United States Estate and Gift Taxation of the Nonresident Alien

Executive summary
The United States has unique estate and gift tax rules applicable to resident and nonresident aliens. A practitioner who advises nonresident alien clients who plan any contact with the United States, either by spending time in the United States, or by investing in assets situated in the United States, should be aware of the rules that might impact their clients’ U.S. estate and gift tax liability attributable to the value of assets transferred at death or during their lifetime.

Introduction
The following is a description of the major provisions of the United States estate and gift transfer taxes as they apply to transfers by nonresident aliens.

What is Subject to U.S. Estate Tax?
Worldwide assets of:
• U.S. Citizens.
• Aliens who are “residents” for estate tax purposes.

Assets located in the U.S. of:
• Non-US citizens who are not “residents” for estate tax purposes.

What makes an Alien a U.S. Resident?
• Must be “domiciled” in the U.S. to be a resident for estate and gift tax purposes.
• Domicile is a subjective status that is achieved by living in the U.S., if even for a brief time, with no definite present intention of moving at a later time.
• A “resident,” for income tax purposes, is a different status, based on the three objective tests established in the Internal Revenue Code Sec. 7701(b): 2
  » Substantial Presence Test.
  » Green Card Test.
  » First Year Elections Test.

Provisions in income tax treaties may override these tests.

What determines domicile for estate and gift purposes?

- Presence in the U.S. with no definite current intention to leave.
- Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change, unless accompanied by actual removal.
- Residing in the U.S. without definite intention to remain does not make one a U.S. domiciliary, regardless of length of time spent as a U.S. resident.
- “The U.S. has entered into a number of estate tax treaties. When a person dies, and is a citizen of, or domiciled in, one of the countries party to a treaty with the U.S., the treaty provisions must be consulted.”

The U.S. currently has estate and/or gift tax treaties with the following countries:

- Australia
- Austria
- Belgium
- Canada*
- Denmark
- Finland
- Germany
- Greece
- Ireland
- Italy
- Japan
- Netherlands
- Norway
- South Africa
- Switzerland
- United Kingdom

Canada is covered under the U.S. – Canada Income Tax Treaty.

Estate Taxation of Non U.S. Citizens Who Are Not Domiciled in the U.S. (Non-residents for estate tax purposes)

- Subject to estate tax on U.S. situs assets owned at the time of death.
- Assets with U.S. situs include:
  - Real property located in the U.S.
  - Tangible personal property located in the U.S.
  - Stock in U.S. domestic corporations.
  - Debt obligations of U.S. persons or governmental units.
  - Partnership interests: There is very little authority on the proper situs rule to be employed. “Neither the U.S. tax Code, nor the Regulations, specifically address the situs of partnership interests for estate tax purposes or for gift tax purposes, and case law and rulings are inconclusive. It seems reasonable to conclude that a nonresident alien’s interest in a U.S. partnership, particularly, if it owns U.S. situs property, or is engaged in a U.S. trade or business, will be subject to U.S. estate tax in the nonresident alien’s estate.”
  - Bank deposits: Generally, bank deposits with U.S. domestic banks are deemed to be situated outside the U.S., unless deposits are effectively connected with a U.S. trade or business. “Non-bank deposits, such as cash accounts, in a U.S. brokerage firm, are likely to be U.S. situs property and subject to U.S. estate tax.”
- Property with non-U.S. situs that is not included in the estate of a nonresident includes:
  - Real property located outside the U.S.
  - Bank deposits not effectively connected with a U.S. trade or business
  - Foreign stocks and debt obligations
  - Life insurance proceeds on the life of a nonresident alien.

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* Id.
Computation of the Estate Tax

Like the estates of citizens and resident aliens, estates of nonresident aliens are subject to the unified estate and gift tax system. Therefore, computation of the nonresident alien’s estate tax liability requires a “grossed-up” or a combination of the decedent’s lifetime taxable gifts and the decedent’s taxable estate to which the tax rate schedule is then applied. Any available credits are subsequently taken to obtain the decedent’s actual estate tax liability (the amount of tax to be paid by the estate).

Estates of U.S. citizens, resident aliens, and nonresident aliens share the same estate tax rate schedule as follows:

<table>
<thead>
<tr>
<th>Taxable Estate</th>
<th>Tentative Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>not over $10,000</td>
<td>18% of such amount</td>
</tr>
<tr>
<td>$10,000–$20,000</td>
<td>$1,800 + 20% of excess over $10,000</td>
</tr>
<tr>
<td>$20,000–$40,000</td>
<td>$3,800 + 22% of excess over $20,000</td>
</tr>
<tr>
<td>$40,000–$60,000</td>
<td>$8,200 + 24% of excess over $40,000</td>
</tr>
<tr>
<td>$60,000–$80,000</td>
<td>$13,000 + 26% of excess over $60,000</td>
</tr>
<tr>
<td>$80,000–$100,000</td>
<td>$18,200 + 28% of excess over $80,000</td>
</tr>
<tr>
<td>$100,000–$150,000</td>
<td>$23,800 + 30% of excess over $100,000</td>
</tr>
<tr>
<td>$150,000–$250,000</td>
<td>$38,800 + 32% of excess over $150,000</td>
</tr>
<tr>
<td>$250,000–$500,000</td>
<td>$70,800 + 34% of excess over $250,000</td>
</tr>
<tr>
<td>$500,000–$750,000</td>
<td>$155,800 + 37% of excess over $500,000</td>
</tr>
<tr>
<td>$750,000–$1,000,000</td>
<td>$248,300 + 39% of excess over $750,000</td>
</tr>
<tr>
<td>Over $1,000,000</td>
<td>$345,800 + 40% of excess over $1,000,000</td>
</tr>
</tbody>
</table>

