

Estate Planning Opportunities for the Non-Citizen

Introduction

Estate planning for transnational clients presents unique challenges and opportunities. Thus, it is important to be knowledgeable of some of the most common tax issues transnational clients' face before assisting them with their estate planning.

The estate tax applies differently to the estates of U.S. citizens, resident aliens, and nonresident aliens.¹ A person's citizenship and domicile largely determine his or her estate tax status. Residence and domicile are not synonymous. Domicile is the place which an individual has freely chosen as the center of his or her domestic and legal relations -- the principal and permanent residence -- with no present intent of leaving. Simply put, domicile equals physical presence plus intention to remain indefinitely. Residence without intention to remain indefinitely does not constitute domicile.² A domicile, once acquired, is presumed to continue until it is shown to have been changed.³

Resident Alien

A resident alien is a non-citizen whose domicile (*see above*) is the United States. The estate tax rates for resident aliens and U.S. citizens are the same, but the deductions are different.

Nonresident Alien

A nonresident alien is a non-citizen whose domicile is not in the U.S. The estate of a nonresident alien is taxed only on the transfer of property situated or deemed situated in this country with exceptions for savings accounts, certain debt obligations, and life insurance. A nonresident alien must be both a "nonresident" and a "non-citizen."

For estate tax purposes, "domicile, not residence," is controlling. The term "nonresident" means a decedent, who, at the time of his or her death, had

his or her domicile outside the U.S.⁴ Natural born citizens of Puerto Rico, the Virgin Islands, and other U.S. territories, so long as they have not relocated to one of the fifty states, are considered "non-resident aliens."⁵

Unified Tax Credit

Individuals receive a lifetime unified tax credit against estate and gift taxes owed on applicable transfers of property.

U.S. Citizens and Resident Aliens

For 2026, the unified tax credit provides a basic exclusion amount of \$15,000,000 from estate or gift tax owed by a U.S. citizen or resident alien. In addition, a surviving spouse can use the unused portion of a previously deceased spouse's unified credit.⁶ A married couple can therefore transfer \$30,000,000 without incurring estate or gift taxes.

Nonresident Aliens

For a nonresident alien, the credit generally provides an exemption equivalent of only \$60,000, unless the U.S. possession or U.S. treaty exceptions apply.⁷

Tax Treaties and the Unified Credit

To the extent specified within estate or gift tax treaties between the U.S. and foreign countries, the applicable credit allowed to the estate of a nonresident alien in 2026 is the amount which bears the same ratio to the 2026 credit amount of \$5,945,800, as the gross estate situated in the U.S. bears to the decedent's entire gross estate. If any applicable credit has been allowed against the gift tax on gifts made by decedent, the \$5,945,800 amount must be reduced by the amount of the



credit allowed. The credit cannot exceed the amount of the estate tax before credits.⁸

For example: A nonresident alien dies domiciled in a foreign country which has an estate tax treaty with the U.S. Under the treaty, the U.S. is obligated to allow domiciliaries of the foreign country the applicable credit allowed to a U.S. citizen, multiplied by the proportion of the total gross estate situated in the U.S. Decedent's total gross estate is \$10,000,000 of which \$6,000,000 is situated in the U.S. Since 60% of the decedent's gross estate is situated in the U.S., 60% of the 2026 credit amount is allowed as a credit against estate taxes due on the decedent's property situated in the United States.

The U.S. has entered into estate tax treaties (also called tax conventions) for the avoidance of double taxation on U.S. situs property and preventing fiscal evasion with a number of countries. Estate tax treaties are currently in effect with the following countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, Spain, South Africa, Switzerland and the United Kingdom.

Section 2014 of the Internal Revenue Code also provides a statutory credit for citizens and resident aliens for foreign death taxes paid (on foreign-situated property only) which are subject to U.S. estate tax.

Marital Deduction

Under ordinary circumstances, the use of the marital deduction allows an individual to pass an unlimited amount of his or her property to a surviving spouse free of federal transfer taxes.

Marital Deduction for U.S. Citizens

For U.S. citizens, a marital deduction is allowed, subject to certain limitations, for the value of any property interest included in the gross estate that passes from the decedent to his or her surviving spouse. The property interest must pass to the lawful spouse as defined by state statute. No deduction is allowed for property passing to a former spouse.

