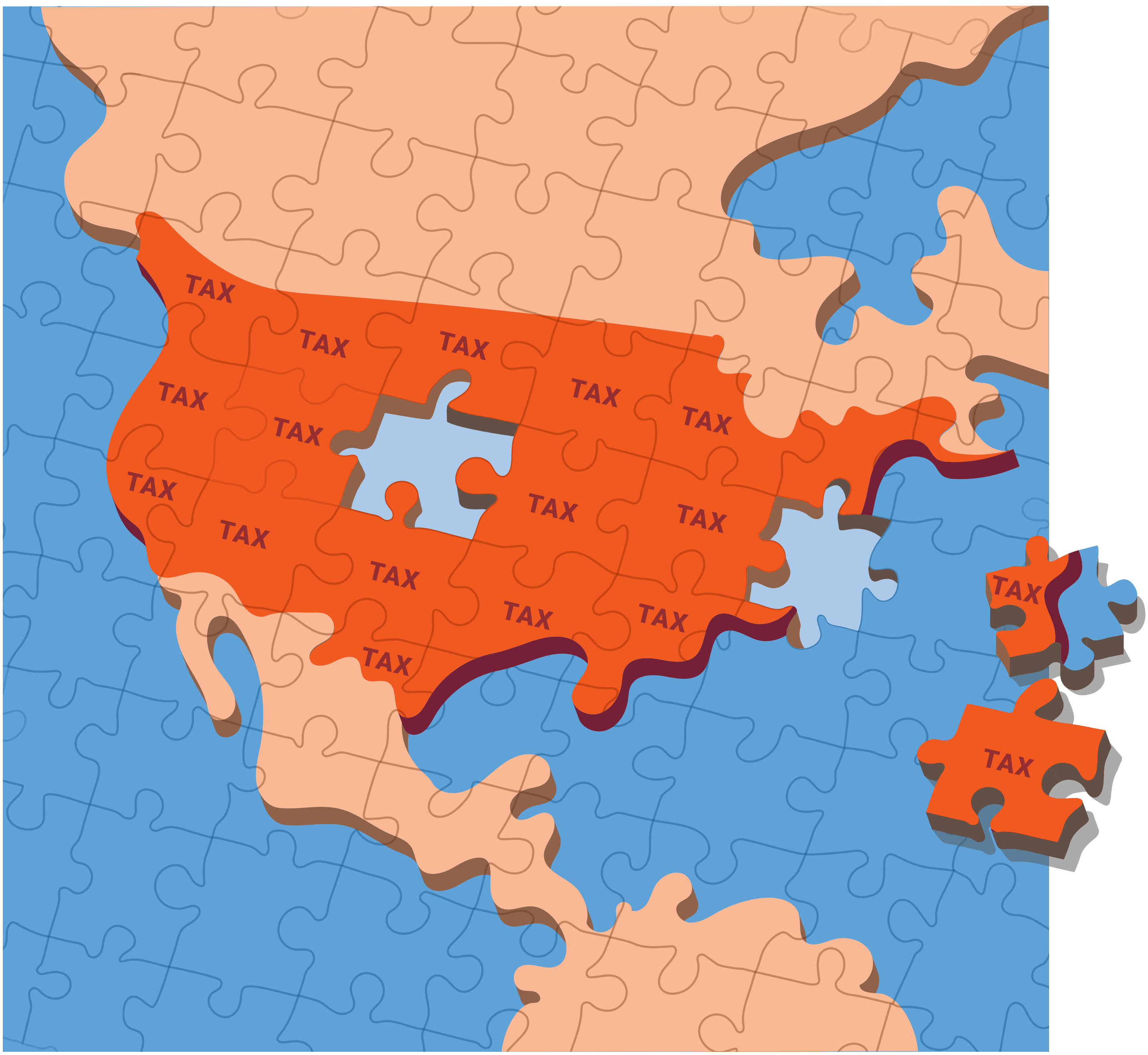
Navigating international tax and estate planning with your global clients

Part 2: Transfer taxation of noncitizens – Basic concepts

WHITE PAPER



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Transfer taxation of noncitizens– Basic concepts

Lance Winston, J.D., LL.M. and Mark Phelps, CLU® collaborated to bring you valuable international tax information presented in both a technical and a practice implementation format. This can help you gain an understanding of the tax laws as they pertain to your foreign national clients so that you can identify situations that can arise in your cases and plan accordingly.

