ESTATE PLANNING *News*

TO PROTECT YOUR ASSETS, LOVED ONES AND LEGACY, YOU NEED A PLAN.

In This Issue:

- Estate Planning For Noncitizen Spouses
- Your Questions What Is Gift Splitting?

KIRSTEN HOWE
ATTORNEY AT LAW

Kirsten provides all of the following estate planning services and more:

- Traditional estate planning, including wills, revocable trusts, powers of attorney, health care directives
- Advanced estate planning, including irrevocable life insurance trusts, gift programs, minors' trusts, generation-skipping trusts, tax planning
- Business planning, including family limited liability companies, family limited partnerships, structured ownership, reorganization, succession
- Probate, trust and estate administration

ESTATE PLANNING FOR NONCITIZEN SPOUSES

Noncitizens who reside in the U.S. (sometimes referred to as "resident aliens") have some—but not all—of the gift and estate tax exemptions available to U.S. citizens. The exclusion amounts available to U.S. citizens are the same for noncitizens making transfers, For example, noncitizens who live in the U.S. do have the full applicable credit amount against U.S. estate tax and generation-skipping transfer ("GST") tax, which is currently $2 million per person. Noncitizens can also use the $1 million lifetime gift tax exemption and the annual gift tax exclusion (currently $12,000) during their lives. Beyond these exemptions, noncitizens are subject to the same gift and estate tax rates that are levied on U.S. citizens, up to a maximum rate of 45% in 2008 for the largest estates.

However, when the noncitizen spouse is the recipient rather than the donor the rules change a bit. The unlimited estate and gift tax marital deduction that is available to U.S. citizens is not available for lifetime gifts to noncitizen spouses or to estates where the surviving spouse is not a U.S. citizen. For lifetime transfers, the annual exclusion from gift tax for transfers to a noncitizen spouse is $100,000. In order to obtain the marital deduction on transfers to a surviving spouse who is a noncitizen, the deceased spouse must establish a trust known as a qualified domestic trust, or QDOT. It is important to remember that the citizenship of the spouse who is the beneficiary/recipient of the marital trust makes a difference for tax planning purposes—not the citizenship of the donor spouse. For example, if a husband is a U.S. citizen and his wife is not a U.S. citizen, the husband's will or living trust should contain QDOT provisions, whereas the wife's will or living trust can provide for a typical marital trust, known as a qualified terminable interest property trust, or QTIP, to qualify for the unlimited marital deduction.

Requirements for a QDOT. A QDOT must have at least one U.S. trustee (a U.S. individual or a U.S. corporation) and must also satisfy the general marital deduction requirements of U.S. estate tax law under Internal Revenue Code section 2056, which covers qualified terminal interest in property (QTIP) trusts, the more conventional marital deduction trust. The main requirements of section 2056 for a typical QTIP trust are the following:

(1) The surviving spouse must be the sole income beneficiary of the trust during her life;

(2) All the trust assets must have been included in the decedent spouse's gross estate before passing to the surviving spouse;

(3) The surviving spouse must have a qualifying income interest for his/her lifetime; and

(4) The trust property cannot be appointed to any person other than the surviving spouse.

Income distributions to the surviving spouse from the QDOT trust will not be subject to the U.S. federal estate tax, but distributions of principal to the surviving spouse will be subject to estate tax when the distributions are made, unless the distributions are made on account of hardship. Hardship is defined as a distribution to meet an immediate financial need for the health, maintenance, education or support of the spouse or his/her legal dependents, if the spouse does not have other liquid assets available to meet the need.

In addition, as with typical marital trusts, the QDOT assets must be included in the surviving spouse's taxable estate upon his/her death. If the value of the QDOT assets exceeds $2 million, it is considered a large QDOT and the trust must name a U.S. bank or trust company to act as trustee, or must provide that the U.S. trustee must furnish a bond or letter of credit security arrangement in the amount of 65% of the value of the QDOT.

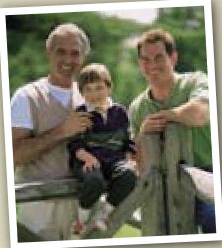
QDOT Qualification After Death. If the noncitizen spouse becomes a U.S. citizen before the date that the deceased spouse's federal estate tax return is due (nine months after the date of death) the spouse can be treated as a U.S. citizen for estate tax purposes and qualify for the unlimited marital deduction.

If the estate plan of a married couple does not include any QDOT provisions, the surviving spouse can still assign the assets that must qualify for the marital deduction in order to delay the imposition of estate tax to a QDOT that is created after the first spouse's death. Again, this must be done within nine months of the first spouse's death.

✷ YOUR QUESTIONS ✷

What is Gift Splitting?

Gift splitting is the term for a gift that is made by one spouse but reported by, or excluded from reporting requirements because deemed to have been made by, both spouses. As you may have guessed, this estate planning tool can be very useful in the blended family context. An example will help you understand why:



Kirsten Howe's practice focuses on two closely intertwined areas of the law: business and estate planning. She has extensive experience in both. On the business planning side, Kirsten has represented numerous companies including startups, non-profits, small institutional lenders and investment advisors. She has assisted them from initial organization through ongoing compliance, growth, and succession. This background in business law makes her uniquely qualified to help business owners plan their estates and protect and preserve their businesses. She is particularly adept at helping clients structure their entities so that disputes are extremely unlikely to arise in the first place and, if they do, making sure they are resolved in the way that was expected. ✷

Assume Henry and Wilma are married, Wilma has three children from her first marriage, Henry has no children. Wilma came to the marriage with a lot of money. Henry is comfortable but not nearly as affluent as his wife. Wilma would like to make annual gifts to her three children, both to help them out and to begin reducing the size of her taxable estate. As regular readers already know, Wilma can give each of her three children up to $12,000 per year without any gift tax consequences. These gifts will not require her to file a gift tax return, nor will they count toward her lifetime exclusion from gift tax which is currently $1 million.

Because Wilma and Henry are married, though, Wilma can give each of her children an additional $12,000 per year by splitting her gifts with her husband. Even though the gifts are made from her money and not Henry's, for gift tax purposes they can be considered to be made half from Wilma and half from Henry.

Additionally, Henry and Wilma can do gift splitting with respect to gifts in excess of their annual exclusion amount. Wilma could choose to give each child $100,000 in one year, so that they can each make a down payment on a home. The first $24,000 of each gift will be gift tax free because Henry and Wilma will split that gift and they each are allowed to give $12,000 per year. The remaining $76,000 of each gift will have to be reported on gift tax returns. If Henry and Wilma split those gifts they will each report three taxable gifts of $38,000. This means that each of their lifetime exclusions from gift tax will be reduced by $114,000 (3 times $38,000), leaving them with $886,000 in taxable gifts that they may make over the course of their lives without incurring gift tax. If Wilma was not married, She would have to use up $264,000 of her lifetime gift tax exclusion in order to give each child $100,000. ✷

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KIRSTEN HOWE

ATTORNEY AT LAW

1512 Bonanza Street, Walnut Creek, California 94596

Ph: 925-943-2740 | *Fax:* 925-943-3105

www.kirstenesq.com *kirsten.howe@prodigy.net*