Certain interests in property passing from the decedent to his or her surviving spouse are referred to as "terminable interests." Such an interest will not qualify for the marital deduction if another interest in the same property passes from the decedent to some other person for less than adequate and full consideration and such other person or his heirs may enjoy part of the property after the termination of the surviving spouse's interest. There are four exceptions to the terminable interest rule. A property interest passing from the decedent to his surviving spouse is not treated as a nondeductible terminable interest if:

1. It is a right to income for life with a general power of appointment meeting certain requirements; or
2. It is a right to income for life passing from a post-1981 decedent meeting certain requirements; or
3. It consists of life insurance or annuity payments held by the insurer with a general power of appointment in the spouse, meeting certain requirements; or
4. It is conditioned on the spouse's surviving for a limited period.

Marital Deduction for Non-citizens

The marital deduction is not permitted for property passing to surviving spouse who is not a U.S. citizen except under certain conditions. This rule applies to both resident and nonresident aliens.

Presumably, Congress' intent was to assure that aliens would not move property to their country of origin which might remove it from the reach of U.S. jurisdiction for federal estate tax purposes.

Therefore, no marital deduction is allowed if the surviving spouse is not a U.S. citizen, unless:

1. The property passes to the surviving spouse in a qualified domestic trust (QDOT) and would otherwise qualify for the marital deduction;⁹ or
2. The surviving spouse becomes a U.S. citizen before the estate tax return is filed (as long as the spouse was a U.S. resident at all times after the decedent's death and before becoming a U.S. citizen).¹⁰

Qualified Domestic Trust (QDOT) Exception

For transfers of property passing to a non-citizen spouse, a QDOT allows the deceased spouse's estate to obtain a deferral of estate tax until the surviving spouse's death, similar to a marital deduction, but at the first decedent's estate tax rate. Additionally, it ensures that eventually, the QDOT property will be subject to federal estate tax by preventing the non-citizen from removing the property from the U.S.

Qualified domestic trusts must meet the following conditions:

1. The trust may be created under U.S. law, the laws of any state, the laws of the District of Columbia, or a foreign jurisdiction.¹¹
2. The trust instrument must require at least one of the trustees be a citizen of the U.S. or a domestic corporation.¹²
3. Although Code section 2056A(a) does not require the non-U.S. citizen surviving spouse to have an income interest in a QDOT, such an interest is generally required in order to satisfy the terminable interest rules under sections 2056(b)(5) and 2056(b)(7).
4. The trust must meet Treasury regulations prescribed to ensure the collectability of estate tax (either on the distribution of trust assets or upon the death of the surviving spouse). The trust instrument must give the U.S. Trustee the right to withhold the amount of any QDOT tax imposed upon the distribution of principal to the non-citizen spouse. The final Treasury regulations add reporting requirements and governing instrument requirements to enforce the QDOT provisions.¹³
5. The executor must make an election (similar to the QTIP election). The election must be made by attaching an election statement to the estate tax return, and, once made, it is irrevocable.¹⁴ The election cannot be made on any return if the return is filed more than one year after the due date (including extensions).¹⁵ Unlike QTIP elections, QDOT elections cannot be partial elections. Although partial QDOTs are still prohibited, multiple QDOTs are allowable if a marital trust is severed in compliance with §2056(b)(7). Elections can be made with respect to some or to all of them.¹⁶

Caution: If there are two or more separate trusts and a QDOT election is made for each, then no hardship distributions are permitted.

6. The trust instrument must provide that no distribution (other than income) may be made unless a trustee who is an individual citizen of the U.S. or a domestic corporation has the right to withhold the QDOT estate tax on the distribution.¹⁷
7. If the QDOT does not contain a testamentary general power of appointment, it must be separately qualified for the marital deduction under Code §2056(b)(7). This means the executor needs to make both QDOT and QTIP elections.¹⁸

The final regulations impose additional requirements on large QDOTs (those that exceed \$2 million in value) and small QDOTs (\$2 million or less). This value threshold is determined as of the decedent spouse's date of death. Large QDOTs must meet one of the first two requirements below, while small QDOTs must meet any one of the three:

1. At least one of the United States trustees must be a "bank" as defined in I.R.C. §581, Regs. §20.2056A-2(d)(1)(i)(A). The final regulations now provide that a U.S. branch of a foreign bank may satisfy the bank trustee requirement, provided the trust instrument names at least one U.S. trustee as co-trustee of the QDOT at all times.
2. If the U.S. trustee is an individual, he or she must furnish a bond or security equal to 65% of the value of the QDOT at the decedent spouse's death.¹⁹ The final regulations provide latitude by also allowing a specific letter of credit format to suffice as an alternative to a bond. The letter of credit may be issued by a bank described in section 581; or a U.S. branch of a foreign bank; or, a foreign bank and confirmed by a Section 581 U.S. bank.²⁰
3. QDOTs of \$2 million or less may simply require that no more than 35% of the trust assets, valued as of the last day of the trust's taxable year, consist of real property located outside of the United States.²¹

If a small QDOT complies with the Foreign Real Property Requirement, a bank trustee or letter of credit will not be necessary.²²

Annual Valuation Requirement. The annual statement under the final regulations is required to be filed only in cases where the QDOT owns foreign real property unless the security of a bond or a letter of credit has been met. Failure of the trustee to promptly file could result in termination of the QDOT's special status and immediate imposition of the postponed estate tax upon the entire accumulated value of the QDOT. The residence exclusion may apply for determining the \$2 million dollar threshold by allowing the executor to exclude up to \$600,000 of the value of real property owned by the QDOT which is used by the spouse as a principal residence or a second residence.²³

Look-Through Rule. A difficult valuation issue may arise when a QDOT holds an equity interest in a closely held entity. When the QDOT holds more than a 20% voting interest or value in a corporation or partnership, all of the value of the underlying pro-rata assets owned by that corporation or partnership will be deemed to be owned directly by the QDOT for purposes of determining whether no more than 35% of the fair market value of the QDOT assets consists of foreign real property if that entity is owned by 15 or fewer owners.²⁴ Furthermore, all members of the surviving spouse's family are included when calculating the number of shareholders and voting interest of such an entity under the attribution rules of §267(c)(4).

Reformation of Faulty Instruments. A trust can qualify as a QDOT up until the time the federal estate tax return is due. It may also be modified through a reformation suit to qualify.²⁵

The QDOT may be created by the executor or the surviving spouse.

If the decedent's will leaves an outright bequest to a surviving non-citizen spouse, both TAMRA and the '89 Act are silent as to the question of whether such a bequest can be salvaged through transfer to a QDOT created after the decedent's death. In Estate of Nagle, a New York Surrogate (probate) judge determined a will of a spouse leaving his entire residuary estate outright to the surviving spouse could be reformed to create a QDOT. However, the final Regs. at §20.2056A-4(b) now permit even a direct bequest to be disclaimed in favor of a QDOT as long as the property would otherwise qualify for the marital deduction. The property must be transferred or assigned to a QDOT before the estate tax return is filed and on or before the last date prescribed by law that the QDOT election may be made under an enforceable and irrevocable written assignment.

The failure to provide for a QDOT by trust or will can be very costly in regard to gift and generation-skipping transfer taxes. Property assigned or transferred to a QDOT by a surviving, non-citizen spouse, pursuant to §2056(d)(2)(B) is treated as passing from the decedent in a QDOT solely for the purposes of §2056(d)(2)(A). For all other purposes (income, gift, estate, generation-skipping transfer taxes, and the §1491 excise tax), the surviving spouse is treated as the transferor of the property to the QDOT.²⁶

Non-Probate Property. Property passing outside the probate estate (e.g., life insurance proceeds) may be treated as passing to a QDOT if such property is transferred to a QDOT before the day on which the estate tax return is due.²⁷

The rule disallowing a gift tax marital deduction where the donee spouse is not a U.S. citizen does not apply to any transfer resulting from the acquisition of rights under a joint and survivor annuity where only the donor spouse and donee spouse have the right to receive payments before the death of the last spouse to die.²⁸

Upon death, the annuity would qualify for the estate tax marital deduction only if it meets the QDOT requirements.

Impact of Community & Joint Property Ownership. Community property has a preferred status to other property with a non-citizen surviving spouse. The non-citizen's one-half share of the community property is not affected. Thus, regardless of the order of deaths, the applicable credits of both spouses will be available to reduce the tax. This will not be the result with other property where a QDOT trust is used because the non-citizen's applicable credit cannot be used against trust property because of the operation of 2056A(b)(6). In disallowing the marital deduction when the surviving spouse is not a citizen, I.R.C. §2056(d)(1) states that I.R.C. §2040(b) shall not apply. This means that one-half of the value of a qualified joint interest (property held by the spouses as tenants by the entirety or as joint tenants with right of survivorship) will not be excluded from the gross estate, except to the extent consideration was furnished by the surviving spouse, pursuant to the tracing requirements of I.R.C. §2040(a). No part of the value remaining in decedent's estate will qualify for the marital deduction unless it is transferred to a QDOT.