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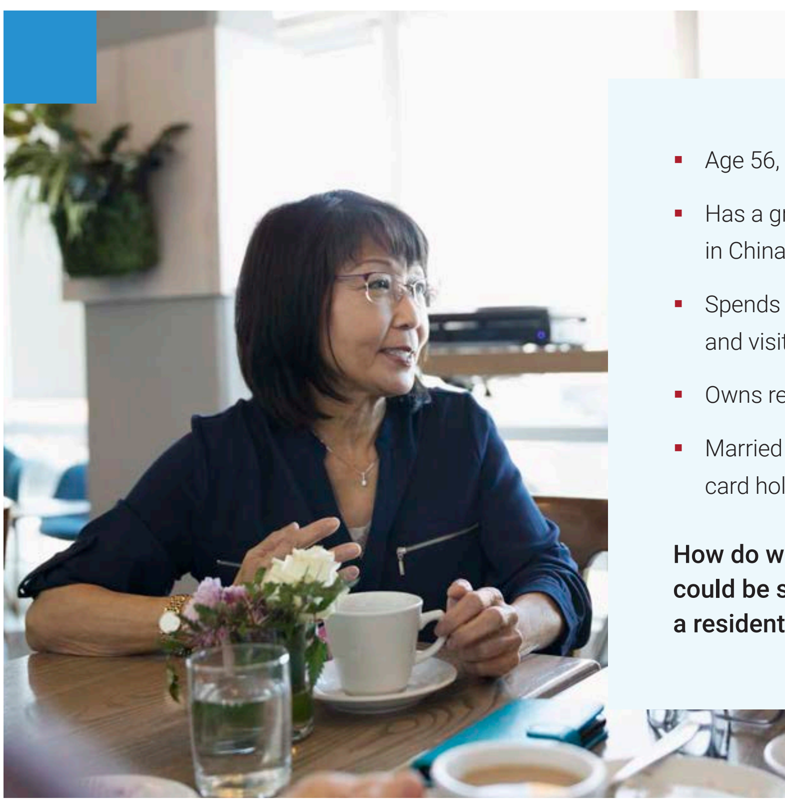
When approaching global clients, the complications of cross-border taxation can be daunting for those of us who aren't tax professionals. The goal of this white paper is to equip you with the basic knowledge you will need in order to point your clients in the right direction and help them navigate their initial conversations with the right professionals.

Life insurance can be an important part of financial planning for wealthy global clients. Your value will likely be your knowledge of U.S. life insurance products and process, but we want you to be ready for your seat at the table with the client's other professionals.

Did you know that a noncitizen client:

- **Isn't able to claim the unlimited marital deduction for lifetime gifts or death time transfers if his or her spouse is not a U.S. citizen?** Think about your noncitizen clients who might have a large estate or business**. Is the estate prepared to pay taxes at the first death?**
- **Can receive a much larger gift than the annual exclusion without triggering a gift tax?** This is commonly referred to as the "super exclusion" and is available each year, indexed for inflation. **Are your clients taking advantage of that benefit?**
- **May only have a $60,000 U.S. estate tax exemption?** Many noncitizen nonresident clients don't know which of their assets might be included in their U.S. taxable estate. **Do they need a plan for paying or mitigating U.S. estate taxes?**

Meet Esther



- Age 56, Chinese citizen
- Has a green card, but spends most of the year in China
- Spends a few months a year vacationing and visiting her son and his family in the U.S.
- Owns real estate both in China and the U.S.
- Married to a Chinese citizen (not a green card holder)

How do we know which of Esther's assets could be subject to U.S. estate tax? Is Esther a resident or a nonresident?

What determines residency in the U.S. transfer tax context?

"Transfer tax" includes federal estate, gift and generation-skipping transfer (GST) tax. See Part 1 of the white paper for information about income tax.

