PLANNING FOR TRANSFERS TO NON-CITIZEN SPOUSES

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I. INTRODUCTION

A. Prior Law

Prior to the enactment of the Technical and Miscellaneous Revenue Act of 1988,\textsuperscript{1} a donor who was a U.S. citizen or resident was allowed an unlimited Federal gift tax marital deduction for the value of all gifts to his or her spouse, regardless of the donee spouse’s citizenship.\textsuperscript{2} The estate of a U.S. citizen or resident was allowed an unlimited Federal estate tax marital deduction for the value of all property passing to the surviving spouse, regardless of the surviving spouse’s citizenship.\textsuperscript{3} No deduction was allowed in computing the taxable gifts of a nonresident alien donor or the taxable estate of a nonresident alien decedent for the value of gifts or bequests to a spouse, even if the recipient spouse was a U.S. citizen.

The assumption underlying the allowance of the Federal gift and estate tax marital deductions is that the property with respect to which the deduction is allowed would be includible in the estate of the recipient spouse to the extent not consumed or given away (perhaps as a taxable gift) prior to the spouse’s death. Congress determined that while this assumption is generally valid where the surviving spouse is a U.S. citizen, who would therefore be subject to Federal estate taxation on his worldwide assets, the situation was different when the surviving spouse was not a U.S. citizen, since he could leave the U.S., return to his country of origin, and thereby give up his U.S. residence. By doing so, he would be subject to Federal estate taxation only on his U.S.-situs assets, rather than on worldwide property.\textsuperscript{4} As a result, there was a greater likelihood that the

\textsuperscript{1} Pub. L. No. 100-647.

\textsuperscript{2} Prior §2523(a) of the Internal Revenue Code of 1986. All Section references are to the Internal Revenue Code of 1986, as amended, unless otherwise noted.

\textsuperscript{3} §2056(a).

\textsuperscript{4} See §2103.
property (which already had escaped Federal estate tax at the death of the first spouse due to the availability of the unlimited marital deduction) could also escape the imposition of the Federal estate tax at the death of the surviving spouse.²

Congress remedied this perceived loophole by:

- Denying the Federal estate tax marital deduction for bequests to surviving spouses who were not U.S. citizens (“noncitizen spouses”) unless such property passes to or is placed into a “qualified domestic trust” (“QDOT”).³

- Denying the unlimited Federal gift tax marital deduction for transfers to a noncitizen spouse and introducing an increased annual exclusion from the Federal gift tax.⁴

- Making §2040(b) -- under which only half the value of property jointly held by spouses is includable in the gross estate of the first spouse to die, regardless of which spouse provided the consideration for the property -- inapplicable to the estate of a decedent spouse where the surviving spouse is not a U.S. citizen.⁵

- Reenacting §§2515 (without the election provisions of §2515(c)) and 2515A of the Internal Revenue Code of 1954 (the “1954 Code”) 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.⁶

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³ §2056(d).

⁴ §§2523(i)(1) and (i)(2).

⁵ §2056(d)(1)(B).

⁶ See §2523(i)(3).
TAMRA, as amended by Omnibus Budget Reconciliation Act of 1989 ("OBRA 1989"),\textsuperscript{10} the Omnibus Budget Reconciliation Act of 1990 ("OBRA 1990"),\textsuperscript{11} and the Taxpayer Relief Act of 1997 ("TRA 1997"),\textsuperscript{12} and as interpreted and implemented by the final regulations, is a very broad response to these perceived problems. It places substantial burdens and restrictions on recipient noncitizen spouses, creates technical inconsistencies with existing laws, and discriminates against noncitizen spouses rather than equalizing the tax treatment afforded citizen and noncitizen spouses.

B. Background


Section 5033 of TAMRA restricts the availability of the Federal estate and gift tax marital deduction where the recipient spouse or the donee spouse is not a U.S. citizen. These provisions were amended by OBRA 1989, OBRA 1990, and TRA 1997.

2. Proposed Regulations

On January 5, 1993, proposed regulations implementing these provisions were issued.\textsuperscript{13} The proposed regulations provided practical guidance and answered many questions encountered by practitioners attempting to comply with the marital deduction limitations. However, in an effort to ensure collection of the deferred estate tax imposed on QDOTs, the proposed regulations imposed burdensome information and record-keeping requirements on QDOT trustees. In addition, the proposed regulations imposed numerous “governing instrument” requirements, under which the failure to include any such provisions prevented a trust from qualifying as a QDOT, even if the trust actually complied with the regulatory requirements.


\textsuperscript{12} Pub. L. No. 105-34.

\textsuperscript{13} 58 Fed. Reg. 305 (January 5, 1993).
3. **Temporary and Final Regulations**

On August 22, 1995, final and temporary regulations were issued. The portion of the regulations issued in final form covered all the provisions introduced by the TAMRA legislation except those concerning security arrangements for the collection of the QDOT Tax under §2056A(a)(2) (the “Security Requirements”). The final regulations were quite comprehensive and generally responsive to many of the concerns raised in comments to the Treasury.

In recognition of the substantial changes that were made from the proposed regulations, the provisions governing the Security Requirements were issued in temporary and proposed form. Final regulations governing the Security Requirements were issued on November 29, 1996. Finally, on December 9, 1996, the IRS issued Rev. Proc. 96-54, which included sample language that satisfies the Security Requirements.

II. **DISALLOWANCE OF FEDERAL ESTATE TAX MARITAL DEDUCTION**

A. **General Rule**

In calculating the Federal estate tax, the value of the gross estate is reduced, subject to application of the terminable interest rules of §2056(b), by the value of all property passing to a surviving spouse. However, if the surviving spouse is not a U.S. citizen at the date of death of the decedent spouse, no marital deduction is allowed to the decedent spouse’s estate unless such property passes to the surviving spouse in a QDOT.

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5. §2056(a); Regs. §20.2056(a)-1(a).
In order for property passing to or for the benefit of a surviving spouse who is not a U.S. citizen at the date of the decedent spouse’s death to qualify for the Federal estate tax marital deduction, the regulations\textsuperscript{20} impose two requirements:

1. The property must pass from the decedent to (or pursuant to)--
   a. A QDOT described in §2056A and Regs. §20.2056A-2;
   b. A trust that, although not meeting all of the requirements for a QDOT, is reformed after the decedent’s death to meet the requirements of a QDOT;\textsuperscript{21}
   c. The surviving spouse not in trust (e.g., by outright bequest or devise, by operation of law, or pursuant to the terms of a plan or arrangement) and, prior to the date that the estate tax return is filed and during the time that the QDOT election may be made (that is, no more than one year after the time prescribed by law, including extensions, for filing the return), the surviving spouse either actually transfers the property to a QDOT or irrevocably assigns the property to a QDOT;\textsuperscript{22} or
   d. A plan or other arrangement that would have qualified for the marital deduction had the surviving spouse been a U.S. citizen, and whose payments are not assignable or transferable to a QDOT, if the requirements of Regs. §20.2056A-4(c) are met;\textsuperscript{23}

2. The executor of the decedent spouse’s estate must make a timely QDOT election under Regs. §20.2056A-3.\textsuperscript{24}

\textsuperscript{20} Regs. §20.2056A-1(a).

\textsuperscript{21} See Regs. §20.2056A-4(a) and discussion at Section IV, below.

\textsuperscript{22} See Regs. §20.2056A-4(b) and discussion at Section V, below.

\textsuperscript{23} See discussion at Section VI, below.

\textsuperscript{24} See Section III.C.3., below.
B. Treatment of Jointly Held Property (With Right of Survivorship) at Death

1. Rules Prior to TAMRA

Generally, the value of property titled jointly with right of survivorship or as tenants by the entireties is included in the gross estate of the first joint tenant to die except to the extent that the executor of the decedent’s estate can demonstrate that the surviving joint tenant supplied the consideration for the property. Only one-half of the value of the property is included in the decedent’s estate where the property was acquired by the joint tenants by gift, devise, bequest, or inheritance.\(^{25}\)

In order to exclude such property from the estate, the decedent’s executor must “submit[ ] facts sufficient to show that property was not acquired entirely with consideration furnished by the decedent, or was acquired by the decedent and the other joint owner or owners by gift, bequest, devise, or inheritance.”\(^{26}\)

Section 2040(b) provides that only one-half of the value of property owned by the decedent and his spouse as joint tenants or as tenants by the entireties is included in the decedent’s estate, regardless of the amount of the consideration furnished by the decedent.\(^{27}\) With respect to spousal joint tenancies created prior to the enactment of §2040(b) in 1976, the provisions of §2040(a) may be applicable.\(^{28}\)

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\(^{25}\) §2040(a); Regs. §20.2040-1(a)(1), (2).

\(^{26}\) Regs. §20.2040-1(a) (last sentence).

\(^{27}\) §2040(b), added by §§2002(c)(1) and (d)(3) of the Tax Reform Act of 1976.

\(^{28}\) See, e.g., Gallenstein v. U.S., 975 F.2d 286 (6th Cir. 1992), holding that where the husband purchased real property with his own funds in 1955, and took title to the property in joint name with right of survivorship with his wife, the entire value of the property was included in his gross estate on his death in 1988. See also Patten v. U.S., 116 F.3d 1029 (4th Cir. 1997).
2. Legislative and Regulatory Amendments

TAMRA made §2040(b) inapplicable to the estate of a decedent spouse where the surviving spouse is not a U.S. citizen. 29 The effect of this provision, except as described below, is to require the decedent’s executor to trace the consideration provided by each spouse in order to determine how much of such property must be included in the decedent’s gross estate.

a. Limited Grandfathering Relief

OBRA 1989 provided some relief from these burdensome tracing requirements. With respect to joint tenancies to which the “half-half” rule of §2040(b) is inapplicable solely by reason of the TAMRA changes, consideration furnished for such interest by the decedent prior to July 14, 1988, to the extent treated at the time as a gift (for purposes of the Federal gift tax) to the noncitizen surviving spouse, is treated as consideration furnished by the noncitizen spouse in applying §2040(a). 30 Specifically §7815(d)(16) of OBRA 1989 provides that consideration “shall be treated as consideration originally belonging to such [noncitizen] spouse and never acquired by such spouse from the decedent.” 31

OBRA 1990 further amended this grandfathering provision to provide that a transfer creating a spousal joint tenancy that would have constituted a gift to the noncitizen spouse had the donor been a U.S. citizen will be treated as consideration belonging to the donee spouse. For example, a nonresident alien provided all the consideration for the purchase of non-U.S. situs real property after December 31, 1981 and prior to July 14, 1988, and such property was titled in the name of the donor spouse and his noncitizen donee spouse. Under these facts, the noncitizen donee spouse will be treated, for purposes of §2040(a), as having provided one-half of the consideration for the purchase of the property, even though there was no gift for Federal gift tax purposes because the transfer involved a “gift” of non-U.S. situs property by a non-U.S. citizen

29 §2056(d)(1)(B); Regs. §20.2056A-8(a)(1).

30 See discussion at Section IX.B., below, of the gift tax effects of creation of spousal joint tenancies.

31 See also Regs. §§20.2056A-8(a)(2) and -8(c) (Example 1).
or resident.\textsuperscript{32} In determining whether the consideration was a gift by the decedent under §2511 for purposes of applying the grandfathering provision, the regulations presume that the decedent was a U.S. citizen at the time the consideration was furnished to the spouse.\textsuperscript{33} Of course, if the donor spouse dies first, and if he or she is still a nonresident alien, presumably such property will not be includible in his or her gross estate.\textsuperscript{34}

**Example:** In 1987, D, a U.S. citizen, purchases real property and takes title in the names of D and S, D’s spouse (a noncitizen, but a U.S. resident), as joint tenants with right of survivorship. In accordance with Regs. §25.2511-1(h)(5), one-half the value of the property is a gift to S. D dies in 1996. Because S is not a U.S. citizen, the provisions of §2040(a) are determinative of the extent to which the real property is includible in D’s gross estate. Because the joint tenancy was established before July 14, 1988, and under the applicable Code provisions and regulations the transfer was treated as a gift of one-half the property to S, one-half of the value of the property is deemed attributable to consideration furnished by S for purposes of §2040(a). Accordingly, only one-half of the value of the property is includible in D’s gross estate under §2040(a).\textsuperscript{35}

b. **Donee Spouse Dies First**

The legislative history is silent on whether the same tracing rules must be applied where the decedent spouse is a noncitizen who provided none of the actual consideration for the purchase of jointly held property. Section 7815(d)(16) of OBRA 1989 addressed only the situation where the noncitizen spouse is the survivor and the decedent spouse provided the consideration. Under the literal language of §7815(d)(16), the rule would not

\textsuperscript{32} See §§2511(a) and 2501(a)(1) and (2).

\textsuperscript{33} Regs. §20.2056A-8(a)(2).

\textsuperscript{34} See §2103.

\textsuperscript{35} See Regs. §20.2056A-8(c) (Example 1). See also PLR 9151044 (September 26, 1991) (Entire value of jointly titled residence purchased by decedent and his noncitizen spouse in 1977 with funds “all or substantially all” provided by decedent is included in decedent’s gross estate).
apply in the reverse situation. The regulations provide that the
deemed consideration rule applies only where the donor spouse
dies first. Where the donee spouse dies first, any portion of the
consideration treated as a gift to the donee spouse/decedent at the
creation of the tenancy (or subsequently), regardless of the date the
tenancy was created, will not be treated as a consideration
furnished by the donee spouse/decedent for purposes of applying
§2040(a).  

Example: Assume the same facts as in the previous example,
except it is S who dies in 1996, survived by D, who is not a U.S.
citizen. For purposes of applying §2040(a), D’s gift to S at the
creation of the tenancy will not be treated as consideration
furnished by S toward the acquisition of the property.
Accordingly, since S made no other contributions with respect to
the property, no portion of the property is includible in S’s gross
estate.  

c. Amount Required to be Transferred to QDOT

If only a portion of the value of a jointly-held property interest is
includible in a decedent’s gross estate, only that portion that is so
includible may be transferred to a QDOT in order to obtain the
estate tax marital deduction for the property. If the surviving
spouse becomes a U.S. citizen prior to the date on which the
decedent spouse’s Federal estate tax return is filed, in accordance
with the requirements of §2056(d)(4) and Regs. §20.2056A-1(b),
then the “half-half” rule of §2040(b) applies to determine the
portion of spousal joint tenancy property that is to be included in
the gross estate of the decedent spouse.  

\[\text{Example: Assume the same facts as in the previous example,}
\text{except it is S who dies in 1996, survived by D, who is not a U.S.}
\text{citizen. For purposes of applying §2040(a), D’s gift to S at the}
\text{creation of the tenancy will not be treated as consideration}
\text{furnished by S toward the acquisition of the property. Accordingly, since S made no other contributions with respect to the property, no portion of the property is includible in S’s gross estate.} \]

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with the requirements of §2056(d)(4) and Regs. §20.2056A-1(b),
then the “half-half” rule of §2040(b) applies to determine the
portion of spousal joint tenancy property that is to be included in
the gross estate of the decedent spouse.  

\[\text{Example: Assume the same facts as in the previous example,}
\text{except it is S who dies in 1996, survived by D, who is not a U.S.}
\text{citizen. For purposes of applying §2040(a), D’s gift to S at the}
\text{creation of the tenancy will not be treated as consideration}
\text{furnished by S toward the acquisition of the property. Accordingly, since S made no other contributions with respect to the property, no portion of the property is includible in S’s gross estate.} \]

c. Amount Required to be Transferred to QDOT

If only a portion of the value of a jointly-held property interest is
includible in a decedent’s gross estate, only that portion that is so
includible may be transferred to a QDOT in order to obtain the
estate tax marital deduction for the property. If the surviving
spouse becomes a U.S. citizen prior to the date on which the
decedent spouse’s Federal estate tax return is filed, in accordance
with the requirements of §2056(d)(4) and Regs. §20.2056A-1(b),
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d. **Proof of Consideration Furnished**

The decedent’s estate bears the burden of proof regarding the consideration furnished by the decedent and the surviving joint tenant.\[d\] The lapse of time and the failure to keep contemporaneous records may result in a lack of solid direct proof of which spouse provided the consideration. However, the regulations indicate that proof of the consideration furnished by the decedent and the surviving spouse towards the purchase price and improvements to jointly held property can be shown indirectly. For example, the regulations provide that where a down payment and subsequent mortgage payments and improvements are paid from a joint bank account held by the husband and wife, and the only funds deposited in the joint bank account are the earnings of the two spouses, proof of the approximate ratio of the earnings contributed to the bank account will be sufficient to establish the relative contributions of each spouse to the consideration for the purchase of the property.\[d\] Furthermore, where the contribution of the surviving spouse to the purchase price of a parcel of real estate is limited to mortgage payments on which the spouses are jointly liable, the IRS has indicated that it will calculate the surviving spouse’s contribution by multiplying the date-of-death value of the property by a fraction, the numerator of which is one-half of the date-of-death balance of the mortgage, and the denominator of which is the purchase price of the property.

**Example:** D dies survived by his noncitizen spouse, S. D and S purchased Blackacre in 1979 for $300,000, with D paying the entire $20,000 down payment. D and S are jointly liable on the mortgage. At D’s death, the mortgage balance is $200,000 and the property is worth $500,000. The entire value of the property is included in D’s estate except to the extent that D’s estate can show that S provided the consideration. S’s contribution to the purchase price, and thus the amount excluded for D’s gross estate, will be $166,667, and the value included in D’s gross estate will be $333,333 determined as follows:

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\[d\] **Regns. §20.2040-1(a)(2).**

\[d\] **See Regns. §20.2056-8(c) (Example 3).**
C. Allowance of Marital Deduction When Surviving Spouse Becomes a U.S. Citizen

The disallowance of the estate tax marital deduction under §2056(d) will not apply and the regular marital deduction rules of §2056(a) will apply to the estate of the decedent spouse if two conditions are met:

- The surviving spouse becomes a U.S. citizen prior to the day on which the decedent’s Federal estate tax return is made; and
- The surviving spouse is a U.S. resident at all times after the date of death of the decedent spouse and before becoming a U.S. citizen.\(^{42}\)

For purposes of qualifying for this exception, the surviving spouse is a “resident” only if he is a U.S. resident for purposes of the Federal estate tax.\(^{43}\) The status of the spouse as an income tax resident under §7701(b) is not relevant to this determination except to the extent that the income tax residency of the spouse is pertinent in applying Regs. §20.0-1(b)(1).\(^{44}\) In this connection, the surviving spouse will not fail to qualify for the relief provided under §2056(d)(4) merely because he was temporarily out of the U.S. after the date of the decedent spouse’s death and before the date on which U.S. citizenship was obtained.

The provisions of §2056(d)(4) may provide only a limited escape from the application of the QDOT rules. The IRS has indicated that it will strictly interpret the requirement that the surviving spouse actually become a U.S. citizen prior to the date in which the Federal estate tax return is filed. In PLR 9021037 (February 23, 1990), the surviving spouse, who was a Canadian citizen, had applied for U.S. citizenship prior to the death of his wife, and had represented that this application


\(^{43}\) §§2056(d)(A) and (B), added by OBRA 1989.

\(^{44}\) See Regs. §20.0-1(b)(1). A resident decedent is a decedent who, at the time of his death, has his domicile in the United States. A person acquires domicile, for U.S. estate tax purposes, by living in a place, even for a brief period of time, with no definite present intention of moving therefrom. See Est. of Khan v. Comm’r., T.C. Memo 1998-22

\(^{45}\) Regs. §20.2056A-1(b).
would likely be processed prior to the due date of the Federal estate tax return. In addition, the surviving spouse claimed that his “history and continuing ties with the United States...” should be considered to satisfy the concerns which prompted Congress to pass §2056(d). The IRS ruled that surviving spouse would nevertheless have to utilize a QDOT since the disallowance of the marital deduction under §2056(d)(1) applies without exception to estates of decedents who die after November 10, 1988, if the surviving spouse is not a U.S. citizen. The fact that the surviving spouse has demonstrated loyalty by applying for citizenship or by other means is not sufficient to override the statute.

In addition, the Preamble to the final regulations rejected the suggestion of certain commentators that if the surviving spouse has filed an application for naturalization within a reasonable time after the decedent’s death, then any late filing of the return pending the outcome of the citizenship process should be treated as due to reasonable cause for purposes of applying §6651 (imposing penalties for failure to file return and the failure to pay tax). The IRS refused to adopt this suggestion, stating that the existence of reasonable cause for late filing and late payment should be determined on a case-by-case basis applying standards as prescribed in current law.

As a practical matter, if the naturalization process was not initiated prior to the date of death of the decedent spouse, it may be very difficult to complete the process within the nine months (or even fifteen months with the automatic extension of time to file the Federal estate tax return) following the decedent’s death. Of course, if the surviving spouse becomes a U.S. citizen, and the provisions of §20.2056A(b)(10) are satisfied, the QDOT can be terminated at that time.

Notice, however, that for purposes of qualifying for the §2056(d)(4) exception to the marital deduction limitations, the regulations state that a Federal estate tax return filed prior to the due date (including extensions) is considered to be filed on the last date that the return is required to be filed, including extensions, and a late return is considered to be filed on the date it is actually filed.

Comment: If an extension of time within which to file the Federal estate tax return can be obtained, such an extension will extend the time during which the surviving spouse can obtain U.S. citizenship

47 See Section VII.F., below.
48 Regs. §20.2056A-1(b). See also PLR 9808022.
and avoid the marital deduction limitations of §2056(d)(1). Further, under the regulations, a late filed return has the effect of extending the time during which citizenship can be obtained. Of course, a late filed return may give rise to penalties\(^{49}\) and may prevent timely elections and allocations to be made.

### III. QUALIFICATION AS A QDOT

#### A. In General

The statute and the regulations set out numerous requirements for ensuring that a trust meets the requirement of a QDOT. Broadly speaking, these requirements fall into three categories: the Marital Deduction Requirements, the Statutory Requirements, and the Security Requirements to ensure collection of the QDOT Tax.

#### B. Marital Deduction Requirements

There are three different methods by which the Marital Deduction Requirements can be satisfied, depending on the type of property involved and how it passes to the surviving spouse.

1. **Property Passing Directly to a QDOT**

   If property passes from the decedent spouse to a QDOT, the trust must also qualify for the Federal estate tax marital deduction under:

   a. §2056(b)(5) (as a life estate with power of appointment);
   
   b. §2056(b)(7) (as qualified terminable interest property, including joint and survivor annuities under §2056(b)(7)(C));
   
   c. §2056(b)(8) (surviving spouse is the only noncharitable beneficiary of a charitable remainder trust); or
   
   d. Regs. §20.2056(c)-2(b)(1)(i)-(iii) (meeting the requirements of an estate trust).\(^{50}\)

\(^{49}\) See §§6651(a)(1) and (a)(2). However, if as a result of the delay, bequests to the surviving spouse qualify for the estate tax marital deduction and no estate tax is due, then no penalties will be imposed.

\(^{50}\) Regs. §20.2056A-2(b)(1). An estate trust is a form of marital trust sanctioned by the
2. Property Passing Outright to Surviving Noncitizen Spouse

Property that passes outright to the surviving spouse in a manner that, but for the marital deduction limitations of §2056(d)(1), would qualify for the marital deduction (e.g., proceeds of insurance payable to the spouse or property passing to the spouse by operation of law) qualifies for the estate tax marital deduction only if the surviving spouse actually transfers the property to, or irrevocably assigns the property to, a trust that meets the Statutory Requirements (discussed in Section III.C., below) and the Security Requirements (discussed in Section III.D., below).\(^{31}\)

The transfer or irrevocable assignment of property to a QDOT must take place prior to the filing of the Federal estate tax return and before the due date of the QDOT election.\(^{32}\) Note that the trust to which such property is to be transferred need not meet the requirements for the Federal estate tax marital deduction under §§2056(b)(5), 2056(b)(7), 2056(b)(8) or the requirements of an estate trust. In fact, the surviving spouse need not even be a beneficiary of such a QDOT. However, because the surviving spouse will be deemed to be the transferor of the property for purposes of the estate tax,\(^{33}\) the retention by the spouse of rights to income or principal, or the holding of even a limited power of appointment over the trust property, will cause the QDOT property to be included in his gross estate.