Assets passing by joint tenancy are subject to special rules.²⁹ Asset-tracing applies to all jointly-owned assets except foreign situs real property purchased by nonresident non-citizens after January 1, 1982 and before July 14, 1988. There is no similar relief from the tracing requirements for U.S. citizens or residents who are survived by a non-citizen spouse.

Taxation of the Qualified Domestic Trust. An estate tax is imposed on distributions (other than income) made prior to the surviving spouse's death; and, also on the value of all property remaining in the trust at the spouse's death. The tax is also imposed on the trust property if a person other than an U.S. citizen or domestic corporation becomes a trustee of the trust; or, if the trust ceases to meet requirements in the regulations.³⁰

There is an exception for tax-exempt distributions from the QDOT principal on account of "hardship." This includes a distribution in response to an immediate and substantial need relating to the health, maintenance, education or support of the spouse or anyone the spouse is legally obligated to support.³¹

The amount of estate tax is the additional estate tax that would be due had the property subject to the tax been included in the (first) decedent's estate. Any estate tax due is treated as if it were taxed in the (first) decedent's estate, and not the surviving spouse's estate.³²

The surviving alien spouse's estate is entitled to the benefits of alternate valuation, special use valuation, Section 303 redemption, the charitable and marital deductions, and Section 6166 deferrals, if such benefits would otherwise be allowed.³³ The benefits to which the estate of the surviving non-citizen spouse is entitled for QDOT property was expanded by RRA '90 to include the credit for state death taxes and the credit for foreign death taxes.

In the event a taxable event occurs before the estate tax on the decedent's estate has been finally determined, a tentative tax is imposed using the highest estate tax rate in effect as of the date of the decedent's death. When the decedent's estate tax liability is finally determined, the excess of the tentative tax over the additional estate tax which would have been imposed had the property been includable in the gross estate is refundable.³⁴

The estate tax on QDOT distributions is due on the 15th day of the fourth month of the calendar year following the end of the calendar year in which the taxable event occurs.

Basis. The basis of property is adjusted under I.R.C. §1014 to the date of death value at the time of the citizen spouse's death. However, the basis of the property is not adjusted subsequent to its transfer to the QDOT if it is distributed from the QDOT to the non-citizen spouse prior to the non-citizen spouse's death.

Basis in a taxable distribution from a QDOT is computed as though the transfer was made by gift rather than by transfer at death. That is, an upward adjustment is made in the recipient's hands to account for any estate tax paid on the growth in value of the property occurring after the first spouse's death. For example, if property worth \$1 million is placed in a QDOT, and is later paid out to the surviving spouse when it has appreciated to \$1.3 million, it will be taxed at distribution at the increased value (\$1.3 million). The recipient will receive a basis adjustment for the estate tax paid on the \$300,000 increase in value between the date of death and the later distribution.³⁵

Drafting the QDOT. If the client's will is dated pre-November 10, 1988, assuming he has both credit shelter and QTIP trusts, the client's attorney may help execute a codicil to the will with a "savings" provision to the effect that he wishes to take advantage of QDOT treatment.

The codicil should be drafted to void any power, duty, or discretionary authority given to the executor or trustees that would jeopardize the marital deduction.

The codicil should make citizenship a condition to marital bequests under the terms of the existing will. If, as anticipated, the spouse has become a citizen prior to the testator's death, the codicil is ineffective.

Even though the surviving spouse is not required to receive all the income, the clients may prefer to have the QDOT drafted to pay all income to the spouse at least annually, since income distributions are excepted from the tax.

If a tax is imposed on a corpus distribution, the amount of the tax payment is treated as an additional distribution (unless paid out of income). To avoid this tax on a tax, the QDOT should be drafted to allocate QDOT tax to income.³⁶ No QDOT estate tax is imposed on any distribution to the surviving spouse to the extent the distribution is to reimburse the surviving spouse for any federal income tax imposed on any item of income of the trust to which the surviving spouse is not entitled.³⁷

Taxation Without the QDOT

If a marital deduction is denied because the surviving spouse is not a U.S. citizen and a QDOT is not employed – or is otherwise disqualified -- and, at the time of the surviving spouse's death, his or her estate is subject to U.S. estate tax, the estate tax paid by the first decedent on the property passing to the surviving spouse will be allowed as a credit against the tax payable by his or her estate.³⁸

Impact of Surviving Spouse's Subsequent Citizenship

Sometimes the simplest solution to a problem is overlooked precisely because of its simplicity. Your clients may each (or both) become citizens and obtain citizenship rights. (Assuming, of course, there are no other social, political or financial reasons for maintaining the status quo and the clients receive appropriate legal advice.)