Domicile

A U.S. resident as defined under IRC §7701(b)(1)(A) applies only for U.S. federal income tax purposes. These rules do not apply for purposes of U.S. transfer tax. IRC §7701(b)(1). Rather, for U.S. transfer tax purposes, an individual is a resident if "domiciled" in the U.S. at the time of his or her gift or death. Reg. §20.0-1(b); Reg. §25.2501-1(b). An individual acquires a domicile in the U.S. by living in the U.S., even for a brief period, with no definite present intention of leaving. Reg. §20.0-1(b); Reg. §25.2501-1(b). Residence in the U.S. without the requisite intention to remain indefinitely is not enough to constitute a domicile in the U.S., and the individual will be treated as a nonresident for U.S. transfer tax purposes. Reg. §20.0-1(b); Reg. §25.2501-1(b). Conversely, once an individual establishes a domicile in the U.S., a change in his or her intention to remain indefinitely, unless he or she actually leaves the U.S., will not affect such intention to change domicile, and the individual will be treated as a resident for U.S. transfer tax purposes. Reg. §20.0-1(b); Reg. §25.2501-1(b).

Unlike, the objective test of residency for U.S. federal income tax purposes, the test of residency for U.S. transfer tax purposes is predicated on a much more subjective analysis to determine an individual's intent, and it's based on all relevant facts and circumstances. Although, an individual, obtaining a green card, is a resident for U.S. federal income tax purposes, this status is not conclusive evidence of being domiciled in the U.S. for transfer tax purposes, but it clearly has probative value, and may provide a strong indication of the individual's intent to remain in the U.S. indefinitely. Courts have weighed the following factors in determining domicile in U.S. transfer tax cases:

- **Location of business interests.** See *Estate of Khan v. Commissioner*, T.C. Memo 1998-22; *Paquette Est. v. Comr*., T.C. memo 1983-571.
- **Family immigration history and the location of family members and close friends.** See *Estate of Khan v. Commissioner*, T.C. Memo 1998-22; *Estate of Nienhuys v. Commissioner*, 17 T.C. 1149 (1952).
- **Location of residential properties and comparisons relative to sizes and values, physical characteristics, and whether owned or rented.** See *Estate of Nienhuys v. Commissioner*, 17 T.C. 1149 (1952); *Estate of Fokker v. Commissioner*, 10 T.C. 1225 (1948).
- **Testimony, declarations and statements of the individual made in visa applications, wills, trusts, gift deeds, letters, and oral statements.** See *Estate of Nienhuys v. Commissioner*, 17 T.C. 1149 (1952); *Farmers' Loan & Tr. Co. v. United States*, 60 F. 2d 618 (S.D.N.Y. 1932); *Cooper v. Reynolds*, 24 F. 2d 150 (D. Wyo. 1927); *Estate of Khan v. Commissioner*, T.C. Memo 1998-22; Estate of *Fokker v. Commissioner*, 10 T.C. 1225 (1948).

- **Motivations for being in the U.S.** See *Estate of Paquette v. Commissioner*, T.C. Memo 1983-571; *Estate of Khan v. Commissioner*, T.C. Memo 1998-22; *Estate of Fokker v. Commissioner*, 10 T.C. 1225 (1948).
- **Travel frequency and duration of stays in the U.S.** See *Paquette Est. v. Comr*., T.C. memo 1983-571; *Cooper v. Reynolds*, 24 F.2d 150 (D. Wyo. 1927).
- **Location of spiritual, religious, social affiliations and memberships, and community affairs.** See *Estate of Fokker v. Commissioner*, 10 T.C. 1225 (1948); *Rogers v. Commissioner*, 17 B.T.A. 570 (1929); Rev. Rul. 80-209.

The definition of "residency" is different for transfer tax than it is for income tax. For transfer tax, the definition is less objective. To paraphrase, the client is "domiciled" in the U.S. if he or she lives here and doesn't intend to leave. There are a number of factors that courts have used to analyze a client's "intentions," so it's important that clients consult tax and legal professionals who are familiar with this area of law. Integrating life insurance can protect against uncertainty and/or future changes in your client's residency status.

Esther has a green card, so she must be a resident, right? Wrong.

For income tax purposes, yes. But, for estate, gift and GST tax, not necessarily. Unless she lives in the U.S. with no definite present intention of leaving, she's probably not a resident.

Esther is only spending three to four months in the U.S. each year. She doesn't live here, so she isn't a resident. But, what if her son becomes ill and she decides to stay in the U.S. to help his family until he is better? At that point, she would be living in the U.S. You could argue that she is "definitely intending" to leave once her son is better. On the other hand, if he remains ill, she will stay in the U.S. In that case, could her intent to leave really be described as "definite"?

