U.S. Estate and Gift Taxation of Nonresident Aliens

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I. Introduction

The United States imposes three distinct transfer taxes on the gratuitous transfer of property: the estate tax, the gift tax and the generation-skipping transfer tax. The estate tax applies to transfers at death; the gift tax applies to lifetime transfers; and the generation-skipping transfer tax applies to transfers of property that effectively "skip" a generation, from the transferor to a person or persons at least two generations below that of the transferor.

The U.S. transfer tax regime requires special planning for nonresident aliens who invest in the United States. The U.S. estate and gift tax rules for individuals look first to whether an individual is a U.S. citizen. If the individual is not a U.S. citizen, then the next inquiry is whether the individual is a resident of the United States, with residence in the transfer tax context being synonymous with being a U.S. domiciliary. While U.S. citizens and residents are subject to worldwide estate and gift taxation on their gratuitous transfers, nonresidents (meaning here persons who are neither U.S. citizens nor U.S. domiciliaries) are only subject to the U.S. transfer tax system on property that is situated, or deemed situated in the United States. In addition, nonresident aliens are generally not subject to U.S. gift tax on the transfer of intangible property (such as U.S. securities) regardless of where the property is situated or deemed situated.

Further, nonresidents are only subject to the Federal generation-skipping transfer tax with respect to transfers that are subject to the Federal estate or gift tax.

II. Residence for Federal Estate and Gift Tax Purposes

While the determination of U.S. citizenship is generally very straightforward, the concept of residence differs for Federal income tax and Federal estate and gift tax purposes. Federal income taxation focuses on citizenship or residency, with residency being predicated upon either having a "green card" (the permanent resident test) or based on meeting a mechanical test for determining substantial presence in the United States. In contrast, residence

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for Federal estate and gift tax purposes is predicated upon domicile. Accordingly, determining the domicile of an individual who is not a U.S. citizen is critical to the essential planning of his or her estate if U.S. property is involved.

For Federal estate and gift tax purposes, "[a] person acquires domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom."[1] Although the intent of an individual is subjective, it is established by objective criteria such as his statements and conduct and by external facts and circumstances. Because they are prone to being self-serving, an individual's statements concerning his or her domicile are generally accorded only a relatively small amount of weight. Therefore, courts generally will consider additional factors such as the location of an individual's: (i) residential real property; (ii) social and religious affiliations; (iii) business activities; (iv) bank accounts; (v) personal property; (vi) jurisdiction for voting purposes; (vii) driver's license; and (viii) registration of personal property, such as automobiles, boats and airplanes, as well as other factors that demonstrate that a particular jurisdiction has the most significant relationship to the individual.[2]

Unlike the mechanical tests that are used to determine residence for income tax purposes,[3] there is no clear, objective standard to ascertain whether an individual is domiciled in the United States.

Because there are different standards to determine the application of the Federal income tax laws and the Federal estate and gift tax laws, it is possible for an individual to be a resident of the United States for Federal income tax purposes but not a domiciliary of the United States for Federal estate and gift tax purposes, and vice versa.

III. Federal Estate Taxation of Nonresident Aliens

For Federal estate tax purposes, the value of the U.S. gross estate of a nonresident alien consists only of property (including property that is beneficially owned) that is situated, or deemed situated, in the United States at the time of his or her death.[4] Importantly, property situated outside the United States need not be disclosed to the Internal Revenue Service unless certain deductions or credits are claimed, or in certain instances where the decedent is an expatriate of the United States who renounced his U.S. citizenship or long-term residency prior to June 17, 2008.

The following general rules apply to determine the situs of property for U.S. estate tax purposes:

Tangible Personal Property

The tangible personal property of a nonresident alien that is actually located in the United States has a U.S. situs and is subject to the Federal estate tax (as well as to the Federal gift tax).[5] For this purpose, cash is considered to be tangible personal property.[6] Therefore, any cash in the United States, including cash in a safe deposit box in the nonresident's name, is includible in the nonresident's gross estate.

An important exception to the general rule that tangible personal property located in the United States is includible in a nonresident's gross estate applies in the case of works of art on loan for exhibition in a non-profit art gallery or museum. Such works of art are not deemed situated in the United States

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for Federal estate tax purposes.[7]

Real Property

Real property is deemed situated where it is located.[8] Because the Internal Revenue Code and the Treasury Regulations thereunder do not define real property, one must look to the law of the jurisdiction where the property is located to determine whether it is characterized as real property. Generally, real property includes improvements, fixtures, crops, timber and mineral interests.

Security interests in real property, such as mortgages, are usually considered debts and not real property for Federal estate tax purposes, and the rules (discussed below) for debt obligations apply to them.

Importantly, where a nonresident mortgages his U.S. real property on a non-recourse basis and, thereby, has no personal liability for the indebtedness, only the equity value of the real property is includible in his U.S. gross estate. On the other hand, if the mortgage is a recourse mortgage (*i.e.*, it is the personal obligation of the nonresident and is enforceable against him or his estate), the total fair market value of the U.S. real property is includible in the nonresident's estate. In the latter case, only a portion of a mortgage is deductible, and then only if the personal representative of the nonresident discloses the value of the nonresident's worldwide assets on the Federal estate tax return.[9] Frequently, such full disclosure will not be desirable, and, accordingly, where possible, it is preferable if the mortgage on the nonresident's U.S. real property is non-recourse.

Certain types of mortgages which are peculiar to certain jurisdictions may be considered real property. Generally, leases are not considered real property.

A condominium will generally be considered real property. In contrast, a cooperative apartment will generally be considered intangible personal property because it consists of an interest in the shares of a U.S. corporation, plus a proprietary lease.

Because U.S. real property is deemed situated in the United States, nonresident investors frequently use non-U.S. corporations to acquire title to real property located in the United States.

If a nonresident investor already owns real property in the United States, it may be possible for him to transform it into non-U.S. intangible personal property by transferring it to a foreign (non-U.S.) corporation in consideration for the shares of the corporation. In this manner, the nonresident investor may be able to avoid having the property deemed situated in the United States for Federal estate tax purposes. Although such a transformation may be possible from a Federal estate tax standpoint, it may trigger certain adverse income tax consequences under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), and such consequences require careful analysis.

A nonresident's acquisition, directly or indirectly, of certain interests in U.S. property or business enterprises through a corporation or other entity may be subject to separate nontax reporting requirements with the U.S. Commerce Department and the U.S. Department of Agriculture, depending upon the circumstances.

Intangible Personal Property

The estate taxation of a nonresident alien's intangible personal property

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can be complex and depends on the type of property involved. Generally, intangible personal property, the written evidence of which is not treated as property itself (such as cash bills), is deemed situated within the United States if it is issued by, or enforceable against, a U.S. person.[10] However, as described more fully below, there are several exceptions to this general rule.