3. Property Passing to the Noncitizen Surviving Spouse Under a Nontransferable Plan or Arrangement

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regulations under §2056. Unlike the requirements for a general power of appointment marital trust or a QTIP trust, an estate trust does not mandate satisfaction of the “qualifying income interest for life.” See Regs. §§ 20.2056(b)-5(f), 20.2056(b)-7(d). Instead, the estate trust allows for the accumulation of some portion or all of the trust income, provided that any such accumulated income be paid over to the surviving spouse’s estate on his or her death.


\(^{32}\) Id. The provisions regarding transfers and assignments of property to a QDOT are discussed in detail in Section V, below.

\(^{33}\) See §2056(d)(2)(B); Regs. §20.2056A-4(b)(5).
The regulations provide special rules for property passing from the decedent under a plan or other arrangement that will qualify for the marital deduction but for the limitations imposed by §2056(d)(4) and payments from which are not assignable or transferable. Under these provisions, such nonassignable annuities or arrangements will be treated as satisfying the Marital Deduction Requirements, the Statutory Requirements and the Security Requirements if the provisions of Regs. §20.2056A-4(a) are satisfied.\textsuperscript{54}

C. **Statutory Requirements**

1. **Trustee**

In order to qualify as a QDOT, the trust instrument must require that at least one trustee be an individual who is a U.S. citizen or a domestic corporation.\textsuperscript{55} This constitutes a significant relaxation of the rule originally enacted in TAMRA, which required all trustees of a QDOT to be either U.S. citizens or domestic corporations.

OBRA 1989 amended §2056A(a)(1) to provide that the trust instrument must require that no distribution from a QDOT be made without the approval of the U.S. trustee. This requirement, read literally, created a potential conflict with the requirements of the marital deduction under §§ 2056(b)(5) and (b)(7).\textsuperscript{56}

OBRA 1990 again amended the trustee requirement by bifurcating the provisions of §2056A(a)(1). Following OBRA 1990, a QDOT must still require that at least one trustee be an individual who is a U.S. citizen or

\textsuperscript{54} See Regs. §20.2056A-2(b)(3) and Section VI, below.

\textsuperscript{55} §2056A(a)(1).

\textsuperscript{56} The prior law requirement that the U.S. trustee approve QDOT distributions would appear to run afoul of the mandatory income interest requirements of a general power of appointment marital deduction trust set out in §20.2056(b)-5(f)(7) and the “qualifying income interest for life” requirement of a QTIP trust as set out in §2056(b)(7)(B)(ii) and Regs. §20.2056(b)-7(d). Moreover, the “approval” requirement may also be inconsistent with the general power of appointment marital trust insofar as §2056(b)(5) requires that the surviving spouse’s power to appoint the trust assets must be exercisable alone and in all events. See Regs. §§20.2056(b)-5(a)(3) and (4) and 20.2056(b)-5(g). If the power of appointment could only be exercised with the consent of the U.S. trustee, this requirement would not be satisfied.
In addition, however, the trust instrument must provide that no distribution (other than income) may be made from the trust unless a U.S. trustee “has the right to withhold from such distribution” the QDOT Tax imposed on such distribution. In addition, however, the trust instrument must provide that no distribution (other than income) may be made from the trust unless a U.S. trustee “has the right to withhold from such distribution” the QDOT Tax imposed on such distribution. OBRA 1990 also eliminated any potential conflict with the requirements of the marital deduction by making explicit that any provision of the QDOT that permits the trustee to withhold from any distribution an amount to pay the QDOT Tax on such distribution will not cause the QDOT to fail to meet the requirements of §§2056(b)(5) and 2056(b)(7). These amendments were effective retroactively as if included in TAMRA. As a result, QDOTs drafted to comply with the prior requirements of §2056A(a)(1) -- as, for example, instruments that required the approval of the U.S. Trustee for all distributions -- most probably will not satisfy the withholding requirements enacted by OBRA 1990. For a QDOT that is presently irrevocable, the trustee may have to reform the trust (either pursuant to a judicial reformation or pursuant to the terms of the trust instrument) in order to ensure that it meets the requirements of §2056A(a)(1)(B). TRA 1997 enacted additional relief, by providing that any trust executed prior to the November 5, 1990 date of enactment of OBRA 1990 will be treated as meeting the requirements of §2056A(a)(1) if the instrument required that all trustees of the trust be individual U.S. citizens or domestic corporations. This provision is effective as if included in OBRA 1990. Again, however, trusts drawn to comply with the U.S. trustee “approval” requirement enacted in OBRA 1989 will likely not meet the requirements of §2056A(a)(1) without a timely and effective reformation.

a. **Corporate Trustee**

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§\[2056A(a)(1)(A).\)

§\[2056A(a)(1)(B).\)


Some transitional relief was provided to allow a reformation proceeding under §2056(d)(5)(A)(ii) to be commenced at any time before May 5, 1991, the date six months after enactment of OBRA 1990, even if the Federal estate tax return had previously been filed. See §11701(1)(2) of OBRA 1990. See also 1990 House Technical Corrections Report, at p. 29. The reformation provisions are discussed at Section IV, below.
For purposes of the trustee requirements, 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.\(^6\)

b. **Individual Trustee**

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.\(^6\)

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.\(^6\)

§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.\(^6\)

2. **Withholding Requirement.**

The trust instrument must provide that no distribution other than income may be made from the trust unless the U.S. Trustee has the right to withhold the amount of any QDOT Tax imposed on such distribution.\(^6\)

There is apparently no requirement that the U.S. Trustee actually withhold the amount of such tax; rather, the trustee must simply be authorized to do so. As a practical matter, it will make sense for the trustee to actually withhold the amount of the QDOT Tax to ensure that when the Form 706-QDT is filed, the trustee has sufficient funds with which to pay the QDOT

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\(^6\) See Regs. §1.911-2(b).

\(^6\) See Regs. §1.911-2(b).

\(^6\) See Regs. §20.2056A-2(b).

\(^6\) See Regs. §2056A(a)(1)(B).
Tax. On the other hand, other trust assets should be available to the trustee for payment of the QDOT Tax. However, where the trust assets are illiquid, it may be prudent to withhold the amount of the tax from the distribution.

3. **Election by Executor**

The decedent spouse’s executor must make an election to treat the trust as a QDOT. The election must be made on the Federal estate tax return, in the form and manner as set forth on the return, including applicable instructions.\(^66\) Once made, the election is irrevocable.\(^67\)

Under the current version of Schedule M of the Form 706, the requirement that the executor signify the QDOT election by checking a box has been replaced with a provision that states that if the surviving spouse is not a U.S. citizen, the QDOT election is presumed to have been made with respect to any property passing to the noncitizen surviving spouse for which the marital deduction had been claimed, and the executor must affirmatively **elect out** of QDOT treatment. This provision of the Form 706 is similar to the provisions governing the QTIP election and should decrease the incidence of the inadvertent failure to properly signify the QDOT election.

a. **Time Limitations**

The election to treat a trust as a QDOT must be made on the last Federal estate tax return filed before the due date (including extensions of time to file actually granted) or, if a timely return is not filed, on the first Federal estate tax return filed after the due date.\(^68\) However, in no case may the election be made on any return filed more than one year after the time prescribed by law (including extensions) for filing such return.\(^69\)

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\(^{66}\) §§2056A(a)(3) and 2056A(d); Regs. §§20.2056A-3(a),-3(d); H.R. No. 1104, 100th Cong., 2d. Sess. 115 (“1988 Conference Report”).

\(^{67}\) Regs. §20.2056A-3(a).

\(^{68}\) Id.

\(^{69}\) §2056A(d). See PLR 9843030 (July 24, 1998).
b. **Partial QDOT Election**

An election to treat a trust as a QDOT may not be made with respect to a specific portion of an entire trust that would otherwise qualify for the marital deduction but for the application of the marital deduction limitations of §2056(d). The Preamble to the proposed regulations stated that such partial elections were not authorized by the statute and “would present computational difficulties in determining the deferred estate tax in the event of a distribution of corpus from the trust.” However, if the trust is actually severed in accordance with the applicable requirements of §2056(b)(7), a QDOT election may be made for any one or more of the severed trusts.

Under the QTIP regulations, a marital trust may be divided into separate trusts to reflect a partial QTIP election that has been made or is to be made, if the division is authorized under the governing instrument or is otherwise permissible under local law. The regulations provide that the division of the trust must be done on a fractional or percentage basis to reflect the partial election (although the separate trusts do not have to be funded with a pro rata portion of each asset held by the undivided trust) and that a trust may be divided only if the fiduciary is required, either by applicable local law or by the express or implied provisions of the governing instrument, to fund the trust on the basis of the fair market value of the assets of the trust at the time of the division.

c. **Protective QDOT Elections**

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[70] Regs. §20.2056A-3(b).


[72] Regs. §20.2056A-3(b). See PLR 9505007 (November 3, 1994), allowing an extension of time within which to divide a QTIP trust and make QTIP and QDOT elections with respect to only one of the trusts. See also Gilpatric v. Cabour, 450 Mass. 1025, 879 N.E.2d 1236 (2008), allowing a division of a Marital Trust under Massachusetts law to allow for a smaller QDOT election.

[73] Regs. §20.2056(b)-7(b)(2)(ii).

[74] Id.
A protective election to treat property as a QDOT may be made only if at the time the Form 706 is filed, the executor of the decedent spouse’s estate reasonably believes that there is a bona fide issue that concerns (1) the residency or the citizenship of the decedent, (2) the citizenship of the surviving spouse, (3) whether an asset is includible in the decedent’s estate, or (4) the amount or nature of the property the surviving spouse is entitled to receive.\footnote{Reg. \S20.2056A-3(c).}

Under the regulations, a “bona fide issue” arises where the estate is involved in a will contest, where there are questions concerning the inclusion in the gross estate of an asset which, if includible, would be eligible for the QDOT election, where there is uncertainty regarding the status of the decedent as a resident alien or a non-resident alien for estate tax purposes, or a similar controversy regarding the citizenship status of the surviving spouse.\footnote{Id.}

The protective election must be made within the time prescribed for making the QDOT election under \S2056A(d), i.e., on the last Federal estate tax return filed before the due date (including extensions of time to file actually granted) or, if a timely return is not filed, on the first Federal estate tax return filed after the due date (including extensions).\footnote{Under the regulations, a protective election is in addition to, and is not in lieu of, the requirements in connection with the reformation provisions set forth in Regs. \S20.2056A-4.}

There are numerous requirements for a valid protective QDOT election. The protective election must be made in a written statement signed by the executor under penalties of perjury. The written statement must be attached to the Federal estate tax return and must identify the specific assets to which the protective election refers and the specific basis for making the protective election. Subject to these requirements, the protective election may be defined by means of a formula, such as the minimum amount necessary to reduce the estate tax to zero.\footnote{Regs. \S20.2056A-3(c).} Once made, however, the protective election is irrevocable. By way of example, the regulations note that if a protective election is made

\footnote{Reg. \S20.2056A-3(c).}
because a bona fide question exists as to the includability of an asset in the decedent’s gross estate, and if it is finally determined that the asset is so includible, the protective election becomes effective with respect to the asset and cannot be revoked.

**Comment:** Notwithstanding the liberalization of the protective election provisions in the final regulations, the “bona fide issue” requirement is still a strict standard. It was hoped that final regulations would have allowed a protective QDOT election to be made whenever the executor has a legitimate question regarding any aspect of the marital deduction, including questions that could arise after the Federal estate tax return is filed, such as during audit of the return. This position was not adopted by the regulations.

4. **Situs and Administration Requirements**

In order to qualify as a QDOT, the trust must be maintained under the laws of a U.S. state or the District of Columbia. A trust is treated as maintained under the laws of a U.S. state or the District of Columbia if the records of the trust (or copies thereof) are kept in that state (or the District of Columbia). The administration of the trust must be governed by the particular laws of a U.S. state or the District of Columbia. Further, the trust may be established pursuant to an instrument executed under either the laws of a U.S. state or the District of Columbia or pursuant to an instrument executed under the laws of a foreign jurisdiction, such as a foreign will or trust, provided such instrument designates the law of a U.S. state or the District of Columbia as governing the administration of the trust and such designation is effective under the law of the designated jurisdiction.\[79\]

5. **Trust Requirement**

The QDOT must constitute an “ordinary trust,” as that term is defined in Regs. §301.7701-4(a), and not any other type of entity. Because bequests to the noncitizen spouse must be held in a QDOT in order to qualify for the marital deduction, where an active trade or business constitutes a significant portion of the QDOT assets, there is a possibility that the QDOT could lose its status as a trust and instead be treated as an association taxable as a corporation.\[80\] However, the regulations provide

\[79\] Regs. §20.2056A-2(a).

\[80\] See PLR 9032014 (May 11, 1990), in which the IRS ruled that a trust to be funded primarily with stock of a foreign corporation would qualify as a QDOT, but did not address
that for purposes of determining whether the trust meets the statutory requirements, the trust will not fail to constitute an ordinary trust solely because of the nature of the assets transferred to the trust, regardless of the trust’s classification under the rules of Regs. §§301.7701-2 through 301.7701-4.

D. Security Requirements for Collection of the QDOT Tax

1. Introduction

A QDOT must meet the requirements prescribed by the regulations in order to ensure the collection of QDOT Tax imposed on the trust.\textsuperscript{81} The legislative history states Congress’ expectation that such QDOT Tax “Security Requirements” would require a sufficient portion of trust assets to be subject to U.S. jurisdiction so as to ensure that any QDOT Tax imposed on the trust can be collected.\textsuperscript{82} As an example, the legislative history provides that the regulations might require a portion of the trust property be physically situated in the U.S., or that the trustee be an institution with substantial U.S. assets.\textsuperscript{83} Congress gave no guidance, however, regarding the effect of fluctuations in the value of the U.S. assets or changes in the financial condition of a corporate QDOT trustee on qualification of the trust as a QDOT.

As noted above, in Section I.B., the Security Requirements were issued as part of the proposed regulations implementing §§2056(d) and 2056A. While the remainder of these regulations were subsequently issued in final form, the security requirements contained so many changes from the proposed provisions that they were reissued in temporary form. The final regulations were a substantial improvement over the original proposed regulations, easing many of the requirements originally included by the IRS. However, the Security Requirements still contain many onerous provisions that seem excessive in view of the security concerns of the Treasury.

\textsuperscript{81} §2056A(a)(2).

\textsuperscript{82} 1988 Conference Report, at p. 115.

\textsuperscript{83} Id. at pp. 114-15.
2. **General Comments on the Regulations**

a. **Governing Instrument Requirements**

The regulations require a trust to include substantial governing instrument requirements in order to satisfy the Bank Trustee Requirement of Regs. §20.2056A-2(d)(1)(i)(A), the Bond Requirement of Regs. §20.2056A-2(d)(1)(i)(B), the Letter of Credit Requirement of Regs. §20.2056A-2(d)(1)(i)(C) and the Foreign Real Property Requirement of Regs. §20.2056A-2(d)(1)(ii). A trust in actual compliance with the requirements, but which does not explicitly include the required language, will not qualify as a QDOT. In order to eliminate this potential hazard, the IRS has issued Rev. Proc. 96-54, setting out model language that may be included in the governing trust instrument to ensure compliance with the Security Requirements.

**Comment**: The existence of such a substantial number of governing instrument requirements increases the difficulty in drafting a QDOT and may render the resulting trust a cumbersome document which will have to include many detailed provisions that will likely never be applicable. In light of this problem, it seems clear that every QDOT should explicitly provide the trustee with the authority to amend the trust in any manner necessary to ensure that the trust meets all the requirements of §2056A, the applicable Treasury regulations, any administrative pronouncements issued by the IRS under §2056A, or any judicial decisions interpreting these provisions.

b. **Valuation and Indebtedness**

Proper valuation is a key element in the application of the Security Requirements. Specifically, as discussed in Section III.B.3., below, whether the QDOT has assets in excess of, equal to, or less than $2,000,000 is the threshold determination. In addition, the value of the QDOT assets determines the value of the bond or letter of credit needed in order to satisfy the Bond Requirement or

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[^4]: There are certain limited effective date exceptions to the application of the Security Requirements. See Section XI.B.2., below, and Regs. §20.2056A-2(d)(6).

the Letter of Credit Requirement of Regs. §§20.2056A-2(d)(1)(i)(B) or (C).

Under the regulations, the determination of whether a QDOT is a Large QDOT or a Small QDOT is made by measuring the fair market value of the assets passing to, or treated or deemed to have passed to, the QDOT (or in the form of a QDOT), “determined without reduction for any indebtedness with respect to the assets. . . .” Likewise, the value of the bond to be furnished or a letter of credit to be undertaken must equal 65% of the fair market value of the trust assets “(determined without regard to any indebtedness with respect to the assets. . . .)” In determining the value of the property passing to or held in the QDOT, it would seem reasonable that the value of any indebtedness should be deducted since the debt represents a reduction in the value of the property that would be subject to the QDOT Tax. Moreover, the failure to deduct indebtedness can result in a double counting, since the assets of the decedent’s estate likely includes the value of the proceeds of the indebtedness.

c. Final Determination

As discussed in more detail below, numerous provisions of the Security Requirements apply the concept of values “as finally determined.” The regulations set out the requirements for a final determination, relying largely on the mitigation provisions of §1311. Specifically, the fair market value of an asset will be “finally determined” for purposes of the Security Requirements on the first to occur of:

(A) The entry of a decision, judgment, decree, or other order by any court of competent jurisdiction that has become final;

(B) The execution of a closing agreement made under section 7121;

(C) Any final disposition by the Internal Revenue Service of a claim for refund;

\[86\] Regs. §§20.2056A-2(d)(1)(i) and (1)(ii).

\[87\] Regs. §§2056A-2(d)(1)(i)(B) and (C).
(D) The issuance of an estate tax closing letter (Form L-154 or equivalent) if no claim for refund is filed; or

(E) The expiration of the period of assessment.\textsuperscript{88}

3. Rules Governing Classification as Large QDOT or Small QDOT

a. General Rule

Under the Security Requirements, QDOTs are divided into two classes: those having assets at the date of death of the decedent spouse of $2 million or less (“Small QDOTs”) and those having assets in excess of $2 million at the decedent spouse’s date of death (“Large QDOTs”).

The determination of whether a QDOT is a Small QDOT or a Large QDOT is based on the value, as of the date of death or as of the alternate valuation date available under §2032, if applicable, of the assets passing, treated or deemed to have passed to the QDOT. As noted above, this determination is to be made without reduction for any indebtedness with respect to such assets.\textsuperscript{89} For purposes of determining whether the $2,000,000 threshold is met, if more than one QDOT is established for the benefit of the surviving spouse, the fair market value of all trusts is aggregated.\textsuperscript{90}

b. Audit Adjustments

The regulations provide a grace period for valuation adjustments on audit. Specifically, if the value of the property passing or deemed to have passed to the QDOT, as reported on the decedent spouse’s Form 706, is equal to or less than $2,000,000 (i.e., a Small QDOT), but the fair market value of such property is finally determined to be in excess of $2,000,000 (i.e., a Large QDOT), the U.S. Trustee is granted a reasonable period of time, not exceeding 60 days, within which to comply with the Bank Trustee Requirement, the Bond Requirement or the Letter of Credit

\textsuperscript{88} Regs. §20.2056A-2(d)(1)(iii).

\textsuperscript{89} Regs. §§20.2056A-2(d)(1)(i) and (1)(ii).

\textsuperscript{90} Regs. §20.2056A-2(d)(1)(ii)(A).
Requirement. Note also, as discussed below in Section III.D.6, below, that a substantial understatement of the value of QDOT assets may result in a disallowance of the marital deduction in its entirety.

c. Personal Residence Exclusion

In response to numerous concerns regarding the effect of residential real estate held in a QDOT, the regulations provide a special election to exclude the value of the surviving spouse’s personal residence, as well as any related furnishings, from (a) the value of the property passing to the QDOT for purposes of determining whether the QDOT is a Large QDOT or a Small QDOT, and (b) the size of the bond or letter of credit necessary to comply with the Bond Requirement or the Letter of Credit Requirement. Specifically, under the “Personal Residence Exclusion,” in determining whether the $2 million threshold is met, the executor of the decedent spouse’s estate may elect to exclude up to $600,000 in value attributable to real property, wherever situated, as well as related furnishings, that are owned directly by the QDOT. Similarly, in connection with valuing the QDOT to determine the proper amount of the bond or of the letter of credit, up to $600,000 of the value of the QDOT attributable to a personal residence of the surviving spouse, as well as related furnishings, may be excluded. The Personal Residence Exclusion does not, however, apply for purposes of determining whether the 35% test of the Foreign Real Property Exclusion is satisfied.

For purposes of this Exclusion, the term “personal residence” refers to the surviving spouse’s principal residence, as that term is defined in §1034, and one other residence of the surviving spouse. The personal residence may include appurtenant

\[^{91/}\text{Regs. }\text{§20.2056A-2(d)(1)(ii).}\]
\[^{92/}\text{Regs. }\text{§20.2056A-2(d)(iv)(A).}\]
\[^{93/}\text{Regs. }\text{§20.2056A-2(d)(iv)(B).}\]
\[^{94/}\text{Regs. }\text{§20.2056A-2(d)(iv)(C).}\]
\[^{95/}\text{See }\text{Regs. }\text{§20.2056A-2(d)(1)(iv)(D). Compare }\text{Regs. }\text{§25.2702 5(c)(2) (defining a personal residence for purposes of a qualified personal residence trust under }\text{§2702).}\]
structures used by the surviving spouse for residential purposes and adjacent land not in excess of that which is reasonably appropriate for residential purposes, taking into account the size and location of the residence. The residence may be located in or out of the U.S., must be available to the surviving noncitizen spouse at all times, and may not be rented to a third party, even when not occupied by the spouse.  

The term “relating furnishings” refers to furniture and commonly included items, such as appliances, fixtures, decorative items, and china “that are not beyond the value associated with normal household and decorative use.” The regulations make clear that rare artwork, valuable antiques and automobiles of any kind or class are not within the meaning of the term “related furnishings.”

In order to qualify for the exclusion, the residence must be owned directly by the QDOT. Therefore, an interest in a residence held through another entity, such as a family limited partnership or limited liability company, would not qualify for the exclusion.

The Personal Residence Exclusion is claimed by attaching a written statement to the decedent spouse’s estate tax return on which the QDOT election is made and clearly identifying any property with respect to which the election is made. If the Personal Residence Exclusion is not claimed at the time of filing the Federal estate tax return, such as where the Bond or the Letter of Credit Requirements are selected, the election must be attached

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provision represents a significant expansion of the residence exclusion provided under the temporary regulations, which applied only to a spouse’s principal residence. See Regs. §20.2056A-2(d)(1)(iii)(D). Note that while TRA 1997 repealed §1034, the definition of “principal residence” contained in the statute and regulations should continue to apply.

96/ Regs. §§20.2056A-2(d)(1)(iv)(A) and (B).
100/ Id.
to the Form 706-QDT. Also, in order to cancel a Personal Residence Exclusion election that is in place, a statement must be attached to the Form 706-QDT.

The potential disadvantage of making the election is that the U.S. trustee may have to file information statements for any year in which the residence is sold or ceases to be used as a personal residence. That statement, described in Section III.D.10., below, requires the inclusion of extensive information concerning the assets held in the QDOT and their value.

Generally, if the residence ceases to be used by or held for the use of the surviving spouse as a personal residence, or if the residence is sold during the term of the QDOT, the Personal Residence Exclusion ceases to apply unless the adjusted sales price is reinvested in a new personal residence within 12 months. If less than all of the adjusted sales price is reinvested in a new personal residence within the twelve-month period, the exclusion may continue to be claimed in an amount equal to the amount reinvested in a new personal residence plus the amount previously allocated to any other residence held in the QDOT that continues to apply for the Exclusion.

Upon the sale of a personal residence, or if the residence ceases to be used by or held for the use of the spouse, the exclusion may be reallocated to another qualifying residence held in the QDOT or another QDOT created for the benefit of the spouse. The amount of such reallocation may allow for the full utilization of the $600,000 Personal Residence Exclusion, even if less than the full amount was previously claimed.