The Courts may look at a number of other factors if Esther's domicile isn't clear:

- *Where do her friends and family live?* For Esther, most of her family is in China, including her husband.
- *Where does she have a driver's license?* She doesn't drive.
- *Where does she own property?* She owns an apartment in China, a vacation home in Italy, and a couple commercial properties in California.
- *Where does she work?* She works in her husband's business, which is located in China.
- *What is the location of religious or social groups to which she belongs?* For Esther, most of her social circle is in China.

Residency is not always obvious. This is all the more reason to involve the right legal counsel.

Effect of tax treaties

The concept of domicile and the relevant facts and circumstances necessary to determine an individual's intent, necessary to establish domicile, may be different in various countries. Under certain circumstances an individual could be domiciled in both the U.S. and another country, under each country's internal laws, and subject to double taxation on his or her worldwide assets. If the two countries have a bilateral estate and/or gift tax domicile-type treaty, it often prescribes tiebreaker rules, to eliminate conflicts over domicile, that give primary taxing authority to the treaty country in which the individual maintains his or her "fiscal domicile." It's based on the following factors, in order of priority: (1) location of permanent home, (2) location of closest personal and economic interests (center of vital interests), (3) habitual abode, and (4) country of citizenship. The U.S. is a party to 15 bilateral estate and/or gift tax treaties with the following countries: Australia, Austria, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, the Netherlands, Norway, South Africa, Switzerland, and the United Kingdom. However, the treaty with Norway was officially terminated, effective January 1, 2015, due to Norway's 2014 repeal of its inheritance tax. The U.S. is also a party to a bilateral income tax treaty with Canada that addresses U.S. transfer taxes as well as Canadian income tax at death. Each tax treaty is unique and must be consulted if applicable.

It's important for your client to verify if there are any estate and gift tax treaties that would apply to your client's situation. The purpose of those treaties is to minimize double taxation. Each of the treaties is a little bit different, so you should advise your client to consult a tax attorney.

Does the U.S. have an estate or gift tax treaty with China?
No. So, Esther and her U.S. attorney will want to connect with local counsel in China to find out if she will need to worry about any double taxation.

U.S. possessions

A special rule applies for certain individuals residing in a U.S. possession (American Samoa, Commonwealth Northern Mariana Islands, Guam, Puerto Rico, and the U.S. Virgin Islands). An individual domiciled in a U.S. possession at the time of his or her gift or death who acquires U.S. citizenship solely by reason of being a citizen of such U.S. possession, or by reason of his or her birth, or residency in such U.S. possession, is deemed a non-U.S. resident, non-U.S. citizen, for U.S. transfer tax purposes. IRC §2209; IRC §2501(c); Reg. §20.2209-1; Reg. §25.2501-1(d).

A client who lives in a U.S. possession, like Puerto Rico, will want to check with the appropriate professional about his or her tax status. There is a good chance he or she will be considered a nonresident for U.S. transfer tax purposes.

Esther doesn't have to worry about this, but she has a cousin who is a citizen of Guam. Esther's cousin may be treated as a nonresident for transfer tax purposes.

Why residency status is important

"Domicile" affects which assets could be subject to U.S. transfer tax

An individual's status as a resident for U.S. federal estate, gift and GST tax purposes (broadly referred to as "U.S. transfer taxes"), determines the extent to which he or she is subject to U.S. transfer tax. A U.S. resident, like a U.S. citizen, will be subject to U.S. transfer tax on his or her worldwide assets. IRC §2001(a); IRC §2031; IRC §2501(a)(1); IRC §2601; Reg. §25.2501-1(a)(1); Reg. §26.2611-1; Reg. §26.2652-1(a)(2). Whereas, a non-U.S. citizen, non-U.S. resident, is subject to U.S. transfer tax only on property situated or deemed situated in the U.S. (U.S. situs property) at the time of the gift or at death. IRC §2101; IRC §2103; IRC §2511(a); IRC §2663; Reg. §25.2511-1(b); Reg. §26.2652-1(a)(2); Reg. §26.2663-2(b)(1); Reg. §26.2663-2(b)(2). Property owned by a non-U.S. resident, situated outside of the U.S. (foreign situs property), is generally not subject to U.S. transfer tax.

Just like with income taxation, residency effects WHICH of a noncitizen's assets could be subject to U.S. estate tax. U.S. residents need to take all of their worldwide assets into account, whereas, non-U.S. residents may only need to consider certain assets in the U.S. — commonly referred to as their "U.S. situs" property.

Which assets are considered "U.S. situs" property?

