MARITAL DEDUCTION PLANNING
FOR THE NONCITIZEN SPOUSE

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I. INTRODUCTION

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A. The “Problem”

1. The Fleeing Spouse. Where a spouse died leaving the estate to a noncitizen spouse in a form qualifying for the marital deduction, the surviving spouse had the ability to return to the country of nationality and die a nonresident alien in which case no Federal estate tax would be imposed in the estate except for U.S. situs assets. §2103. All or a major portion of the estate would pass to the children who could return or might never have left the U.S. without having paid significant Federal estate taxes.

2. The Legislative Response. Although no case has been made as to the frequency of the phenomenon of a surviving spouse not a citizen of the U. S. leaving the U.S. to escape the payment of estate taxes, Congress simply denied the marital deduction to all noncitizen spouses without hearings, without warning, without transitional rules and even without grandfathering provisions for spouses who, because of incompetency, are unable to change their estate plans.

B. The Legislation

1. Marital Deduction Denial. TAMRA denies the marital deduction for property passing at death to a surviving spouse who is not a U.S. citizen. §2056(d)(1)(A). Prior to TAMRA, citizenship had never been a requirement for qualification for the marital deduction.

2. Gift Limitation. Consistent with the denial of the estate tax marital deduction, the marital deduction for gifts to a spouse is denied where the donee spouse is a noncitizen spouse, although the annual exclusion was raised from $10,000 to $100,000 per year for noncitizen spouses. §2523(i).

3. Qualified Joint Tenancies. Further, section 2040(b) relating to qualified joint tenancies no longer applies to joint tenancies between husband and wife. §2056(d)(1)(B). Instead, the law returned to inclusion of the joint tenancy property in the estate of the deceased joint tenant with the burden on the surviving spouse to prove contribution. Congress reenacted section 2515 (without the election provisions of section 515(c)) and section 2515A of the Internal Revenue Code of 1954 to determine whether a gift results from the creation and termination (other than by death of a joint tenant) of a joint tenancy between spouses where the donee spouse is not a U.S. citizen.

4. QDOTs. To provide some relief to the noncitizen spouse and to insure the collection of tax, TAMRA introduced the qualified domestic trust (“QDOT”). §2056(d)(2); §2056A.

C. Technical Amendments.

1. OBRA ’89. Title XI of H.R. 3299, the Revenue Reconciliation Act of 1989, constitutes the revenue provisions of the Omnibus Budget Reconciliation Act of 1989 (“OBRA ’89”) and section 11815 (c) of the House bill contained a number of changes to the marital deductions provisions applicable to the noncitizen spouse. H.R. 3299 was passed in the House of Representatives on October 5, 1989 and was accompanied by the Report of the Committee on the

2. TAMRA. Title VI of S.B. 1750, the Revenue Reconciliation Act of 1989, was approved by the Senate Finance Committee on October 4, 1989 for inclusion in OBRA ‘89, and section 6815(d) of the bill likewise contained proposed changes to the marital provisions introduced by TAMRA relating to noncitizen spouses. The marital deduction provisions were stripped out of the Senate bill before the Senate approved the bill and sent it to Conference Committee. The House and Senate Finance Committee proposals were virtually identical but did differ on a few points. The Statement of the Managers on Revenue Provisions of Conference Agreement on H.R. 3299 (released Nov. 21, 1989) indicates that the House Report was adopted in all respects except for the extent to which distributions from a QDOT will be non-taxable. H.R. Conf. Rep. No. 225, 101st Cong., 1st Sess. 217, 219 (1989).


D. Treasury Regulations.

1. On January 5, 1993, proposed regulations were published purporting to providing some assistance in complying with the new legislation, but imposing burdensome disclosure and record-keeping requirements with respect to QDOTs and imposing numerous provisions which were required to be included in “governing instruments.” Failure to include such “governing instrument” provisions would disqualify the trust as a QDOT. 58 Fed. Reg. 305. On August 22, 1995, final and temporary regulations were issued. T.D. 8612, 60 Fed. Reg. 43, 53. The final regulations covered all of the provisions implemented by TAMRA except provisions related to requirements imposed to ensure collection of the new tax under section 2056A(a)(2) ("Security Arrangements").


