citizen/domiciled person is allowed the $13,610,000 gift exemption amount, unlimited amounts cannot be transferred to a non-U.S. citizen. Only $185,000 per year (annual exclusion), after that the U.S. citizen/domicile must use his or her exemption amount to gift to a non-U.S. citizen spouse, even if he or she has a green card.
- **Exceptions**: No Interest loans; Intangible gifts if gifted by a non-U.S. domiciled person to anyone; and relevant Estate/Estate and Gift tax treaties

U.S. Gift Tax - Planning to Avoid U.S. Estate Tax

1. Non-U.S. domiciles can gift U.S. intangibles U.S. gift tax free;
2. However, Non-U.S. domiciles have ZERO gift tax exemption amount on gifts of tangible assets.

Relevant for U.S. Gift Tax

1. **Tangible**
    a. U.S. real estate
    b. jewelry
    c. art
    d. cash
2. **Intangibles**
    a. stock
    b. debt obligations
    c. T-Bills

Portability and Planning Consideration

For property passing to a non-U.S. citizen, the deceased spouse's unused estate tax exemption ("DSUE amount") calculated under the rules applicable to a U.S. citizen spouse are subject to adjustments upon final distribution or other termination of the QDOT.

Careful planning for the use of a QDOT and its interaction with portability can significantly increase the portion of a couple's overall estate that passes to their heirs.

We must select the appropriate DESIGN

Facts

Assume the following facts:

1. The Deceased U.S. citizen is married to a Non-U.S. citizen but is U.S. domiciled;
2. The estate tax exclusion is $5,430,000, the value of 2015
3. The value of the Deceased spouse's estate is $10,000,000; with $100,000 of admin expenses;
4. The Surviving spouse (a noncitizen resident/domicile of the United States) has her own estate of $10,000,000, and is considered U.S.-domiciled.
5. All property appreciates at 5%.

Credit for Examples to: Understanding Qualified Domestic Trusts and Portability (December 2016) Brent W. Nelson and Anne V. Roed

Example 1 – No Planning (But use of §2013 credit)

1. The property of the Deceased passes outright to SS and not into a QDOT;

2. Tax is paid would be $1,788,000

3. At SS death, SS's estate is $23,116,012. The tax is $5,246,405., after apply the unified credit and the § 2013 credit for estate tax paid on the first deceased spouse's estate. The couple would pass $17,769,607 to heirs. (77.21% of their wealth)

| Example 2 – Use of QDOT

1. All property, after admin expenses, of the Deceased passes directly to a QDOT;
2. At SS death, her estate is $25,398,003 (consisting of property of her estate and the value of the QDOT property – estate tax was deferred until on the QDOT property)
3. The Deceased spouse used none of his exemption amount, the SS is not entitled to any DSUE amount because the DSUE amount is adjusted down to zero by the value of the QDOT property at the date of death of the Surviving spouse.
4. The QDOT property is subject to estate tax of $2,882,075.
5. The SS's estate is subject to $5,065,126.
6. $17,350,802 passes down to heirs.
7. (68.59% of their wealth)
8. See § 20.2010-2(c)(5) for adjustment calculations

Example 3 – Forget the QDOT and Fund Bypass

1. Deceased spouse's estate would fund a Bypass trust leaving only $4,470,000 in the QDOT.

2. In that case at SS death, the value of the SS's estate and the QDOT assets would $18,467,79.

3. There's no DSUE amount but now $20,122,885 passes to the couple heirs.

4. 79.54%

Example 4 – When Portability Works

1. Deceased spouse's estate is $1,000,000
2. SS has $19,000,000 estate tax value
3. Deceased spouse includes his assets in a QDOT.
4. At SS death, her estate would be $25,398,003 (QDOT value is $1,148,653).
5. The SS would be entitled to $4,281,347 of Deceased spouse DSUE amount.
6. $19,063,340 passes to heirs.
7. (75.36%)

Example 5 – SS is non-dom/non-citizen

1. Still, Deceased spouse's estate would fund a Bypass trust leaving only $4,470,000 in the QDOT. (Remember…we can design this better!)
2. But, SS's estate is $10,000,000 not situated in the U.S.
3. Then at death of the SS's, no DSUE is allowed because non-U.S. domiciled spouses are not allowed any DSUE amount.
4. However, the tax on the QDOT is $2,064,800.
5. $20,351,128 passes to heirs.
6. 80.45%

Hardship Distribution

1. Distributions to the Surviving spouse on account of hardship will not attract the QDOT tax.
2. Treas. Reg. §S 20.2056-5(c)(1). Under the Treasury Regulations, distributions are considered to be made on account of hardship if made to the spouse from the QDOT "in response to an immediate and substantial financial need relating to the spouse's health, maintenance, education, or support or that of someone he or she is legally obligated to support.
3. Selling of closely-held assets are not considered "reasonably available" but public securities are.
4. Such hardship distributions are not taxable.

Estate/Estate And Gift Tax Treaties

- Permits more generous exemptions against U.S. estate tax.
- A deceased U.S. domiciled spouse's unused lifetime exemption is not portable to a non-U.S. spouse (unless allowable under a treaty) but is to a U.S. domiciled spouse.

Example: U.S.- U.K.

- This treaty increases the available exemption for estate, gift, and GST to the same amount as a U.S. resident domiciled on citizen, for the non-domiciled decedent but some rules apply for non-citizen donee, after exemption amount

CYNTHIA D. BRITTAIN

Cindy Brittain focuses her practice on high net worth, multinational families and individuals who themselves and their global companies require expertise in sophisticated cross-border income and estate tax planning strategies. Working closely with family members, Cindy obtains a comprehensive understanding of their values and dynamics, ensuring that unique personal and business goals are achieved. Cindy's extensive experience includes advising families on the complex issues relevant to pre-immigration planning, international corporate tax, and both international and domestic wealth and asset transfer strategies. Cindy also has extensive experience with cross-border regulatory laws that affect U.S. domestic planning as well as with U.S. tax compliance under the several voluntary disclosure regimes.

Practice focus

- Advanced domestic and international estate and tax planning; Transactional tax and corporate cross-border design
- Pre-immigration strategies for corporate assets; Multi-generational succession and entity planning
- Trust and legacy design; Multi-state trust strategies to mitigate California state income tax
- Charitable planning for effective tax and philanthropic goals; Family governance and family retreats for NextGen Education