Stock in a U.S. Corporation and a Foreign Corporation

Shares of stock issued by a U.S. corporation and owned (or deemed beneficially owned by a nonresident alien at his death) are deemed situated in the United States.[11] Conversely, shares of stock issued by a foreign corporation and owned (or deemed beneficially owned) by a nonresident alien at his death are not deemed situated in the United States.[12] The location of the share certificate evidencing ownership of stock is irrelevant to the taxability of such shares for Federal estate tax purposes. Furthermore, the use of agency arrangements or nominees will not alter the tax consequences.

In order to be certain that a foreign corporation will eliminate exposure to Federal estate taxation, it is essential that the corporation have a business activity and be a *bona fide* corporation that does the following:

- observes all the usual corporate formalities, including having officers and directors, holding regular corporate meetings, adopting formal corporate resolutions, and authorizing and ratifying important actions that are undertaken by the corporation;
- maintains a corporate bank account;
- is the legal and beneficial owner of the property; and
- performs functions so as to avoid characterization as a passive, sham corporation, set up merely as a blind to deter creditors.

Activities such as the payment of debts, the payment of interest or other expenses, the management of property, the involvement in litigation, and the purchase of property, all in varying combinations, have been found to constitute the requisite business activity.

Assuming that the necessary corporate formalities and activities are observed, it is important to ensure that the corporation is not treated as a nominee of its shareholders, as in *Fillman v. United States*.[13] In *Fillman*, the Court of Claims considered the circumstances of a deceased nonresident alien who established two foreign corporations and funded them with stock and bonds, the certificates for which were then deposited by the corporations in a U.S. bank. Under the then existing provisions of the Internal Revenue Code, the Federal estate taxation of stocks and bonds of a corporation depended on where the certificates were physically present and whether they were "owned and held" by a nonresident alien at his death. Upon considering the facts and circumstances presented, the court held that the securities were includible in the nonresident's estate and were subject to Federal estate tax because the decedent had ignored the two foreign corporations during his lifetime and retained all practical and beneficial ownership of the underlying investment securities. The court pointed out that every action of the foreign corporations with respect to the securities was performed in their capacity as mere depositors and custodians for the nonresident. Thus, if a foreign corporation is illusory and is determined by a court

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to be the alter ego of the nonresident alien, it may be ignored for Federal estate tax purposes with the result that the nonresident shareholder will be deemed to own directly the corporate property located in the United States.

In addition, it is essential that the corporation be recognized as a corporation under the tax laws of the United States. For example, some foreign entities organized for business purposes, such as *stiftungs* (foundations), are not necessarily considered corporations for Federal estate tax purposes. In *Swan v. Commissioner*,[14] a *stiftung*, which resembled a corporation, was found to be a revocable trust for Federal estate tax purposes because the founder, through his right of amendment, controlled the economic benefits of the *stiftung.*

United States Treasury Regulations under section 7701 of the Internal Revenue Code permit the owners of certain "business entities" that are not automatically classified as corporations to elect to be treated as an association taxable as a corporation or a partnership (if it has two or more members), or to be disregarded[15] (if it has a single member) for Federal tax purposes.[16] A "business entity" is defined as an organization or other contractual arrangement that qualifies as an "entity" for Federal tax purposes, but is not treated as a trust (or subject to other special treatment). Trusts are not eligible to elect to be treated as corporations or partnerships (or to be disregarded) for Federal tax purposes.

If a foreign corporation is used to hold property situated or deemed situated in the United States, it is preferable for the foreign corporation to acquire the property directly, if possible.[17] On the other hand, if the property is transferred by a nonresident alien to a wholly owned foreign corporation in consideration for the corporation's issuance of shares of stock of that corporation, the ability to shield the underlying property from Federal estate tax is less certain and the Internal Revenue Service will likely scrutinize whether the transfer to the foreign corporation constituted a *bona fide sale* for full and adequate consideration in money or money's worth.[18]

In addition, the Internal Revenue Service has privately ruled that American Depositary Receipts ("ADRs") should not be includible in the gross estate of a nonresident alien. Despite being registered and issued generally by U.S. banks, ADRs represent shares of stock of foreign corporations and should be treated as such for Federal estate tax purposes.[19]

Debt Obligations

The situs rule for debt obligations is similar to the situs rule for stock in a corporation. Thus, debt obligations of a U.S. person[20] or of a U.S. governmental entity which are owned (or deemed owned) by a nonresident alien decedent are deemed property situated in the United States "whether the written evidence of the debt obligation is treated as being the property itself or whether the decedent was engaged in a business in the United States at the time of his death."[21] The converse is also true.[22] Thus, debt obligations of a U.S. person or of a U.S. governmental entity are subject to Federal estate tax unless an exception applies.[23]

The following exceptions apply to the general rule regarding the U.S. situs of debt obligations of a U.S. person or a U.S. government agency:

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i. Bank Deposits.

U.S. bank deposits generating interest income that is exempt from Federal income tax to a nonresident alien are not subject to Federal estate tax.[24] Interest earned on a nonresident's deposits with banks and savings and loan associations (or similar institutions) is exempt from Federal income tax, provided it is not effectively connected with a U.S. trade or business.[25]

Although the rule that U.S bank deposits are not subject to Federal estate tax is generally clear with regard to U.S. bank deposits held by a nonresident,[26] the Internal Revenue Service takes the position that if funds are held in special deposits by a U.S. bank in a custodial capacity or in deposits held at U.S brokerage firms or other financial institutions which are not considered banks, they are not exempt from the Federal estate tax.[27] This distinction may require a nonresident or foreign fiduciary to understand carefully and completely the nature of any account that he opens with a U.S. bank or financial institution. Clearly, any form of special deposit should be avoided if the circumstances do not warrant its use. In addition, cash stored in a bank's safety deposit box is not within the bank deposits exception.[28]

ii. Portfolio Interest Debt Instruments.

Debt obligations, the interest on which qualifies as "portfolio interest," are excludable from the gross estate of a nonresident decedent.[29] To qualify as a debt instrument which generates portfolio interest and consequently will be treated as non-U.S. situs property, an obligation must have been issued after July 18, 1984, and either (1) the obligation must be in registered form,[30] or (2) if the obligation is not in registered form, (i) there must be arrangements reasonably designed to ensure that such obligation will be sold or resold in connection with its original issuance only to non-U.S. persons, (ii) interest on such obligation must be payable only outside the United States and its possessions, and (iii) on the face of such obligation there must be a statement that any U.S. person who holds such obligation will be subject to limitations under the U.S. federal income tax laws.[31] To be in registered form, (1) an instrument must be registered as to both principal and any stated interest and transfer of the obligation may be effected only surrender of the old instrument and either a reissuance of the old instrument or an issuance of a new instrument by the issuer to the new holder, (2) the right to the principal of, and stated interest on, the obligation may be transferred only through a book entry system maintained by the issuer (or its agent), or (3) the obligation is registered as to both principal and any stated interest with the issuer (or its agent) and may be transferred through both the methods described in (1) and (2).[32]

iii. Certain short-term debt instruments.