Finally, if as a result of the disallowance or reduction in the dollar value of the Personal Residence Exclusion claimed, a QDOT is reclassified as a Large QDOT, the requirements for a Large QDOT

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must be satisfied within 120 days after the effective date of cessation.\textsuperscript{105}

4. **QDOTs With Assets in Excess of $2 million**

If the QDOT is determined to be a Large QDOT, the governing instrument must require that the trust meet the “Bank Trustee Requirement,” the “Bond Requirement,” or the “Letter of Credit Requirement.” The QDOT may alternate between any one these arrangements, provided that, at any given time, at least one of the arrangements is in effect. On the other hand, the trust instrument may also limit the available options to one or two of these alternate arrangements.\textsuperscript{106}

a. **Bank Trustee Requirement**

Under the Bank Trustee Requirement, the trust instrument must require that during the entire term of the QDOT at least one U.S. Trustee be a bank as defined under §581. Alternatively, the U.S. Trustee may be the U.S. branch of a foreign bank, provided that the trust instrument also requires that during the entire term of the QDOT, a U.S. Trustee acts as a trustee with such foreign bank trustee.\textsuperscript{107}

b. **Bond Requirement**

Under the Bond Requirement, the QDOT must require that the U.S. Trustee furnish a bond in favor of the IRS in an amount equal to 65\% of the fair market value of the trust assets, determined without regard to any indebtedness on such assets. The value of the QDOT assets is the value as finally determined, as of the decedent spouse’s date of death or on the alternate valuation date under §2032, if applicable.\textsuperscript{108}

If a change is made on audit to the fair market value of the QDOT assets, the U.S. Trustee has up to 60 days within which to adjust

\textsuperscript{105} Id.

\textsuperscript{106} Regs. §20.2056A-2(d)(1)(i).

\textsuperscript{107} Regs. §20.2056A-2(d)(1)(i)(A).

the amount of the bond accordingly, provided that the penalty for substantial valuation understatement, discussed below in Section III.D.6, does not apply.\textsuperscript{109} As discussed above, if the executor of the estate elects the Personal Residence Exclusion, the amount of the bond required in order to satisfy the Bond Requirement is calculated by excluding up to $600,000 in value attributable to real estate, wherever situated (and related furnishings) owned directly by the QDOT and used by the surviving spouse as the spouse’s personal residence.\textsuperscript{109} 

The bond must remain in effect until termination of the trust and the payment of any QDOT Tax liability finally determined to be due.

\textbf{Comment:} This may require the bond to remain in effect until the running of the statute of limitations on collection of the QDOT Tax, thereby resulting in an undue delay in the final distribution of the trust property.

The bond itself must be placed with a satisfactory surety and is subject to IRS review. Further, the bond may not be canceled, it must be for a term of at least one year, and it must be automatically renewable at the end of the term on an annual basis unless the IRS is notified at least 60 days prior to the end of the term. Under the regulations, the IRS must be given notice of nonrenewal at least 60 days prior to the end of the bond term, and the IRS will not draw on the bond if, within 30 days of receipt of the notice of failure to renew, the U.S. Trustee notifies the IRS that alternate Security Requirements will take effect immediately upon expiration of the bond.\textsuperscript{111} 

The final regulations include a sample form for the Bond and require that the bond be in that form, in a form that follows that form in all material respects, or in any form approved by the IRS in published guidance.\textsuperscript{112} 

\begin{itemize}
  \item \textsuperscript{109} Id.
  \item \textsuperscript{110}Regs. §20.2056A-2(d)(1)(iv)(B).
  \item \textsuperscript{111}Regs. §20.2056A-2(d)(1)(i)(B)(1).
  \item \textsuperscript{112}Regs. §20.2056A-2(d)(1)(i)(B)(2). No alternate bond language has been published by the Service.
\end{itemize}
Payment on the bond is required at any time the IRS, in its sole discretion, determines that a taxable event with respect to the trust has occurred, that the trust no longer qualifies as a QDOT, or that a distribution subject to the QDOT Tax has been made. The QDOT must also provide that if the IRS draws on the bond, neither the U.S. Trustee nor any other person will seek a return of any part of the remittance until April 15 of the calendar year following the year that the bond is drawn upon. After that date, the remittance will be treated as a deposit that can be returned without interest if the U.S. Trustee requests it, unless it is determined that the collection of the QDOT Tax is in jeopardy. However, any jeopardy assessment will first be credited to the QDOT Tax as reported on the 706-QDT, then to any unpaid balance of the QDOT Tax (plus interest and penalties) for the prior taxable years, with the balance of the bond amount returned to the U.S. Trustee.\footnote{Regs. §20.2056A-2(d)(1)(i)(B)(3).}

The bond must be filed with the decedent spouse’s Form 706 (or 706NA, as the case may be) unless an extension for filing the bond is granted under Regs. §301.9100. The U.S. Trustee must also include a written statement listing the assets used to fund the QDOT and the value of these assets.\footnote{Regs. §§20.2056A-2(d)(1)(i)(B)(3) and (4).}

**Comment:** As a practical matter, it seems unlikely that the executor of the decedent spouse’s estate will be able to list the specific assets that will secure the bond undertaking as of the date the Form 706 is filed. It seems reasonable to conclude that listing of those assets included on the Form 706 from which the QDOT will be funded should satisfy the requirement.
c. **Letter of Credit Requirement**

The third Security Requirement alternative for a Large QDOT is for the U.S. Trustee to furnish an irrevocable letter of credit. In order to satisfy the letter of Credit Requirement the QDOT must require the U.S. Trustee to provide a letter of credit issued by either (1) a bank described in §581, (2) the U.S. branch of a foreign bank, or (3) a foreign bank and confirmed by a bank described in §581.115

The Letter of Credit must be in an amount equal to 65% of the fair market value of the trust assets, determined without regard to any indebtedness on the trust assets. As with the Bond Requirement discussed above, the value of the QDOT assets is the date-of-death value of the QDOT (or the alternate valuation date value, if applicable), as finally determined. Subject to the substantial undervaluation penalty, discussed below, the U.S. Trustee has 60 days from the conclusion of the final determination of the value of property held on the QDOT within which to adjust the value of the letter of credit to the estate tax value of the QDOT assets. In determining the value of the QDOT assets for purposes of the Letter of Credit Requirement, the executor may elect the Personal Residence Exclusion to exclude the value up to $600,000 of the spouse’s primary residence.

The letter of credit must be irrevocable and must provide for sight payment. In addition, it must last for a term of at least one year and must be automatically renewable at the end of the term, “at least on an annual basis,” unless notice of the failure to renew is received by the IRS at least 60 days prior to the end of the term.116

If the letter of credit is issued by the U.S. branch of a foreign bank, and the U.S. branch is closing, the branch of the foreign bank must notify the IRS of the closure, and the notice of closure must be mailed at least 60 days prior to the date of the closure.

**Comment**: Query whether such information would be public 60 days prior to the happening of the event.

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116 See Regs. §20.2056A-2(d)(1)(i)(c)(1). It is unclear how the annual renewal requirement would apply to a multiyear letter of credit.
Upon the closure or nonrenewal of the letter of credit, the IRS will not draw on the letter of credit if, within 30 days of receipt of the notice of failure to renew or of closure, the U.S. trustee notifies the IRS that an alternate arrangement has been put in place.

The regulations include sample forms for an irrevocable letter of credit and a confirmation (to be used if the letter of credit is issued by a foreign bank).\textsuperscript{117}

Governing instrument requirements similar to those included with respect to the Bond Requirement are included in the regulations for the Letter of Credit Requirement.\textsuperscript{118}

5. **QDOT’s Having Assets of $2 Million or Less**

If the fair market value of the property passing to the QDOT is finally determined, as of the date of the decedent spouse’s death (or the alternate valuation date, if applicable) to be $2,000,000 or less, then the trust will be classified as a Small QDOT. In order for a Small QDOT to satisfy the Security Requirements, the governing trust instrument must require that the trust meet either the Bank Trustee Requirement, the Bond Requirement, the Letter of Credit Requirement, or the Foreign Real Property Requirement.

a. **Foreign Real Property Requirement**

The Foreign Real Property Requirement is satisfied where the governing instrument requires that no more than 35 percent of the fair market value of the trust assets, determined annually on the last day of the QDOT’s taxable year, consist of real property located outside of the U.S. that is owned by the trust. Note that the Personal Residence Exclusion, discussed above, does not apply for purposes of determining whether the 35% foreign real property threshold is satisfied.\textsuperscript{119}

\textsuperscript{117} SeeRegs. §§20.2056A-2(d)(1)(i)(C)(2) and (3).


\textsuperscript{119} Regs. §20.2056A-2(d)(1)(iii)(C).
**Comment:** Under these provisions, the attorney drafting a Small QDOT that holds no foreign real estate -- a common fact pattern -- can satisfy the Security Requirements simply by including a provision barring the trust from owning, directly or indirectly, foreign real property. By including such a provision, the trust will satisfy the Foreign Real Property Requirement without having to file annual information reports (discussed below). Further, so long as the instrument includes an amendment provision, the trustee should be able to bring the trust into compliance with the Security Requirements should circumstances change.

If, based on an examination of the decedent spouse’s estate tax return, the value of the property passing to a Small QDOT is finally determined to be in excess of $2 million, the U.S. Trustee has a 60-day grace period within which to satisfy the Security Requirements applicable to Large QDOT’s. However, the substantial understatement penalty of Regs. §20.2056A-2(d)(i)(D), discussed in Section III.D.6, below, may apply.\(^{120}\)

If in any year a Small QDOT is relying on the Foreign Real Property Requirement, and the value on the last day of the QDOT’s tax year of the foreign real property held in the QDOT exceeds 35% of the fair market value of the trust assets by virtue of either (1) distributions of QDOT principal during the year, (2) fluctuations in the value of foreign currency where the real estate is located, or (3) fluctuations in the value of trust assets, the QDOT will not be treated as failing to meet the Foreign Real Property Requirement -- and, therefore, will not cease to be a QDOT -- if at the end of the taxable year of the QDOT that immediately follows the year in which the 35% limit was exceeded, the trust is brought into compliance with the percentage limitations of the Foreign Real Property Requirement. Alternatively, the QDOT may elect to meet the requirements of an alternate arrangement such as the Bank Trustee, Bond, or Letter of Credit.\(^{121}\)

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\(^{120}\) Id.

\(^{121}\) Regs. §20.2056A-2(d)(1(ii)(D).
b. **Look-Through Rules**

The regulations adopt a limited look-through rule that is applied solely for purposes of determining compliance with the 35% limitation of the Foreign Real Property Requirement.\(^{122}\) Therefore, no look through rule is required for a QDOT, whether Large or Small, that utilizes the Bank Trustee Requirement, Bond Requirement or Letter of Credit Requirement.\(^{123}\)

When applicable, the look-through rule treats the QDOT as holding a pro rata share of all the assets owned by (a) a corporation having 15 or fewer shareholders, where the QDOT owns more than 20% of the voting stock or the value of the corporation, or (b) a partnership having 15 or fewer partners, where the QDOT owns more than 20% of the capital interest. In the case of a partnership, the QDOT’s pro rata share of partnership assets is based on the greater of the QDOT’s capital interest or profits interest in this partnership.\(^{124}\)

**Comment:** It would appear that minority and lack of marketability discounts would be unavailable in valuing the pro rata interest of the QDOT in a corporation or partnership.

The regulations contain an attribution rule that applies solely for applying the threshold shareholder/partner and percentage ownership tests. Specifically, all stock in a corporation, and all interests in a partnership, as the case may be, owned or held for the benefit of the surviving spouse or any members of the surviving spouse’s family (within the meaning of §267(c)(4)) are treated as owned by the QDOT.\(^{125}\) The attribution rules do not apply, however, in measuring the QDOT’s interest in the underlying

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\(^{122}\) The proposed Security Requirements applied a look-through rule in all cases where the QDOT owned certain interests in corporations or partnerships to determine whether the trust was a Small QDOT or a Large QDOT. See Prop. Regs. §20.2056A-2(d)(1)(ii)(B).


\(^{124}\) Id.

\(^{125}\) Id. Under §267(c)(4), an individual’s family includes siblings, spouses, ancestors and lineal descendants.
assets of the corporation or partnership. Interests owned by the QDOT in other entities (such as an interest in a trust or a limited liability company) are to be accorded treatment consistent with these attribution rules.

Where the application of the look-through rule results in deemed ownership of foreign real estate by a QDOT using the Foreign Real Property Requirement, the QDOT will have annual reporting obligations under Regs. §20.2056A-2(d)(3).

6. **Substantial Undervaluation Provisions**

As noted above, where final adjustments are made to the value of property passing to a QDOT from those reported on the decedent spouse’s Form 706, and as a result, either (a) a QDOT originally qualifying as a Small QDOT is recharacterized as a Large QDOT, or (b) the amount of the bond or the letter of credit must be increased, the U.S. Trustee has up to 60 days within which to make any required changes. However the grace period may be unavailable where the value of property passing to the QDOT is substantially greater than that reported on the estate tax return. Specifically, if the value of the QDOT property reported on the decedent spouse’s Form 706 is 50% or less of the amount finally determined to be the correct value of the property for Federal estate tax purposes, the estate tax marital deduction will be disallowed in its entirety. This penalty will not apply if there was reasonable cause for the undervaluation, and the fiduciary of the estate acted in good faith, as determined by reference to the rules of Regs. §1.6664-4(b).

**Comment:** In order to avoid the possible imposition of the disqualification penalty in these circumstances, it may make sense to make a protective QDOT election and/or protective assignment.

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127 Regs. §20.2056A-2(d)(1)(ii)(c)


129 See Reg. §§20.2056A-2(d)(1)(i)(B) and (C) and §20.2056A-2(d)(1)(ii).


of property to the QDOT. This might be an especially effective strategy where the estate holds difficult-to-value assets, such as a partnership interests.

7. **Anti-abuse Rule.**

Regardless of whether the QDOT utilizes the Bank Trustee Requirement, the Bond Requirement, the Letter of Credit Requirement, or the Foreign Real Property Requirement, if the trust utilizes any device or arrangement that has, as a principal purpose, the avoidance of liability for the QDOT Tax or a prevention of the collection of the tax, the trust will immediately cease to qualify as a QDOT.\(^{132}\) An example of the abuses intended to be reached by this rule include the selection of a U.S. Trustee that is domestic corporation established with insubstantial capitalization by the surviving spouse or members of the spouse’s family.

**Comment:** Given the lack of examples in the regulations as to what constitutes an abuse reached by this rule, and given the harshness of the penalty (immediate disqualification of the QDOT and imposition of the QDOT Tax on the entire value of the property then held in the QDOT), it seems that the QDOT Trustee should be afforded some period in which to correct the improper practice after discovery.

8. **Request for Alternate Arrangement or Waiver**

The regulations state that if the IRS provides guidance pursuant to which a testator, executor, or U.S. Trustee may adopt an alternate plan or arrangement for the collection of the QDOT Tax, and if such alternate plan or arrangement is properly adopted, then the QDOT will be treated as meeting the Security Requirements. Any such alternate plan arrangement will, in all cases, be subject to the anti-abuse rule described in Section III.D.7., above. Prior to the publication of such guidance, taxpayers may submit a request for a private letter ruling for the approval of any alternate plan or arrangement to ensure the collection of the QDOT Tax.\(^{133}\)

9. **Adjustment of Dollar Threshold and Exclusion**


\(^{133}\) Regs. §20.2056A-2(d)(4). No such rulings have been granted.
The IRS may increase or decrease the $2,000,000 threshold for Large and Small QDOTs and for the $600,000 Personal Residence Exclusion.\footnote{134}

11. **Annual Reporting Requirements**

The final regulations substantially reduced the burden of the annual reporting requirements imposed on the U.S. Trustee from those included on the proposed regulations.

a. **When Required**

The U.S. Trustee must file an annual report in any year in which the QDOT satisfies either one of the following criteria:

1. A QDOT relying on the Foreign Real Property Requirement for satisfaction of the Security Requirements owns directly or, after application of the look-through rule of Regs. §20.2056A-2(d)(1)(ii)(B), is deemed to own, any foreign real estate on the last day of the taxable year of the QDOT; or

2. The personal residence previously subject to the personal residence exclusion is sold, or ceases to be used or held for use as a personal residence, during the year.\footnote{135}

b. **Required Information.**

Where the information report is required to be filed, it must include the name, address, and taxpayer identification number (if any) of the U.S. Trustee and of the QDOT, and a list summarizing the assets held by the QDOT, together with the fair market value of each listed QDOT asset determined as of the last day of the QDOT’s taxable year.\footnote{136}

If the look-through rule applies to a Small QDOT attempting to satisfy the Foreign Real Property Requirement, the information statement must also identify the partnership, corporation, trust or

\footnote{134}{Regs. §20.2056A-2(d)(5).}

\footnote{135}{See Regs. §20.2056A-2(d)(3)(i).}

\footnote{136}{Regs. §20.2056A-2(d)(3)(iii)(A) and (B).}
other entity, and list the QDOT’s pro rata share of the assets owned by that entity as if directly owned by the QDOT.\textsuperscript{137}

**Comment:** If the QDOT does not hold a controlling interest in such a corporation, partnership or other entity, it may be extremely difficult, if not impossible, for the QDOT Trustee to obtain such asset and valuation information on the entity.

Where the personal residence previously subject to the Personal Residence Exclusion is sold during the taxable year, the information statement must include the date of sale, the adjusted sales price, and the extent to which the adjusted sales price has been or will be used to purchase a new personal residence. In addition, if or to the extent that such proceeds are not to be timely reinvested, the statement must indicate what steps will be taken to ensure that the QDOT meets the Security Requirements.\textsuperscript{138}

Similarly, if the personal residence ceases to be used as such by the surviving spouse during the year, the information statement must describe the steps that will or have been taken to ensure that the QDOT complies with the Security Requirements.\textsuperscript{139}

c. **Time and Manner of Filing Statement**

The information statement must be filed for any taxable year of the QDOT in which any of the events or conditions specified above for filing the statement have occurred or are satisfied. The information statement must be attached to Form 706-QDT, and must be filed no later than April 15th of the calendar year following the calendar year in which or with which the taxable year of the QDOT ends.\textsuperscript{140} Form 706-QDT, with the statement attached, must be filed regardless of whether the Form would otherwise be required to be filed.\textsuperscript{141} Failure to timely file the information statement may subject the QDOT to the provisions of

\begin{itemize}
  \item \textsuperscript{137} Regs. §20.2056A-2(d)(3)(ii)(B).
  \item \textsuperscript{138} Regs. §20.2056A-2(d)(3)(iii)(C).
  \item \textsuperscript{139} Regs. §20.2056A-2(d)(3)(iii)(D).
  \item \textsuperscript{140} The time for filing the information statement can be extended under the rules provided under Regs. §20.2056A-11(a). See Section VII.E.5., below.
  \item \textsuperscript{141} Regs. §20.2056A-2(d)(3)(ii).
\end{itemize}
the anti-abuse rule of Regs. §20.2056A-2(d)(1)(v), discussed above, violation of which could result in termination of QDOT status and imposition of the QDOT Tax on the entire value of the QDOT property at that time.\textsuperscript{142}

E. Miscellaneous QDOT Issues

1. Who May Create a QDOT?

Section 2056(d)(2)(B) allows the marital deduction for property passing from the decedent spouse to the surviving noncitizen spouse if such property is transferred or irrevocably assigned to the QDOT prior to the date on which the Federal estate tax return is made. The statute does not explicitly state whether only the decedent can create a QDOT or whether the noncitizen surviving spouse and/or the personal representative of the decedent spouse may create such a QDOT. The 1989 House Report states in a footnote that there is no requirement that the QDOT be created by the decedent, and that, therefore, “the QDOT may be created by the executor or the surviving spouse.”\textsuperscript{143} This position is adopted in the final QDOT regulations.\textsuperscript{144}

2. Conflicts of Interest in Making the QDOT Election

As with any discretionary postmortem actions affecting the tax liability of the decedent’s estate, decisions regarding the qualification for the marital deduction of bequests and other testamentary transfers to the surviving noncitizen spouse may give rise to conflicts between and among beneficiaries and fiduciaries. The potential for conflict is driven primarily by the terms of the estate plan and the allocation of tax liability. For instance, if the estate taxes due at the death of the decedent spouse are to

\textsuperscript{142} Id.

\textsuperscript{143} 1989 House Report, at p. 1431, n.96. See Section V.K., below, discussing the tax effects of the transfer by the surviving spouse of property to a QDOT.

\textsuperscript{144} See Regs. §§20.2056A-2(b)(2) (in order to qualify for the marital deduction, property passing directly to the surviving spouse must be transferred or assigned “to a trust (whether created by the decedent, the decedent’s executor or the surviving spouse)” . . .); 20.2056A-4(b)(1) (QDOT to which nontrust marital transfer is made to a noncitizen surviving spouse may qualify for marital deduction if transferred or assigned to a QDOT “created by the decedent (during life or by will), by the surviving spouse, or by the executor.”)
be borne by his residuary estate, the failure of the executor -- who may be
the surviving spouse -- to make the QDOT election or to make only a
partial election -- will adversely affect the amount of property to be
received by the residuary beneficiaries.

Where the surviving spouse is also the residuary beneficiary or one of
several beneficiaries of a residuary trust, the potential for conflict may be
diminished. However, if the residuary beneficiaries are persons other than
the noncitizen spouse -- the decedent spouse’s children by a prior marriage
or a Credit Shelter Trust for their benefit, for example -- the decision as to
whether or not to make the QDOT election or to reform a trust to allow the
QDOT election to be made, can put the surviving spouse and the other
beneficiaries in direct conflict. Moreover, if the residuary beneficiary is a
trust designed to capture the decedent’s unified credit exemption amount,
it is arguable that the ability of the noncitizen spouse to control whether
and to what extent the QDOT election is made -- and, therefore, the
amount of property passing to the trust -- is tantamount to a general power
of appointment over the trust. An independent executor may mitigate
some of the conflict, at least in respect of bequests under the decedent
spouse’s estate plan directly to a QDOT. However, even if the surviving
spouse is not the executor of the decedent’s estate, the surviving spouse
retains control over whether or not to transfer jointly titled property or
other nonprobate property to a QDOT and whether to take the necessary
steps to qualify nonassignable annuities or other payments for the marital
deduction. In these situations, equitable adjustments may be available to
minimize adverse tax effects. However, the better course would be to
thoroughly discuss these issues with the testator in the planning process
and, if necessary, draft tax clauses that equitably apportion liability.

3. QDOT as S Corporation Shareholder

Only certain kinds of trusts are permissible shareholders of an electing
small business corporation under Subchapter S of the Code (an “S
corporation”). If a trust meets the requirements of a qualified
Subchapter S trust (a “QSST”) and the trust beneficiary makes the QSST
election, then the trust will be a permissible S corporation shareholder.
However, care should be used when stock of an S corporation is
transferred to a QDOT, since §1361(c)(2)(A) limits the time that shares of
such stock may be held by a trust prior to the making of the QSST
election.

\footnote{See §1361(c)(2).}

\footnote{See §1361(d)(1).}
In order to qualify as a QSST, the terms of the trust must require that (1) there be only one current income beneficiary of the trust, (2) principal distributions may be made only to that beneficiary during the beneficiary’s life, (3) the income interest terminates upon the first to occur of the death of the income beneficiary and the termination of the trust, and (4) upon termination of the trust prior to the death of the income beneficiary, all trust property must be distributed to the income beneficiary.\textsuperscript{147}\textsuperscript{1} Finally, all of the income of the trust must be distributed currently to the income beneficiary, and the income beneficiary must be a U.S. citizen or resident.\textsuperscript{147}\textsuperscript{2} Therefore, unless the surviving spouse is a U.S. resident, the QDOT will not qualify as a QSST, and the trust will not be a permissible S Corporation shareholder.

If the surviving spouse is a U.S. resident, then a QDOT that qualifies as a general power of appointment marital trust or a QTIP trust should meet the requirements of a QSST, provided that the surviving spouse makes the election required under §1361(d)(2). Likewise, an estate trust will qualify as a QSST if all trust income is actually distributed to the surviving spouse who is a U.S. resident. Alternatively, the trustee may be able to make the ESBT election under §1361(c)(3) to qualify the trust as an eligible S Corporation shareholder.