The unified transfer tax credit is available against both lifetime gift tax liabilities and the estate tax liability. To the extent this credit is used to offset gift taxes, it is unavailable to offset estate taxes. The IRC refers to the credit as an ‘applicable exclusion amount’; that is, the amount of taxable gifts or estate that the credit would cover. Estates of nonresident aliens are entitled to a credit of $13,000. Estates of nonresident aliens may apply this credit against their estate tax liability, as determined in the chart above, which effectively eliminates estate tax on the first $60,000 of assets.7

Gift Taxation of a Non-U.S. Resident8

- Residence or non-residence of donee is not relevant.
- Subject to gift tax on real and tangible property situated in the U.S.
- Intangible property: generally not subject to gift tax, even if intangible property has situs in the U.S. Gifting of stock in a U.S. corporation is not subject to gift tax, even though the stock would be subject to estate tax.
- Cash: The Internal Revenue Service and the courts generally have taken the position that cash constitutes tangible personal property, so that cash gifts from funds on deposit in a U.S. bank are subject to gift tax, even though the deposit would not be subject to the estate tax.9
- An annual exclusion of $14,000 is allowed. Gift splitting is not allowed.

Rules Applicable to Non-U.S. Citizen Spouses

- **Estate Tax**
  - The estate of a decedent (regardless of whether a resident or non-resident) is allowed a deduction for assets passing to U.S. citizen spouse.
  - No deduction is allowed for non-U.S. citizen spouses, unless the assets are transferred to a qualified domestic trust (“QDOT”).
- **Gift Tax**
  - The amount of a gift to a U.S. citizen spouse may be deducted from the amount of a gift.
  - No deduction is allowed for gifts to non-U.S. citizen spouses.
  - Annual exclusion gifts to non-citizen spouses are $100,000, indexed for inflation ($145,000 in 2014, $147,000 in 2015).10

Like the estates of citizens and resident aliens, estates of nonresident aliens are subject to the unified estate and gift tax system.

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Computation of the Gift Tax

A nonresident alien donor follows the same guidelines for determining gift tax liability as citizen/resident alien donors. The tax liability of a taxable gift is measured initially by the value of the transferred property. The tax is then applied cumulatively to taxable gifts made over the donor’s lifetime. The rate schedule reflected on page 3 is used in calculating the tax.

The actual computation of the gift tax for each calendar year is completed in three steps. First, the donor’s taxable gifts for the calendar year and any preceding calendar years are totaled and the tentative tax determined. Second, the tentative tax is again calculated using the total taxable gifts for the preceding calendar years. Third, the result from step two is subtracted from the result of step one, and the donor’s unused unified tax credit is applied to the remaining amount.

Table 1. Summary of Estate and Gift Tax Differences for U.S. Citizens, Resident Aliens, and Nonresident Aliens

<table>
<thead>
<tr>
<th>Decedent/Spouse</th>
<th>Gross Estate</th>
<th>Estate Tax Applicable Exclusion Amount</th>
<th>Estate Tax Marital Deduction</th>
<th>Annual Gift Tax Exclusion Amount</th>
<th>Annual Marital Gift Tax Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Citizen/U.S. Citizen</td>
<td>All property wherever situated</td>
<td>$5,430,000</td>
<td>Unlimited</td>
<td>$14,000</td>
<td>Unlimited</td>
</tr>
<tr>
<td>U.S. Citizen/Resident Alien</td>
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<td>$5,430,000</td>
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<td>$147,000</td>
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<td>$14,000</td>
<td>$147,000</td>
</tr>
<tr>
<td>Nonresident Alien/U.S. Citizen</td>
<td>Property “situated” in the United States</td>
<td>$60,000</td>
<td>Unlimited</td>
<td>$14,000</td>
<td>Unlimited</td>
</tr>
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<td>Nonresident Alien/Resident Alien</td>
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12 Id. (Original chart updated to reflect current Annual Marital Gift Tax Deductions).
QDOT: Qualified Domestic Trust

“If the surviving spouse is not a U.S. citizen (regardless of whether he or she resides in the United States), the bequest to the surviving spouse will not qualify for the marital deduction unless the property is held in a qualified domestic trust (QDOT) or unless the surviving spouse becomes a U.S. citizen within a specified period after the decedent spouse’s death.

“The purpose of the QDOT is to ensure the payment of the federal estate tax that was deferred on the death of the first spouse through the marital deduction because of the possibility that the surviving noncitizen spouse’s estate will not be subject to the federal estate tax. A QDOT must have at least one U.S. trustee who is an individual citizen or a domestic corporation and has veto power over distributions from the trust. The trust instrument of a QDOT must prevent distributions from the trust unless a U.S. trustee has the right to withhold estate tax imposed on the distribution. If the assets passing to the QDOT exceed $2 million, the U.S. trustee for the QDOT must either be a bank or must furnish a bond or letter of credit.

“The estate’s executor must make an election to apply the QDOT rules. The estate tax is payable on a taxable event, which includes principal distributions from the QDOT to the surviving noncitizen spouse. The balance of the trust value is taxed at the noncitizen spouse’s death. The estate tax is calculated based on the decedent’s tax brackets and can account for the decedent’s taxable gifts and other adjustments.”

Conclusion

In the age of global mobility, it is not unusual for non-U.S. citizens to own property or live in the U.S. for varying periods of time, without being aware of the estate or gift tax consequences of such activities. Understanding the rules described above, should allow the practitioner to advise clients who may have a potential tax liability, in order to avoid surprises, and take steps to reduce or eliminate their U.S. estate or gift tax liability.