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Planning for Non-U.S. Citizens

We thought you would like to see this.

No matter where a U.S. citizen or resident (domiciliary) lives or who his beneficiaries are, both federal estate and gift tax (and presumably generation-skipping transfer tax) rules apply. The U.S. taxes the assets of its citizens and residents no matter where in the world those assets are located.

Many of us are married to or have family members who either live outside the U.S. or inside our country but who are not U.S. citizens.

This commentary is to alert you to some of the special problems and unique planning opportunities which are present when a family member is not a U.S. citizen or resident. (Of course, if this discussion doesn't apply to you, feel free to share it with a friend who may find it useful.

First, if you are married to or have family members who either live outside the U.S. or inside our country but who are not U.S. citizens, it's very important to let the members of your planning team know this fact. Don't assume that they do!

Second, if you or a family member are either not a U.S. citizen or live in a foreign country, your planning team needs to know if you or a family member living here owns property outside the U.S.

Here are some facts you should know if one spouse is not a U.S. citizen:

- ❖ No marital deduction will be allowed — for estate tax purposes — for transfers made directly to or in trust for a surviving spouse where the surviving spouse is not a U.S. citizen. Absent a marital deduction, assuming a significant estate, there may be an immediate and large tax that can't be deferred until the death of the surviving spouse. The impact of this tax is potentially disastrous!
- ❖ There is a tool called a QDOT (Qualified Domestic Trust) which enables a deferral of the federal estate tax on property that passes to the QDOT for the noncitizen spouse at the U.S. citizen's death. Unfortunately, this QDOT merely serves to delay the imposition of the tax. It is NOT equivalent to a regular marital deduction in any sense — except for the fact that there is no immediate tax at the death of the first spouse to die and that income paid from the trust is not subject to federal estate tax.
- ❖ There is a provision in the tax law that creates what some authorities call a "super annual exclusion." Using this provision, gifts to a non-citizen spouse that otherwise

qualify for the annual gift tax exclusion can be made in amounts of up to \$110,000 (2002) (adjusted for inflation) a year — every year.

You may want to consider a popular technique for leveraging the "super annual exclusion:" The citizen spouse makes gifts to the non-citizen spouse each year — up to the \$110,000 tax exempt gift limit. The non-U.S. citizen spouse then leverages this "super-annual exclusion" gift by purchasing life insurance on her/his citizen spouse's life with all or a significant portion of it. The death benefit generated by the coverage would provide significant financial security that would be free from the citizen spouse's creditors, estate and income tax, as well as probate free. Policy proceeds could be used to purchase assets from the estate of the U.S. citizen spouse and obtain a new and "stepped-up" basis (cost) for those assets.

There is, of course, much more to know where one or more family members are not a U.S. citizen or someone owns property outside the U.S.

As always, please feel free to call us to discuss this or other topics affecting your financial security. You can reach us at 480/998-5100 in Phoenix, 505/455-1500 in Santa Fe, 505/856-1100 in Albuquerque or toll free 866/856-1100.

Warmest Regards,

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