4. Foreign Trust Status

a. A QDOT trust may also be subject to the rules governing foreign trusts. For U.S. tax purposes, a foreign trust is any trust which does not satisfy both of the following tests:

- A court within the United States is able to exercise primary supervision over the administration of the trust (the “Court Test”), and
- One or more United States persons have the authority to control all substantial decisions of the trust (the “Control Test”).\textsuperscript{149}\textsuperscript{1}

\textsuperscript{147}\textsuperscript{1} See §1361(d)(3)(A).

\textsuperscript{147}\textsuperscript{2} §1361(d)(3)(B).

\textsuperscript{149}\textsuperscript{1} See §§7701(a)(31)(B), 7701(a)(30)(i)-(ii), Reg. §301.7701-7.
b. **Court Test**

If a trust is to qualify as a QDOT, “the trust must be maintained under the laws of a state of the United States or the District of Columbia, and the administration of the trust must be governed by the laws of a particular state of the United States or the District of Columbia.” A trust is maintained in a particular state if the records (or copies of the records) of the trust are kept in that state. Thus, a QDOT is likely to meet the Court Test, which is satisfied if:

- The trust instrument does not direct that the trust be administered outside of the United States;
- The trust in fact is administered exclusively in the United States; and
- The trust is not subject to an automatic migration provision.

For this purpose, administration “means the carrying out of the duties imposed by the terms of the trust instrument and applicable law, including maintaining the books and records of the trust, filing tax returns, managing and investing the assets of the trust, defending the trust from suits by creditors, and determining the amount and timing of the distributions.”

c. **Control Test**

However, a QDOT may not satisfy the Control Test, which requires that one or more U.S. persons have the authority to control all substantial decisions of the trust. “Substantial decisions” include whether and when to distribute income or corpus; the amount of any distribution; the selection of any beneficiary;

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\(_{150}\) Regs. §20.2056A-2(a).

\(_{151}\) Regs. §20.2056A-2(a).

\(_{152}\) Regs. §301.7701-7(c)(1).

\(_{153}\) Regs. §301.7701-7(c)(3)(v).
whether a receipt is allocable to income or principal; whether to terminate the trust; whether to compromise, arbitrate, or abandon claims of the trust; whether to sue on behalf of the trust or to defend suits against the trust; whether to remove, add, or replace a trustee; whether to appoint a successor trustee; and investment decisions.\textsuperscript{154}

Since a QDOT requires only that one trustee be a U.S. person, it is possible that a QDOT will not satisfy the Control Test. For instance, the Control Test will be satisfied if there are three trustees, two of whom are U.S. persons and if all decisions of the trustees are made by majority vote.\textsuperscript{155} If, in such a situation, the trustees may only act by unanimous vote, or if the non-U.S. trustee possessed a veto over the actions of the U.S. trustees, the Control Test will not satisfied and the trust will be characterized as a foreign trust.\textsuperscript{156}

If foreign trust status is not desired, the QDOT should be drafted so that non-U.S. persons are not given the authority to control all substantial decisions of the trust.

IV. WHEN IS QUALIFICATION AS A QDOT DETERMINED? -- PROVISIONS FOR REFORMATION

A. General Rules

The determination of whether a trust qualifies as a QDOT will be made generally as of the date on which the Federal estate tax return is made.\textsuperscript{157} However, if an interest in property passes from the decedent spouse to a trust for the benefit of a noncitizen surviving spouse and if the trust otherwise qualifies for a marital deduction but for the provisions of §2056(d)(1)(A), the property interest is treated as passing to the surviving spouse in a QDOT if the trust is reformed, either in accordance with the terms of the decedent’s will or trust agreement, or pursuant to

\textsuperscript{154} Regs. §301.7701-7(d)(1)(ii)(A)-(J).

\textsuperscript{155} Regs. §301.7701-7(d)(1)(v) (Example 2).

\textsuperscript{156} Regs. §301.7701-7(d)(1)(v) (Example 1). \textit{See, e.g.,} PLR 199918039 (February 8, 1999).

\textsuperscript{157} §2056(d)(5)(A)(i).
a judicial proceeding to meet the requirements of a QDOT.\textsuperscript{158} For these purposes, the requirements of the QDOT include all applicable Marital Deduction Requirements, Statutory Requirements and the Security Requirements.\textsuperscript{159}

A reformation pursuant to the terms of the decedent’s will or trust instrument must be completed by the time prescribed for the filing of the decedent’s estate tax return (including extensions). For this purpose, a return filed prior to the due date (including extensions) is considered to be filed on the last day that the return is required to be filed (including extensions), and a late return filed at any time after the due date is considered filed on the date that it is actually filed.\textsuperscript{160}

\textbf{Comment:} The inclusion of provisions in the QDOT authorizing the trustee to reform or modify the QDOT to meet the statutory or regulatory requirements of the QDOT should be sufficient to authorize such reformations and should alleviate the necessity of obtaining a judicial reformation of the trust.

A reformation pursuant to a judicial proceeding must be commenced on or before the due date (determined with regard to extensions actually granted) for filing the Federal estate tax return for the decedent spouse’s estate, regardless of the date on which the return is actually filed.\textsuperscript{161}

Prior to the time that a judicial reformation of a trust is completed, the trust must be treated as a QDOT. Therefore, the trustee must file Form 706-QDT, pay any QDOT Tax that becomes due, and file any annual statement that is required under the Security Requirements. The failure to comply with these requirements may


\textsuperscript{159} Regs. §20.2056A-4(a)(1). See Section III, above.

\textsuperscript{160} Id.

\textsuperscript{161} Regs. §20.2056A-4(a)(2). See e.g., PLRs 199904023 (October 30, 1998); 9848007 (July 27, 1998); 9148021 (August 26, 1991). Compare PLR 9017015, discussed above at Section III.C.1, where the executor initiated a court proceeding to reform decedent’s will to create a trust that qualified as a QDOT, rather than modify an existing trust to qualify as a QDOT. Although the IRS discussed the reformation provisions, it seems clear that the executor’s reformation of the outright bequest would not qualify under the precise language of §2056(d)(5). The ruling request was submitted prior to the enactment of OBRA 1989 and, therefore, prior to the enactment of the reformation provisions of §2056(d)(5). At that time, it was not clear that the decedent’s executor or the surviving spouse could create a QDOT.
cause the trust to be subject to the anti-abuse rule provided under Regs. §20.2056A-2(d)(1)(v), discussed above in Section III.D.7.

If the judicial proceeding is terminated prior to the time the reformation is completed, the decedent’s estate will be required to pay the resulting increased estate tax imposed on the decedent’s estate (plus interest and any applicable penalties) that is due at the time of such termination as a result of the failure of the trust to comply with the marital deduction requirements of §2056(d). \^162

Where a reformation proceeding is commenced, the statute of limitations on assessment of a Federal estate tax deficiency attributable to the failure of the trust to qualify as a QDOT will not close prior to the date which falls one year after the IRS is notified that the trust reformation has been completed or that the judicial proceeding has been terminated. \^163

The reformation (whether pursuant to a judicial proceeding or otherwise) must result in a trust that is effective under local law. Further, under the regulations, a reformed trust may be revocable by the spouse, or otherwise be subject to the spouse’s power of appointment, provided that no person, including the spouse, has the power to amend the trust during the continued existence of the trust such that it would no longer qualify as a QDOT. \^164

B. Limitations and Uses of Reformation Provisions

The reformation provisions provide some relief from the burden created by the absence of liberal grandfathering provisions and transition rules in the statute. In addition, they allow QDOTs drafted before the issuance of regulatory guidance to be amended to comport with those requirements. \^165

Where property passes to a trust for the benefit of the noncitizen surviving spouse, and the trust does not qualify as a QDOT, the surviving spouse or the decedent’s executor may not create a trust that meets the requirements of a QDOT and transfer the property to such a trust. The IRS takes the position that §2056(d)(2)(B)(ii), discussed in Section V, below, is “intended to cover a situation where property passes directly from the decedent to the surviving spouse

\^162 Regs. §20.2056A-4(a)(2).

\^163 §2056(d)(5)(B).

\^164 Regs. §20.2056A-4(a)(2).

\^165 See PLR 199904023 (October 30, 1998).
under a will or the spouse receives nonprobate property.\footnote{166} In such a case, property can be transferred to a QDOT created by the surviving spouse or the decedent spouse’s executor. However, if the decedent spouse makes a bequest to the surviving spouse in trust, and such trust does not conform to the requirements of §2056A, then reformation of the recipient trust is the appropriate manner to ensure that the bequest qualifies for the estate tax marital deduction.

Note that the reformation provisions may not be applied to amend a trust to meet requirements for the marital deduction that are independent of the QDOT requirements.\footnote{167} In addition, the reformation provisions, as originally enacted, appear to have only prospective application. Therefore, they are of no assistance to estates that filed their Federal estate tax returns prior to the December 19, 1989 effective date of OBRA 1989, since under §2056(d)(5), the reformation must be commenced before the date of the Federal estate tax return. This is a harsh result, especially given the liberalizing intent of the reformation provisions.

OBRA 1990 provided some relief by allowing reformation proceedings to be commenced prior to May 5, 1991, the date six months after the date of enactment of OBRA 1990, notwithstanding the prior filing of an estate tax return.\footnote{168}

V. TRANSFERS BY THE SURVIVING SPOUSE OF OUTRIGHT BEQUESTS AND NONPROBATE PROPERTY TO A QDOT

A. Statutory Provisions

The decedent spouse can, through his or her will or by a trust or through beneficiary designations, direct that property must pass into a QDOT. Such property will qualify for the Federal estate tax marital deduction, because it is property passing to a surviving spouse in a QDOT in accordance with §2056(d)(2)(A). Further, property passing to a noncitizen surviving spouse will be treated as passing to the spouse in a QDOT if either (1) the property is transferred to the QDOT before the date on which the Federal estate tax return is made\footnote{169} or (2) the property is irrevocably assigned to the QDOT under an irrevocable assignment that is enforceable under local law and which is made on

\footnote{166} PLR 9043070 (August 3, 1990).

\footnote{167} 1989 House Report, at p. 1431.


\footnote{169} §2056(d)(2)(B)(i).
or before the date on which the return is made. In addition, property may be treated as passing directly from the decedent to the QDOT if such property is distributed pursuant to a settlement agreement which is negotiated at arm’s length and which represents the bona fide settlement of a legally enforceable claim.

B. Effective Dates

§ 7815(d)(4)(B) of OBRA 1989 provides that with respect to decedents dying prior to December 19, 1989 (the date of enactment of OBRA 1989), property passing from such decedents will be treated as qualifying for the marital deduction if such property is transferred or irrevocably assigned to a QDOT within one year following the date of enactment. Persons dying after November 10, 1988, but whose Federal estate tax returns were filed prior to enactment of OBRA 1989, were also allowed to avail themselves of the broader rules regarding assignments and transfers of probate property to a QDOT, and perhaps then amend their Federal estate tax returns. In addition, OBRA 1990 provided some additional relief by allowing a proceeding to reform a trust to qualify as a QDOT to be commenced at any time prior to May 5, 1991, the date six months after the date of enactment of OBRA 1990, even if the estate tax return had previously been filed.

C. Regulatory Provisions Governing Transfers of Property to a QDOT

1. General Rule

The special provisions allowing for the transfer of non-trust marital property to a QDOT apply with respect to interests in property passing outright from the decedent to a noncitizen surviving spouse, whether by bequest or devise, by operation of law, or pursuant to an annuity or other similar plan or arrangement. However, any such property interest passing to the surviving spouse must, but for the marital deduction limitations under § 2056(d), otherwise qualify for the estate tax marital deduction.

2. Application of Marital Deduction Requirements to Transferee Trust

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172 §11701(l)(2) of OBRA 1990.

173 Regs. §20.2056A-4(b)(1).
If the only property to be held in the QDOT is property transferred by the surviving spouse, then the QDOT need not qualify for the Federal estate tax marital deduction under §2056(a); that is, the trust need not be a §2056(b)(5) or §2056(b)(7) trust, or an estate trust. Therefore, the trust need not require the distribution of all income to the surviving spouse and could have current beneficiaries other than the surviving spouse. This rule applies, however, only if all the trust property has been transferred or assigned to the trust by the surviving spouse; if any property is or has been transferred to the QDOT by the decedent spouse, then the trust must include provisions necessary to ensure that all the trust property qualifies for the marital deduction under §2056.\textsuperscript{174} Thus, if the decedent is a U.S. citizen and bequeaths property to a U.S. trust that is not a general power of appointment marital trust, a QTIP trust or an estate trust (e.g., a credit shelter trust), that trust cannot be used as a transferee QDOT since after the trust is fully funded, a portion of the value of the property attributable to property bequeathed to the trust of the decedent will not qualify as a marital deduction under §2056.

Likewise, if a nonresident alien decedent bequeaths non-U.S. situs assets to a trust created under his will, the surviving spouse may not transfer U.S.-situs assets passing to the spouse outside of the will to such a trust.\textsuperscript{175}

D. Who May Make the Transfer

The regulations provide that the transfer of property to a QDOT may be made by the surviving spouse, the surviving spouse’s legal representative (if the surviving spouse is incompetent), or the personal representative of the surviving spouse’s estate (if the surviving spouse has died).\textsuperscript{176}

E. When Must the Transfer to the QDOT Be Made?

Property passing from the decedent spouse to the noncitizen surviving spouse must be placed in or irrevocably assigned (in a manner enforceable under local law) to a QDOT “before the date on which the return of the tax imposed by this chapter is made . . . .”\textsuperscript{177} The regulations provide that a property interest must be

\textsuperscript{174} Id.

\textsuperscript{175} Id.

\textsuperscript{176} Id.

\textsuperscript{177} §2056(d)(2)(B)(i) (emphasis added).
actually transferred to a QDOT “before the estate tax return is filed and on or before the last date prescribed by law that the QDOT election may be made,”\textsuperscript{178} and that property may be assigned to a QDOT under an enforceable and irrevocable assignment “made on or before the date on which the return is filed and on or before the last date prescribed by law that the QDOT election may be made.”\textsuperscript{179}

\textbf{Comment:} Thus, an extension of time within which to file the Federal estate tax return also extends the time during which outright bequests and nonprobate property can be transferred or irrevocably assigned to a QDOT.\textsuperscript{180}

\section*{F. Irrevocable Assignment of Property to a QDOT}

Since the enactment of OBRA 1989, both probate and nonprobate property may be irrevocably assigned to a QDOT under an irrevocable assignment which is enforceable under local law.\textsuperscript{181} The legislative history indicates that Congress intended the Treasury to use the regulatory authority granted to it under §2056A(e) to provide rules regarding the treatment of property that is assigned to a QDOT but not actually transferred within a fixed period of time.\textsuperscript{182} The 1989 House Report notes that such regulations might treat the failure to actually make the transfer of the assigned property interest to the QDOT as a trust distribution subject to an estate tax or as giving rise to disallowance of the marital deduction.

Property irrevocably assigned but not actually transferred to the QDOT before the estate tax return is filed must actually be conveyed and transferred to the QDOT under applicable local law before the administration of the decedent’s estate is completed. If there is no administration of the decedent’s estate (because, for

\textsuperscript{178} Regs. §20.2056A-4(b)(1). Section 2056A(d) provides that in no case shall the election be made more than one year after the time prescribed for filing the Federal estate tax return, with extensions.

\textsuperscript{179} Regs. §20.2056A-4(b)(1).

\textsuperscript{180} See PLR 9148021 (August 26, 1991), where outright residuary bequests to a noncitizen surviving spouse, and nonprobate property passing to the surviving spouse, all of which were transferred to a QDOT after an extension of time to file the Federal estate tax return was granted but prior to the timely filing of the return satisfied the requirements of §2056(d)(2)(B) and qualified for the marital deduction.

\textsuperscript{181} See, e.g., PLR 200352005 (December 26, 2003)

\textsuperscript{182} 1989 House Report, at p.1431, n.95.
example, none of the decedent’s assets are subject to probate under local law), the actual conveyance of the property assigned to the QDOT must be made on or before the date that is one year after the due date (including extensions) for filing the decedent spouse’s Form 706. 183

If an actual transfer to the QDOT is not timely made, §2056(d)(1)(A) applies, and the marital deduction is not allowed. 184 Presumably, the disallowance of the marital deduction is limited to the property assigned but not actually transferred to the trust. The executor of the decedent’s estate may request a private letter ruling from the IRS extending the time for completing the conveyance or waiving the actual conveyance under specified circumstances under Regs. §301.9100-1(a). 185

G. Special Rules for Transferable Annuities

For purposes of these assignment provisions, an assignment of rights under an annuity or other similar arrangement which is assignable or transferable is treated as though the property were actually transferred to the QDOT (regardless of the method of payment actually elected under such annuity or plan), even if the plan assets are not, in fact, transferred to a QDOT. 186

For these purposes, individual retirement annuities described in §408(b) are non-assignable annuities by virtue of application §408(b)(1), and thus, do not come within this rule. 187 On the other hand, unless the terms of the account agreement provide otherwise, individual retirement accounts provided under §408(a) are assignable and are subject to this special rule. However, for purposes of applying the special rules for non-assignable annuities, the surviving spouse may elect to treat individual retirement accounts as being non-assignable, and therefore eligible for the procedures for such non-assignable annuities. 188

183/ Regs. §20.2056A-4(b)(6).

184/ Id. See, e.g., PLR 200352005 (December 26, 2003)

185/ Regs. §20.2056A-4(b)(6).

186/ Regs. §20.2056A-4(b)(7)(i). See, e.g., PLRs 9544038 (August 9, 1995), 9322005 (February 24, 1993), and 9321032 (February 24, 1993) for rulings in which the IRS allowed the marital deduction for payments by IRAs through a QTIP trust that also qualified as a QDOT. See also Section VI, below, discussing qualification for the marital deduction of annuities and other similar payments that are not transferable or treated as being not transferable.


188/ Regs. §20.2056A-4(b)(7)(iii). See Section VI, below.
The provisions regarding the assignment of rights under annuities or similar arrangements that are transferable apply solely for purposes of qualifying the annuity or account for the marital deduction under §2056(b). The regulations note that reference should be made to other sections of the Code, e.g., §§408(d) and 4980A, to examine the consequences of an assignment for purposes of other provisions of the Code.\footnote{\textsuperscript{189}}

H. Special Provisions Governing Assignments and Transfers

A transfer or assignment of property to a QDOT must be in writing and must otherwise be in accordance with all local law requirements for such assignments or transfers. Copies of the transfer or assignment documentation must be submitted with the decedent’s estate tax return.\footnote{\textsuperscript{189}} The transfer or assignment may be of a specific asset or a group of assets, or a fractional share of either, or may be of a pecuniary amount.\footnote{\textsuperscript{191}} If a transfer or assignment is of a specific asset or group of assets, only assets passing from the decedent to the spouse and included in the decedent’s gross estate (or the proceeds from the sale, exchange or conversion of such assets) may be transferred or assigned to the QDOT.\footnote{\textsuperscript{192}}

The noncitizen surviving spouse may not transfer or assign to the QDOT property owned by the surviving spouse at the time of the decedent’s spouse’s death in lieu of property included in the decedent’s estate that passes to the spouse (or in lieu of the proceeds from the sale, exchange or conversion of such includible assets). Further, if only a portion of an asset is includible in the decedent’s gross estate, the spouse may only transfer the portion of the asset that is includible to the transferee trust.\footnote{\textsuperscript{192}}

A transfer or assignment of less than an entire interest in an asset or a group of assets may be expressed as a formula (such as the minimum amount necessary to...

\footnote{\textsuperscript{189}} Regs. §20.2056A-4(b)(7)(iv). For example, the payment of IRA distributions to a QDOT that qualifies as a QTIP trust may bar the surviving spouse from electing under Regs. §1.408-8, A-4(b) to treat the IRA as her own for purposes of determining the required beginning date. See, e.g., PLRs 9322005 (February 24, 1993) and 9321032 (February 24, 1993). Note also that §4980A was repealed by TRA 1997.

\footnote{\textsuperscript{190}} Regs. §20.2056A-4(b)(2).

\footnote{\textsuperscript{191}} Id.

\footnote{\textsuperscript{192}} Regs. §20.2056A-4(b)(3).

\footnote{\textsuperscript{193}} Id.
reduce the estate tax to zero). If the transfer or assignment is expressed in the form of a pecuniary amount (such as a fixed dollar amount or a formula designed to reduce the decedent spouse’s estate tax to zero), the transfer or assignment must satisfy certain funding valuation requirements. Specifically, pecuniary formula assignments must require either that:

- Assets actually transferred to the QDOT in satisfaction of the transfer or assignment have an aggregate fair market value on the date of actual transfer to the QDOT amounting to no less than the amount of the pecuniary transfer or assignment; or

- The assets actually transferred to the QDOT be fairly representative of appreciation or depreciation in the value of all property available for transfer to the QDOT between the valuation date and the date of actual transfer to the QDOT, if the assignment is to be satisfied by accounting for the assets on the basis of their fair market value as of some date before the date of actual transfer to the QDOT.

Example: D, a U.S. citizen, dies survived by his spouse, S, who is not a U.S. citizen at the time of D’s death. Under the terms of D’s will, the entire probate estate passes outright to S. Prior to the date D’s estate tax return is filed and before the date that the QDOT election must be made, S establishes a QDOT and irrevocably assigns to the QDOT that portion of the gross estate necessary to reduce the estate tax to zero, taking into account all available credits and deductions. The assignment meets the requirements ofRegs. §20.2056A-4(b), assuming that the QDOT is funded no later than the date that administration of D’s estate is completed.

I. Protective Assignments of Property to a QDOT

1. The Problem

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194 Regs. §20.2056A-4(b)(2).
197 Regs. §20.2056A-4(d) (Example 2).
§2056(d)(2)(B) does not provide for protective assignments of property to a QDOT. Such protective assignments are critical where, at the date the decedent spouse’s Federal estate tax return is filed, valuation of assets is not conclusively determined. For example, the repeal of §2040(b) where the surviving spouse is not a U.S. citizen requires tracing of the consideration furnished by the respective spouses. This may be an extremely difficult task, and the executor’s inability to substantiate to the satisfaction of an examining agent the amount of consideration furnished by the noncitizen spouse may, in the case of a large jointly held asset such as a residence, require the inclusion of the property in the gross estate of the decedent spouse at a time when the transfer to a QDOT will no longer be timely.

Protective assignments are also important when the decedent spouse’s status as a U.S. domiciliary or a nonresident alien is unclear, because such status determines what property is subject to U.S. estate tax and whether the exemption equivalent of the decedent spouse’s unified credit is the amount provided under §2001 or §2101, respectively.

2. Protective Assignments Under the Regulations

A protective assignment of property to a QDOT may be made only if, at the date the estate tax return is filed, the executor of the decedent’s estate reasonably believes that there is a “bona fide issue” that concerns either the residency or citizenship of the decedent, the citizenship of the surviving spouse, the includability of an asset in the decedent’s gross estate, or the amount and nature of the property that the decedent’s spouse is entitled to receive. By way of example, the regulations provide that if at the time the decedent’s Federal estate tax return is filed, the estate is involved in a bona fide will contest; there is uncertainty regarding the inclusion in the gross estate of an asset, which if includible, would be eligible for the QDOT election; where there is uncertainty regarding the status of the decedent as a resident alien or a nonresident alien for Federal estate tax purposes; or a similar uncertainty regarding the citizenship status of the surviving spouse, a protective assignment may be made.

Many of the provisions governing protective assignments of property to a QDOT are similar to those governing protective QDOT elections, discussed in Section III.C.3.c., above. The protective assignment must

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198 §2056(d)(1)(B).

