

# Planning for non-citizens

In brief

## U.S. TAXATION OF NON-CITIZENS

### Resident (Non-U.S. Citizen Living in the United States)

- **Income Tax** – All income earned worldwide is subject to U.S. taxation.
- **Gift Tax** – The lifetime gift tax exemption (\$12,060,000 in 2022) and the annual exclusion (\$16,000 in 2022) are available. Gift splitting is available if the spouse is a citizen or a resident. The gift tax marital deduction is not available for gifts to a non-citizen spouse, but an enhanced annual exclusion (\$164,000 in 2022) is available for gifts to a non-citizen spouse.
- **Estate Tax** – All property worldwide is included in the individual's U.S. taxable estate. The estate tax exemption (\$12,060,000 in 2022) is available. The estate might qualify for a credit for any foreign death taxes paid. The estate tax marital deduction is available except for a transfer to a non-citizen spouse.
- **Generation Skipping Transfer Tax** – The GST exemption (\$12,060,000 in 2022) is available.

### Non-Resident (Non-U.S. Citizen Living Outside the United States)

- **Income Tax** – Limited to income from U.S. sources or connected to a U.S. trade or business.
- **Gift Tax** – Limited to gifts of real or tangible personal property located in the U.S. No gift tax exemption is available, but the annual exclusion is available. Gift splitting with a non-resident spouse is not possible.
- **Estate Tax** – The taxable estate is limited to assets situated in the U.S. The estate tax exemption is capped at \$60,000 (not adjusted for inflation). Life insurance owned by the insured is property situated outside the U.S., so it is not included in the taxable estate.
- **Generation Skipping Transfer Tax** – Applies only if U.S. gift or estate taxes apply. The GST exemption is available.

### Non-Citizen Spouse as Gift Donee or Surviving Transferee

- Citizenship and residency of the transferring spouse are not factors in determining the availability of the gift tax or estate tax marital deductions.
- Lifetime gifts to a non-citizen spouse do not qualify for the unlimited gift tax marital deduction, but they enjoy an enhanced annual exclusion (\$164,000 in 2022).
- Transfers to a surviving spouse who is not a U.S. citizen do not qualify for the estate tax marital deduction.
- If the surviving spouse is not a U.S. citizen, assets in excess of the estate tax exemption must be placed into a Qualified Domestic Trust (QDOT) until the survivor's death in order to defer estate taxes.

### Tax Treaties

- A treaty between the U.S. and a foreign country can alter general tax rules.

(REV 0222)

## Expatriation

- A “covered expatriate” is a U.S. citizen who relinquishes citizenship, or a non-citizen long-term resident who ceases to be a resident, and
  - For the preceding five years ending before the date of loss of residency, has an average net income tax liability exceeding \$178,000 (2022 figure);
  - Has a net worth exceeding \$2 million; or
  - Fails to certify compliance with all U.S. tax requirements and obligations for the preceding five years.
- A covered expatriate is deemed to sell his property for the fair market value on the day prior to expatriation. Gain or loss is recognized in the year of the deemed sale. The first \$767,000 (2022 figure) of gain is excluded from tax. Payment of the tax on a deemed sale can be deferred using the rules of Section 6601.
- Certain property owned by a covered expatriate is treated differently under the deemed sale rules.
  - **Qualified retirement plans, qualified annuities, SEP, SIMPLE plans.** Amounts can remain in the plan. The payer is required to deduct and withhold 30% from a taxable payment made to a covered expatriate.
  - **Individual Retirement Accounts, 529 accounts, Coverdell Education Savings Accounts, Health Savings Accounts, Archer Medical Savings Accounts.** A distribution of the entire balance is deemed to occur on the day prior to expatriation. No early distribution penalties are assessed.
  - **Nonqualified deferred compensation.** An amount equal to the present value of the benefit is treated as having been distributed to the covered expatriate on the day prior to expatriation.
  - **Non-grantor trusts.** The trustee is required to deduct and withhold 30% from the taxable portion of a distribution to a covered expatriate.

## QUALIFIED DOMESTIC TRUSTS (QDOTS)

If the surviving spouse is not a U.S. citizen, the QDOT can defer until the surviving spouse’s death the estate taxes which would have been owed upon the death of the first spouse.