As a resident alien, the spouse is already subject to U.S. income, gift and estate taxes and GSTT. Citizenship would allow estate planning techniques not permitted under the strict QDOT rules.

The estate tax marital deduction is allowed for property passing to a non-citizen spouse if that spouse becomes a U.S. citizen before the estate tax return is filed, as long as the spouse was a U.S. resident at the date of the decedent's death and at all times thereafter before becoming a U.S. citizen.³⁹

Provided the alien spouse was a U.S. resident at decedent's death -- and at all times thereafter -- and later becomes a citizen, post-citizenship QDOT distributions will not be taxed.⁴⁰

Furthermore, there will be no QDOT tax if the spouse becomes a citizen and makes an election to treat pre-citizenship principal distributions from the QDOT as taxable gifts made by the spouse. However, in community property states, the surviving spouse will own a one-half share of the community property at the spouse's death.

Gift Tax & Non-Citizens

Nonresident aliens are subject to the federal gift tax on gifts of their interest in U.S. real estate and tangible personal property situated in the United States.⁴¹ For most types of intangible property, regardless of the location of the property, gifts made by a nonresident alien are not subject to the federal gift tax.⁴² Unless the non-citizen spouse

has sufficient assets to fully fund his own credit shelter trust, he will lose the benefit of the full lifetime credit.

Annual Exclusion Gifts

U.S. Citizens, residents, and non-resident aliens may gift up to \$19,000 in 2026 (indexed for inflation) of present interest property annually to a donee.⁴³ No limit is imposed on the number of donees. "Gift splitting" is not available to nonresident alien donors or citizen donors with noncitizen spouses.⁴⁴

Gift Tax Marital Deduction and the Annual Exclusion for Inter-spousal Gifts

U.S. gift tax law does not provide for a gift tax marital deduction for spouses who are not U.S. citizens. Therefore, the unlimited gift tax marital deduction available for gifts from one spouse to his or her U.S. citizen spouse is not available for spousal gifts to a non-citizen spouse. Gifts to the non-citizen spouse are not deductible, but they are eligible for a spousal "annual exclusion" indexed for inflation (\$194,000 in 2026). To the extent that gifts are made in excess of that amount, no marital deduction will apply to reduce the gift tax.⁴⁵

The entire \$194,000 annual exclusion in 2026 for transfers by gift to a non-citizen spouse is allowed only if the gift qualifies as a present interest transfer. The exclusion permitted non-citizen spouses must be transferred in a form that would qualify for the marital deduction if the donee were a U.S. citizen.⁴⁶ For example, a gift in trust does not qualify for the annual exclusion unless it is within one of the exceptions to the terminable interest rules.

Clients with non-citizen spouses may wish to divide their estates into two portions, one of which can be exempted under the available applicable credit; and the other of which will be deductible by means of the marital deduction under the QDOT rules.

Please advise your client to review these provisions with a tax professional before taking any action on his or her own affairs.

Life Insurance

U.S. Citizens and Resident Aliens

Life insurance proceeds from a contract in which the decedent possessed an incident of ownership within three years of death are includable in the gross estate.⁴⁷

If a resident alien does not want his estate to be diminished in order to pay estate taxes, a life insurance trust can provide an attractive solution. If the insurance is purchased and owned by the trust as beneficiary, the proceeds will be received estate and income tax free by the trust (and its beneficiaries). This life insurance trust can also provide needed liquidity to purchase estate assets to preclude a forced sale to pay taxes.

Nonresident Aliens

Amounts receivable as insurance on the single life of a nonresident alien are not deemed property within the U.S. and are therefore exempt from the estate tax.⁴⁸ Joint and survivorship insurance, discussed below, is not quite as straightforward.

Life insurance proceeds, if structured properly, may be used to pay estate taxes without increasing the size of the tax burden already imposed.

Survivorship Insurance

Life insurance planning for survivorship policies is more complex compared to single life policies. The caveat for survivorship policies is who owns the policy when the proceeds are paid.