An additional exception from the Federal estate tax applies to certain short-term debt instruments. These are interest bearing obligations and obligations issued at a discount with a maturity date of 183 days or less from the date of original issuance, which are exempt from withholding tax for Federal income tax purposes.[33] Those instruments which generate interest income exempt from withholding tax because of this 183-day exemption are excluded from the gross estate of a nonresident alien decedent provided that the interest on

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such instrument is not effectively connected with the conduct of a U.S. trade or business.[34]

iv. Foreign Branch Bank Deposits.

Deposits with a foreign branch of a domestic corporation or partnership engaged in the commercial banking business are treated as foreign situs property.[35]

v. U.S. Branch Bank Deposits.

Similarly, deposits with a U.S. branch of a foreign bank conducting business in the United States should also be treated as U.S. situs property.[36]

vi. Pension and Profit-Sharing Plans.

Rights under pension and profit-sharing plans appear to be subject to the debt obligation rules and thereby includible if the obligor is a U.S. person unless, perhaps, the individual's employment took place outside the United States.

vii. Joint Obligors.

Where a debt obligation is payable by joint obligors, one of whom is a citizen or resident of the United States and the other of whom is not, an analysis is made of all the facts and circumstances of the indebtedness and, depending upon the result of this analysis, the debt is apportioned between them.[37]

Life Insurance

Insurance proceeds payable by a U.S. insurance company on the life of a nonresident insured owner of the policy are deemed property situated outside the United States.[38] In contrast, if a nonresident alien owns a life insurance policy issued by a U.S. insurance company on the life of another person, the value of that policy is includible in the nonresident owner's estate.

Partnership Interests

To lessen the impact of income taxation, partnerships and entities treated as partnerships for Federal tax purposes are sometimes used by nonresidents as investment vehicles for property situated in the United States. Caution is necessary, however, because to the extent that a nonresident makes an investment in a U.S. partnership through a foreign corporation, branch profits tax exposure may arise. Branch profits tax exposure may be avoided, however, by making the investment through a U.S. corporation which in turn is owned by a foreign corporation.

The law regarding the situs of a partnership interest for Federal estate tax purposes varies depending upon whether, under the applicable local law, a partnership qualifies as a separate and distinct legal entity and whether the partnership survives the death of one of its partners.

If the partnership is not recognized as a legal entity or terminates upon the death of the partner, the situs of the decedent's partnership interest is the location of the underlying partnership assets.

In contrast, if the partnership is both recognized as a separate legal entity and survives the death of its partners, the situs may be determined either by reference to the domicile of the deceased partner or by reference to where the business of the partnership is conducted. Despite judicial authority for the former position (i.e., determining situs by reference to the domicile of the deceased partner), the Service primarily focuses on where the business of the

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partnership is conducted.[39]

Limited liability companies are increasingly used as business structures. If a limited liability company has at least two members, it may be treated for U.S. tax purposes as a partnership. If a domestic limited liability company has only one member and the check-the-box election for treatment as a corporation has not been made, it is disregarded as an entity.[40] For foreign limited liability companies, the U.S. federal tax treatment of the entity depends upon whether each member of the entity has limited liability.[41] If each member has limited liability, it is treated as an association and may be taxable as a corporation.[42] If any member does not have limited liability, it is treated as a partnership.[43]

Trust Interests

There are two threshold requirements for a trust interest to be includible in a nonresident decedent's gross estate for Federal estate tax purposes: (1) the trust must be a valid trust on the nonresident decedent's date of death and (2) his interest in the trust must be indefeasibly vested in such manner as would cause estate tax inclusion if he were a U.S. citizen or resident (domiciliary) pursuant to Sections 2033 through 2046 of the Internal Revenue Code.[44] If these two preliminary requirements are met, then an analysis of the rules of Sections 2104 and 2105 of the Code, which sections classify property as having a situs within and without the United States, is necessary to determine whether the nonresident alien decedent's interest in the trust is includible in his gross estate for Federal estate tax purposes.

***i. Nonresident is the Beneficiary of the Trust*.**

Since an interest must be indefeasibly vested, a mere expectation that a person will receive property is insufficient to trigger Federal estate taxation. If a nonresident decedent is the beneficiary of a non-U.S. trust and has a general testamentary over of appointment over the trust property (pursuant to Section 2041 of the Code) which consists of U.S. situs property (such as shares of stock in a U.S. corporation), such U.S. situs property will be includible in the nonresident's U.S. gross estate. [45]

***ii. Nonresident is the Settlor of the Trust*.**

A nonresident alien decedent will be subject to U.S. estate tax inclusion where the nonresident settles a trust consisting of U.S. situs property either at the time that the property is transferred to the trust, or at the time of the decedent's death, and retains strings so as to cause estate tax inclusion under Sections 2035-2038 or 2042 of the Internal Revenue Code.[46]

***iii. General Considerations*.**

The above results are consistent with principles of estate taxation for U.S. citizens or residents (domiciliaries). These principles provide for the inclusion of trust property in the decedent's gross estate where he holds powers over the economic benefits of the trust either as a beneficiary (holding a general power of appointment over trust property) or as a settlor (holding other powers over the trust property). Thus, if a nonresident alien decedent holds certain proscribed powers over, or interests in, a trust (whether foreign or domestic) pursuant to any of sections 2035 through 2038, 2041 and 2042 of the Code, the trust's property will be included in his U.S. gross

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estate if it is U.S. situs property on either the date of the transfer or the date of death.[47] The situs of such property held by the trust is determined based upon the rules set forth in Sections 2104 and 2105 of the Code.

Patents, Trademarks, Copyrights and Contractual Rights

Patents, trademarks and copyrights obtained from a jurisdiction's governmental agencies are generally limited to that jurisdiction and appear to be situated in that jurisdiction.[48] If the right is not statutory, such as a common law copyright, a different result may apply. For example, humorist P.G. Wodehouse gave his wife a manuscript before registering it in the United States and the manuscript was deemed not to be situated in the United States at the time of the gift.[49]

In general, contractual rights, such as licenses of patents and trademarks, are deemed to be situated in the jurisdiction for which the license is granted.[50] However, an argument can be made that they are situated where they are enforceable, namely, the jurisdiction of the licensor.[51]

Business Interests

A sole proprietorship is the alter ego of the sole proprietor, and its assets should be deemed situated wherever located. However, because there are no clear rules, some assets, such as goodwill, may raise questions. It would appear that because goodwill is an intangible asset that is not enforceable against a U.S. person, it should be situated in the jurisdiction of the nonresident alien decedent's domicile, as opposed to being allocated among the jurisdictions in which the sole proprietorship is conducted. But this result is not entirely certain.

Estate Tax Consequences When Property is Transferred with Strings

Under section 2104(b) of the Code, a transfer of property (in trust or otherwise) situated in the United States either at the time of transfer or at the time of the transferor's death causes the property to be includible in the transferor's gross estate for Federal estate tax purposes if the "string provisions," namely sections 2035 through 2038 and 2042 of the Code, apply.[52] The principles used to determine whether property is situated within the United States for Federal estate tax purposes also apply here. Therefore, shares of stock of a domestic (U.S.) corporation which were directly transferred to a revocable trust would be ensnared by this rule notwithstanding that for purposes of the Federal gift tax, such shares were deemed to be situated outside the United States.