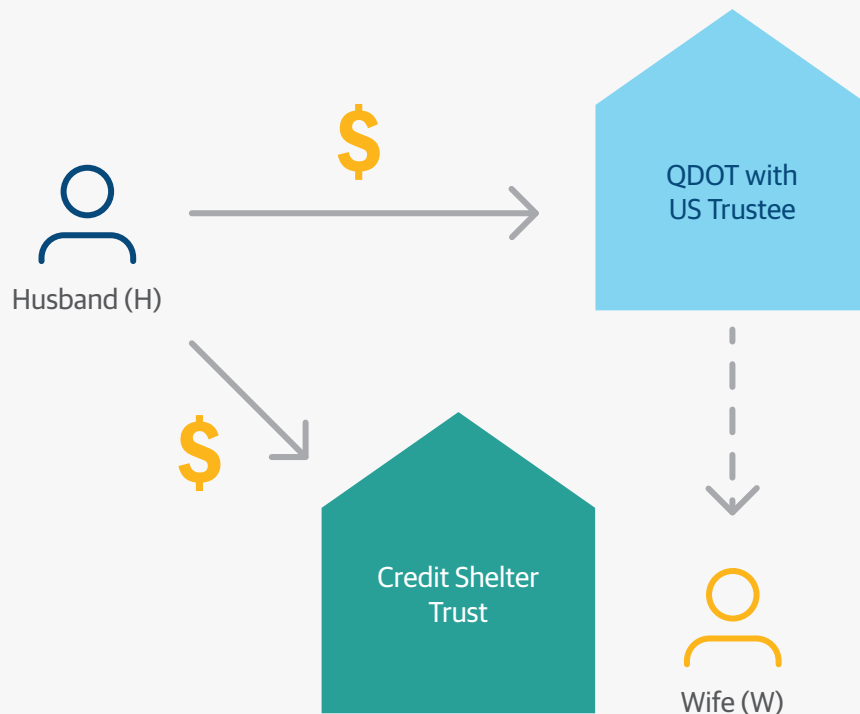
### Requirements

- Assets placed in the QDOT must qualify for the marital deduction but for the fact the surviving spouse is not a U.S. citizen.
- At least one trustee must be a U.S. bank, trust company, or individual U.S. citizen (often referred to as a “U.S. trustee”).
- The U.S. trustee must have the ability to withhold any deferred estate tax from distributions.
- If the U.S. trustee is an individual, he must generally obtain a bond or letter of credit.

### Taxation

- Deferred estate tax is determined as if the QDOT assets were included in the estate of the first-to-die spouse. The tax tables, deductions, and credits in effect at the first death are applied.
- Non-hardship distributions of QDOT principal are subject to deferred estate tax.
- Distributions of QDOT principal due to hardship are not subject to deferred estate tax. Hardship is narrowly defined.
- Distributions of QDOT income are not subject to deferred estate tax.

- Upon the death of the surviving spouse, QDOT assets are added back into the taxable estate of the first spouse to die, and estate tax liability is calculated using the tax tables in effect at the first spouse to die's death. QDOT assets are also included in the survivor's taxable estate. The survivor's estate receives a credit for any deferred estate taxes paid on distributions during the survivor's life and at the survivor's death.
- If a trust ceases to qualify as a QDOT, the trust is taxed as if the non-citizen survivor died on the day the trust ceased to qualify.



### Example

- W is not a citizen. It does not matter whether H is a U.S. citizen or resident.
- Upon H's death, H's credit shelter trust is fully funded using his estate tax exemption (\$12,060,000 in 2022).
- The remaining assets go into the QDOT with a U.S. trustee in order to defer H's estate taxes.
- Distributions of QDOT principal due to hardship and distributions of QDOT income are received by W free of H's deferred estate tax.
- Non-hardship distributions of QDOT principal are taxed using the tax tables, deductions, and credits in effect at H's death.
- H's deferred estate tax is payable upon W's death.
- QDOT assets are also included in W's taxable estate at her death.
- W's estate can claim a credit for H's deferred estate tax paid on distributions of QDOT principal during W's life and at her death.

## NORTHWESTERN MUTUAL AND NON-CITIZENS

Northwestern Mutual does not make any statement about the foreign tax consequences or treatment relating to its products, accounts, or services.

Northwestern Mutual generally insures permanent U.S. residents on the same basis as U.S. citizens. For a temporary resident, Northwestern Mutual considers the length of residency in the U.S., visa status, and the country that the temporary resident will move to if or when he fails to obtain permanent residency. Contact the product Underwriting Department for information on specific cases.