Nonresidents are generally only subject to U.S. transfer tax on their U.S. situs assets. A tax or legal professional can best help determine whether a client's specific assets could be subject to U.S. tax. See Part 3 of the white paper for details about each type of asset and for information about how these assets are treated differently for estate and gift tax purposes.

U.S. situs assets: for nonresident noncitizens

Asset	U.S. estate-taxable to a nonresident?	U.S. gift-taxable to a nonresident?
Tangible personal property located in the U.S. (such as artwork, jewelry)	Yes	Yes
Currency in U.S. safe deposit box	Yes	Yes
U.S. real estate	Yes	Yes
Non-U.S. real estate	No	No
U.S. government and corporate bonds	No	No
Non-U.S. stocks	No	No
Life insurance death benefits	No	Yes[1]
U.S. state/muni bonds	Yes	No
U.S. stocks	Yes	No
U.S. partnerships/LLC interest	Uncertain	Probably not[2]
Life insurance cash values	Yes	No
Cash deposits in a U.S. bank	No	Yes

[1] Assumes life insurance policy has a different owner, insured, and beneficiary. *Goodman v. Commissioner*, 156 F.2d 218 (2nd Cir.1946).

[2] IRS will not issue letter rulings or determination letters on whether a partnership interest is intangible property for purposes of IRC §2501(a)(2) (dealing with transfer of tangible property by a nonresident not a citizen of the U.S.). Rev. Proc. 2017-7, 2017-1 IRB, §4.01(28).

Apply the chart to Esther's U.S. taxable estate.

Is Esther's U.S. real estate considered U.S. situs property? Yes. **How about her Chinese real estate?** No. **If Esther buys a U.S. life insurance policy, will the death benefit be included in her U.S. taxable estate?** No.

Another important consideration in Esther's case: How are her U.S. assets owned? In this case, Esther owns her U.S. property in her own name. Sometimes, though, clients have chosen ownership structures that minimize or eliminate taxation.

U.S. estate taxation of noncitizens: calculation of the gross estate

For U.S. federal estate tax purposes, a non-U.S. resident decedent's gross estate value is determined in the same way as for a U.S. citizen or resident. IRC §2103. It includes the value of all property interests described in, and in accordance with, the general principles of IRC §2033 through IRC §2044. Reg. §20.2031-1. Therefore, the value of a non-U.S. resident decedent's gross estate may include:

- Any interest the decedent had in property at the time of his or her death. IRC §2033.
- Gratuitous lifetime transfer made by the decedent (by trust or otherwise) with respect to any property, during the three-year period ending on the date of the decedent's death and the value of such property (or an interest therein) would have been included in the decedent's gross estate under IRC §2036, IRC §2037, or IRC §2038 if such interest had been retained by the decedent on the date of his or her death. IRC §2035. (IRC §2035 includes IRC §2042, however, IRC §2105(a) renders IRC §2042 inapplicable to nonresident decedent's estates).
- Gratuitous lifetime transfer made by the decedent (by trust or otherwise) with respect to any property to which the decedent retained the income or the power to designate who shall enjoy the income. IRC §2036.
- Gratuitous lifetime transfer made by the decedent (by trust or otherwise) subject to change by the decedent alone or by the decedent in conjunction with any other person, at the decedent's death, to alter, amend, revoke, or terminate. IRC §2038.
- Joint ownership property (joint tenants with rights of survivorship or tenants by the entirety) held by decedent at his or her death. IRC §2040.
- Property subject to a general power of appointment held by decedent at his or her death. IRC §2041.
- Any property in which the decedent previously received a marital deduction. IRC §2044.

Basically, anything a noncitizen owns at death may be included in his or her U.S. gross estate if the noncitizens meets certain residency requirements. (Remember, nonresident noncitizens should only have to consider certain U.S. situs assets as a part of this calculation.)

"Gratuitous transfers" mean gifts. There are many ways to use gifts in estate planning, but clients will want to be aware that removing an asset from his or her gross estate is not always just as easy as giving it away. If the client makes a gift but retains an interest in the property, it might still be includable in his or her U.S. gross estate.

Also, you'll see in the next section that nonresidents don't often have access to a lifetime exemption, so gifts of U.S. situs property may be taxable in the year they are made.

Esther has a net worth of over $20 million, including what she owns in the U.S., China, and other countries.