For example: X and Y are lawfully married spouses. X is a resident alien. Y is a non-resident alien. X and Y purchase a survivorship policy. If X is the surviving owner of the policy, the policy will be included in his estate. If Y is the surviving owner of the policy, the policy is not included in her estate.

The following ownership possibilities exist:

1. **Resident alien as sole owner.** This subjects the proceeds to estate tax in his or her estate (if he or she is the survivor), although the applicable credit would be available to offset some of the proceeds.
2. **Hold policy jointly until the first death.** By intentionally failing to transfer the policy to the QDOT, you will use the first spouse's applicable credit to shelter the cash value; but this should

be minimal since the cash value will be limited at the first death.

3. **Use an irrevocable life insurance trust to own the policy.** The U.S. estate tax can be avoided at both deaths by giving the surviving spouse no interest beyond a life estate. This method maximizes the wealth transferred to the next generation.

Irrevocable Life Insurance Trust (ILIT)

An ILIT is an irrevocable inter vivos (living) trust created by a grantor who wishes to obtain federal income and estate tax savings.

Using an ILIT, the trust is the applicant, owner and beneficiary of the life insurance policies on the grantor's life. By utilizing an ILIT, the proceeds of the life insurance policies can be kept free of federal estate tax. By various provisions in the trust agreement, the grantor can direct the use of the death proceeds for the benefit of named beneficiaries. The trust may also use the proceeds to buy assets from, or lend money to, the estate to create needed liquidity. Proceeds can also provide needed funds to avoid diminishing the estate to pay taxes. Estate tax implications of an ILIT. The trust corpus will not be includable in the estate of the grantor if the grantor does not retain either a lifetime interest in the income of the trust or the right to use or enjoy the trust property. The prohibited incidents of ownership include retention of the right to use or enjoy the trust property; to designate who will presently or ultimately receive trust principal or income; a reversionary interest; or the right to alter, amend, or revoke the trust.

Subject to the three-year rule discussed below, the insured must transfer all incidents of ownership in the policy before his death and must also make sure the beneficiary and/or the trustee is not under a legal obligation to make use of the insurance proceeds to pay estate taxes or other estate obligations. If the beneficiary or the trustee has such an obligation, the proceeds would become an estate asset and be taxable as such.

If a life insurance policy is transferred to an ILIT within three years of the grantor's death, (or if the policy is transferred more than three years before death but the grantor does not release all incidents of ownership within three years of death), the proceeds are brought back into the grantor's estate for purposes of calculating the gross estate for estate tax purposes.

The three-year rule of Section 2035 does not apply if the policy was purchased by the trust and the grantor never had any incidents of ownership.⁴⁹

Income tax implications of an ILIT. The income earned by an irrevocable trust, if any, will not be taxed to the grantor of the trust unless:

1. The trust income is distributed in the discretion of the grantor or a non-adverse party or both; or, may be distributed to, or accumulated for the grantor or the grantor's spouse, or applied to pay premiums on insurance on the life of the grantor or the grantor's spouse; or
2. The income is used to support a person whom the grantor is legally obligated to support or it may be used in the discharge of any legal obligations of the grantor; or
3. The grantor retains certain administrative powers, or the power to control beneficial enjoyment of the trust principal or income, or a reversionary interest, which takes effect within ten years.

Income not taxed to the grantor is taxed either to the trust or to the beneficiaries or both. Distributed income is taxed directly to the recipient beneficiaries.

Gift tax implication of an ILIT. The transfer of property to an irrevocable trust is a completed gift, for gift tax purposes, and the transfer is subject to the federal gift tax. The value of an insurance policy transferred to an ILIT is roughly the replacement value of that policy. Additionally, any gifts of money to the trust to pay subsequent premiums are taxable gifts. The trust beneficiaries, rather than the trust or the trustee, are the donees.

Generally, a gift in trust is a gift of a future interest, and therefore the \$19,000 per year (in 2026), per donee, exclusion is not available. (The exclusion may not be used for a gift of an income interest in trust unless the trust requires the income to be distributed at least annually.) In order to satisfy the present-interest requirement, the beneficiary(ies) may be given "Crummey" powers, or demand rights, over the property in trust.

The so-called "Crummey" power is the right of the beneficiary, during a limited period of time, to demand from the trustee the right to receive the value of the current gifts made to the trust.