The transfers to which Section 2104(b) apply are as follows:

- transfers of property interests that would otherwise be includible in the transferor's gross estate under section 2035, 2036, 2037, 2038 or 2042 of the Code, within three years of the decedent's death;[53]
- transfers in which the decedent retained for his life, or a period not ascertainable without reference to his death, or for any period which does not in fact end before his death, the possession or enjoyment of the property, or the right to the income from the property, or the right to designate who would possess or enjoy the property or its income;[54]
- transfers which require that in order to possess and enjoy the property the transferee must survive the transferor who retained a reversionary interest worth more than

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five percent of the value of the property immediately prior to his death;[55] and

- transfers which at the date of the transferor's death are subject to a power in the transferor to alter, amend, revoke or terminate the same, or where the transferor relinquished any such power within three years of his death.[56]

The string provisions also affect property situated in the United States that a nonresident gratuitously transfers to a foreign trust. If a nonresident alien retains the right to alter, amend or revoke such a trust, the value of the property remains includible in his U.S. gross estate. Therefore, if the property is tangible personal property (such as cash), it should be removed from the United States before being contributed to the trust and should not be located in the United States at the time of the nonresident grantor's death.

U.S. real property presents different problems because it is not transportable and different Federal income tax rules may apply. It is usually difficult to transfer such property without Federal income tax consequences because of the application of FIRPTA. For example, if such property had appreciated in value, generally, even the transfer of such property to a foreign corporation wholly owned by the nonresident would trigger a tax on its appreciation. If there were no appreciation in value, however, such real property could be contributed to a foreign corporation in exchange for stock in such corporation without any tax being incurred as a result of the transfer. Likewise, if it is not desirable to sell the stock of a U.S. corporation, such stock could be contributed to a foreign corporation in exchange for the foreign corporation's stock.

Where property is contributed for stock, the transaction needs to be carefully structured so as to fall within the exception to the application of Sections 2035, 2036 and 2038 for a "bona fide sale for an adequate and full consideration in money or money's worth"[57] in order to avoid estate tax inclusion under Section 2104(b).

Jointly Held Property

Generally, under Code section 2040(a), if property is held by a decedent and other persons as joint tenants with the right of survivorship the value of the jointly held property included in the estate of the first joint tenant to die is based on the amount of consideration the deceased joint tenant originally provided to acquire such property and to pay for subsequent capital improvements thereon.[58] There is in effect a "tracing rule." Thus, upon the death of a joint tenant, an appropriate percentage of the value of the jointly held property as of the date of the decedent's death (or alternate valuation date) will be included in the decedent's gross estate. This amount of estate tax inclusion is determined by multiplying the date of death value (or value as of the alternative valuation date) of the property by a fraction, the numerator of which is the amount of consideration furnished by the decedent and the denominator of which is the total amount of consideration provided by all joint tenants.

Notwithstanding the general rule of Code section 2040(a), under Code section 2040(b), if a decedent and the surviving spouse are the only joint tenants of the property, one-half of the value of the property will be includible in the deceased spouse's gross estate.[59] Thus, for such "qualified joint interests," the decedent's interest in jointly held property can be determined without resort to a complicated tracing rule.

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Code section 2040(b), however, does not apply if the surviving spouse is not a citizen of the United States at the time of the decedent's death.[60] Accordingly, in such cases, the decedent's estate must employ the general "tracing rule" of Code section 2040(a) to determine the amount includible in the deceased spouse's estate.

Credits

The applicability of credits depends on the type of property that is included in the nonresident's gross estate and is frequently limited.

i. The Applicable Exclusion Amount.

A nonresident is allowed a "credit" against the Federal estate tax of $13,000.[61] This credit is the equivalent of an exclusion of $60,000, and therefore pales in comparison to the applicable exclusion amount of $5,340,000 that is currently allowed to U.S. citizens and residents who die in 2014. Treaties, where applicable, may increase the amount of exclusion to which a nonresident decedent is entitled, generally determined by a fraction, the numerator of which is the nonresident's gross estate situated in the United States and the denominator of which is the nonresident's worldwide gross estate. In many instances, residents of treaty jurisdictions may prefer the lower fixed dollar amount of the credit available to nonresidents under the Code ($13,000) because, in order to take advantage of the credit allowed under a treaty, the nonresident's estate must disclose the full nature and value of the worldwide assets of the nonresident decedent. A nonresident (or his legal representative) generally will wish to avoid such complete disclosure.

Portability of the applicable exclusion amount between spouses for federal estate and gift tax purposes is *not* allowed for nonresident decedents who were not U.S. citizens at the time of their deaths.[62] In addition, a nonresident surviving spouse who is not a U.S. citizen at the time of making a gift or at the time of her death may *not* take into account any deceased spousal unused exclusion ("DSUE") amount of a deceased spouse, except as may be allowed under an applicable treaty obligation of the United States.[63]

ii. Credit for Tax on Prior Transfers.

There is a credit for Federal estate taxes paid on property passing to the nonresident within ten years prior to and two years after the death of the nonresident.[64] However, the amount of the credit is limited to an amount of tax paid by the transferor's estate that is attributable to the property passing to the nonresident transferee. The amount of such credit is calculated by taking a ratio, the numerator of which is the adjusted value of such property passing to the nonresident in the transferor's estate,[65] over the denominator which is the total value of the transferor's U.S. taxable estate (less any death taxes), multiplied by the amount of the Federal estate tax, as adjusted, paid by the transferor's estate.[66]

A further limitation on the amount of the available credit is that it is reduced by 20 percent for each two-year period that passes following the death of the transferor. Consequently, if the transferor predeceases the transferee by ten years, no credit is available.

TAMRA removed the time limitations applicable to the credit on prior taxed transfers with regard to certain property passing to a spouse who is not a U.S. citizen. Therefore, if property passes to a non-U.S. citizen spouse outright and is subject to the Federal estate tax because either (i) it does

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not qualify for the marital deduction or (ii) it passes in a trust known as a Qualified Domestic Trust (discussed hereafter) and distributions made from such trust are later subject to Federal estate tax, the entire amount of the Federal estate tax attributable to such property or distribution qualifies for the credit. The credit is available irrespective of when the Federal estate tax is paid, provided that the property would have been eligible for the marital deduction in the estate of the first spouse to die had the non-U.S. spouse been a U.S. citizen.

iii. Other Credits.

No credit is allowed to the estate of a nonresident for death taxes paid to foreign governments.[67] In addition, it should be noted that the state death tax credit that used to be available on a fractional basis to nonresident alien decedents under Section 2011 has been replaced by a deduction under Section 2058.