Esther's husband, who is also a nonresident, will want to pay attention in case joint ownership or "community property" would affect his U.S. estate.

Is there a U.S. federal estate tax exemption available to non-U.S. citizens?

U.S. resident noncitizens

A unified credit of the "applicable credit amount" is allowed against the estate tax imposed by IRC §2001 on estates of U.S. citizens and residents, and gift tax imposed by IRC §2501 on taxable gifts made by U.S. citizens and residents. IRC §2010; IRC §2505; Reg. §20.2010-1(a); Reg. §25.2505-1(a). The applicable credit amount is determined by applying the unified rate schedule in IRC §2001(c)(1), in the year of the decedent's death, to the "applicable exclusion amount." IRC §2010(c)(1); Reg. §20.2010-1(d)(1). In other words, the applicable credit amount converts the applicable exclusion amount into a credit, and is equal to the tentative tax on the applicable exclusion amount.

The applicable exclusion amount is the sum of the "basic exclusion amount," and in the case of a surviving spouse, a deceased spousal unused exclusion (DSUE) amount. IRC §2010(c)(2); Reg. §20.2010-1(d)(2). In 2022, the basic exclusion amount, adjusted for inflation using chained Consumer Price Index for all Urban Consumers (C-CPI-U), is $12,060,000, or an applicable credit amount of $4,769,800. IRC §2010(c)(3); Reg. §20.2010-1(d)(3); Rev. Proc. 2019-44. The DSUE amount, generally, refers to the unused portion of the decedent's applicable exclusion amount to the extent this amount does not exceed the basic exclusion amount in effect in the year of the decedent's death. Reg. §20.2010-1(a)(4).

The purpose of the DSUE provision is to allow portability of the decedent's DSUE amount and add it to the surviving spouse's basic exclusion amount to determine the surviving spouse's applicable exclusion amount. To the extent the DSUE provision is inapplicable, the surviving spouse's applicable exclusion amount is equal to the surviving spouse's basic exclusion amount. The portability rule is between U.S. citizen and resident spouses, and only applicable if the deceased spouse was a U.S. citizen or resident at the time of death, and the surviving spouse was a U.S. citizen or resident at the time of death. Reg. §20.2010-2(a)(5); Reg. §20.2010-3(e).

U.S. residents, like U.S. citizens, can take advantage of the full U.S. estate tax exemption — which is $12,060,000, in 2022, and is adjusted for inflation. In practice, the exemption is actually applied as a credit. So, instead of subtracting 12,060,000 from the gross estate value, you would actually calculate the gross estate tax and then subtract $4,769,800 (corresponding credit). In cases where both spouses are either U.S. citizens or residents, the surviving spouse can use whatever exemption (credit) is left over from the spouse who passed first.

Nonresidents

Unlike U.S. citizens and residents, the applicable exclusion amount/applicable credit amount, under IRC §2010, is not available to nonresidents even though the estates of nonresidents are subject to the same tax rates, under IRC §2001(c), as the estates of U.S. citizens and residents. IRC §2101(a); IRC §2102(b); Reg. §20.2101-1; Reg. §20.2102-1(c)(1). Instead, the estates of nonresidents are allowed a unified credit against the estate tax that is significantly smaller than for U.S. citizens and residents. In general, unless an applicable treaty requires otherwise, the estates of nonresidents are allowed a unified credit of $13,000, which is the equivalent to an exclusion of $60,000. IRC §2102(b)(1); IRC §2102(b)(3)(A); Reg. §20.2102-1(c)(1); Reg. §20.2102-1(c)(2).

Unlike the applicable exclusion amount or basic exclusion amount, the $13,000 unified credit is not adjusted for inflation nor can it be used to offset gift tax imposed by IRC §2501 on taxable gifts made by nonresidents. IRC §2505. IRC §2505 is only applicable to U.S. citizens and residents and cross-references IRC §2010(c). There is no corresponding statutory gift tax provision for nonresidents that cross-references IRC §2102(b)(1). Moreover, since the applicable exclusion amount is not available to the estates of nonresidents and the DSUE is computed and defined by reference to IRC §2010, rather than the unified credit under IRC §2102, the portability rule is inapplicable if the decedent was a nonresident at the time of death and the surviving spouse was a nonresident at the time of death, except to the extent allowed by an applicable treaty. Reg. §20.2010-2(a)(5); Reg. §20.2010-3(e).