199 Regs. §20.2056A-4(b)(8).
identify the specific assets to which the assignment refers and the specific reason for the protective assignment, but may otherwise be defined by means of a formula (such as the minimum amount necessary to reduce the estate tax to zero). A copy of the assignment must be submitted with the decedent’s estate tax return. Once made, the protective assignment cannot be revoked. The regulations provide, by way of example, that if a protective assignment is made because a question exists as to the includability of an asset in the decedent’s gross estate and it is later determined that the asset is so includible, the protective assignment becomes effective with respect to the asset and cannot be revoked.201

Protective assignments are, in all events, subject to the rules of Regs. §20.2056A-4(b)(6), requiring that property assigned to a QDOT must, in general, be actually transferred to the QDOT prior to the completion of administration of the estate.202

J. Non-Transferable Property

Because many civil law countries do not recognize trusts, the requirement that property passing to a noncitizen surviving spouse be held in a QDOT in order to qualify for the marital deduction may put the surviving spouse in a no-win situation. The problem is especially acute with respect to real property located in such countries. Prior to enactment of TRA 1997, neither the statutory provisions nor the legislative history explicitly addressed this problem, and no procedures were provided where the transfer of assets to a trust is not permitted.

One possible solution would be to include provisions in the decedent’s estate planning instruments to allow the decedent’s executor to transfer such assets into a corporation, partnership or other entity. If such transfers are permitted under local law, and if there are no adverse tax consequences (such as excessive transfer taxes), then the stock or partnership interest could be transferred to a QDOT.203

200 Id.

201 See, e.g., PLR 200910019 (November 20, 2008).

202 But see PLR 200448027 (July 29, 2004), waiving the requirement of actual conveyance to the QDOT where the surviving spouse became a citizen before the assigned property was actually transferred to the QDOT.

203 See PLR 199918039 (February 8, 1999) (marital deduction allowed for stock conveyed by surviving spouse to a QDOT where surviving spouse transferred foreign real property to foreign corporation in exchange for stock of the corporation).
Comment: Note that under the final regulations governing collection of the QDOT Tax (the “Security Requirements”), a Small QDOT relying on the Foreign Real Property Requirement may be subject to the look-through rule of Regs. §20.2056A-2(d)(1)(ii)(B), where the trust owns 20% or more of the voting stock or value of a corporation having 15 or fewer shareholders or 20% of the capital interest in a partnership with 15 or fewer partners. If the look-through rule is applied, the QDOT will be treated as owning a pro rata portion of each asset owned by the corporation, partnership or other entity to which the property is transferred. As a result, the QDOT may be unable to meet the Foreign Real Property Requirement if the entity owns a substantial amount of foreign real estate.\textsuperscript{204}

In any case, the decedent’s will should provide the executor with broad powers to incorporate businesses, and to join and create partnerships and joint ventures.\textsuperscript{205}

\textsuperscript{204} See Section III.D., above.

\textsuperscript{205} But see PLR 9101034 (October 11, 1990). In this ruling, real and personal property were to be transferred to a trust for the benefit of the surviving, noncitizen spouse in settlement of claims by the surviving spouse against the estate. After setting out the provisions of the trust, the ruling stated that a provision of the trust, authorizing the trustees “to form, at any time and from time to time, a corporation or other entity under the laws of any jurisdiction and to convey all or any part of the trust assets to such corporation or entity in exchange for property (including securities) of such corporation or entity and to continue to hold such property” would be deleted prior to the date on which the decedent spouse’s federal estate tax return was made. No explanation was provided for this deletion.

Under the position taken in certain early letter rulings, a QDOT could be initially funded with stock of a foreign corporation, provided that the stock certificates were held in the U.S. by a U.S. trustee and that the U.S. trustee retains sufficient assets to pay any QDOT Tax imposed on the trust. These rulings could be read to require stock or other evidence of ownership constituting a significant portion of the property transferred to the QDOT to be held by the U.S. Trustee. Although a similar position was adopted in the proposed regulations (see Prop. Regs. §20.2056A-2(d)(3)), it was rejected in the final regulations.

PLR 9043070 (August 3, 1990), which predated the final QDOT regulations, considered the issue of whether a QDOT may be permitted to hold foreign real property. In this ruling, the IRS concluded that a marital trust would qualify as a QDOT if it were reformed to include certain specific provisions, including a prohibition on the trustee “from investing in realty that is not situated in the United States.” Likewise, in PLRs 9003030 (October 24, 1989), 9044072 (August 8, 1990), 9109021 (November 30, 1990) and 9151044 (September 26, 1991), the IRS concluded that trusts created by the surviving spouse that
The legislative history does indicate that the Treasury’s regulatory authority granted under §2056A(a)(2) to ensure the collection of any QDOT Tax might require that either a sufficient portion of the trust assets be subject to U.S. jurisdiction or that the trustee be an institution with substantial U.S. assets. However, there is nothing to indicate that this would require a complete prohibition against ownership of non-U.S. situs real property or other non-U.S. situs assets. As discussed above, at Section III.D.5., a Small QDOT seeking to comply with the Foreign Real Property Requirement may hold up to 35% of the value of its assets in foreign real property.

Some relief may be available in future regulations. TRA 1997 enacted §2056A(c)(3), which authorizes issuance of regulations to define the term “trust” to include other arrangements having substantially the same affect as a trust. The legislative history indicates Congress’ understanding that such regulations would allow the marital deduction for a nontrust arrangement only when the U.S. could retain jurisdiction and adequate security to impose any transfer taxes on transfers of the property by the surviving spouse. The legislative history contemplates the adoption of bilateral tax treaties or closing agreement procedures under which the surviving spouse waives tax benefits, allows the U.S. to retain taxing jurisdiction over the property, and satisfies security requirements for payment of the tax.

prohibited the trustee from investing in any property located outside the U.S., would qualify as a QDOT. But see PLR 8952005 (September 20, 1989), where the provisions of a QDOT created by the surviving spouse which met the requirements of §2056A, did not include the requirement that all trust property have a U.S. situs. There appears to be no basis for such an absolute prohibition.

See Section III.D., above.


TRA 1997 §1312(a). The amendment is effective for decedent’s dying after August 5, 1997. TRA 1997 §1312(b).

K. Effect of Transfer of Assignment on Other Tax Provisions

1. Statutory Provision

When the noncitizen spouse transfers or irrevocably assigns property to a QDOT, the surviving spouse could be viewed as the transferor of the property for purposes of other tax provisions. The statute provides that property passing from the decedent to the surviving spouse “shall be treated as passing to such spouse” in a QDOT if the transfer or assignment is made prior to the date on which the decedent spouse’s Federal estate tax return is made.\(^{210}\)

The legislative history is silent on whether a deemed gift would occur at the date of transfer or assignment of property to a QDOT. The apparent intent of §2056(d)(2)(B) is to provide a mechanism by which the decedent spouse’s estate may receive a marital deduction for bequests to the noncitizen surviving spouse or for property passing to the noncitizen surviving spouse by operation of law (such as joint tenancy property). In addition, since property so transferred is treated as passing to such spouse in a QDOT, the result, at least from a Federal estate tax policy perspective, should not be any different than when property passes directly to the trustee in a marital trust.


Under the regulations, however, property assigned or transferred to a QDOT pursuant to §2056(d)(2)(B) is treated as passing from the decedent in a QDOT solely for purposes of §2056(d)(2)(A). For all other purposes (e.g., income, gift, estate, generation-skipping transfer taxes),\(^{211}\) the surviving spouse is treated as the transferor of the property to the QDOT.\(^{212}\) The Preamble to the proposed regulations stated that this treatment “comports with §2056(d)(2)(B), which provides that property

\(^{210}\) §2056(d)(2)(B).

\(^{211}\) The regulations also include a reference to the excise tax imposed under §1441. The §1441 excise tax, imposed on certain transfers to foreign trusts, was repealed by TRA 1997 and replaced by new §684. Presumably, the provisions governing the effect of transfers by the surviving spouse to a QDOT would also apply to transfers falling under the provisions of §684.

\(^{212}\) Regs. §20.2056A-4(b)(5).
transferred or assigned by the spouse to a QDOT is treated as passing from
the decedent to the QDOT solely for purposes of §2056(d)(2)(A), and not
for purposes of the income and transfer tax provisions of the Code.\textsuperscript{213}\!
(emphasis added).

The final regulations retained this rule. The Preamble stated the
Treasury’s belief that this treatment is consistent with Congressional intent
as evidenced by the enactment of §2056A(b)(15). This Section exempts
from the QDOT Tax a distribution to the surviving spouse to the extent
that the distribution is used to reimburse the surviving spouse for income
taxes on an item of income from the trust to which the surviving spouse is
not entitled under the terms of the trust. As discussed in Section V.K.3.,
below, §2056A(b)(15) was enacted out of concern that the surviving
spouse would be treated as the owner of the trust property under the
gantor trust rules and would, therefore, be taxed on trust income,
including capital gains, which he would not be entitled to receive.

In an effort to ameliorate the harshness of this rule, the final regulations
provide two additional provisions:

a. **Transfers by Disclaimer**

   The final regulations take the position that the decedent spouse will
   be treated as the transferor of property to a QDOT if the property
   passes to the QDOT by a transfer that satisfies the requirements of
   §2518(c)(3). Therefore, if the decedent spouse’s testamentary
   instruments provide for an outright bequest to the surviving
   spouse, with the provision that if and to the extent that he disclaims
   property, it will pass into a QDOT created under the decedent’s
   will or revocable trust, then the surviving spouse will not be treated
   as the transferor of the property into the QDOT.\textsuperscript{214}

\textsuperscript{213} 58 Fed. Reg. 305.

\textsuperscript{214} Regs. §20.2056A-4(b)(5).
b. **Application of Chapter 14 Valuation Rules**

The final regulations amended Regs. §25.2702-1(c) by adding an exception to the application of the Chapter 14 valuation rules for transfers or assignments described in §2056(d)(2)(B) by a noncitizen surviving spouse of property to a QDOT, where the surviving spouse retains an interest in the transferred property that is not otherwise a “qualified interest”\(^{215}\) (as defined in §2702(b)).

**Example:** D’s will bequeaths $700,000 outright to S, who is not a U.S. citizen. The bequest qualifies for a marital deduction under §2056(a) except that it does not pass in a QDOT. S creates an irrevocable trust that meets the requirements for a QDOT and transfers the $700,000 to the QDOT. The QDOT instrument provides that S is entitled to all the income from the QDOT payable at least annually and that, upon the death of S, the property remaining in the QDOT is to be distributed to the grandchildren of D and S in equal shares. The trust instrument contains all other provisions required to qualify as a QDOT. On D’s estate tax return, D’s executor makes a QDOT election under §2056A(a)(3). Solely for purposes of the marital deduction, the property is deemed to pass from D to the QDOT trust, and, therefore, D’s estate is entitled to a marital deduction for the $700,000 value of the property passing from D to S. However, S’s transfer of property to the QDOT is treated as a gift of the remainder interest for gift tax purposes, because S’s transfer creates a vested remainder interest in the grandchildren of D and S. Accordingly, as of the date that S transfers the property to the QDOT, a gift tax is imposed on the present value of the remainder interest. In addition, at S’s death, S is treated as the transferor of the property into the trust for estate tax and generation-skipping transfer tax purposes.\(^{216}\) The trust is not eligible for a reverse QTIP election by D’s estate under §2652(a)(3) because a QTIP election cannot be made for the QDOT. This is so because the marital deduction is allowed under §2056(a) for the outright bequest to the spouse and the spouse is then separately treated as the transferor of the property to the QDOT.\(^{217}\)

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\(^{215}\) Id. and Regs. §25.2702-1(c)(8).

\(^{216}\) See, e.g., §§2036 and 2652(a)(1).

\(^{217}\) Regs. §20.2056A-4(d) (Example 5).
Comment: The provisions of §2056(d)(2)(B) state only that “for purposes of subparagraph (A), such property shall be treated as passing to such spouse in a qualified domestic trust....” There is no use of the term “solely” in the statute. Further, the legislative history is silent on whether a deemed gift would occur at the date of transfer or assignment of property to a QDOT. The apparent intent of §2056(d)(2)(B) is to provide a mechanism by which the decedent spouse’s estate may receive a marital deduction for bequests to the noncitizen surviving spouse or for property passing to the noncitizen surviving spouse by operation of law (such as joint tenancy property). In addition, since property so transferred is treated as passing to such spouse in a QDOT, the result, at least from a Federal estate tax policy perspective, should not be any different than when property passes directly to the trustee in a marital trust.

Comment: The easiest way to avoid the adverse gift tax effects of this provision is to ensure that the surviving spouse has a special power of appointment over the property in the trust to which the property is transferred or irrevocably assigned, thereby avoiding a completed gift.218

3. Grantor Trust Status of QDOT Created by the Surviving Spouse

Where the noncitizen spouse creates a QDOT and transfers property to it, and with respect to any property added to a QDOT created by the decedent or by the decedent spouse’s executor, the surviving spouse may be treated as the owner of the trust for purposes of the grantor trust rules.219 Depending on the terms of the trust, the noncitizen spouse may be treated as the owner of any capital gains incurred by the trust. In that case, he or she will be liable for any income tax thereby due.

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218 See Regs. §20.2056A-4(d) (Example 1). See also PLRs 9808022 (November 19, 1997) (special power of appointment retained by surviving spouse) 9551014 (September 21, 1995) (retention of general power of appointment by surviving spouse prevents gift tax on funding of QDOT by surviving spouse).

219 See §§671 et seq. Note that application of §672(f) may, in certain circumstances, prevent a QDOT classified as a foreign trust from being a grantor trust.
Under the provisions of §2056A, as in effect prior to OBRA 1990, if the trust paid the capital gains tax for the surviving spouse, or distributed to the surviving spouse property in an amount equal to the tax due, the amount paid or distributed would itself be a distribution subject to the QDOT Tax, even where the capital gains were not distributed to the surviving spouse. However, §2056A(b)(15), added by OBRA 1990, changed this by providing that no QDOT Tax shall be imposed under §2056A(b)(1) on any distribution to the surviving spouse to the extent such distribution is made to reimburse the surviving spouse for any tax imposed by subtitle A of the Code on any item of income of the QDOT to which such surviving spouse is not entitled under the terms of the trust.\textsuperscript{220}

The legislative history explains that, under this provision, “the QDT tax is not imposed upon any distribution to reimburse the spouse for Federal income tax paid on an item of income of the QDT to which the spouse is not entitled under the terms of the trust, e.g., capital gains if such gains are taxable to the spouse.”\textsuperscript{221}

VI. SPECIAL RULES FOR NON-ASSIGNABLE ANNUITIES AND OTHER ARRANGEMENTS

A. Background

Under §2056A(e), the Secretary of the Treasury is provided with broad regulatory authority to carry out the purposes of §2056A. The Treasury is directed to “prescribe such regulations under which there may be treated as a qualified domestic trust any annuity or other payment which is includible in the decedent’s gross estate and is by its terms payable for life or a term of years.”\textsuperscript{222}

The legislative history of OBRA 1989 makes explicit that this treatment is available only where the annuity or other payment would otherwise qualify for the marital deduction.\textsuperscript{223}

The legislative history also suggests that the payor of a joint and survivor annuity may be required to withhold amounts equal to the QDOT Tax imposed on such distributions and meet other conditions to ensure collection of the tax.\textsuperscript{224}

\textsuperscript{220} §11702(g)(2)(B) of OBRA 1990.


\textsuperscript{222} §2056A(e).


\textsuperscript{224} 1989 House Report, at p. 1433.
In addition, the regulatory authority granted under §2056A(e) is to “be applied to property interests that cannot be transferred to a QDOT under Federal law.”\textsuperscript{225} This most commonly arises in respect to the anti-alienation provisions contained in the Retirement Equity Act of 1984 on qualified plans.\textsuperscript{226} The legislative history failed to take account of those annuities or other payments which are transferable under Federal law, but which are subject to transfer restrictions imposed by the plan itself, by state law or by foreign law. The legislative history suggests that if the annuity or other payment is part of a non-qualified plan or is otherwise free of Federal law transfer restrictions, then it may not itself be treated as a QDOT and must, therefore, actually be transferred to a QDOT in order to qualify for the marital deduction. However, so long as the conditions imposed by the regulations to ensure collection of the QDOT Tax on nontransferable annuities and other payments are also imposed on those annuities and other payments that are transferable, there would appear to be no reason not to treat transferable annuities or other payments as QDOTs without actually placing them into a QDOT.

Further, if under the retirement plan the surviving spouse receives a lump sum at the death of the decedent spouse which he or she then rolls over to a spousal Individual Retirement Account (“IRA”), it is not clear from the legislative history whether the spousal IRA could be treated as a QDOT. However, in PLR 9109021 (November 30, 1990), the surviving spouse irrevocably transferred funds received by her from the decedent spouse’s IRA and the portion of a death benefit received by her from the decedent spouse’s §403(b) retirement plan into a spousal rollover individual retirement trust that qualified as a QDOT. The IRS ruled that, provided the transfer was irrevocable and completed prior to the date the decedent’s estate tax return was filed, the transfer of such funds would qualify for the marital deduction. Also, in PLR 9151043 (September 26, 1991), the noncitizen surviving spouse, who was designated as the beneficiary of two IRAs, irrevocably designated a QDOT created after the death of the decedent spouse as the beneficiary of the IRAs. The ruling held that the IRAs would be treated as assets of the QDOT and would qualify for the marital deduction. However, this ruling contains some questionable language and should be read carefully.

The final regulations note that the IRS will prescribe by administrative guidance the extent, if any, to which the provisions governing qualification of otherwise non-assignable annuities or other arrangements for the marital deduction apply to a rollover from a qualified trust to an eligible retirement plan within the meaning of §402(c) or a distribution from an individual retirement annuity that is paid

\textsuperscript{225} 1989 Conference Report, at p. 670.

\textsuperscript{226} See §§401(a)(11) and 417 and §401(a)(13).
through an individual retirement account or an individual retirement annuity within the meaning of §408(d)(3). 227

B. Final Regulations Governing “Non-Assignable Annuities or Other Payments”

1. Overview

The final regulations provide extensive detail regarding qualification of nonassignable annuities for the marital deduction. Under the final regulations, any “nonassignable annuity or other arrangement” will be treated as meeting the Marital Deduction Requirements,228 the Statutory Requirements,229 and the Security Requirements230 if either the requirements ofRegs. §§20.2056A-4(c)(2) (the “Current Tax Method”) or 20.2056A-4(c)(3) (the “Roll Over Method”) are satisfied.231

A “nonassignable annuity or other payment” is a plan, annuity, or other arrangement, whether qualified or not qualified under Part I of Subchapter D of Chapter 1 of Subtitle A of the Code (§§401 through 419A), that qualifies for the marital deduction but for the limitations of §2056(d)(1)(A), and whose payments are not assignable or transferable to the QDOT under either Federal law, state law, foreign law, or the terms of the plan or arrangement itself. An assignment meeting the requirements ofRegs. §20.2056A-4(b) of rights under annuities or similar arrangements which are transferable is treated as having been actually transferred to a QDOT regardless of the method of payment actually elected under an annuity or plan.232

As noted above, the final regulations clarify the treatment of individual retirement accounts and annuities as non-assignable annuities or other payments. Specifically, underRegs. §20.2056A-4(b)(7), individual retirement annuities are classified as non-assignable because of provisions of §408(b)(1). On the other hand, individual retirement accounts were

227 Regs. §20.2056A-4(c)(1) (last sentence). Such guidance has not been issued.

228 See Section III.B. above.

229 See Section III.C. above.

230 See Section III.D. above.

231 See PLR 1999904023 (October 30, 1998).

232 Regs. §20.2056A-4(c)(1).
determined to be assignable and are therefore subject to the rule discussed at Section V.G., above. However, under the final regulations, the surviving spouse may elect to treat the individual retirement account as being non-assignable, and therefore eligible for the special rules governing non-assignable annuities or payments.

2. **The Current Tax Method**

The requirements of the Current Tax Method are set out at Regs. §20.2056A-4(c)(2). The Current Tax Method is intended to approximate the result that would occur if the plan or annuity arrangement itself constituted a QDOT and distributed a portion of corpus to the spouse annually. The Current Tax Method requires:

a. The noncitizen surviving spouse to agree to pay the QDOT Tax due on the “corpus portion,” as defined in Regs. §20.2056A-4(c)(4) (see Section VI.B.6., below), of each nonassignable annuity or other payment received under the plan or arrangement.\(^{233}\)

b. The executor of the decedent’s estate to file with the estate tax return the Information Statement described in Regs. §20.2056A-4(c)(5).\(^{234}\)

c. The executor to file with the Federal estate tax return the “Agreement To Pay Section 2056A Estate Tax.”\(^{235}\) That statement must be signed by the surviving spouse (or by the surviving spouse’s legal representative if the surviving spouse is legally incompetent to sign the agreement) and must be in the form set out in Regs. §20.2056A-4(c)(6)(ii).

d. The executor to make the QDOT election under Regs. §20.2056A-3 with respect to the nonassignable annuity or other payment.\(^{236}\)

3. **The Roll Over Method**

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\(^{233}\) Regs. §20.2056A-4(c)(2)(i).

\(^{234}\) Regs. §20.2056A-4(c)(2)(ii).

\(^{235}\) Regs. §20.2056A-4(c)(2)(iii).

\(^{236}\) Regs. §20.2056A-4(c)(2)(iv).
The Roll Over Method is intended to approximate the same result as if the present value of the survivor benefit were transferred to a QDOT in a lump sum and, thereafter, the noncitizen spouse received the income from the QDOT. The requirements of the Roll Over Method are set out at Regs. §20.2056A-4(c)(3) and are satisfied if:

a. The noncitizen surviving spouse agrees to roll over and transfer the corpus portion of each annuity payment to a QDOT, whether the QDOT is created by the decedent’s will, the executor of the decedent’s estate, or the surviving spouse. 237/

b. A QDOT for the benefit of the surviving spouse is established prior to the date that the Federal estate tax return is filed and on or prior to the last date prescribed by law for making the QDOT election. 238/

c. The executor of the decedent’s estate files with the Federal estate tax return the Information Statement described in Regs. §20.2056A-4(c)(5). 239/

d. The executor files with the estate tax return the “Agreement To Roll Over Annuity Payments” described in Regs. §20.2056A-4(c)(7). 240/ That statement must be signed by the surviving spouse or by the legal representative of the surviving spouse if the surviving spouse is legally incompetent to sign the agreement and must be in the form set out in Regs. §20.2056A-4(c)(7)(ii).

e. The executor makes the election under Regs. §20.2056A-3 with respect to the nonassignable annuity or other payment. 241/

Comment: In connection with the Roll Over Method, the surviving spouse may incur an income tax liability on the receipt of amounts that must then be transferred to the QDOT. Regs. §20.2056A-5(c)(3)(iv)(A) exempts from the QDOT Tax amounts

paid from the QDOT (by actual payment or by withholding) to reimburse the spouse with respect to the income tax imposed on the amounts transferred to the QDOT under the Roll Over Method.\textsuperscript{242}

**Comment:** It appears likely that the Roll Over Method will be the preferred option for a surviving spouse beneficiary of a non-transferable plan, since it provides a greater opportunity for deferral of the QDOT Tax. This would clearly be the case when the surviving spouse is contemplating obtaining U.S. citizenship.

**Comment:** Where the surviving spouse anticipates electing Roll Over treatment with respect to annuity payments, an issue may arise as to what actions are to be taken with respect to annuity payments received by the surviving spouse after the death of the decedent but prior to the filing of the Federal estate tax return and the creation of the QDOT which will receive the corpus portion of the annuity payments. In PLR 199904023 (October 30, 1998), the QDOT Tax was paid on the corpus portion of the annuity payments received after the decedent’s death and prior to the filing of decedent’s estate tax return, in accordance with the Current Tax Method. On the Form 706, the executor properly made the Roll Over Method election and transferred the corpus portion of the annuity payments received thereafter to the QDOT. The regulations do not appear to require adoption of the Current Tax Method with respect to annuity payments received in the interim period ending with the filing of the Federal estate tax return. It would seem reasonable that holding the corpus portion in a separate account pending creation of the QDOT and filing of the Form 706, followed by a timely remittance when the QDOT is completed, should satisfy the requirements of the Roll Over Method.