Deductions

In addition, the availability of deductions from the gross estate of a nonresident alien is similarly limited. Deductions attributable to property situated outside the United States are not available, and certain deductions attributable to property situated within the United States are available on a proportionate basis.

i. Marital deduction.

Federal tax law provides an unlimited marital deduction to the estate of a nonresident (dying after November 10, 1988) who leaves his property situated, or deemed situated in the United States to a U.S. citizen surviving spouse, provided that the usual statutory requirements to ensure that the property will be taxable at the death of the surviving spouse are met.[68] In contrast, transfers of such U.S. property from a nonresident to his non-U.S. citizen spouse will qualify for the marital deduction only if the property is also transferred to a Qualified Domestic Trust ("QDOT") for the benefit of the surviving spouse.[69]

Similarly, a marital deduction with respect to the estate tax is allowed to the estate of a U.S. citizen or resident (domiciliary) for transfers to his non-U.S. citizen spouse only if the property transferred is held in a QDOT for the benefit of the spouse.[70] In order to qualify for the marital deduction, all property, whether probate or non-probate, passing to a non-U.S. citizen surviving spouse must be placed in or irrevocably assigned to a QDOT on or before the extended due date of the Federal estate tax return, with the outside limit for such transfers being one year after the time prescribed by law, including extensions, for filing the Federal estate tax return.[71] A QDOT may be created by a decedent, his or her executor or surviving spouse.

In order for a trust to be a QDOT, the following requirements must be met:

1. The trust must require that at least one trustee be an individual U.S. citizen or U.S. corporation;[72]
2. The trust instrument must provide the U.S. trustee with the right to withhold the estate tax imposed on any distribution of principal from the trust;[73]
3. The trust must comply with such regulations as are promulgated to ensure the collection of any estate tax imposed on the trust;[74]
4. The executor of the decedent must make an irrevocable election with respect to the trust on the decedent's Federal estate tax return, which must be filed within one year of the due date for the return, including

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extensions;[75] and

5. The trust must be organized as a trust or, in foreign jurisdictions which do not recognize trusts, must have substantially the same effect as a trust.[76]

Property passing to a QDOT must qualify as qualified terminable interest property under Section 2056(b)(7) or otherwise qualify for the marital deduction under section 2056.[77] If a trust does not meet the requirements for a QDOT, as set forth above, but would have qualified for the marital deduction in all other respects, the time for determining whether a trust will qualify as a QDOT may be extended if a reformation proceeding is commenced prior to the due date for filing the estate tax return. In that event, the determination of whether the trust qualifies as a QDOT will be made at the conclusion of the reformation proceedings.

The purpose of the third requirement set forth above is generally to ensure that an estate tax (the "deferred estate tax") is paid at the earlier of the following occurrences: (a) upon distribution of trust principal before the surviving spouse's death (except in the case of hardship), in which case the deferred estate tax would apply to the value of the principal distributed, or (b) upon the death of the surviving spouse, in which case the deferred estate tax would apply to the value of the principal remaining in the trust as of the surviving spouse's death.[78] The imposition of the deferred estate tax would be accelerated, however, if there were no U.S. citizen or domestic corporation acting as a trustee of the trust or if the trust were to cease to meet the regulatory requirements to ensure the collection of tax.[79] If the trust were thus disqualified, the estate tax would apply to the value of the principal remaining in the trust at that time.

The amount of the deferred estate tax imposed is designed to equal the additional estate tax that would have been due had the value of the principal of the trust subject to the deferred estate tax been included in the decedent spouse's gross estate.[80] The deferred estate tax imposed on the QDOT would be treated as an estate tax paid with respect to the decedent's estate.

To the extent that the estate tax (deferred or not) is imposed with respect to property because of (a) a distribution of principal to the surviving spouse, (b) the death of the surviving spouse or (c) because a QDOT is not utilized, a credit generally will be allowed against any estate tax imposed on the surviving spouse's estate with respect to that property. In the event the estate tax imposed on the estate of the deceased spouse has not finally been determined prior to (a) a distribution of principal from the QDOT to the surviving spouse or (b) the death of the surviving spouse who has an interest in a QDOT, the rate of the applicable estate tax at either of the foregoing events will be the highest rate of estate tax in effect on the date of the decedent's death.[81] There is provision for a credit or a refund once the tax is finally determined.[82]

Significantly, all trust distributions of income to the non-U.S. citizen surviving spouse are exempt from the estate tax. In addition, estate tax-free distributions of principal are permitted in the case of hardship.[83]

Although the Code provides a marital deduction to the estate of a nonresident alien, estate planners should be careful in using it. For example, if a nonresident is married to a U.S. citizen, it is generally not advisable to leave property that

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otherwise is not subject to the Federal estate tax to his surviving spouse in a manner that will cause such property to be taxed in the estate of such spouse. In such case, it may be better to leave such property to the surviving U.S. citizen spouse in trust, rather than outright, and ensure that the provisions of the trust will not cause the assets thereof to be includible in the gross estate of the U.S. citizen spouse such as by conferring upon the surviving spouse a general power of appointment.

Certain treaties, as well as the U.S. Treasury Department's Model Estate and Gift Tax Treaty,[84] recognize some form of marital deduction. However, the marital deduction rules vary from treaty to treaty. Therefore, it is essential to review the appropriate treaty provisions to ascertain the marital deduction rules that apply. In the case of the estate of a surviving nonresident spouse who is the beneficiary of a QDOT, the estate may choose either the statutory deduction under the QDOT provisions of the Code or the marital deduction allowed under the applicable tax treaty, but not both.[85]

ii. Charitable Deductions.

Bequests, legacies, devises or transfers from a nonresident to the United States or any political subdivision thereof, or to any charitable corporation organized in the United States and established and operated for religious, scientific or educational purposes, or to a trustee or fraternal organization for charitable purposes within the United States, are allowed as a charitable deduction. If charitable transfers qualify, the entire deduction is allowed and no apportionment is required,[86] but the personal representative must disclose the value of the decedent's worldwide gross estate in order to claim the charitable deduction.[87]

iii. Deductions for Funeral and Administration Expenses, Claims Against the Estate, Indebtedness, Taxes and Losses.

Section 2053 of the Code allows deductions for funeral and administration expenses, claims against the estate, indebtedness in respect of property which is includible in the U.S. gross estate, and taxes. In addition, Section 2054 allows deductions for losses. Further, under Section 2058, a deduction is available for state death taxes. Each of these Code sections are subject to their own limitations, including in the case of claims and administration expenses, regulations under Section 2053 that are applicable to decedents dying on or after October 20, 2009.[88]

Importantly, in order for a nonresident's estate to take any deduction under Section 2053 or 2054, the nonresident's entire estate must be disclosed to the Internal Revenue Service, and the decedent's personal representative may not wish to disclose this information. Consequently, the personal representative may decide to forego the deduction for Federal estate tax purposes.[89] Therefore, it may be advisable for the estate planner to include in any nonresident's will disposing of U.S. property a provision which authorizes the fiduciary to forego any such U.S. deductions, and additional provisions that expressly exonerate the fiduciary from liability for failing to take such deductions.