Unless the withdrawal right is limited to the greater of \$5,000 or 5% of the principal of the trust, the

beneficiary will be deemed to have made a gift back to the trust when he lets his demand power lapse.⁵⁰

Hanging Powers. Alternatively, the trust can be worded so that the power holder's right lapses during any year only to the extent that the power does not exceed \$5,000 or 5% of the assets out of which the power could be satisfied. The balance of the withdrawal power builds up, or "hangs," until a future date. Careful wording is necessary, since the Service has ruled that hanging powers worded to "terminate as soon as such termination will not result in a taxable gift," are invalid as a condition subsequent, defeating the enforcement of the Federal Gift Tax.⁵¹

Generation Skipping Transfer (GST) Tax

The Generation Skipping Transfer Tax (GSTT) also applies to nonresident aliens.⁵² A flat tax (equal to the highest current estate or gift tax bracket) is imposed on every generation-skipping transfer. A generation-skipping transfer is a transfer (whether or not in trust) that will benefit grandchildren (or others in the same or lower generations as grandchildren).

The GST tax is imposed on "direct skips" (a transfer of property outright or in trust that benefits only a "skip generation" beneficiary); taxable distributions (a distribution of income or corpus from a trust to a skip person); and taxable terminations (such as would occur at the death of a trust beneficiary that results in a skip person holding all the interests in the trust).

Every U.S. citizen or non-citizen regardless of domicile is allowed a \$15,000,000 GST exemption that he or she may allocate during his or her lifetime or at death in order to exempt transfers from the GST tax. The exemption is \$30,000,000 during 2026 if the transfers are made by a married couple.

Transfers that qualify for the gift tax annual exclusion will be GST tax free as long as:

1. No portion of the trust's income or principal can be distributed to or used for the benefit of anyone other than the grandchild; and
2. The assets of the trust are includible in the grandchild's estate if he or she should predecease the grandparent.

The only portion of a nonresident alien's estate subject to the GSTT is that portion which would

nevertheless be subject to gift and/or estate tax in the U.S. It is against this portion of property that the GSTT exemption may be allocated by a nonresident alien. Accordingly, a nonresident alien's foreign situs property can directly skip to a U.S. grandchild without imposition of the GST tax.

A nonresident alien will want to ensure his or her estate is not subject to U.S. estate tax if he or she plans to have a direct bequest to a grandchild. In light of the former and proposed regulations -- and possible uncertainty with prospective estate tax developments -- the nonresident alien may want to prevent his or her assets from ever reaching U.S. jurisdiction by employing an offshore trust for the grandchild.

Expatriation

The decision to relinquish U.S. citizenship or terminate long-term residency may be considered in certain circumstances, including where individuals seek to reduce future U.S. income, estate, or gift tax exposure. However, expatriation is a significant step with complex tax consequences and should be evaluated carefully.

Under current law, individuals who expatriate may be classified as "covered expatriates" under IRC §877(a)(2) if certain objective thresholds are met. An individual will be treated as a covered expatriate if any of the following apply:

- The individual's average annual net income tax liability for the five taxable years preceding expatriation exceeds a specified threshold (indexed for inflation);

The individual's net worth is \$2,000,000 or more (not indexed for inflation); or

- The individual fails to certify compliance with all U.S. federal tax obligations for the five preceding years.

For expatriations in 2026, the indexed income tax liability threshold is \$210,000.

Covered expatriates are subject to a mark-to-market "exit tax" regime under IRC §877A, which generally treats the individual as having sold all worldwide assets for fair market value on the day before expatriation, with tax imposed on the resulting net unrealized gain to the extent it exceeds an exclusion amount (\$910,000 in 2026, as adjusted annually for inflation). In addition, transfers of property by a covered expatriate to U.S. persons (by gift or at death) may be subject to transfer tax under IRC §2801.

A "long-term resident" is generally defined as an individual who has been a lawful permanent resident of the United States in at least eight of the fifteen taxable years preceding expatriation. Long-term residents who terminate their U.S. residency are subject to the same covered expatriate rules described above.

Reporting Requirements for Expatriates

Expatriates must provide information statements to Federal authorities.⁵⁵

The penalty for failure to provide the information statement is \$10,000 unless it is shown that such failure to file is due to reasonable cause and not willful neglect.

Conclusion

Life insurance sales opportunities exist for agents who work in the transnational market. However, in order to effectively assist clients with their unique planning needs, it is important to be able to identify and address the issues raised herein.

¹Citizenship is defined under Immigration and Nationality Act 8 USC Sec. 1101.