4. **Failure to Comply with Agreements**

Under the proposed regulations, both the Current Tax Agreement and the Rollover Agreement to be executed by the surviving spouse provided for the imposition of the QDOT Tax on the entire remaining present value of the annuity upon the failure to pay the QDOT Tax due or to file the Form 706-QDT. This rule was unnecessarily severe, especially since the surviving spouse would not have had access to the entire value of the plan on which the QDOT Tax would be imposed. Under terms of these

\textsuperscript{242} See \textit{e.g.}, PLRs 9746049 (August 15, 1997) and 9729040 (April 23, 1997).
Agreements as adopted in the final regulations, the failure either to timely file Form 706-QDT or to timely pay the tax imposed on the corpus portion of any annuity payment (under the Current Tax Method) or to transfer any required amount with respect to any annuity payment or timely file the Form 706-QDT reporting the transfers in a year (in the case of the Roll Over Method), may cause the surviving spouse to become immediately liable to pay the QDOT Tax on the entire remaining present value of the annuity. The regulations provide that the surviving spouse may make an application for relief under Regs. §301.9100-1 from the consequences of failing to timely file the QDOT Tax return and to pay the QDOT Tax necessary or to timely transfer the corpus portion of any annuity to the QDOT.

5. **Foreign Plans or Arrangements**

Under the final regulations, in the case of a plan or arrangement established and administered by a person or entity located outside the U.S. for the benefit of a surviving spouse of a non-resident alien decedent or a surviving spouse of a U.S. citizen who died domiciled outside of the U.S., the surviving spouse must agree when requested by the District Director to enter into a security arrangement to secure any undertakings of the surviving spouse.

6. **Determination of Corpus Portion of Annuity Payment**

The regulations set out in step-by-step detail the manner in which the Corpus Portion is determined for purposes of applying the Current Tax Method and the Roll Over Method. Note that these rules do not apply where the surviving spouse is receiving amounts under a nonassignable plan or other arrangement other than in the form of an annuity, even if the Current Tax Method or the Roll Over Method is elected. This could occur when the surviving spouse rolls over plan balances into an Roll Over IRA and the required beginning date has not yet been reached. In such cases, the determination of corpus and income is determined as if the IRA were itself a trust, in accordance with the rules of §2056A(c)(2) and the regulations.\(^\text{243}\)

| a. **Corpus Portion.** The “corpus portion” of each nonassignable annuity or other payment is the “corpus amount” of the annual payment divided by the total annual payment. |

\(^\text{243}\) See e.g., PLRs 9746049 (August 15, 1997) and 9729040 (April 23, 1997).
b. **Corpus Amount.** The “corpus amount” of the annual payment is determined in accordance with the following formula:

\[
\text{Total present value of Corpus Amount} = \frac{\text{annuity or other payment}}{\text{Expected annuity term}}
\]

c. The “total present value of the annuity or other payment” is the present value of the nonassignable annuity or other payment as of the date of the decedent’s death, determined in accordance with the interest rates and mortality data prescribed by §7520.

d. The “expected annuity term” is the number of years that would be required for the scheduled payments to exhaust a hypothetical fund equal to the present value of the scheduled payments.

(2) This is determined by first dividing the total present value of the payments by the annual payment.

(3) From this quotient, the expected annuity term is derived by identifying the term of years that corresponds to the annuity factor equal to the quotient. This is determined by using column 1 of Table B, for the applicable interest rate, contained in Internal Revenue Service Publication 1457, “Actuarial Valuations (May 2009)”. If the quotient obtained falls between two terms, the longer term is used.\(^{24a}\)

**Example:** At the time of D’s death in September 2009, D is a participant in an employees’ §401(a) pension plan. On D’s death, D’s spouse S, a U.S. resident, becomes entitled to receive a survivor’s annuity of $100,000 per year, payable monthly, for life. At the time of D’s death, S is age 65. Assume that under §7520, the appropriate discount rate to be used for valuing annuities at D’s date of death is 3.4%. The annuity factor at 3.4% for a person age 65 is 12.458. The adjustment factor at 3.4% for monthly payments is 1.0155. Accordingly, the right to receive $100,000 a year on a monthly basis is equal to the right to receive $101,550 ($100,000 x 1.0155) on an annual basis.

\(^{24a}\) Regs. §20.2056A-4(c)(4)(i) and (ii).
The corpus portion of each annuity payment received by S is determined as follows:

First, determine the annuity factor for the number of years that would be required to exhaust a hypothetical fund that has a present value and a payout corresponding to S’s interest in the payments under the plan, determined as follows:

(A) Present value of S’s annuity:
$101,550 \times 12.458 = $1,265,110

(B) Annuity Factor for Expected Annuity Term:
$1,265,110/$101,550 = 12.458

Second, determine the number of years that would be required for S’s annuity to exhaust a hypothetical fund of $1,265,110. The term certain annuity factor of 12.458 falls between the annuity factors for 16 and 17 years in a 3.4% percent term certain annuity table (Column 1 of Table B, Aleph Volume). Accordingly, the expected annuity term is 17 years.

Third, determine the corpus amount by dividing the expected term of 17 years into the present value of the hypothetical fund as follows:

Corpus amount of annual payment:
$1,265,110/17 = $74,418

Fourth, determine the corpus portion of each annuity payment by dividing the corpus amount of each annual payment by the annual annuity payment as follows:

Corpus portion of each annuity payment:
$74,418/$101,550 = 0.733

Accordingly, 73.3 percent of each payment to S is deemed to be a distribution of corpus.\footnote{See Regs. §20.2056A-4(d) (Example 4).}

Comment: Lower interest rates increase dramatically the corpus portion of each payment. At higher §7520 rates, e.g., 9%, the corpus portion will be closer to 50%.

7. Hardship Exemption
The final regulations include a hardship provision under both the Current Tax Method and the Roll Over Method. Specifically, if the financial circumstances of the surviving spouse are such that an amount equal to all or a portion of the corpus portion of a non-assignable annuity payment received by the spouse would be subject to the hardship exemption provided under Regs. §20.2056A-5(c) if paid from a QDOT, then all or a corresponding part of the corpus portion will be exempt from either the current tax payment required under the Current Payment Method or the rollover required under the Roll Over Method.  

8. Information Statement

In addition to the requirements set out above, in order for a nonassignable annuity or other payment to qualify under either the Current Tax Method or the Roll Over Method, Regs. §20.2056A-4(c)(5)(i) requires an extensive Information Statement, containing the information set out below, to be filed with the decedent spouse’s Federal estate tax return.

\[ See \text{ Regs. } §20.2056A-4(c)(2)(i) \text{ and } (3)(i) . \]
a. **Annuity source information**

(1) **Employment-related annuity.** If the nonassignable annuity or other payment is employment-related, the following information must be provided:

   (a) The name and address of the employer;

   (b) The date of retirement or other separation from employment of the decedent;

   (c) The name and address of the pension fund, insurance company, or other obligor that is paying the annuity (or similar payment); and

   (d) The identification number that the obligor has assigned to the annuity or other payment.

(2) **Annuity not employment related.** If the nonassignable annuity or other payment is not employment-related, the following information must be provided:

   (a) The name and address of the person or entity paying the nonassignable annuity or other payment;

   (b) The date of acquisition of the nonassignable annuity contract by the decedent or by the decedent and the surviving spouse; and

   (c) The identification number, if any, that the obligor has assigned to the nonassignable annuity or other payment.

b. **The total annuity amount payable each year.**

   (1) The total amount payable annually under the nonassignable annuity or other arrangement;

---


(2) A description of whether the annuity is payable on a monthly, quarterly, or other interval;

(3) A description of any scheduled changes in the annuity payout amount.²⁴⁹

c. The duration of the annuity. A description of the term of the nonassignable annuity or other payment in years, if it is determined by a term certain, and the name, address, and birth date of any measuring life if the nonassignable annuity or other payment is determined by one or more lives.²⁵⁰

d. The applicable market interest rate under §7520.²⁵¹

e. Calculations showing the determination of corpus portion of each payment.²⁵²

f. For the Roll Over Method, the name and address of the U.S. Trustee and the name and taxpayer identification number of the QDOT.²⁵³

g. Certification statement. The Information Statement must be signed under penalties of perjury by both the executor of the decedent’s estate and by the surviving spouse (or the legal representative of the surviving spouse if the surviving spouse is legally incompetent) to certify as follows:

Under penalties of perjury, I hereby certify that, to the best of my knowledge and belief, the information reported in this Information Statement is true, correct and complete.²⁵⁴

²⁴⁹ Regs. §20.2056A-4(c)(5)(iii).

²⁵⁰ Regs. §20.2056A-4(c)(5)(iv).

²⁵¹ Regs. §20.2056A-4(c)(5)(v).

²⁵² Regs. §20.2056A-4(c)(5)(vi).

²⁵³ Regs. §20.2056A-4(c)(5)(vii).

²⁵⁴ Regs. §20.2056A-4(c)(5)(viii).
VII. TAXATION OF QDOTS

A. Taxable Events

1. General Rule

The QDOT Tax is imposed on certain distributions from a QDOT during the life of the surviving spouse,\(^255\) and upon the value of the property remaining in the QDOT at the date of death of the surviving spouse.\(^256\) In addition, if, at any time, there is no trustee who is a U.S. citizen or a domestic corporation, or if the QDOT fails to meet any other requirement imposed by §2056A(a)(1) or by the Security Requirements, the QDOT Tax will be imposed as if the surviving spouse died on the date the trust ceased to qualify as a QDOT.\(^257\) Finally, any trust property that is used to pay the QDOT Tax imposed under §2056A(b)(1) is itself a distribution subject to the QDOT Tax in the year that the tax is paid.\(^258\)

2. Are Distributions of Accumulated Income Taxable Events?

There are situations where all of the income of a QDOT may not be required to be distributed in order for a trust to qualify as a QDOT.\(^259\) For example, where the QDOT is in the form of an estate trust all of the income need not be distributed to the surviving spouse. In addition, where the surviving spouse transfers property to a QDOT, and no property passed from the decedent spouse to the same trust, then the QDOT need not satisfy the mandatory income provisions of §2056(b)(5) or §2056(b)(7) in order to meet the Marital Deduction Requirement.\(^260\) In these situations, a portion of a distribution from a QDOT may constitute accumulated income. There is no indication as to whether such a distribution will be treated as a tax-free distribution of income or a distribution of principal subject to the QDOT Tax. Logically, it should be treated as a

\(^{255}\) §2056A(b)(1)(A) and Regs. §20.2056A-5(b)(1).

\(^{256}\) §2056A(b)(1)(B) and Regs. §20.2056A-5(b)(2).

\(^{257}\) §2056A(b)(4); Regs. §20.2056A-5(b)(3).

\(^{258}\) §2056A(b)(11); Regs. §20.2056A-5(b)(1).

\(^{259}\) §7815(d)(7)(A) of OBRA 1989.

\(^{260}\) See Section III.B.2., above.
distribution of income; however, such amounts should be segregated by the trustee to avoid the need for tracing. Of course, if the trust is a QTIP trust or a general power of appointment marital trust, there would be no accumulated income because under both such trusts, income must be distributed to the surviving spouse no less frequently than annually.

B. **Amount Subject to Tax**

1. **Lifetime Distributions of Principal**

If a taxable event occurs during the surviving spouse’s lifetime, the QDOT Tax is imposed on the amount of money and the fair market value of the property that is distributed, including property distributed from the trust pursuant to the exercise of a power of appointment, and including any amount withheld from the distribution by the U.S. Trustee to pay the tax. If the QDOT Tax is not withheld by the U.S. Trustee but is paid by the U.S. Trustee out of other assets of the QDOT, an amount equal to the tax so paid is treated as an additional distribution to the spouse in the year that the tax is paid.\(^{261}\)

2. **Death of the Surviving Spouse**

The amount subject to tax at the death of the surviving spouse is the fair market value of the trust assets at the date of the spouse’s death or on the alternate valuation date, if applicable. With respect to non-assignable plans or arrangements, any corpus portion amounts remaining in a QDOT after a surviving spouse’s death are subject to the QDOT Tax, as well as any residual payments from a non-assignable plan or arrangement that are payable to the spouse’s estate or to successor beneficiaries.\(^{262}\)

3. **Trust Ceases to Qualify as QDOT**

If a taxable event occurs as a result of the trust ceasing to qualify as a QDOT, the amount of property subject to the QDOT Tax is the fair market value of the trust assets on the date of disqualification.\(^{263}\)

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\(^{261}\) Regs. §20.2056A-5(b)(1).

\(^{262}\) Regs. §20.2056A-5(b)(2).

\(^{263}\) Regs. §20.2056A-5(b)(3).
C. **Amount of Tax**

1. **Rate of Tax**

The amount of the QDOT Tax imposed equals the Federal estate tax that would have been imposed under §2001 on the estate of the decedent spouse had such decedent’s taxable estate been (a) increased by the sum of (i) the amount of property involved in the taxable event and (ii) the aggregate of the amounts involved in all previous taxable events with respect to all QDOTs of the decedent spouse, and (b) reduced by the Federal estate tax which would have been imposed on the decedent spouse’s estate had it been increased by the amount involved in all previous taxable events.264 For purposes of applying this provision, the estate tax which would have been imposed on the decedent spouse’s estate means the net tax after allowance of any available credits, including the unified credit (applicable credit amount) allowable under §2010, the credit or deduction for state death taxes under §2011 or 2058, the credit for tax on prior transfers under §2013, and the credit for foreign death taxes under §2014.265

In the case of a nonresident alien decedent, the applicable credits are determined under §2102.266

In making this calculation, for decedent spouse dying before January 1, 2002, the 5% surtax that eliminates the benefits of the graduated estate tax rates and the unified credit under §2001(c)(2) applies.267

The QDOT Tax, net of any allowable credits, constitutes an estate tax for purposes of the income tax deduction provided under §691(c)(2)(A).268

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264 §2056A(b)(2)(A).

265 Regs. §20.2056A-6(a).

266 Id.

267 Id.

268 Id. This provision in the regulations is necessary since the §691(c) deduction allows an income tax deduction for the estate tax imposed under §§2001 and 2101 on items of IRD, and the QDOT Tax, although designated as an estate tax, is imposed under §2056A(b).
Example: D, a U.S. citizen, dies in 1997 with a gross estate of $1,200,000. Under D’s will, a pecuniary bequest of $700,000 passes to a QDOT for the benefit of D’s spouse, S, who is a resident but not a citizen of the U.S. D’s estate tax is computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross estate</td>
<td>$1,200,000</td>
</tr>
<tr>
<td>Marital Deduction</td>
<td>(700,000)</td>
</tr>
<tr>
<td>Taxable Estate</td>
<td>$ 500,000</td>
</tr>
<tr>
<td>Gross Tax</td>
<td>$ 155,800</td>
</tr>
<tr>
<td>Less: Unified Credit</td>
<td>(155,800)</td>
</tr>
<tr>
<td>Net Tax</td>
<td>0</td>
</tr>
</tbody>
</table>

At S’s subsequent death, the value of the corpus of the QDOT is $700,000. Assuming there were no taxable events during S’s lifetime with respect to the QDOT, the QDOT Tax imposed under §2056A(b)(1)(B) is $235,000, computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>D’s actual taxable estate</td>
<td>$ 500,000</td>
</tr>
<tr>
<td>QDOT property</td>
<td>700,000</td>
</tr>
<tr>
<td>Total</td>
<td>$1,200,000</td>
</tr>
<tr>
<td>Gross Tax</td>
<td>$ 427,800</td>
</tr>
<tr>
<td>Less: Unified Credit</td>
<td>(192,800)</td>
</tr>
<tr>
<td>Net Tax</td>
<td>$ 235,000</td>
</tr>
<tr>
<td>Less: Tax that would have</td>
<td>0</td>
</tr>
<tr>
<td>been imposed on D’s actual</td>
<td></td>
</tr>
<tr>
<td>taxable estate of $500,000</td>
<td></td>
</tr>
<tr>
<td>Deferred Estate Tax</td>
<td>$ 235,000</td>
</tr>
</tbody>
</table>

2. Change in Rate of Tax

The QDOT Tax is imposed at the highest marginal Federal estate tax rate under §2001 applicable to the estate of the decedent spouse, taking into account the amounts involved in all previous taxable events. It is not clear from the statute what happens if there is a change in the marginal Federal estate tax rates or allowable unified credit between the death of the decedent spouse and the time of the taxable event. The statute refers only to “the tax which would have been imposed under §2001 on the estate of the decedent.”\(^{270}\) However, the legislative history states that the amounts

\(^{269}\) See Regs. §20.2056A-6(b).

\(^{270}\) §2056A(b)(2)(A)(i).
involved in taxable events are “subject to an estate tax based on the
decedent’s rates and unified credit.” Under the regulations, the tax is
imposed in accordance with the rate schedule under §2001 in effect at the
date of the decedent spouse’s death. Therefore, scheduled increases in
the unified credit and decreases in top marginal estate tax rates enacted by
the TRA 1997 and the Economic Growth and Tax Relief Reconciliation
Act of 2001 (“EGTRRA”) will not affect the QDOT Tax imposed on
decedents dying during the full phase-in of the increased exclusion
amount.

Similarly, the 1-year repeal of the Federal estate tax in 2010, does not
prevent the imposition of QDOT Tax on taxable events occurring in 2010
in respect of QDOTs created by decedents dying before 2010. Of course,
a decedent whose death occurs in 2010, survived by a non-U.S. citizen
spouse, will have no need to create a QDOT or make the QDOT election,
thereby eliminating any QDOT Tax exposure going forward.

3. Tentative Tax Imposed When Decedent Spouse’s Federal Estate Tax Not
Determined

If, at the date the Form 706-QDT is filed, the Federal estate tax imposed
on the estate of the decedent spouse has not been finally determined, the
QDOT Tax imposed on the amount involved in the taxable event is
determined based on the highest marginal estate tax rate in effect under
§2001 applicable to the decedent spouse’s estate. The tax on the
decedent spouse’s estate will not be finally determined for purposes of the
tentative tax if, for example, the statute of limitations on the estate is still
open, or if a judicial proceeding to determine such tax has not been com-
pleted. The legislative history indicates that a tax may be finally deter-
mined by a closing agreement executed in accordance with §7121.


Regs. §20.2056A-6(d).


EGTRRA, §511, 521.

§2056A(b)(2)(B)(i).


Id.
If, after the tax is finally determined on the decedent spouse’s estate, a refund is due to the QDOT because the decedent spouse’s marginal Federal estate tax rate is determined to be lower than that applied to the calculation of the tentative QDOT Tax, then the trustee may claim a refund or credit. Such a refund or credit now bears interest; prior to the enactment of OBRA 1989, the statute made no provision for the payment of interest on a claim for refund of the tentative tax. The claim for refund or credit must be filed within one year after the final determination of the Federal estate tax on the decedent spouse’s estate.

4. Multiple QDOTs

a. General Rules

OBRA 1989 enacted harsh rules when there is more than one QDOT created with respect to a decedent spouse, unless the decedent’s executor designates either an individual who is a U.S. citizen or domestic corporation to be responsible for the filing of all returns of the QDOT Tax imposed under §2056A(b)(1) and the payment of any such tax. If no such “designated return filer” is appointed, or if such person fails to meet any applicable regulatory requirements, the QDOT Tax imposed on the amount involved in any taxable event with respect to any such QDOT will be determined by applying the highest marginal Federal estate tax rate in effect at the date of the decedent spouse’s death. However, there is no mechanism for the redetermination of the Federal estate tax imposed as there is when a tentative QDOT Tax is imposed under §2056A(b)(2)(B). In addition, where no such appointment is made, or when the person appointed fails to meet the regulatory requirements, the exemption from the QDOT Tax on distributions on account of hardship provided under §2056A(b)(3)(B) will be unavailable.

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278 §2056A(b)(2)(B)(ii).

279 See §5033(a)(2) of TAMRA.


281 §2056A(b)(2)(C).

282 See §2056A(b)(3)(B), discussed and Section VII.D.3., below.
b. **Designation of Return Filer**

The legislative history states Congress’ intention that the regulations regarding designation of the person required to file the QDOT Tax return and pay the QDOT Tax shall ensure collection of the Federal estate tax.\(^{283/}\) Under the regulations, the Designated Return Filer must be a U.S. Trustee of the QDOT. If the U.S. Trustee is an individual, the individual must have a tax home (as defined in §911(d)(3)) in the U.S.\(^{284/}\) The designation of the Designated Return Filer must be made on either the decedent spouse’s Federal estate tax return or on the first Form 706-QDT that is due and is filed by its prescribed date, including extensions.\(^{285/}\) At least sixty days before the due date for filing the Form 706-QDT, the U.S. Trustee(s) of each of the QDOTs must provide to the Designated Return Filer all of the necessary information relating to distributions from their respective QDOTs.\(^{286/}\) The U.S. Trustee of each QDOT submits to the Designated Return Filer a Schedule B to the Form 706-QDT setting out the required information.

Unless the decedent has provided for a successor Designated Filer, where the Designated Filer ceases to qualify as a U.S. Trustee, or otherwise becomes unable to serve as a designated filer, the remaining trustees of each QDOT must select a qualifying designated successor (who is also a U.S. Trustee) prior to the due date for filing of Form 706-QDT, including extensions, and such selection must be indicated on the Form 706-QDT.\(^{287/}\)

c. **Allocation of QDOT Tax**

The regulations provide that the QDOT Tax due from each QDOT is to be allocated on a pro-rata basis, based on the ratio of the amount that each distribution constituting a taxable event bears to the amount of all such distributions. However, this proration will

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\(^{284/}\) Id. Regs. §20.2056A-9. See Section III.C.1., above.

\(^{285/}\) Id.

\(^{286/}\) Id.

\(^{287/}\) Id.
not apply where a different allocation is required under the terms of the governing instrument or under local law.\textsuperscript{288} It is unclear whether a non-pro rata allocation of the taxes is permissible where the governing instrument merely authorizes, but does not require, a different allocation of the tax. There appears to be no reason why the authorization of a non-pro rata allocation of any QDOT Tax should not be respected.

D. Distributions Exempt From Tax

1. Distributions of Income

   a. Background and General Rules

   Distributions of income from a QDOT to the noncitizen surviving spouse are not subject to the QDOT Tax imposed under §2056A(b)(1).\textsuperscript{289} For purposes of the QDOT provisions, the term “income” has the same meaning as it has in §643(b), subject to any regulatory modifications.\textsuperscript{290} Section 643(b) states that, for purposes of Subchapter J of the Code, income is determined in accordance with the terms of the governing trust instrument and applicable local law. The Code allows the trustee, acting in good faith, to allocate certain types of income, including extraordinary dividends or taxable stock dividends, to trust corpus if, under local law or the trust instrument, such items would not be considered income.\textsuperscript{291}

   Prior to OBRA 1989, §2056A(c)(2) did not explicitly provide the Secretary with authority to modify the definition of income for purposes of the QDOT provisions. The legislative history states:

   The Secretary of the Treasury is granted regulatory authority to modify the definition of income for purposes of determining the amount subject to the tax. The committee intends that such regulations define income so as to prevent avoidance of the estate tax. Thus, the characterization of income and corpus contained in the governing instrument would not control for purposes of the

\textsuperscript{288} Id.

\textsuperscript{289} §2056A(b)(3)(A).

\textsuperscript{290} See §§2056A(c)(2), 2056A(e).

\textsuperscript{291} Section 643(b); Regs. §1.643(b)-1.
estate tax. For example, capital gain generally would not be
treated as income for purposes of the estate tax on QDOTs,
regardless of the characterization contained in the trust
instrument.  

Under the prior regulations, “income” refers to income as defined in
§643(b), except that income does not include capital gains or other items
that would be allocated to corpus under applicable local law governing the
administration of trusts without regard to any specific trust provision to
the contrary. Where there is no statutory or case law regarding the
allocation of items of income under the law governing the administration
of the QDOT, the regulations take the position that such allocation must
be governed by general principles of law (including but not limited to any
uniform state acts such as the Uniform Principal and Income Act, or any
restatement of applicable law).

b. New Section 643 Regulations

For tax years ending after January 2, 2004, the broad definition of income
found in the revised §643 regulations applies and provides greater
flexibility for QDOT beneficiaries. Specifically, the regulations provide
that an allocation of amounts between income and principal pursuant to
applicable local law will be respected if local law provides for a
reasonable apportionment between income and remainder beneficiaries of
the total return of the trust for the year, including ordinary income, tax-
exempt income, capital gains, and appreciation. These provisions take one
of two forms: a “unitrust provision,” under which a state statute provides
that income is a unitrust amount of no less than 3%, and no more than 5%
of the fair market value of the trust assets, and an “adjustment provision,”
under which a state statute permits the trustee to make adjustments
between income and principal to fulfill the trustee’s duty of impartiality
between income and remainder beneficiaries.