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IV. Federal Gift Taxation of Nonresident Aliens

What is Subject to Gift Tax?

A gift is a gratuitous transfer of a property interest. A gift can take a variety of forms, such as an outright gift, a forgiveness of a debt, an assignment of property, a constructive gift or the establishment and funding of a trust.[90]

A nonresident is subject to the Federal gift tax only on transfers (direct or indirect, by trust or otherwise) of real or tangible personal property situated in the United States.[91] In contrast, transfers of intangible property by nonresidents, such as shares of stock of domestic corporations or debts of a U.S. person or entity, are specifically excluded from the gift tax unless the donor is a nonresident who expatriated from the United States prior to June 17, 2008 and meets certain statutory requirements.[92] Accordingly, in determining the Federal gift tax for a nonresident (and assuming that a pre-June 17, 2008 expatriation situation does not apply), the only issues that need to be addressed are:

(1) whether the gift consists of real or tangible personal property and, if so,

(2) whether it is situated in the United States.

As with the estate tax, real or tangible property is situated in the United States only if it is physically located in the United States.[93]

Because no gift tax applies to gifts of debt obligations of U.S. persons or stock of U.S. corporations, a nonresident may wish to make gifts of this type of property, especially since they would be subject to the Federal estate tax if held at death. In addition, if a nonresident wishes to make a gift of tangible personal property which is located in the United States, he should remove it from the United States before making the gift to avoid the Federal gift tax. In this way, he will avoid both the Federal gift tax and the "gross up" consequence if the Federal estate tax applies to his estate.

If a nonresident wishes to make a gift of real or tangible personal property located in the United States but is unable or unwilling to remove the same from the United States, it is unlikely that he would be able to avoid taxation by transferring the property to a foreign corporation and, thereafter, transferring the shares of the foreign corporation.[94]

Importantly, even if the donor removes the property from the United States to transfer it gratuitously, he should not retain rights or powers that, under sections 2035 through 2038, 2041 and 2042 of the Code, make the property includible in his gross estate if situated in the United States at the time of his death.[95]

If a nonresident purchases tangible personal property while visiting the United States, it is clearly advisable from the nonresident's standpoint to hold off making any gifts of such property until after he has left the United States to avoid the federal gift tax.

Moreover, when a nonresident transfers funds to a donee who is located in the United States, as an extra layer of precaution (although technically not required), the nonresident should avoid using checks drawn on U.S. banks and wire transfers into the United States.

Computation of the Gift Tax

The federal gift tax is a cumulative tax that is determined by computing a tentative tax on taxable gifts made during the applicable period, plus taxable gifts made subsequent to June 6, 1932. The tentative tax

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applicable to the prior gifts is then subtracted to determine the actual tax.

i. Annual Exclusion.

The annual exclusion of $14,000 per donee is available to a nonresident.[96] In order to qualify, the gift must be of a present interest in property. Significantly, nonresident spouses are unable to split gifts to effectively double the annual exclusion. As more fully discussed below, the annual exclusion amount for gifts by a spouse to a non-U.S. citizen spouse is increased to $100,000, subject to indexing (with this amount at $143,000 for 2013 and $145,000 for 2014).

ii. Gift Tax Exclusion for the Direct Payment of Tuition or Medical Care.

A donor (including a nonresident) is permitted to exclude from taxable gifts amounts paid on behalf of an individual as tuition to a qualifying educational organization for the education or training of such individual, or amounts paid on behalf of an individual to any person who provides medical care (as defined in IRC § 213(d)) with respect to such individual as payment for such medical care.[97] The payments of these expenses by a donor must be made *directly* to the educational institution or provider of medical services. If a donor intends to transfer assets to a donee and such a transfer would be subject to gift taxes, the donor may instead pay educational or medical expenses of the donee directly, and such payments will not be subject to gift taxes if the IRC § 2503(e) requirements are met.[98] This exclusion also applies for generation-skipping transfer tax purposes,[99] and is a powerful estate planning tool often overlooked by well-meaning grandparents.[100]

iii. Federal Gift Tax Rates.

The Federal gift tax schedule of rates for nonresidents is the same as the unified estate and gift tax rate schedule for U.S. citizens and residents. However, in contrast to the $13,000 credit available to nonresidents for estate tax purposes, no credit against gift tax is available to nonresidents.[101] Under current law, the rates begin at 18 percent on taxable gifts under $10,000 and go up to 40 percent.

iv. Unified Credit.

Although the credit applicable to Federal estate taxes is not available to a nonresident at the time the gift is made, gifts that are included in the calculation of the nonresident's Federal estate tax as adjusted taxable gifts are allowed a credit for the Federal gift tax if a Federal estate tax return for the nonresident is filed.[102]

v. Marital Deduction.

A nonresident is eligible for a marital deduction for a gift of U.S. situs property to his U.S. citizen spouse.[103]

However, whether the donor is a U.S. citizen, a U.S. domiciliary or a nonresident alien, no marital deduction is allowed at all for gifts to or for the benefit of a non-U.S. citizen spouse. As partial compensation for the complete loss of a marital deduction, the annual exclusion amount allowable for any gifts to a non-U.S. citizen spouse under Section 2503(b) of the Code is increased to $100,000, indexed for inflation.[104] For 2013 the indexed amount is $143,000, rising to $145,000 for gifts made to non-U.S. citizen spouses in 2014.

Special gift tax rules apply to joint interests created between a U.S. citizen or non-U.S. citizen spouse and his non-U.S. citizen donee spouse depending on whether the interest

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transferred is in real property or in personal property.[105]

vi. Charitable Deduction.

Charitable deductions by a nonresident are limited to gifts made to U.S. charitable corporations in the United States, any state, or any political subdivision of the United States, domestic veterans organizations and trusts, funds, foundations, fraternal orders or lodges for use within the United States.[106]

vii. Joint Gifts by Spouses.

As noted above, gift-splitting by spouses to third parties under section 2513 of the Code is permitted only if both spouses are U.S. citizens or residents (domiciliaries).[107]

viii. Treaties.

The United States has gift tax treaties with the following countries: Australia, Austria, Denmark, France, Germany, Japan, Sweden and the United Kingdom. These treaties may vary the application of the Federal gift tax provisions and should be reviewed when a nonresident from one of those jurisdictions makes a gift of U.S. property.[108]

V. Generation-Skipping Transfer Tax of Nonresident Aliens

Special generation-skipping transfer tax ("GST tax") rules apply to transfers by nonresident aliens that "skip" a generation (as further explained below). The generation-skipping transfer, or "GST" tax, is currently a flat 40% tax imposed on transfers to "skip persons," a term which includes family members more than one generation, and unrelated persons more than 37½ years, younger than the donor.[109] The purpose of this tax is to ensure that property will be subject to full transfer taxation at each generational level. This tax is imposed in addition to the gift tax or estate tax.