²Treasury Reg. § 20.0-1(b)(1)

³Rev. Rul. 80-363, 1980-2CB 249

⁴Treasury. Reg. § 20.0-1(b)(2)

⁵I.R.C. §2209

⁶I.R.C. § 2010(c)(2)(B)

⁷I.R.C. §2102(b). The credit against tax is \$13,000 which creates a \$60,000 exemption equivalent. If the individual is a resident of a U.S. possession, he is considered to be a nonresident alien for estate tax purposes. If that is the case, his applicable credit is the greater of \$13,000, or that proportion of \$46,800 which the value of the decedent's gross estate situated in the U.S. bears to the value of his entire gross estate wherever situated, *See*, I.R.C. §2102(b)(2).

⁸I.R.C. § 2102(c)(3)-(4)

⁹I.R.C. § 2056(d)(2)(A)

¹⁰I.R.C. §2056(d)(4)

¹¹Reg. §20.2056A-2

¹²I.R.C. §2056A(a)-(a)(A); Reg. § 20.2056A-2

¹³I.R.C. §2056A(2); Reg. 20.2056A-2

¹⁴I.R.C. §2056A(a)(3); §2056A(d); Regs §20.2056A-3

¹⁵I.R.C. §2056A(d), added by RRA `90

¹⁶Reg. §20.2056A-3(b)

¹⁷I.R.C. §2056A(a)(1)

¹⁸PLR 8942056*

¹⁹Regs. §20.2056A-2(d)(1)(i)(B) and (C)

²⁰Reg. 20.2056A-2(d)(1)(i)(C)

²¹Reg. §20.2056A-2(d)(1)(ii)

²²Reg. §20.2056A-2(d)(1)(ii)

²³Reg. §20.2056A-2(d)(1)(iv)

²⁴Reg. §20.2056A-2(d)(1)(ii)(B)

²⁵I.R.C. §2056(d)(5)

²⁶Reg. §20.2056A-4(b)(5)

²⁷I.R.C. §2056(d)(2)(B)

²⁸I.R.C. §2523(1)(3); I.R.C. §2523(f)(6)

²⁹Reg. §20.2056A-8

³⁰I.R.C. §2056A(c)(2)

³¹Reg. §20.2056A-5(c)

³²I.R.C. §2056A(b)

³³I.R.C. §2056A(b)(10)

³⁴I.R.C. §2056A(b)(2)(B)

³⁵I.R.C. §1014, 1015(d), 2056A(b)(13), and H. Rep. at 489

³⁶I.R.C. §2056A(b)(7)

³⁷I.R.C. §2056A(b)(15)

³⁸I.R.C. §2056(d)(3)

³⁹I.R.C. §2056(d)(4)

⁴⁰I.R.C. §2056(d)(4)

⁴¹I.R.C. §2501 and §2511

⁴²I.R.C. §2501(a)(2)

⁴³I.R.C. § 2503.

⁴⁴I.R.C. §2513

⁴⁵I.R.C. §2523(i); I.R.C §2523(a)

⁴⁶RRA '90; House Report 101-894, p.29

⁴⁷I.R.C. §2035 and §2042

⁴⁸I.R.C. §2105(a)

⁴⁹*See Estate of Joseph Leder*, 89 T.C. 235 (1987), and *Estate of Eddie L. Headrick, et al v. Commissioner*, 93 T.C. No.18 (August 7, 1969).

⁵⁰I.R.C. §2041(b)(1)

⁵¹PLR 8901004*

⁵²*See* I.R.C. §§ 2631(c), 2010(c). *See also* Treas. Regs. § 26.2663-2 (1995) (final GST tax regulations providing for a GST exemption of \$1,000,000 in accordance with the GST exemption at that time, but presumably intended to track subsequent increases in the GST exemption amount)

⁵³I.R.C. §2107

⁵⁴I.R.C. §877(e)(1)

⁵⁵I.R.C. §6039G

* A private letter ruling (PLR) is issued by the IRS National Office in response to a specific request from a taxpayer as to the tax consequences of a proposed transaction. A PLR applies tax laws to specific facts only, is solely for the taxpayer who requested it and should not be relied upon as authority by other taxpayers. Additionally, PLRs may later be revoked by the IRS. As such, PLRs do not carry the stamp of law, but they do give an indication of the IRS's current thinking towards a specific type of transaction. All reference to PLRs in this current comment are for informational purposes only.

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