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QDOT AND THE UNIFIED CREDIT FOR ESTATE PLANNING

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No gift or estate tax need be paid during lifetime or at death for transfers between spouses.

Each spouse can transfer **\$5M for 2011 (\$5,120,000 for 2012)** into a trust without paying gift or estate tax. There are no estate taxes to be paid if their combined estate is equal to or less these amounts.

The rules above apply if both spouses are citizens. **But what if the spouse is not a US citizen?** The **exemptions are reduced and the spouse does not get any credit.** Before we discuss the solution, let me give you a historical perspective so you will understand why non-citizens are not allowed credits and what we can do about it.

The unlimited marital deduction that allows both spouses to leave all their estate free of estate tax to each other was added to the estate tax laws in 1981. At that time, members of Congress worried that a spouse who is not a US citizen can simply return to his/her country of origin and escape the estate tax. Congress addressed this loophole for non-citizen in 1988 by mandating that a US citizen can leave only **\$3 million** free from tax to a non-citizen spouse instead of **\$7 million**. Without the unlimited marital deduction, all of the deceased's assets in excess of **\$3 million** would therefore be subject to estate tax.

We do have a solution to this problem: **A Qualified Domestic Trust (QDOT for short)**. Under the terms of a QDOT, the first estate is left open. When the second spouse dies, the money left in the trust stays in the estate of the first to die.

For example, you die leaving an estate of \$4 million to your spouse. Your estate owes no tax. When your non-citizen spouse dies, her unified credit shelters only \$2 million causing unnecessary and expensive taxes. With a QDOT, your spouse would owe no taxes at all on a \$4 million of estate.

There are rules to follow. To qualify, all income must be distributed at least annually to the surviving spouse and no one else. In addition, distributions of principal must be made only to the surviving spouse. One of the trustees must be a US citizen or a US corporation. All assets must be kept under US tax jurisdiction. Any withdrawals of principal would be subject to immediate estate taxation at the decedent's marginal rate. The trustee is liable to see that taxes are paid from each principal withdrawal.

A solution to this problem would be for the spouse to become a citizen during the other spouse's lifetime or before the estate tax return is filed within nine months. (Note that a surviving spouse who becomes a naturalized citizen can serve as a trustee of the QDOT). The trust will not cease to qualify as QDOT if the survivor becomes a trustee after becoming a US citizen. If the QDOT ceases to meet the requirements as to a US citizen trustee, the estate tax is imposed as of the date that the trust ceases to satisfy either of the requirements as if the surviving died on that date.

As you can see, there is a need for you to review your estate plan documents if you have one. If you do not have one, make sure that a QDOT is part of your new estate plan if one spouse is not a U.S. citizen. Consult lawyers who do estate plan. Most lawyers do not routinely ask if you are a citizen. If you are not, make sure that your lawyer creates a QDOT for you.