



# ADVANCED MATTERS

## INTERNATIONAL MARRIAGE AND THE U.S. ESTATE TAX

**Globalization isn't just a business catchphrase—it's transcended into family life. In the United States, 20% of families include a foreign born spouse.<sup>1</sup> Nearly five million Americans were married to someone born in another country as of 2010, double the number 50 years ago.<sup>2</sup>**

International marriage brings some additional complications, but one complication that many couples may not be aware of is the different treatment under the U.S. gift and estate tax laws. Simply stated, there is no unlimited marital deduction for transfers to a non-citizen spouse.

Most planners are aware that there is not a U.S. estate tax on assets transferred to a surviving U.S. citizen spouse due to the unlimited marital estate tax deduction.<sup>3</sup> For this reason, many do not think that there is any particular need for estate planning for couples with less than \$10.68 million in assets. However, this can be an expensive oversight and a missed opportunity for those couples where one or both spouses are not U.S. citizens. The non-citizen spouse does not receive the benefit of the estate tax marital deduction for U.S. estate taxes due on a deceased spouse's estate. Estate taxes are due after transfers of \$5.34 million from a U.S. resident or citizen, or they must establish a qualified domestic trust (QDOT). Naturally, there are many more couples with more than \$5.34 million than couples with \$10.68 million.

### **Definition of a Qualified Domestic Trust (QDOT)**

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A QDOT provides deferral of estate taxes during the surviving spouse's life. The assets in the QDOT will not be subject to estate taxes unless they are distributed to the surviving spouse from the QDOT, and they may be distributed without estate taxation if the distribution is a result of immediate, substantial financial hardship related to the health, maintenance or support of the survivor spouse. Income from the QDOT assets may also be distributed to the survivor spouse without owing estate tax, but this distribution is subject to income tax by the spouse. Moreover, at the death of the surviving spouse, the deferral of estate tax provided by the QDOT ends. The remaining QDOT assets are subject to estate taxes at the rate and in the amount that would have otherwise been due as part of the first decedent spouse's estate. If the assets have appreciated in value, the ultimate estate tax due may be greater than if the full amount had been subjected to estate taxes at the time of the first spouse's death. The QDOT itself will also require a U.S. trustee--possibly an institutional trustee--necessitating annual trustee fees and legal fees to establish the trust.

### **Life insurance as a solution**

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Life insurance can be a better planning option than a QDOT. Life insurance is often paid for using tax exempt gifts. For example, spouses who are both US citizens can freely transfer assets between themselves without owing gift taxes. However, while there is no marital deduction for a gift to a non-citizen spouse, the annual exempt gift allowed is \$145,000 per year, indexed for inflation.<sup>4</sup> This compares to an annual gift tax exempt amount of \$14,000 to a non-spouse. This annual exempt gift can be used to fund a life insurance policy owned by the spouse or held in an irrevocable life insurance trust (ILIT). In many cases, the amount of life insurance that can be purchased with this amount will cover potential future U.S. estate taxes. The death benefit will be free

<sup>1</sup>Married-Couple Households by Nativity Status: 2011 ACSBR/11-16 American Community Survey Briefs, U.S. Census Bureau

<sup>2</sup>A Global Love Affair, by Neil Parmar, The Wall Street Journal 5/21/2013

<sup>3</sup>IRC § 2056(d)(1)

<sup>4</sup>IRC Sec. 2523(i); Rev.Prc. 2011-52, Sec. 3.31 (2)

of U.S. income taxes to the beneficiary as well as estate taxes in the decedent insured's estate, so long as the decedent did not hold any incidents of ownership in the policy at death.<sup>5</sup> When life insurance death benefit is available to the surviving spouse to cover the deceased spouse's estate taxes, a QDOT may not be necessary to defer estate taxes and the assets and income of the deceased's estate can be used without restriction. The surviving spouse does not need to turn to a QDOT trustee for money.

This article addresses the basics of estate planning for married couples with diverse citizenships and U.S. estates. Many additional factors come into play when working through considerations for a specific couple, including estate tax and income tax treaties with the country or countries of citizenship and residence for the couple, laws of succession in the involved countries, and the overall estate planning goals of the couple. Transamerica's Advanced Marketing team is here for you as you help clients, and we can help coordinate with the client's legal and tax advisors to determine the requirements and optimal solutions for each case.

### **Contact Transamerica's Advanced Marketing team for more information.**

<sup>5</sup> IRC § 2042(2); IRC § 101(a)(1)

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