The lifetime exemption available to U.S. citizens and resident noncitizens is not available to nonresident noncitizens. The exemption amount available to nonresidents is $60,000 and is only available at death (not for gifting during lifetime). This exemption is applied as a credit of $13,000 and is not adjusted for inflation. Because this exemption is so low, it represents a distinct planning need for many nonresident clients with U.S. property.

Coordination with treaties

To the extent required by an applicable treaty, the estates of nonresidents are allowed a credit equal to the amount which bears the same ratio to the applicable credit amount in effect under IRC §2010(c), for the calendar year which includes the date of death, as the value of the part of the decedent's gross estate which at the time of his or her death is situated in the U.S. bears to the value of his or her entire gross estate wherever situated. IRC §2102(b)(3)(A). In order to claim the increased credit under the applicable treaty, the nonresident decedent's worldwide assets would need to be disclosed.

Always have your client check to see if there is an estate tax treaty with any other applicable country. The handful of treaties that exist can significantly increase the exemption amount for nonresidents and might even allow for portability of remaining exemption between spouses.

Residents of U.S. possessions

In the case of a decedent who is considered a nonresident, non-U.S. citizen under IRC §2209, there is allowed a unified credit equal to the greater of $13,000, or $46,800 multiplied by the proportion that the decedent's gross estate situated in the U.S. bears to the total gross estate of the decedent wherever situated. IRC §2102(b)(2); Reg. §20.2102-1(c)(3).

Esther's tax and legal professionals are the right people to do her U.S. estate tax calculations, but we'll make some assumptions and see how some rough calculations might apply to her situation.

We know that she currently owns $3,500,000 of U.S. real estate.

What kind of U.S. estate tax liability might Esther be dealing with, even if we assume no growth in her current real estate holdings?

$3,500,000

Esther's U.S. taxable estate

$1,345,800

Esther's gross U.S. estate tax liability:

- $345,800 (first $1 million of taxable estate is taxed at a graduated rate)
- $1,000,000 (remaining $2.5 million of taxable estate is taxed at a flat 40% rate)

$1,332,800

Esther's net U.S. estate tax liability after applying the credit of $13,000 (credit corresponds with the $60,000 exemption)

Does Esther realize that her U.S. estate may owe over $1.3 million in taxes at her death? How will her estate cover that liability?

Is the unlimited marital deduction available to non-U.S. citizens?

The unlimited marital deduction allows U.S. citizen spouses to transfer an unlimited amount of property to each other during life or at death without triggering U.S. transfer taxation. The decedent's estate may claim the deduction at the death of the first spouse.

The availability of the estate and gift tax unlimited marital deduction depends on the citizenship status of the recipient spouse and not the citizenship or residency status of the decedent or donor spouse. Reg. §25.2523(a)-1(a); Reg. §25.2523(i)-1(a). If the recipient spouse is a U.S. citizen at the time of the decedent's death, or at the time of the gift, whether the decedent or donor spouse is a U.S. citizen, U.S. resident, or nonresident is immaterial, and an estate or gift tax unlimited marital deduction is allowed. IRC §2056(a); IRC §2523(a); Reg. §25.2523(i)-1(a). Thus, nonresidents, like U.S. citizens and residents, are allowed an unlimited marital deduction against the estate tax imposed by IRC §2001, and gift tax imposed by IRC §2501, on testamentary transfers or lifetime gifts, of any property interest that passes to a U.S. citizen spouse. IRC §2056(a); IRC §2106(a)(3); IRC §2523(a); Reg. §25.2056(a)-(1)(a); Reg. §2523(i)-1(a).

In the case of testamentary transfers, if the surviving spouse is not a U.S. citizen at the time of the decedent spouse's death, the estate tax unlimited marital deduction is generally disallowed, unless an applicable treaty allows otherwise, or the property passes to a qualified domestic trust (QDOT) as described in IRC §2056A(a). IRC §2056(d)(1); IRC §2556(d)(2). (A review of QDOTs is beyond the scope of this white paper. QDOTs will be discussed in Part III of this series).

In situations where at least one spouse is a noncitizen, the unlimited marital deduction may not be available. The result? Unexpected gift taxation or, even a first-death U.S. estate tax for wealthy couples. The key question is: who is the surviving spouse? If the surviving spouse is a U.S. citizen, the unlimited marital deduction is available. If the surviving spouse is a noncitizen, the unlimited marital deduction is likely not available. Potential solutions will be discussed in more detail in Part 3, but life insurance can also be introduced as a way to plan for liquidity at first death.