GST tax is imposed on three types of transfers:

i. Direct Skips: These are transfers to a skip person that are subject to the estate tax or the gift tax.[110]

ii. Taxable Terminations: These occur upon the termination (whether by death, lapse of time, release of a power, or otherwise) of an interest in property held in trust[111] unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from a trust to a skip person.[112]

iii. Taxable Distributions. These are distributions from a trust to a skip person that are neither a direct skip nor a taxable termination.[113]

Under current law in effect for 2014, the "GST exemption" permits a donor to transfer a total of $5,340,000 to skip persons free of GST tax.[114] The GST exemption is a one-time, cumulative exemption from taxation.

Significantly, with respect to nonresident aliens, transfers which are not subject to the Federal gift or estate tax (such as transfers of non-U.S. situs property by a nonresident alien) are not subject to the GST tax.[115]

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[1] Treas. Reg. § 20.0-1(b).

[2] *See* Patrick J. Lannon, *Domicile Planning - Don't Take it for Granted*," The Florida Bar Journal (Jan. 2006).

[3] *See* I.R.C. § 7701(b).

[4] *See* I.R.C. § 2103.

[5] *See* Treas. Reg. §§ 20.2104-1(a)(2), 20.2105-1(a)(2), 25.2511-3(b)(1).

[6] *See* Treas. Reg. § 20.2104-1(a)(2).

[7] *See* I.R.C. § 2105(c); Treas. Reg. § 20.2105-1(b). Significantly, there is no corresponding exclusion for Federal gift tax purposes.

[8] *See* Treas. Regs. §§ 20.2104-1(a)(1), 20.2105-1(a)(1).

[9] *See* I.R.C. § 2106(b). The amount of this deduction is calculated by multiplying the amount of the outstanding mortgage by a fraction, the numerator of which is the value of the decedent's total U.S.-situs property and the denominator of which is the value of the decedent's total worldwide property.

[10] *See* Treas. Regs. § 20.2104-1(a)(4). There is an extremely significant distinction here between the Federal estate and gift tax rules for nonresident aliens. Intangible property, such as shares of stock of domestic corporations or debts of a U.S. person, irrespective of where the stock certificate or the written evidence of the debt is located, although deemed to be situated in the United States, generally is not subject to the Federal gift tax. *See* Treas. Regs. § 25.2511-3.

[11] *See* I.R.C. § 2104(a); Treas. Regs. § 20.2104-1(a)(5).

[12] *See* Treas. Regs. § 20.2105-1(f).

[13] *Fillman v. United States*, 355 F.2d 632 (Ct. Claims 1966).

[14] *Swan v. Comm'r*, 24 T.C. 829 (Tax Ct. 1955), *aff'd in part, rev'd in part*, 247 F.2d 144 (2d Cir. 1957).

[15] The owner of an entity that is disregarded reports all of the income and expenses of the disregarded entity on his own return and treats the assets of the disregarded entity as his own.

[16] *See Pierre v. Comm'r*, 133 T.C. 2 (Tax Ct. 2009), holding that the "check-the-box regulations" under Section 7701 do not apply for Federal gift tax purposes so as to cause a single member limited liability company to be disregarded for Federal gift tax purposes.

[17] *See* I.R.C. § 2104(b).

[18] *See Bongard v. Comm'r*, 124 T.C. 95 (Tax Ct. 2005).

[19] *See* Priv. Ltr. Rul. 200243031 (Oct. 25, 2002).

[20] *See* I.R.C. § 7701(a)(30) for the definition of a "U.S. person."

[21] Treas. Regs. § 20.2104-1(a)(7); *see* I.R.C. § 2104(c).

[22] *See* Treas. Regs. § 20.2105-1(k).

[23] Federal estate taxation of deposits in U.S. banks and of debt obligations follows the income taxation of these items.

[24] *See* I.R.C. § 2105(b).

[25] *See* I.R.C. §§ 871(i)(2)(A), (3) and 881(d).

[26] *See* I.R.C. § 2105(b).

[27] *See* Rev. Rul. 69-596, 1969-2 C.B. 179; G.C.M. 22,419, 1940-2 C.B. 288.

[28] *See* Rev. Rul. 55-143, 1955-1 C.B. 465.

[29] *See* I.R.C. §§ 871(h), 2105(b)(3).

[30] *See* I.R.C. § 871(h)(2)(B)(i). For portfolio interest to be exempt from Federal income tax for a nonresident alien, the recipient of interest payments must also provide the payor with a statement that the beneficial owner of the obligation is not a U.S. person. *See* I.R.C. § 871(h)(2)(B)(ii), (5). This is usually accomplished by furnishing Form W-8BEN. This requirement, however, does not apply when determining the situs of the debt obligation for U.S. Federal estate tax purposes. *See* I.R.C. § 2105(b)(3).

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[31] *See* I.R.C. §§ 163(f)(2)(B), 871(h)(2)(A).

[32] *See* Treas. Regs. § 1.871-14(c). An obligation will be considered transferable through a book entry system if the ownership of an interest in the obligation is required to be reflected in a book entry, whether or not physical securities are issued. A book entry is a record of ownership that identifies the owner of an interest in the obligation.

[33] *See* I.R.C. § 871(a)(1)(A), (C)(ii),(g)(1)(B)(i). This withholding tax exemption is separate from the portfolio interest exemption.

[34] *See* I.R.C. § 2105(b)(4).

[35] *See* I.R.C. § 2105(b)(2).

[36] *See* I.R.C. §§ 2104(c), 2105(b) and 871(i)(3).

[37] *See* Treas. Regs. § 20.2104-1(a)(7).

[38] *See* Treas. Regs. § 20.2105-1(g).

[39] *See* Robert C. Lawrence III, International Tax & Estate Planning – A Practical Guide for Multinational Investors § 3.2.6 at 3-17 – 3-20 (3rd ed. 2009).

[40] *See* Treas. Regs. § 301.7701-3(b)(1).

[41] *See* Treas. Regs. § 301.7701-3(b)(2).

[42] *See id*.

[43] *See id*.

[44] *See* I.R.C. § 2103; Treas. Regs. § 20.2103-1.

[45] *See Comm'r v. Nevius*, 76 F.2d 109 (2d Cir.) (U.S. estate tax inclusion of pro rata share of trust corpus attributable to U.S. securities over which nonresident alien decedent held a testamentary general power of appointment), *cert. denied*, 296 U.S. 591 (1935).

[46] *See* I.R.C. § 2104(b); Rev. Rul. 55-163.

[47] *See* I.R.C. §§ 2103, 2104(b).

[48] *See* Robert C. Lawrence III, *supra*, § 3.2.8 at 3-22.

[49] *See Wodehouse v. Comm'r*, 19 T.C. 487 (1952), *acq.* 1 C.B. 6.

[50] *See* Robert C. Lawrence III, *supra,* § 3.2.8 at 3-22.

[51] *See id*.

[52] *See* I.R.C. § 2104(b).

[53] *See* I.R.C. § 2035(a).

