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ESTATE PLANNING LIBRARY

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Gift Tax Planning for the Non-Citizen Spouse

1. What is different about gift tax planning for the non-citizen spouse?

I think it is better if I explain the “general” rules for citizen spouses first. The goal of the estate and gift taxes (the estate taxation of non-citizen spouses is covered in Number 21 of the Estate Planning Library) is to impose a tax at each generation, but not to financially burden surviving spouses by imposing an estate tax at the death of the first spouse to die. Typically, one spouse dies and leaves any property that would be subject to estate taxes to the surviving spouse and there are no taxes imposed on the transfer to the surviving spouse because of the unlimited marital deduction. When the surviving spouse dies, his or her estate is subjected to estate taxes, if large enough. You can see how there is a certain symmetry to the arrangement. Spouses are protected but the estate of the last to die is subjected to Federal estate taxes.

Likewise with gifts, one spouse can make unlimited gifts to the other spouse, because in the end all of both spouse’s property will be subjected to estate taxes, if the estate is large enough.

2. Isn’t that what happens with non-citizen spouses?

As I mentioned in question one, one spouse can make unlimited gifts to a citizen spouse without gift tax consequences. It doesn’t matter if the spouse making the gift is a non-citizen, only the citizenship status of the recipient or beneficiary spouse that matters. However, if the spouse made the same gift to a non-citizen spouse, the non-citizen spouse could move to his or her country of origin and the Federal government would never get any taxes when the non-citizen spouse died owning the gifted property.

The government decided that it would be unfair to not allow any gifts to non-citizen spouses, or only the current, \$11,000 gift tax exclusion that is available to anyone. To resolve this potential for unfair treatment, the law allows a spouse to make an annual gift of \$110,000. Currently, it is indexed for inflation, to a non-citizen spouse without any gift tax consequences. If a larger gift is made, then some of the donor spouse’s tax exempt amount, currently \$1,000,000 is used up.

3. That sounds simple, the donor spouse simply makes annual gifts of \$110,000, or whatever amount applies when the gift is made, to increase the wealth of the non-citizen spouse, right?

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That is correct, and it is a very effective method to decrease the family's overall estate taxes because the large estate of the wealthy spouse is spread over two \$1,000,000 tax exempt amounts rather than just the wealthy spouse's \$1,000,000 tax exempt amount. In effect, the gifts will enable \$2,000,000 to pass estate tax free rather than just \$1,000,000. Unfortunately, some spouses, and their advisors, are not aware of the rules and may, inadvertently, make gifts to a non-citizen spouse greater than \$110,000 per year.

4. How can people unknowingly make gifts as large as \$110,000? Would you provide an example?

Sure, good idea. Sometimes people just don't think about gift taxes when they are doing things. I suppose the biggest culprit is the use of joint tenancy. Let's assume that a U.S. citizen wife marries a German citizen as her husband, and that the wife has the wealth. Wife has a bank account with \$500,000 that she puts in the name of Wife and Husband as joint tenants with right of survivorship. The question is, has Wife made a gift of \$250,000 to Husband by taking the account in their joint names? If so, Wife has just used up \$140,000 of her tax exempt amount because she made a gift in excess of \$110,000 to her non-citizen spouse.

5. That doesn't make sense, simply putting someone's name on an account cannot be a gift, can it?

In the case of a joint account in personal property, it sure does:

- **Joint Bank or Brokerage Accounts:** The rules are very different for joint accounts with non citizen spouses than for citizen spouses. In 1988, Congress repealed the unlimited marital deduction for gifts to non citizen spouses. Section 2523(i) of the Internal Revenue Code provides that no marital deduction is allowed for gifts to non citizen spouses and as to joint accounts ~~the principles of, repealed, Internal Revenue Code section 2515A shall apply to such accounts.~~ Repealed, yet still effective, as regards joint accounts with non citizen spouses, 2515A provides that a joint account which includes a non citizen spouse shall be treated as owned one-half by each owner and that a gift has occurred if one spouse has contributed less than the other spouse.

Comment: Please reword

However, as you will see in the real property paragraph, if one spouse contributed all of the property, the entire account is included in that spouse's estate at the donor spouse's estate.

- **Nominal Joint Tenancies:** Assume that Husband knew that he was not allowed to withdraw funds from the account unless needed for household expenses. In this case, even if state law created a "real" joint account, the understanding of the parties might cause the gift to not occur, despite what state law said. This is a very intent oriented concept, **and may, likely won't, apply to non citizen spouses.**
- **Joint Tenancies in Real Property:** The gift tax rule for joint tenancies in real property is that the creation of a joint tenancy is **not** treated as a gift, the "no gift rule," if the transfer would otherwise be a gift to a non-citizen spouse. As an example, if Wife withdrew \$200,000 from the joint account and combined it with \$50,000 from Husband, the non-citizen spouse, and purchased a \$250,000 home in joint tenancy, there is no gift because, without the special "no gift rule," the creation would have been a gift of one-half of the property, less the \$50,000 contributed by Husband, under most, if not all, state laws. As you will read in No. 21 of the Estate Planning Library: Estate Tax Planning for the Non-Citizen Spouse, this special "no gift rule" is justified, because when Wife dies, if she dies first, all of the joint tenancy property is included in her estate, except for what Husband contributed. That way the government gets its cut of her \$200,000 but not his \$50,000. All appreciation will belong in her estate. Her estate only gets to deduct the \$50,000.

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