In the case of lifetime gifts, if the recipient spouse is not a U.S. citizen at the time of the donor spouse's gift, the gift tax unlimited marital deduction is disallowed, and in contrast to the estate tax marital deduction, there is no equivalent lifetime QDOT exception. IRC §2523(i)(1)(a); Reg. §25.2523(i)-1(a). Instead a $164,000 gift tax annual exclusion (in 2022 adjusted for inflation) is allowed under IRC §2503(b), in lieu of the $16,000, for gifts from a donor spouse (regardless of citizenship or residency status) to a non-U.S. citizen recipient spouse that qualify as "present interest" gifts. IRC §2523(i)(2); Reg. §25.2523(i)-1(c)(1); Reg. §25.2523(i)-1(c)(2); Rev. Proc. 2019-44. Additionally, for the increased gift tax annual exclusion to be applicable, any gift in excess of the $16,000 annual exclusion amount (in 2022 adjusted for inflation) must be in a form that would otherwise qualify for the marital deduction if the recipient spouse were a U.S. citizen. IRC §2523(i)(2); Reg. §25.2523(i)-1(c)(1). More about gifting in Part 3 of this white paper series.

Even though the unlimited marital deduction isn't generally available when the surviving spouse is a noncitizen, an annual exclusion amount is available. In 2022, you can give $164,000 each year to a noncitizen spouse — usually without paying U.S. gift tax. Do your clients know about this? And, would it make sense to leverage this gift as a life insurance premium?

What does this mean for Esther?

Her husband is not a U.S. citizen, and, therefore, will not benefit from the unlimited marital deduction if she passes first. We've determined that Esther's estate will likely have a U.S. tax liability, so she will want to make sure that there is a plan in place to pay any tax due.

What happens if her husband passes first?

What tools and gifting advantages might be available to help Esther and her husband manage their taxes and efficiently transfer their assets?

Quick view: U.S. estate taxation of noncitizens

Noncitizen status	WHICH ASSETS might be subject to U.S. estate tax?	EXEMPTION available?	UNLIMITED MARITAL DEDUCTION available?
Client is	Decedent	Decedent	Surviving spouse
Resident/Domiciliary	Worldwide	$12,060,000	Not available (may vary per treaty)
Nonresident/ Non-domiciliary	Certain U.S. situs assets	$60,000 (may vary per treaty)	Not available (may vary per treaty)

How about the estate taxation of U.S. life insurance?

For nonresident aliens, a U.S. life insurance death benefit may not be includable in the client's taxable U.S. estate. An ILIT may not be needed, but still may be desirable in some situations.

For resident aliens, the death benefit is includable in the client's U.S. taxable estate.

Be careful: The cash values of a U.S. life insurance policy owned on the life of another person would be includable in the U.S. taxable estate of the owner whether or not the client is a U.S. citizen, resident alien or nonresident alien. Your client will need to work with his or her tax professional or attorney to determine the U.S. estate tax consequences of a U.S. life insurance contract.

As we saw in Part 1, U.S. life insurance is a tax-advantaged asset — even for noncitizens. It's also a flexible asset that allows clients to control how much of their wealth passes on and to whom.

Don't forget that the future brings changes

Tax laws change — in the U.S. and in the client's home country. What you've read here may change in the future. How could that affect your client's tax liability and legacy?

Clients' lives change. What if your client moves to or out of the U.S.? How will his or her tax liability change?

Will the planning your client implemented produce the results he or she wants? Even the most careful planners meet with uncertainty and surprises.

Why not introduce a flexible planning tool that can change as life and laws change? That's U.S. life insurance!

Call your Lincoln representative or email us at ForeignNationals@LFG.com.

Not a deposit
Not FDIC-insured
Not insured by any federal government agency
Not guaranteed by any bank or savings association
May go down in value

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LCN-4476659-030722
POD 4/22 **Z03**
Order code: LIF-FN-WPR002

This white paper focuses on U.S. taxation. It is for educational purposes only and cannot be used as a tool to assist your client with his or her tax questions. You must direct your client to his or her own tax professional for questions that are specific to his or her tax situation. Your client may also have questions about how his or her assets, including life insurance will be taxed in other jurisdictions. You must direct your client to discuss those questions with his or her tax professional.

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