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293/ Regs. §20.2056A-5(c)(2). This would appear to include capital gains incurred on
reinvested income.

294/ T.D. 9102.

295/ Regs. §1.643(b)-1.
The final regulations also amended the provision ofRegs. §20.2056A-5 by adding the following provision:

However, distributions made to the surviving spouse as the income beneficiary in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount), or that permits the trustee to adjust between principal and income to fulfill the trustee’s duty of impartiality between income and principal beneficiaries, will be considered distributions of trust income if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of §1.643(b)-1 of this chapter.296

The effect of the changes is that if a QDOT is administered in accordance with the law of a state that has adopted the Uniform Principal of Income Act297 or under which the unitrust or adjustment provisions exist under state statute or by decisional law, the characterization of distributions in excess of the traditional measures of income will be respected for purposes of determining the portion of such distribution subject to the QDOT Tax. For example, the adoption of a 5% unitrust payment will allow distributions to be classified as “income” for purposes of imposition of the QDOT Tax, even though a portion of the distribution will include capital gains otherwise subject to the tax.

**Comment:** The flexibility incorporated into the revised income regulations may allow significantly larger distributions to be made in the noncitizen spouse, when permitted under state law. Careful drafting and state forum shopping will be required to take advantage of the provisions.

2. Treatment of Income in Respect of a Decedent

Unless the IRS provides guidance to the contrary, income does not include items of IRD as defined in §691.298 However, where the QDOT is designated by the decedent as a beneficiary of a pension or profit sharing

296 Regs. §20.2056A-5(c)(2).


298 Regs. §20.2056A-5(c)(2).
plan or individual retirement account or annuity, the proceeds of which are payable to the QDOT in the form of an annuity, any payments received by the QDOT may be allocated between income and corpus, in accordance with the provisions of Regs. §20.2056A-4(c) regarding the determination of the corpus and income portions of each annuity payment.\textsuperscript{299}

3. \textbf{Principal Distributions on Account of Hardship}

Distributions of trust corpus to the surviving spouse on account of “hardship” are also exempted from imposition of the QDOT Tax.\textsuperscript{300} Distributions made on account of hardship, although free from the QDOT Tax, must be reported on Form 706-QDT even if it is the only distribution that occurred during the filing period.\textsuperscript{301}

The exemption from the QDOT Tax for distributions on account of hardship may be unavailable if there is more than one QDOT in existence with respect to a decedent spouse. Section 2056A(b)(2)(C) provides that where there is more than one QDOT in existence with respect to any decedent, the decedent spouse’s executor must designate a person who is a U.S. citizen or a domestic corporation to be responsible for filing all returns and paying all QDOT taxes due. In addition, such Designated Return Filer must meet any requirements that may be prescribed in regulations. If such person is not designated, or if the person fails to meet such regulatory requirements, the exemption from the QDOT Tax for distributions on account of hardship will be unavailable.

There is no definition of “hardship” provided either in the statute or in the legislative history or in the instructions to Form 706-QDT. The regulations generally adopt a definition of “hardship” set out in Regs. §1.401(k)-1(d)(2)(i) (involving permissible distributions from certain deferred compensation plans). Specifically, a distribution of principal is made on account of hardship if the distribution is made to the spouse from the QDOT in response to an immediate and substantial financial need relating to the spouse’s health, maintenance, education or support, or the health, maintenance, education, or support of any person who the surviving spouse is legally obligated to support. A distribution is not

\textsuperscript{299} Id.

\textsuperscript{300} §2056A(b)(3)(B).

considered made on account of hardship if the amount distributed may be obtained from other sources that are reasonably available to the surviving spouse; e.g., the sale by the surviving spouse of personally owned, publicly traded stock or the cashing in of a certificate of deposit owned by the surviving spouse. For purposes of the application of the hardship exemption, assets such as a closely-held business interest, real estate or tangible personal property are not considered sources that are reasonably available to the surviving spouse.\footnote{Regs. §20.2056A-5(c)(1).}

It is worth noting that legislation was introduced to expand the hardship exemption.\footnote{See H.R. 3299, 101st Cong., 1st Sess. (1989).} Under this proposal, annual distributions of trust principal of up to $100,000, reduced by the amount of income distributed to the surviving spouse during that year, would be made to a noncitizen spouse free of the QDOT Tax.\footnote{H.R. 3299, §7815(d)(7)(B).} This provision would have placed individuals who were not able to take advantage of the $100,000 annual exclusion for gifts permitted under §2523(i) on a more equal basis with those who were able to make such gifts. In addition, as proposed under H.R. 3299, trust distributions made on behalf of the noncitizen spouse to any person for medical care of the spouse were not subject to the QDOT Tax and were excluded in calculating the $100,000 limit on principal distributions.\footnote{Id.} The Senate Finance Committee stripped these two provisions and adopted the exclusion for hardship distributions only.\footnote{See S. 1750, 101st Cong., 1st Sess. §6815(d)(7)(B) (1989).} The failure to provide a certain level of tax-free principal distributions in the statute is clearly unfair to noncitizen surviving spouses of moderate wealth who are more likely to have to invade trust corpus for their support than a wealthy noncitizen surviving spouse whose larger income stream will decrease or eliminate the need for corpus distributions.

4. Additional Distributions and Transactions Not Giving Rise to QDOT Tax

The regulations describe several additional distributions and transactions that do not require the imposition of the QDOT Tax. This list is not intended to be exclusive.\footnote{Regs. §20.2056A-5(c)(3).}
a. Payments for ordinary and necessary expenses of the QDOT, including bond premiums and letter of credit fees incurred if the Bond Requirement or Letter of Credit Requirement is utilized by the U.S. Trustee.

b. Payments to applicable governmental authorities for income tax or any other applicable tax imposed on the QDOT (other than a payment of the QDOT Tax due on the occurrence of a taxable event). This provision allows for the QDOT Tax-free payment of all income taxes -- Federal, state and local and foreign -- imposed on the QDOT.

Note that this provision applies where the tax imposed is a liability of the trust. When the QDOT is funded by an assignment of property by the surviving spouse, this provision will not apply if and to the extent that the QDOT is a grantor trust, since the tax liability falls on the spouse/grantor, and not the QDOT.

On the other hand, the provision will likely apply if an item of IRD is made payable to the QDOT by the decedent spouse; in such a situation, all income taxes imposed on the QDOT should be payable with QDOT assets and not be subject to the QDOT Tax.

c. Dispositions of trust assets by the trustees (such as sales, exchanges, or pledging as collateral) for full and adequate consideration in money or money’s worth.

d. In accordance with the provisions of §2056A(b)(15), amounts paid from the QDOT to reimburse the surviving spouse for Federal income taxes on any item of income of the QDOT to which the surviving spouse is not entitled under the terms of the trust. These distributions include, but under the regulations are not limited to:

(2) Amounts paid from the QDOT to reimburse the spouse for income taxes paid by the spouse (either by actual payment or through withholding) with respect to amounts received from a nonassignable annuity or other arrangement that are transferred by the spouse to a QDOT pursuant to Regs. §20.2056A-4(c)(3); and

See §671.
(3) Income taxes paid by the spouse (either by actual payment or withholding) with respect to amounts received in a lump sum distribution from a qualified plan if the lump sum distribution is then assigned by the surviving spouse to a QDOT.

The amount of the tax eligible for reimbursement under this provision is the difference between the actual income tax liability of the spouse and the spouse’s income tax liability determined as if the item had not been included in the spouse’s gross estate in the applicable tax year.\textsuperscript{309} The IRS has ruled, however, that no §2056A(b)(15) QDOT Tax reimbursement will be allowed for amounts paid in connection with income earned on the assets transferred to the QDOT between the date of the decedent spouse’s death and the transfer to the QDOT.\textsuperscript{310}

E. Administrative Provisions

1. Liability for Tax

Each trustee of a QDOT is personally liable for the amount of any QDOT Tax under rules similar to those in §2204.\textsuperscript{311} Under §2204(b), a fiduciary other than an executor may be discharged from personal liability for taxes due for which he is personally liable by making a proper application to the Secretary of the Treasury and requesting a determination of the amount of any Federal estate tax due for which a fiduciary is personally liable. After payment of any such tax, and posting of a bond, if appropriate, the fiduciary is discharged from personal liability for any deficiency subsequently determined with respect to such tax.

2. Imposition of Withholding Requirement on Payors of Certain Annuities

The personal liability of the QDOT trustee creates a special problem with respect to an annuity or other payment treated as a QDOT and therefore not actually held in trust. Section 2056A(e) provides broad authority to issue regulations “necessary or appropriate to carry out the purposes of” §2056A. With regard to joint and survivor annuities, the legislative history expands on this idea by noting that such annuities may be treated

\textsuperscript{309} Regs. §20.2056A-5(c)(3)(iv) (last sentence).

\textsuperscript{310} See PLR 9235015 (May 23, 1997).

\textsuperscript{311} §2056A(b)(6).
as a QDOT without actually being assigned to such a trust if the payor of the annuity withholds an amount equal to the distribution tax and meets other conditions designed to ensure collection of the tax.\textsuperscript{312/} The payor of the annuity is thus required to become a withholding agent with respect to the annuity. This may impose a significant administrative burden on private corporations and organizations providing such benefits.

3. QDOT Return Filing Requirements - Form 706-QDT

Form 706-QDT (U.S. Estate Tax Return for Qualified Domestic Trusts) is the form for making a return of taxable events and payment of the QDOT Tax.

a. Who Must File Form 706-QDT

The trustee is responsible for filing the Form 706-QDT and paying the QDOT Tax if the surviving spouse is a beneficiary of only one QDOT, or the surviving spouse is the beneficiary of more than one QDOT but the decedent spouse’s executor failed to appoint a designated return filer. If the surviving spouse is the beneficiary of more than one QDOT from a single decedent and that decedent has elected a designated return filer, the designated return filer is liable for filing the return and paying the QDOT Tax, but the trustee must still complete Schedule B of the Form.

b. Summary of Filing Instructions

(1) The Form 706-QDT requests identifying information about the trustees, the designated return filer (if any), the surviving spouse and the decedent spouse, as well as information about the Federal estate tax return filed by the decedent spouse’s estate.

(2) Elections regarding alternate valuation, special use valuation, payment of estate tax in installments and the election to cease application of the QDOT Tax when the surviving spouse becomes a citizen of the U.S. are all made on the Form 706-QDT.

(3) A Schedule B must be completed by the trustee of each QDOT in existence for the benefit of the surviving spouse.

\textsuperscript{312/} 1989 House Report, at p. 1433.
The trustee must state the amount of taxable distributions from that QDOT in prior years and describe in detail taxable distributions and distributions on account of hardship (even though not subject to the QDOT Tax) during the current year.

(4) If the Form 706-QDT is being filed on account of the death of the surviving spouse or because the QDOT ceased to qualify as a QDOT during the year, the Form requires a detailed description of the property remaining in the QDOT, and the property qualifying for the marital and charitable distributions.

(5) If there is only one QDOT in existence for the surviving spouse, the information on Schedule B is used to determine the QDOT Tax due for the year.

(6) If there is more than one QDOT in existence for the surviving spouse, the information for all Schedule B’s is submitted by the trustees to the designated return filer, who summarizes all the taxable events for all QDOTs during the year on Schedule A. This information is then used to determine the QDOT Tax due for the year.

4. Due Date for Payment of Federal Estate Tax

The QDOT Tax is due on the 15th day of the fourth month following the year in which the taxable event occurs. The due date for any QDOT Tax otherwise due on April 15, 1990 was extended indefinitely, due to the unavailability of Form 706-QDT (U.S. Estate Tax Return for Qualified Domestic Trusts).

Form 706-QDT was originally issued with a date of March, 1991. The IRS announced that the reporting date for taxable events occurring after November 10, 1988, and before January 1, 1991, would be September 16, 1991. For taxable events in years beginning after December 31, 1990, Form 706-QDT will be due by April 15 of the year following the year in which the taxable event occurred.

§2056A(b)(5)(A); Regs. §20.2056A-11(a).


Form 706-QDT is also used to report distributions of principal to a spouse on account of “hardship,” even though the distributions are not subject to the QDOT Tax and even though no other taxable event occurred during the tax year.\textsuperscript{316} The QDOT Tax on property held in the QDOT at the surviving spouse’s death is due with the spouse’s Federal estate tax return, nine months from the date of death of the surviving spouse.\textsuperscript{317}

QDOT Tax due on any distributions that occur in the year of the surviving spouse’s death are also due with the spouse’s Federal estate tax return.\textsuperscript{318}

5. Extensions and Time to File Form 706-QDT and Pay The QDOT Tax

a. Filing Extensions

An extension of not more than 6 months may be obtained for the filing of Form 706-QDT under §6081(a) if the conditions specified in that section are satisfied.\textsuperscript{319}

b. Tax Payment Extensions

Pursuant to §§2056A(b)(10)(C) and 6161(a)(2), upon a showing of reasonable cause, an extension of time for a reasonable period beyond the due date may be granted to pay any part of the QDOT Tax that is imposed upon the surviving spouse’s death and shown on the final Form 706-QDT, or any part of any installments of such tax under §6166 (including any part of a deficiency prorated to any installment under such section). The extension may be granted for a reasonable period of time, not to exceed 10 years from the date prescribed for payment of the tax (or in the case of an installment or part of a deficiency prorated to an installment, if later, not beyond the date that is 12 months after the due date for the last installment), by the District Director or the Director of the service center where the Form 706-QDT is filed.\textsuperscript{320}

\textsuperscript{316} Id; Regs. §20.2056A-5(c).

\textsuperscript{317} §2056A(b)(5)(B); Regs. §20.2056A-11(b).

\textsuperscript{318} §2056A(b)(5)(A).

\textsuperscript{319} Regs. §§ 20.2056A-11(a) and (b).

\textsuperscript{320} Regs. §20.2056A-11(c)(1).
An extension of time beyond the due date to pay any part of the
QDOT Tax imposed on lifetime distributions under
§2056A(b)(1)(A), or imposed at the death of the surviving spouse
under §2056A(b)(1)(B), may be granted for a reasonable period of
time, not to exceed 6 months (12 months in the case of the QDOT
tax imposed under §2056A(b)(1)(B) at the surviving spouse’s
death), by the District Director or the Director of the service center
where the Form 706-QDT is filed.221/

6. **Lien for QDOT Tax Due**

Section 6324(a)(1) provides that, unless paid in full sooner, or unless
unenforceable by application of the statute of limitations, the Federal
estate tax imposed by Chapter 11 of the Code shall be a lien upon the
gross estate of the decedent for 10 years from the date of death. No such
lien shall apply to that part of the gross estate used to pay charges against
the estate or expenses of administration of the estate that are allowed by
any court having jurisdiction over the estate.

Any Federal estate tax imposed on a QDOT under §2056A(b)(1) is, for
purposes of §6324, treated as a Federal estate tax imposed under Chapter
11 with respect to a decedent dying on the date of the taxable event. In
addition, the property subject to the taxable event shall be treated as the
gross estate of such decedent.222/

7. **Liability for QDOT Tax**

Under §2056A(b)(6), each trustee (and not solely the U.S. Trustee(s)) of a
QDOT is personally liable for the amount of the QDOT Tax imposed in
the case of any taxable event under §2056A(b)(1). Each trustee is
personally liable for the QDOT Tax imposed on a taxable event with
respect to that trustee’s QDOT, but is not personally liable for any QDOT
Tax imposed on taxable events involving other QDOTs.223/ However, the
assets of any QDOT are subject to collection for any QDOT Tax resulting
from a taxable event with respect to any other QDOT created by the same

221/ Regs. §20.2056A-11(c)(2).

222/ §2056A(b)(8).

223/ Regs. §20.2056A-11(d).
decedent. The trustee may also be personally liable as a withholding agent under §1461 or other applicable provisions of the Code.\textsuperscript{324}

8. Basis of Property Distributed From a QDOT

The provisions of §1015, relating to the basis of property acquired by gift, are applied to determine the basis of property distributed in a taxable distribution from a QDOT. Section 1015(a) provides, generally, that the donee of a gift receives the lower of the donor’s basis in the gifted property or the fair market value of the property. Section 1015(d) allows the basis of gifted property to be increased by that portion of the Federal gift tax paid that is attributable to the appreciation in the gifted property immediately prior to the gift.

Under §2056A(b)(13) and Regs. §20.2056A-12, distributions from a QDOT during the life of the surviving spouse that give rise to a Federal estate tax are treated as transfers by gifts, and the QDOT Tax is treated as Federal gift tax paid. Thus, the basis of the distributed property is increased (but not above fair market value) by the amount of the QDOT Tax allocable to the appreciation in the value of the distributed property after the decedent’s death.\textsuperscript{325} Since the property held in a QDOT is treated as property passing from the decedent spouse, such property will have already received a basis equal to its value at the decedent’s date of death.\textsuperscript{326} Thus, there will be only a small benefit, in the first years after the decedent’s death, from the step-up in basis for the QDOT Tax paid.

In accordance with the provisions of §2056A(b)(13), the regulations provide that in the case of any distribution from a QDOT on which the QDOT Tax is imposed under §2056A(b)(1)(A) on lifetime distributions to the surviving spouse, the distribution is treated as a transfer by gift for purposes of §1015, and any QDOT Tax paid is treated as a gift tax.\textsuperscript{327} The regulations under §1015 provide rules to implement this basis adjustment. Under these rules, any distribution from a QDOT during the noncitizen surviving spouse’s lifetime on which the QDOT Tax is imposed is treated as a transfer by gift, and any QDOT Tax paid on the distribution is treated

\textsuperscript{324} Id.

\textsuperscript{325} 1989 House Report, at p. 1433; Regs. §1.1015-5(c)(1).

\textsuperscript{326} §1014(a).

\textsuperscript{327} Regs. §20.2056A-12.
as a gift tax for purposes of applying the basis adjustment under §1015(d)(6).\textsuperscript{328}

Section 1015(d)(6) provides that the basis of gifted property in the hands of the donee is increased in an amount (not in excess of the amount of gift tax paid) which bears the same ratio to the amount of gift tax paid on the transfer as the net appreciation in value of the gift (that is, the amount by which the fair market value of the property exceeds the donor’s adjusted basis immediately before the gift) bears to the amount of the gift.

**Example:** In 1994, X, who has exhausted his unified credit, makes a gift to Y, an unrelated third party, of a parcel of real estate having a value for gift tax purposes of $100,000. X’s adjusted basis in the real estate immediately before making the gift was $70,000. X also makes a gift the same year to Z, an unrelated third party, of a painting having a value for gift tax purposes of $70,000. X files a timely gift tax return with respect to which X paid gift tax in the amount of $55,500 computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of real estate given to Y</td>
<td>$100,000</td>
</tr>
<tr>
<td>Less: Annual exclusion</td>
<td>($10,000)</td>
</tr>
<tr>
<td>Included amount of gift (C)</td>
<td>$90,000</td>
</tr>
<tr>
<td>Value of painting given to Z</td>
<td>$70,000</td>
</tr>
<tr>
<td>Less: Annual exclusion</td>
<td>($10,000)</td>
</tr>
<tr>
<td>Included amount of gift</td>
<td>$60,000</td>
</tr>
<tr>
<td>Total included gifts (D)</td>
<td>$150,000</td>
</tr>
<tr>
<td>Total gift tax liability for gifts (B)</td>
<td>$55,500</td>
</tr>
</tbody>
</table>

In determining the gift tax paid with respect to the real estate given to Y, the amount of gift tax paid with respect to the gift of $100,000 is determined as follows:

\[
\frac{\$90,000\ (C)}{\$150,000\ (D)} \times \$55,500\ (B) = \$33,300
\]

The amount by which Y’s basis in the real property is increased is determined as follows:

\[
\$30,000\ \text{(net appreciation)} \times \$33,300 = \$11,100
\]

\[
\$90,000\ \text{(amount of gift)}
\]

\textsuperscript{328} Regs. §1.1015-5(c)(4).
Y’s basis in the real property is $70,000 plus $11,100, or $81,100.\textsuperscript{339/}

**Example.** X dies, survived by his spouse, Y, who is not a U.S. citizen. In order to obtain the marital deduction for property passing to X’s spouse, X established a QDOT in X’s will. Subsequently, the trustee of the QDOT makes a distribution of principal from the QDOT in the form of shares of stock having a value of $70,000 and a basis of $50,000. The distribution is not made on account of hardship. No previous taxable distributions from the QDOT have been made. A QDOT Tax is imposed and paid in the amount of $38,500 on the distribution. The amount by which Y’s basis in the shares of stock is increased is determined as follows:

\[
\frac{\$20,000 \text{ (net appreciation)}}{\$70,000 \text{ (amount of distribution)}} \times \$38,500 = \$11,000
\]

Y’s basis in the stock is $50,000 plus $11,000, or $61,100.\textsuperscript{330/}

F. **Cessation of Imposition of the QDOT Estate Tax: The Surviving Spouse Becomes a United States Citizen**

1. **Surviving Spouse is a U.S. Resident**

If the surviving spouse becomes a U.S. citizen after the decedent spouse’s Federal estate tax return is made, and the surviving spouse was a U.S. resident at the date of the decedent spouse’s death and at all times thereafter, the QDOT Tax is no longer imposed on distributions to the spouse is no longer imposed, and there will be no Federal estate tax imposed under §2056A(b)(1)(B) at the death of the surviving spouse.\textsuperscript{331/} For purposes of qualifying for this provision, “residency” is defined by reference to Regs. §20.0-1(b)(1).\textsuperscript{332/}

\textsuperscript{339/} Regs. §1.1015-5(c)(5) (Example 1).

\textsuperscript{330/} Regs. §1.1015-5(c)(5) (Example 2).

\textsuperscript{331/} §2056A(b)(12)(A); Regs. §20.2056A-10(a)(1). The cessation of the imposition of the QDOT Tax has no effect on the other marital trust provisions of §§2056(a) and (b). See PLRs 9848007 (July 27, 1998), 9826028 (March 26, 1998); 9418014 (February 2, 1994).

\textsuperscript{332/} See Regs. §20.2056A-1(b).
The U.S. Trustee(s) of the QDOT must notify the IRS and certify in writing that the surviving spouse has become a U.S. citizen. Notice is to be made by filing a final Form 706-QDT on or before April 15th of the year following the year in which the surviving spouse becomes a U.S. citizen, unless an extension of time for filing is granted under §6081. An extension of time within which to file the required notice should be available under Regs. §301.9100.

2. Surviving Spouse is Not a United States Resident

If the surviving spouse is not a U.S. resident at all times following the death of the decedent spouse, then different rules apply depending on whether or not a QDOT Tax had been imposed on distributions from the QDOT which had been made prior to the date on which the surviving spouse attained U.S. citizenship.

a. QDOT Tax Had Not Been Imposed

If, prior to becoming a U.S. citizen, no QDOT Tax had been imposed on any QDOT distribution, then, upon attaining citizenship, the QDOT Tax will no longer be imposed on amounts involved in any taxable event, and no QDOT Tax will be imposed upon the death of the surviving spouse.

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333 Regs. §20.2056A-10(a)(2).

334 Id. In PLR 9021037 (February 23, 1990), the IRS arguably stated that the rule in §2056A(b)(12)(A) applied only if the surviving spouse was a U.S. resident at all times after the decedent’s death and that no QDOT Tax had been imposed prior to the surviving spouse’s having attained U.S. citizenship. This is an incorrect reading of the provisions of §2056A(b)(12). In informal discussions with the IRS at the time the ruling was released it was acknowledged that the requirements of §2056A(b)(12)(A), (B) and (C) are alternate conditions and not conjunctive ones. Therefore, the statement referred to in PLR 9021037 is incorrect and should not appear in subsequent rulings.