II. THE APPLICABLE LAW

A. Denial of Marital Deduction.
1. **QDOTS and Marital Deduction Trusts.** Section 2056(d) provides that except where property passes in a QDOT, the marital deduction allowed under section 2056(a) shall not be allowed to a noncitizen spouse. Of course, allowance of the marital deduction under section 2056(a) has always been limited by section 2056(b) relating to terminable interests. In other words, in order to qualify under section 2056(a), the estate has had to qualify under some exception to the terminable interest rule under section 2056(b), including a general power of appointment trust, a qualified terminable interest trust (“QTIP”) or an estate trust.

2. **Dual Qualifications.** The House Report makes it clear that the requirements of section 2056(b) must be met in addition to meeting the requirements of the QDOT in order to qualify property passing to a noncitizen spouse for the marital deduction. This includes the requirements for a general power of appointment, a QTIP or an estate trust. House Report, p. 1429.

3. **Annual Exclusion Increased.** The marital deduction was also disallowed for gifts to a noncitizen spouse although the annual exclusion for gifts to a noncitizen spouse was increased from $10,000 to $100,000 per year. §2523(i). OBRA ‘89 added the requirement that for gifts after June 29, 1989, annual exclusion gifts to a noncitizen spouse have to be in a form that qualifies for the marital deduction. §2523(i)(2).

**B. The QDOT.**

1. **Three Requirements.** To qualify as a QDOT, a trust must meet three requirements:

   a. **U.S. Trustee.** The trust instrument must require that at least one trustee of the trust be an individual citizen of the U.S. or a domestic corporation and that no distribution from the trust (other than income) may be made unless the U.S. trustee has the right to withhold the QDOT tax occasioned by the distribution from such distribution. §2056A(a)(B).

      (i) TAMRA had required that all trustees of the trust had to be U.S. citizens or domestic corporations.

      (ii) The change allows the noncitizen spouse to act as one of the trustees of the QDOT.

      (iii) A domestic corporation is a corporation that is created or organized under the laws of the United States or under the laws of any state or the District of Columbia. Reg. §20.2056A-2(c).

      (iv) If the U.S. Trustee is an individual U.S. citizen, the individual must have a tax home (as defined in §911 (d)(3)) in the United States. Reg. §20.2056A-2(d)(2). The term “tax home” is defined as an individual’s home for purposes of § 162(a)(2)
(relating to travel expenses while away from home). An individual’s tax home is considered to be located at his regular or principal (if more than one regular) place of business or, if the individual has no regular place of business, then at his regular place of abode in a real or substantial sense. Reg. §1.911-2(b).

(v) §911 (d)(3) provides that an individual shall not be treated as having a tax home in a foreign country for any period for which his abode is within the U.S. However, the temporary presence of an individual in the U.S., or maintenance of a dwelling in the U.S. by the individual (whether or not used by the individual’s spouse or dependents) is not conclusive proof that the individual’s abode is in the U.S. Id.

(vi) OBRA 1990 eliminated any conflict with the marital deduction requirements of sections 2056(b)(5) and 2056(b)(7) by clarifying that any QDOT provision that authorizes the trustee to withhold the QDOT tax from any distribution on such distribution will not cause the QDOT to fail to meet the requirements of sections 2056(b)(5) and 2056(b)(7).

b. **Security Arrangements.** The trust must meet such requirements as imposed by regulations to ensure the collection of any tax imposed on the QDOT. §2056A(a)(2)

c. **QDOT Election.** An election must be made by the executor to qualify the QDOT for the marital deduction. §2056A(a)(3). This means that if the QDOT takes the form of a QTIP, two elections must be made. Like the QTIP election, the QDOT election is irrevocable once made. §2056A(d).

(i) The Service issued temporary regulations relating to the time and manner of making the QDOT election, effective for all elections made on or after November 10, 1988. T.D. 8267, 1989-45 I.R.B. 15, 21. Generally, the election is made by the executor on the Federal estate tax return filed by the executor before the due date of the return, or if a timely return is not filed by the executor, to the first estate tax return filed by the executor after the due date. Reg. §20.2056A-3(a). However, the return must be filed within one year after the due date (including extensions) for filing the return. §2056A(d).

(ii) Similar to the QTIP election, under the current version of Schedule M of the Form 706, if the surviving spouse is not a U.S. citizen, the QDOT election is presumed to have been