[54] *See* I.R.C. § 2036(a).

[55] *See* I.R.C. § 2037(a).

[56] *See* I.R.C. § 2038.

[57] *See* I.R.C. §§ 2035(d), 2036(a), 2038(a) (each excepting from such string provisions a "bona fide sale for adequate and full consideration in money or money's worth").

[58] *See* I.R.C. § 2040(a); Treas. Regs. § 20.2040-1(c)(3).

[59] *See* I.R.C. § 2040(b). An interest held by a decedent and the decedent's spouse as the only joint tenants (or as tenancy by the entirely) is a "qualified joint interest."

[60] *See* I.R.C. § 2056(d)(1)(B).

[61] *See* I.R.C. § 2102(b)(1). This credit is taken first, before the reduction of the Federal estate tax by the application of any other credits. *See* I.R.C. § 2101(b).

[62] Temp. Reg. § 20.2010-2T(a)(5).

[63] Temp. Reg. §§ 20.2010-3T(e) and 25.2505-2T(f).

[64] I.R.C. § 2013. An example of a circumstance where property could be subject to the Federal estate tax in the transferor's estate after the death of the transferee (nonresident alien) would be where a transfer had occurred during the life of the transferor but was includible in the estate of the transferor because of the application of one of the Federal estate tax provisions, such as one of the string provisions.

[65] *See* I.R.C. § 2013(d).

[66] *See* I.R.C. § 2102(b); Treas. Regs. § 20.2102-1(b).

[67] *See* I.R.C. § 2014. This section of the Code only provides a credit for foreign death taxes imposed by I.R.C. § 2001, which provides for the

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imposition of estate taxes on U.S. citizens and residents.

68 *See* I.R.C. 2106(a)(3).

69 *See* I.R.C. § 2056(d)(2).

70 *See* I.R.C. §§ 2056(d), 2056A.

71 *See* I.R.C. § 2056A(d).

72 *See* I.R.C. § 2056A(a)(1)(A).

73 *See* I.R.C. § 2056A(a)(1)(B).

74 *See* I.R.C. § 2056A(a)(2).

75 *See* I.R.C. § 2056A.

76 *See* I.R.C. § 2056A.

77 *See* Treas. Regs. § 20.2056A-2(b).

78 *See* I.R.C. § 2056A(b)(1)(A), (B).

79 *See* I.R.C. § 2056A(b)(4).

80 *See* I.R.C. § 2056A(b)(2).

81 *See* I.R.C. § 2056A(2)(B)(i).

82 *See* I.R.C. § 2056A(2)(B)(ii).

83 *See* I.R.C. § 2056A(3)(B).

84 U.S. Treasury Department's Model Estate and Gift Tax Treaty of November 20, 1980, I Tax Treaties (CCH) ¶ 214 (2004).

85 *See* Treas. Regs. § 20.2056A-1(c).

86 *See* I.R.C. § 2106(a)(2).

87 *See* I.R.C. § 2106(b).

88 *See* T.D. 9468 (2009) (guidance under the Section 2053 regulations).

89 *See* I.R.C. § 2106(b); Treas. Regs. §§ 20.2106-1(b) and 20.2106-2(a).

90 *See* I.R.C. §§ 2501, 2511; Treas. Regs. § 25.2511-1(a).

91 *See* I.R.C. §§ 2501(a)(2), 2511(a).

92 *See* I.R.C. §§ 2501(a)(3), 2511(b), 2107, 877A (effective June 17, 2008).

93 *See* Treas. Regs. § 25.2511-3(b)(1).

94 *See De Goldschmidt-Rothschild v. Comm'r*, 168 F.2d 975 (2d Cir. 1948).

95 *See* I.R.C. § 2104(b).

96 *See* I.R.C. § 2503(b).

97 *See* I.R.C. § 2503(e).

98 *See* I.R.C. § 2642(c)(3)(B).

99 *See* I.R.C. § 2611(b)(1).

100 To qualify for the tuition exclusion, the educational organization must be one that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. *See* Treas. Regs. § 25.2503-6(b)(2). The educational organization must also have as its primary purpose the presentation of formal instruction. *See* Treas. Regs. § 1.170A-9(b)(1). If an organization is engaged in both educational and non-educational activities, the tuition exclusion is not available unless the non-educational activities are merely "incidental" to the formal educational instruction. *See id*. The term "educational organization" includes primary, secondary, preparatory and high schools, and colleges and universities. *See id*. It includes pre-schools and day care programs only to the extent that they meet these requirements. *See* Rev. Rul. 78-446. The tuition exclusion is also available against the GST tax. *See* I.R.C. § 2642(c)(3)(B).

To qualify, the tuition must be paid directly to the school, and it may not be reimbursed to the student. *See* Treas. Regs. § 25.2503-6(c), exs. 1&2. There is no requirement that the donor and donee be related for this exclusion to qualify. *See* Treas. Regs. § 25.2503-6(a).

Tuition for future years may be prepaid by a donor, and qualify for this exclusion, provided that tuition must be forfeited and cannot be subject to refund in the event the donee ceases to attend school. *See* Priv. Ltr. Rul. 200602002, I.R.S. Tech. Adv. Mem. 199941013.

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Significantly, the tuition exclusion only applies to *tuition* for full-time or part-time studies. *See* Treas. Regs. § 25.2503-6(b)(1). It does *not* cover amounts paid for books, supplies, room and board, or any other incidental expenses that do not constitute tuition. *See* Treas. Regs. § 25.2503-6(b)(2).

[101] *See* I.R.C. § 2505(a).

[102] *See* I.R.C. § 2101(b).

[103] *See* I.R.C. § 2523(a).

[104] *See* I.R.C. § 2523(i).

[105] *See* Robert C. Lawrence III, *supra*, § 2.3.2 at 1-19.

[106] *See* I.R.C. § 2522(b).

[107] *See* I.R.C. § 2513(a)(1).

[108] Treaties will often change the analysis under the Federal estate tax statutes as well, and should be reviewed as warranted.

[109] There is a "predeceased child" exception such that the GST tax does not apply in certain situations where members of an intervening generation are deceased. For example, an outright gift from a grandparent to a grandchild born of the grandparent's deceased child is not subject to GST taxes.

[110] *See* I.R.C. § 2612(c).

[111] For GST tax purposes, an "interest in property held in trust" generally requires that such person be a current beneficiary (whether mandatory, or discretionary with the trustee) of the income or corpus of the trust. Accordingly, an individual who only holds a remainder interest in a trust would not be considered to possess an interest in trust property for GST tax purposes. *See* I.R.C. § 2652(c).

[112] *See* I.R.C. § 2612(a).

[113] *See* I.R.C. § 2612(b).

[114] *See* I.R.C. §§ 2631(c), 2010(c). *See also* Treas. Regs. § 26.2663-2(a) (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); Robert C. Lawrence III, *supra*, § 3.7 n.175, at 3-45 (advocating this construction).

[115] *See* Treas. Regs. § 26.2663-2.

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