### Life Insurance

- Solicitation, application, and delivery must occur within the U.S. A Travel and Residence Questionnaire must accompany a temporary resident's application. Premiums must be paid in U.S. currency.
- If the beneficiary is not a U.S. resident, a Citizenship and Residence Statement must be completed before the death benefit is paid.

### Disability Income Insurance

- Solicitation, application, and delivery must occur within the U.S. A Travel and Residence Questionnaire must accompany a temporary resident's application. Premiums must be paid in U.S. currency.
- A policy rider excluding benefits for a disability occurring outside the U.S. or excluding benefits while the insured resides outside the U.S. might be required.

### Long-Term Care Insurance

- Solicitation, application, and delivery must occur within the U.S. Premiums must be paid in U.S. currency.
- Care must occur in the U.S. to qualify for reimbursement.

### Nonqualified Annuities

- The owner of a nonqualified annuity must be a U.S. citizen or legal resident. A green card (or application for a green card) must accompany the application to verify residency.
- Northwestern Mutual cannot issue a nonqualified annuity to a non-U.S. resident or entity formed or organized outside the U.S.

### Northwestern Mutual Investment Services, LLC (NMIS)

- Northwestern Mutual Investment Services, LLC (NMIS) can open a securities account for a non-citizen legally residing in the U.S. A green card (or application for a green card) must accompany the application to verify residency.

## PRACTICAL TIPS

- Citizenship and Residency
- A QDOT is not necessary if the surviving non-citizen spouse becomes a U.S. citizen prior to the filing of the deceased's estate tax return.
- A non-U.S. citizen who is wealthy enough to face an estate tax problem might consider becoming a U.S. resident to take advantage of the larger estate tax exemption.

### QDOT

- A QDOT is only needed for amounts in excess of the estate tax exemption available at the first spouse's death.
- Use a bank or trust company (as opposed to an individual) as the U.S. trustee. Complex bonding and letter of credit requirements apply if an individual is named as the U.S. trustee.
- Include a "savings clause" allowing the trustee to amend the trust to meet any changes in QDOT requirements.
- Making the QDOT a Qualified Terminable Interest Property (QTIP) trust ensures that trust income is paid to the survivor at least annually while locking in the ultimate recipient of the QDOT corpus.

### Enhanced Annual Exclusion for Gifts to a Non-Citizen Spouse

- Neither lifetime gifts nor at-death transfers to a non-citizen spouse qualify for the unlimited marital deduction. Lifetime gifts to a non-citizen spouse can take advantage of the enhanced annual exclusion (\$164,000 in 2022) to avoid utilizing the donor's gift tax exemption. A wealthy spouse married to a non-citizen can use the enhanced annual exclusion to:
  - Reduce the size of his estate, rendering an ultimate estate tax less likely, and/or
  - Permit the non-citizen spouse to purchase and own life insurance on the wealthy spouse's life, so that the non-spouse can receive death benefit free of both income and estate taxes.

### Irrevocable Life Insurance Trust (ILIT)

- Use a QDOT to defer estate taxes and use a life insurance policy owned by an ILIT to provide the survivor with income and estate tax-free cash.
- A QDOT merely defers estate taxes until the second death. Proceeds of an ILIT are excluded from both spouses' taxable estates.
- No U.S. trustee is required in an ILIT. The non-insured non-citizen spouse can be the ILIT's sole trustee if she resides in the U.S.
- Distributions of ILIT principal are not subject to the deferred estate tax.
- An ILIT can provide the survivor with flexibility and control not found in a QDOT.

This publication is not intended as legal or tax advice. This information is intended solely for the information and education of Northwestern Mutual financial representatives, their customers, and the legal and tax advisors with whom they work. It must not be used as a basis for legal or tax advice, and is not intended to be used and cannot be used to avoid any penalties that may be imposed on a taxpayer. Northwestern Mutual and its Financial Representatives do not give legal or tax advice. Taxpayers should seek advice regarding their particular circumstances from an independent tax advisor. Tax and other planning developments after the original date of publication may affect these discussions.

Investment brokerage services are offered through **Northwestern Mutual Investment Services, LLC**, (NMIS) a subsidiary of NM, broker-dealer, registered investment advisor, and member FINRA and SIPC.

Northwestern Mutual is the marketing name for The Northwestern Mutual Life Insurance Company (NM), Milwaukee, WI (life and disability insurance, annuities, and life insurance with long term care benefits) and its subsidiaries.

Advanced Planning, February 2022

(REV 0222)