CALAMOS® WEALTH MANAGEMENT

FROM THE WEALTH STRATEGY GROUP

Estate Planning When a Spouse is a Non-U.S. Citizen

When a U.S. citizen marries a non-U.S. citizen, estate planning discussions become more specialized, requiring external collaboration with legal and tax experts on international tax and immigration laws. Together, we can assist non-U.S. citizen clients to understand tax and inheritance laws on relevant countries to strategize distribution of wealth during life and at death.

Residency and Domicile

For income tax purposes, in the United States, there is an objective test to determining whether a person is a U.S. resident ("the substantial presence" test) that measures the number of days the taxpayer was physically within the United States.

For transfer tax purposes (gift and estate taxation), it is tied to the concept of domicile rather than residency. Domicile, is acquired by living in a jurisdiction without the present intention of leaving at some later time. Domicile, once created, will likely require an actual move outside the country (with the intention to remain outside) to sever it. Therefore, permanent resident aliens (green card) status would in most cases establish domicile.

The Non-U.S. Citizen May Own Assets Outside of the U.S.

A helpful starting point in the planning process is to identify how much of the wealth is in foreign property and how the property is registered (joint, individual or in trust). Some countries may or may not recognize the concept of trusts as "owners."

When a non-U.S. citizen owns property outside of the United States, the transfer laws of the country where the property is located may affect how it is distributed. The Last Will and Testament with a situs in the United States may not be recognized by the country in which the property is located as a valid document. Therefore, it may be advisable to create multiple wills; each one dealing exclusively with money or property located in the country of situs. It may be beneficial to engage an attorney in a foreign country to create a "geographic Will" identifying the property to pass in that jurisdiction under the foreign country's intestacy laws.

Situs, (or, location) of the property plays an important role in estate planning as transfer tax implications for the non-U.S. citizen will depend on the nature or character of the asset, and the physical location of the property. While a specific country analysis of the situs rules is beyond the scope of this article, some jurisdictions employ situs rules similar to the U.S.

Currently, the United States has estate and/or gift tax treaties with sixteen sovereign nations. The treaty rules establish taxation priority by first determining which jurisdiction was the domicile of the decedent. This may alter the path of estate planning and it may require relevant transfer tax evaluation to determine the transfer tax outcome in consideration of not only the nature of the property and its location, but also the impact of citizenship and domicile on net tax outcomes.

Unlimited Marital Deduction and Gifting

When both spouses are U.S. Citizens, it is unlikely that they will be faced with a gift tax or estate tax bill. The federal estate tax exemption of $11.58 million dollars for each of them and the unlimited marital deduction for a married couple enables them to pass wealth free of tax. The rules don't apply when one of the spouses is not a U.S. citizen.

Gifting during life to a non-U.S. citizen spouse, including making them joint owners of real estate, stocks and bank accounts, may be subject to federal gift tax since the unlimited marital deduction is not available. However, a citizen spouse may gift up to $157,000 per year to a non-U.S. citizen spouse. This amount will increase to $159,000 per year in 2021. The nature, timing and documentation of the gifts should be done with the assistance of a knowledgeable tax professional.

Transferring at Death Rules

What happens when the U.S. citizen spouse passes away naming the non-U.S. citizen spouse as beneficiary? The answer is, the non-U.S. citizen spouse can inherit property in the manner as a citizen. However, under federal estate tax rules, a surviving spouse who is not a U.S. citizen must pay taxes on the inherited amount. The unlimited marital deduction rule does not apply! The federal government does not want someone who isn't a citizen to inherit assets and pay no estate tax for fear that those assets would leave the country untaxed.

DEFINING YOUR RESIDENCY STATUS

Resident Alien: applies to someone who has U.S. permanent or conditional residence, or a green card holder. To keep the "green-card" status, the individual must live in the United States and not remain outside of the US for more than one year. Section 318 of the Immigration and Nationality Act (INA) requires that the naturalization applicant show that he or she has been lawfully admitted to the United States for permanent residence in accordance with all applicable provisions of the INA in effect at the time of admission.

Someone could also be considered a Resident Alien, without having a "green-card", if they meet the "substantial presence test". This means spending 31 days in the United States during the current year and 183 days during a three-year period that includes the current year and two years immediately before that. Some resident aliens may be holding nonimmigrant visas.

Non-Resident Alien: when an individual is in the U.S. but does not meet the green-card **or the substantial presence test. This applies to foreign exchange students and foreign teachers initially.**

When the non-U.S. citizen passes first, and the U.S. citizen spouse is the beneficiary, the property in her name will pass to the U.S. citizen spouse under the federal gift and estate taxes unlimited marital transfer exemption on all of the money both own worldwide. Therefore, when conducting long-term estate

planning, they would be advised to take advantage of the $11.58 million lifetime gift and estate tax exemption and the $15,000 gift tax annual exclusion.

Wealth Strategies

For couples with large estates where one spouse is a non-U.S. citizen, there are two strategies to consider:

1. Apply for Citizenship: The spouse who becomes a U.S. citizen by the time the decedent's federal estate tax return is due, will qualify for the unlimited marital deduction. The return is due nine months after death but there is a six-month extension period. However, waiting until the death of a U.S. citizen spouse for the non-U.S. citizen to apply for citizenship may create some timing issues.

2. Establish a Qualified Domestic Trust (QDOT) approved by the Internal Revenue Code section 2056A. The trust will inherit the property instead of having the non-U.S. citizen receiving the property directly. The surviving non-U.S. citizen spouse is the sole beneficiary of the trust during their lifetime and receives income from the trust.

The Benefits of the Qualified Domestic Trust (QDOT)

To be able to take advantage of transfers between spouses and mitigate potential estate tax consequences, many attorneys create a Qualified Domestic Trust (QDOT) to allow the non-citizen spouse to inherit from a US Citizen's spouse free of estate tax. The QDOT can be created by the will of the decedent, or the QDOT can elected within 27 months after the decedent's death. The surviving spouse is treated as the grantor for income and transfer tax purposes.

Benefits:

- The US citizen can leave property to a trust, rather than giving it outright to the non-US citizen.
- The only beneficiary in the trust is the non-US citizen spouse until he/she dies.
- The trust will provide income from the trust without having to pay the estate tax.
- When the non-US citizen dies, and the principal needs to be distributed to the next beneficiaries, the estate tax applies.
- If the non-US Citizen becomes a US citizen, the principal can be distributed to the spouse without any further tax.
- The QDOT funds are not included in the surviving spouse's estate.
- The QDOT can be established at the time of the first spouse's death.
- The trustee must be a US citizen or a trust company.

Individuals married to non-U.S. citizens who live, work or own property in the U.S. need to have assistance in understanding the potential implications of the U.S. estate and gift tax rules as they may have major tax implications. Estate planning for a non-U.S. citizen spouse can be significantly more complex than planning for a citizen spouse. An international estate planning professional with a legal and accounting background will be engaged with a financial planner to help them determine any potential legal issues.

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