335 See Section XII.B.7.d., below.

336 See Regs. §20.2056A-1(b).

337 §2056A(b)(12)(B); Regs. §20.2056A-10(a)(1).
b. **QDOT Tax Had Been Imposed**

If, however, a QDOT Tax had been imposed on distributions from a QDOT, then to end application of the QDOT Tax, the surviving spouse must elect to treat such distributions as taxable gifts for purposes of (1) the amount of prior taxable gifts in determining the estate tax imposed under §2001 at the surviving spouse’s death\(^{338}\) and (2) calculating the amount of taxable gifts made by the surviving spouse in the year he attains U.S. citizenship and in all future years.\(^{339}\) In addition, the surviving spouse must elect to have his unified credit reduced for purposes of determining the surviving spouse’s future Federal gift and estate tax liability by the amount of the **decedent spouse**’s unified credit allowed against such distributions.\(^{340}\)

These elections are made on Line 4 of Part II of Form 706-QDT filed on or before April 15th of the year following the year in which the surviving spouse becomes a citizen (unless an extension of time for filing is granted under §6081) and attaching notification of the election to the return.\(^{341}\) “Section 9100” relief may be available to make the requisite elections and notification if it is not timely filed.

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\(^{338}\) See §2056A(b)(12)(C)(i)(I).


\(^{340}\) §2056A(b)(12)(C)(ii); Regs. §20.2056A-10(b)(2).

\(^{341}\) Regs. §20.2056A-10(b)(3).
VIII.  DEATH OF THE NONCITIZEN SURVIVING SPOUSE

A.  Credit for Federal Estate Tax Paid

The death of the surviving spouse is a taxable event under §2056A(b)(9), and the property remaining in the QDOT at that time is subject to Federal estate tax as if it were included in the estate of the decedent spouse.\footnote{See §§2056A(b)(1)(B) and 2056A(b)(2)(A).}  The property remaining in the QDOT at the death of the surviving spouse may also be included in his or her estate under §2001 (if the surviving spouse was a U.S. resident at death) or §2101 (if the surviving spouse was a nonresident alien).  To avoid subjecting the property remaining in the QDOT to a double tax, Congress extended the protection of §2013 to the estate of the surviving spouse.\footnote{See also PLR 9003030 (October 24, 1989) (“The amount of estate tax imposed under §2056A(b)(1)(A) is the tax that would have been imposed under §2001 on the estate of [the decedent spouse] had the property been included in [the decedent spouse’s] taxable estate.}  

1.  Calculating the §2013 Credit

Section 2056(d)(3) provides that where (1) property passes to the surviving spouse from the decedent spouse, (2) such property would, but for the disallowance of §2056(d), be eligible for the marital deduction from the decedent spouse’s estate, and (3) the surviving spouse dies and his or her estate is subject to U.S. estate tax, then any Federal estate tax paid, or treated as paid, under §2056A(b)(7) by the decedent spouse with respect to such property shall be allowed as a credit under §2013 to the estate of the surviving spouse.  In calculating the credit, the percentage reductions in the available credit under §2013(a) for elapsed time are disregarded.

Subject to certain adjustments, the credit allowed under §2013(a) is the lesser of (A) the amount of Federal estate tax attributable to the transferred property in the decedent-transferor’s estate (the “First Limitation”),\footnote{§2013(b); Regs. §20.2013-2.}  and (B) the amount of the Federal estate tax attributable to the transferred property in the surviving spouse’s estate (the “Second Limitation”),\footnote{§2013(c); Regs. §20.2013-3.}
As originally enacted in TAMRA, in calculating the allowable credit, the net value of the property passing from the decedent spouse was reduced by the amount of the marital deduction allowed under §2056, thereby reducing the amount of the credit available. Section 7815(d)(6)(B) of OBRA 1989 corrected the problem by providing in §2056(d)(3) (flush language) that the credit is to be determined without deducting from the value of the property passing to the surviving spouse the value of such property that qualified for the marital deduction. The regulations take a position consistent with this change.\footnote{340}

In addition, a prerequisite to the credit under TAMRA was that the surviving spouse’s estate be subject to the tax imposed under §2001. Section 7815(d)(6)(A) of OBRA 1989 amended §2056(d)(3) to require the estate of the surviving spouse to be subject to the tax imposed by “this Chapter,” that is, Chapter 11 of the Code, thereby making the credit available where the surviving spouse is a nonresident alien subject to estate tax under §2101.

2. Application of §2013 Under the Regulations

a. Property Subject to QDOT Election

Section 2056(d)(3) provides special rules for computing the §2013 credit allowed with respect to property subject to a QDOT election. The amount of the credit is determined under §2013 and the regulations thereunder, except that the “first limitation”\footnote{347} is the amount of the QDOT Tax imposed on distributions during the spouse’s life and on the value of the trust corpus on the spouse’s death.\footnote{348} In addition, in computing the “second limitation”\footnote{349} the value of the property transferred to the decedent\footnote{350} is deemed to be the value of the QDOT assets on the date of the surviving spouse’s death, without reduction by the QDOT Tax imposed at the time of the surviving spouse’s death.\footnote{351}

\footnote{340}{See Regs. §20.2056A-7(a).}
\footnote{347}{§2013(b) and Regs. §§20.2013-1(b); 20.2013-2.}
\footnote{348}{Regs. §20.2056A-7(a)(1)}
\footnote{349}{See §2013(c) and Regs. §20.2013-3.}
\footnote{350}{See §2013(d) and Regs. §20.2013-(4).}
\footnote{351}{Regs. §20.2056A-7(a)(2).}
The amount of the credit is determined without regard to the percentage limitations contained in §2013(a).352

b. Property Not Subject to QDOT Election

If (i) property includible in a decedent’s gross estate passes to a noncitizen surviving spouse (the transferee), (ii) no marital deduction is allowed to the decedent’s estate for such property under §2056(a) solely because the requirements of §2056(d)(2) are not satisfied, and (iii) the surviving (transferee) spouse dies with an estate that is subject to tax under §§2001 or 2101, as the case may be, then any credit for tax on prior transfers allowable to the estate of the transferee spouse under §2013 with respect to such property is determined in accordance with the rules of §2013 and the regulations thereunder, except that the amount of the credit is determined without regard to the percentage limitations contained in §2013(a).353

3. Efficiency of Credit

The application of the First Limitation and the Second Limitation on the allowance of the credit may cause the credit to fall short of its purpose of making the family unit whole.

With respect to the First Limitation, the allowance of the credit for state death taxes paid under §2011 may reduce the size of the credit for previously taxed property available to the estate of the noncitizen surviving spouse under §2056(d)(3). As noted above, the provisions of §2056(d)(3) are intended to avoid the double taxation caused by the fact that property remaining in the QDOT at the death of the surviving spouse will not only be subject to Federal estate tax as if it were included in the estate of the first spouse to die, but may also be subject to Federal estate tax in the estate of the noncitizen surviving spouse under the normal marital deduction rules. However, the availability of the state death tax credit to the estate of the first spouse to die will effectively reduce the Federal estate tax imposed on the estate of the first spouse to die. Therefore, because §2013 credits the tax imposed under §2001 on the transferee spouse’s estate with all or a part of the Federal estate tax paid by the

352/ Regs. §20.2056A-7(a)(3).

353/ Regs. §20.2056A-7(b).
transferor spouse’s estate, the reduction in the Federal estate treated as being paid by the first spouse to die because of the application of the state death tax credit will reduce the amount of the §2013 credit available to the estate of the surviving spouse under §2056(d)(3).

The effect of the Second Limitation on the credit is to decrease the maximum allowable §2013 credit where the surviving spouse has fewer assets in his or her estate than the decedent-transferor spouse.

B. Allowance of Certain Tax Benefits

1. Disallowance Prior to OBRA 1989

As originally enacted in TAMRA, many Federal estate tax benefits available in computing the Federal estate tax liability of a decedent who is a U.S. citizen or resident were not allowed to a noncitizen surviving spouse. This was so because QDOT the Tax imposed on QDOT assets at the death of the surviving spouse is treated as a tax on the estate of the decedent spouse.354 In PLR 8942056 (July 25, 1989), for example, X created a QDOT under his will for the benefit of his spouse, Y. The QDOT qualified as a QTIP trust. Upon the death of Y, the property remaining in the QDOT was to be distributed to a §501(c)(3) private foundation. The taxpayer requested a ruling that Y’s estate would be allowed a Federal estate tax charitable deduction for the assets passing to the foundation. The IRS ruled that since the QDOT Tax imposed on the assets remaining in the QDOT at the death of Y was treated as a tax imposed on X’s estate, no Federal estate tax charitable deduction would be allowed at Y’s death.

2. Benefits Allowed

Section 7815(d)(9) of OBRA 1989 enacted §2056A(b)(10) to allow certain benefits for purposes of the QDOT Tax imposed at the death of the surviving spouse. The benefits are available if property with respect to which the benefits are claimed is includible in the estate of the surviving spouse (or would have been had the surviving spouse been a U.S. citizen or resident) and the requirements for those benefits were met, thereby ensuring that those benefits were allowable to the estate of the surviving spouse or would have been allowable if the surviving spouse were a U.S. citizen or resident at his death.355

354 §2056A(b)(7).

355 See also Regs. §20.2056A-6(c)(1).
3. Presumption of Residency.

For purposes of §2056A(b)(10)(A), the regulations presume that the noncitizen spouse is a U.S. resident for purposes of determining whether the QDOT property is includible in the spouse’s gross estate and for purposes of determining whether any of the credits, deductions or deferral provisions are allowable with respect to the QDOT property to the estate of the spouse.\(^{356}\)

The benefits allowable for purposes of determining the QDOT Tax imposed at the death of the noncitizen spouse include those provided under §§2032 (alternate valuation date), 2032A (special use valuation), 2055 (Federal estate tax charitable deduction), 2056 (Federal estate tax marital deduction), and 6166 (payment of Federal estate tax in installments), as well as §2011 (credit for state death taxes) and 2014 (credit for foreign death taxes).\(^{357}\) In addition, if the requirements of §2056A(b)(10)(A) are met, and the estate of the surviving spouse meets the requirements of §303, the QDOT will be entitled to redemption and capital gains treatment on the redemption of certain stock in payment of Federal estate tax in accordance with §303. In calculating the amount of redemptions for which the capital gains treatment afforded by that Section is available, the QDOT Tax is treated as Federal estate tax payable with respect to the noncitizen spouse.\(^{358}\)

4. Special Rule For Trusts Described in §2056(b)(8).

In the case of a QDOT in which the spouse’s interest qualifies for a marital deduction under §2056(b)(8), the provisions of §2056A(b)(10)(A) apply in determining the allowance of a charitable deduction in computing the deferred estate tax, notwithstanding that the QDOT is not includible in the spouse’s gross estate.\(^{359}\)

\(^{356}\) Regs. §20.2056A-6(c)(2).

\(^{357}\) §2056A(b)(10)(A), as amended by §11702(g)(4) of OBRA 1990. Note that §2056A(b)(10)(A) was not amended as part of TRA 1997. Therefore, it would appear that the benefits of §§2057 (qualified family owned business exclusion) and 2031(c) (qualified conservation easement) would be unavailable.

\(^{358}\) §2056A(b)(10)(B).

\(^{359}\) Regs. §20.2056A-6(c)(3).
5. **Credit for State and Foreign Death Taxes**

In order for a credit to be finally allowed for either state death taxes under §2011 or foreign death taxes under §2014, the state or foreign jurisdiction must actually impose death taxes on the property subject to the QDOT Tax and those taxes must actually be paid to the state or foreign jurisdiction. The credit allowable cannot exceed the state or foreign death taxes previously paid at the time of death of the first decedent, and any additional state or foreign taxes imposed on the surviving spouse’s death on the QDOT property, other than taxes imposed on property includible in the spouse’s gross estate.\(^{360}\)

The regulations provide that if assets of the QDOT are included in the surviving spouse’s gross estate (or would have been so includible if the spouse had been a U.S. resident) and state or foreign death taxes are paid by the spouse’s estate with respect to the QDOT property, the taxes paid by the spouse’s estate with respect to the QDOT are creditable to the extent allowable under §§2011 and 2014 in computing the QDOT Tax. In addition, state or foreign death taxes previously paid by the first spouse’s estate are also creditable in computing the QDOT Tax deemed allowable under §§2011 and 2014. The regulations provide substantial detail in the calculation of these credits.\(^{361}\)

6. **Alternate Valuation and Special Use Valuation**

a. **In General**

In order to claim the benefits of alternate valuation under §2032, or special use valuation under §2032A, for purposes of computing the QDOT Tax, an election must be made on the Form 706-QDT that is filed with respect to the property remaining in the QDOT upon the death of the surviving spouse. In addition, the separate requirements for making the §2032 and/or §2032A elections under those sections and the regulations thereunder must be complied with except that, for this purpose, the surviving spouse is treated as a U.S. resident regardless of the surviving spouse’s actual residency status.\(^{362}\)

\(^{360}\) Regs. §20.2056A-6(c)(4).

\(^{361}\) See Regs. §§20.2056A-6(b)(4) and -6(d) (Example 2).

\(^{362}\) Regs. §20.2056A-6(d)(5)(i).
b. **Alternate Valuation**

For purposes of the alternate valuation election under §2032, the election may not be made unless the election decreases both the value of the property remaining in the QDOT upon the death of the surviving spouse and the net amount of QDOT Tax due. Once made, the election is irrevocable.  

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363 Regs. §20.2056A-6(d)(5)(ii).

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364 Regs. §20.2056A-6(d)(5)(iii).

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365 §2056A(b)(10)(C).

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7. **Extension of Time to Pay QDOT Tax**

The provisions of §6161(a)(2) (relating to extensions of time to pay the Federal estate tax) are available with respect to the QDOT Tax imposed upon the death of the surviving spouse. The statute makes clear that the reference to the executor in §6161(a)(2)(A) is to be treated as a reference to the QDOT trustee.
C. Double Taxation

Where the QDOT is subject to a tax in a foreign country at the death of the surviving spouse, the fact that the QDOT Tax is treated as tax on the estate of the first spouse to die would appear to subject the property held in the QDOT at the death of the surviving spouse to double taxation. At the death of the surviving spouse, a QDOT Tax is paid on the property remaining in the QDOT at that time. In addition, if the noncitizen spouse established domicile in a country that subjects the QDOT to its transfer tax, the estate of the noncitizen spouse will be subject to a second tax.

Although discussed in greater detail in Section X, below, the U.S. has a number of bilateral estate tax treaties in force. The primary purpose of these treaties is to prevent or reduce the incidence of double taxation, usually through the allowance of a credit. If the surviving spouse is domiciled at death in a country with which the U.S. has a treaty, and if that country subjects the QDOT to a death tax, the normal credit provisions will be of little assistance, since the only U.S. estate tax imposed on the estate of the noncitizen spouse will be that portion of the tax not eliminated by the credit provided by §2013. Further, §2014 provides a credit against U.S. estate tax for the amount of any death taxes paid to a foreign country in respect of property which is included in the decedent’s gross estate and has a situs, for Federal estate tax purposes, in the foreign country. However, prior to the retroactive changes enacted in OBRA 1990, this credit could not have been used to reduce the double taxation on the QDOT since, as noted above, the QDOT Tax is imposed on the estate of the first spouse to die, and not the noncitizen spouse’s estate.

Some relief was provided by OBRA 1990. §2056A(b)(10)(A), as amended by §11702(g)(4) of OBRA 1990, now allows the benefit of the foreign death tax credit for purposes of the QDOT Tax imposed at the death of the noncitizen spouse, if such credit would otherwise be available with respect to the QDOT property to the noncitizen spouse’s estate (or would have been allowable if the surviving spouse had been a U.S. citizen or resident).

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\(366\) §2056A(b)(1)(B).

\(367\) See Section VIII.A., above.
D. Use of Spouse’s Unified Credit and Federal Estate Tax Brackets

Because the Federal estate tax imposed on a QDOT under §2056A(b)(1) is treated as a tax imposed on the estate of the decedent spouse, the surviving spouse (especially in a noncommunity property state) may be unable to fully use his or her unified credit and Federal estate tax brackets. In a community property state, however, the surviving spouse should be able to use part or all of his unified credit and Federal estate tax brackets since he will own one-half of the community property assets. The purpose of the QDOT provisions is to ensure that property passing to a noncitizen surviving spouse is subject to the Federal estate tax at the death of the surviving spouse. However, treatment of the QDOT Tax as a tax on the estate of the decedent spouse does not appear to be necessary to carry out the purpose of the statute, and has the effect of discriminating against surviving spouses who opt to retain their foreign citizenship. In any case, as discussed in more detail below, these provisions suggest that property be transferred to the noncitizen spouse’s ownership in order to facilitate use of his unified credit and estate tax brackets.

E. Generation-Skipping Transfer Tax

1. Who is the Transferor?

Another result of the treatment of the estate tax imposed on a QDOT as a tax on the estate of the decedent spouse is to confuse the identity of the transferor for purposes of the generation-skipping transfer tax (“GSTT”). For purposes of the GSTT, the “transferor is the decedent, with respect to property subject to the Federal estate tax, and the donor, with respect to any property subject to the Federal gift tax.” Thus, since the QDOT Tax is treated as a tax on the estate of the decedent spouse, the noncitizen surviving spouse’s $1 million exemption from the GSTT provided under §2631(a) may be unavailable for property held in a QDOT.

On the other hand, because qualification as a QDOT requires the trust to meet the other marital deduction rules, it may also be a QTIP, a general

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368/ §2056A(b)(7).

369/ See §§2601 et seq.

370/ §2652(a)(1)(A).

371/ §2652(a)(1)(B).
testamentary power of appointment trust, or an estate trust. The property remaining in the QDOT at the death of the surviving spouse will, therefore, also be subject to Federal estate tax in the estate of the surviving spouse. Because the property is “subject to the tax imposed by chapter 11” at the death of the surviving spouse (even though no Federal estate tax may be paid by the estate of the surviving spouse), the surviving spouse should also be the transferor for purposes of the GSTT under §2652(a)(1)(A).

2. Availability of the “Reverse” QTIP Election

In addition, §2652(a)(3) allows a decedent’s executor (or the donor spouse, in the case of an inter vivos QTIP trust) to reverse the effect of the QTIP election, so that the decedent (or the transferor spouse, in the case of a gift) would be treated as the transferor for GSTT purposes, notwithstanding the subsequent inclusion of the QTIP in the donee spouse’s estate. However, this election is available only when the property qualifies as a QTIP trust. Therefore, if, under the decedent spouse’s estate plan property is transferred to a QDOT, and valid QTIP election is made with respect to the trust, the reverse QTIP election should be available to ensure that the decedent’s spouse remains the transferor for GSTT purposes.

However, if the QDOT is funded with property transferred or assigned by the surviving spouse, the regulations take the position that the surviving spouse is the transferor for all the purposes except for the provisions of §2056(d)(2)(A) of the Code. Thus, to the extent property is transferred to the QDOT by the surviving spouse, the regulations treat the surviving spouse as the transferor of the property for GST tax purposes.

Moreover, because property transferred to a QDOT by the surviving spouse is deemed to qualify for the marital deduction under §2056(a) as an outright bequest to the spouse, and thereby the QTIP election is unavailable. Therefore, the reverse QTIP election under §2652(a)(3) is also unavailable.

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372 See §§2652(a)(3)(A) and (B).

373 See Regs. §20.2056A-4(b)(5) and §20.2056A-4(d) (Example 5), and discussion at Section V.H., above.

374 See Regs. §20.2056A-4(d) (Example 5).
IX. FEDERAL GIFT TAX ON TRANSFERS TO NONCITIZEN SPOUSES

A. Limitation on the Marital Deduction for Gifts to Noncitizen Spouses

1. Extension of Gift Tax Marital Deduction to Nonresidents Alien Donors

Prior to the enactment of OBRA 1989, the Federal gift tax marital deduction was available only for gifts made by U.S. citizens or residents.\footnote{375} A nonresident alien donor is now entitled to the same gift tax marital deduction available to a U.S. citizen or resident.\footnote{376} This is consistent with the extension the Federal estate tax marital deduction to the estates of nonresident alien decedents.\footnote{377}

2. Disallowance of Gift Tax Marital Deduction

For gifts made on or after July 14, 1988, TAMRA denied the unlimited Federal gift tax marital deduction where the donee spouse is not a U.S. citizen.\footnote{378} The regulations make clear that the citizenship or domicile of the donor spouse at the time of the gift is irrelevant; therefore, so long as the donee spouse is a U.S. citizen at the time of the gift and the other provisions of §2523 are met, the marital deduction will be allowed, regardless of whether the donor spouse is a U.S. citizen or U.S. resident.\footnote{379}

3. Annual Exclusion

In place of the marital deduction, the $10,000 annual exclusion provided under §2503(b) is available for gifts to a noncitizen spouse and was increased to $100,000 annually.\footnote{380} For gifts made after June 29, 1989, the annual exclusion is available only for gifts that, but for the denial of the

\footnote{375} §2523(a), prior to enactment of OBRA 1989.

\footnote{376} See §7815(d)(2) of OBRA 1989.

\footnote{377} §2106(a)(3), as amended by §7815(d)(3) of OBRA 1989, allows the marital deduction in computing the Federal estate tax liability of nonresident aliens in the amount which would be deductible with respect to U.S.-situs property under the principles of §2056.

\footnote{378} See §2523(i)(1), added by §§5033(b) and (d)(2) of TAMRA; Regs. §25.2523(i)-1(a).

\footnote{379} Regs. §§25.2523(i)-1(a), (c)(2).

\footnote{380} §2523(i)(2); Regs. §§25.2503-2(f)(1), 25.2523(i)-1(c).
marital deduction under §2523(i)(1), would qualify for the Federal gift tax marital deduction. 381/ Thus, gifts in trust to a noncitizen donee spouse must avoid the terminable interest rules of §2523(b) and must be gifts of present interests in order to satisfy §2503(b). The explanation to TCA 1990 states that “[i]t is intended that the entire $100,000 annual exclusion for gifts to a noncitizen spouse qualify as a present interest under §2503(b), while only the additional $90,000 exclusion permitted noncitizen spouses must be transferred in a form that would qualify for the marital deduction if the donee spouse were a citizen.”382/ The necessity of satisfying the present interest requirement is unclear.

The regulations under §2503 now include provisions to take account of the increase in the annual exclusion afforded donors of gifts to noncitizen spouses. The first $100,000 of gifts made during the calendar year to a noncitizen donee spouse, other than gifts of future interests, are excludible in determining the total amount of gifts for the calendar year.383/ This rule applies to gifts made on or after July 14, 1988, and is subject to the provisions of any applicable gift tax treaty. As noted above, the donor’s citizenship is not relevant; rather, it is the citizenship of the donee spouse at the time of the gift that is determinative of the application of these provisions.

Example: D, a U.S. citizen, transfers a residence valued at $350,000 on December 20, 1993, to D’s spouse, S, a resident alien. On January 31, 1994, S becomes a naturalized U.S. citizen. On D’s Federal gift tax return for 1993, D must include $250,000 as a gift ($350,000 transfer less $100,000 exclusion). Although S becomes a citizen in January, 1994, S is not a U.S. citizen at the time the transfer is made. Therefore, no gift tax marital deduction is allowable. However, the transfer does qualify for the $100,000 annual exclusion.384/

381/ §7815(d)(1)(A) of OBRA 1989; Regs. §25.2523(1)-1(c).


383/ Regs. §25.2503-2(f)(1). Note that §501(c) of TRA 1997 provides that the $10,000 annual exclusion amount will be indexed for inflation after 1998. The $100,000 annual exclusion for transfers to noncitizen spouse’s is also indexed for inflation. For 2010, the exemption is $134,000. See Section 3.30(2) of Rev. Proc. 2009-50.

384/ Regs. §25.2523(i)-1(d) (Example 5).
Further, unless provided otherwise under an applicable estate and gift tax treaty, in the case of gifts made after June 29, 1989, the $100,000 exclusion provided inRegs. §25.2503-2(f)(1) applies only if the gift in excess of the otherwise applicable ($10,000) annual exclusion is in a form that qualifies for the gift tax marital deduction under §2523(a) but for the provisions of §2523(i)(1) (disallowing the marital deduction if the donee spouse is not a U.S. citizen.)

**Example:** Assume the donee, S, is D’s spouse and is not a U.S. citizen at the time of the gift. In 1993, D, a U.S. citizen, transfers to S, outright, 100 shares of X corporation stock valued for Federal gift tax purposes at $130,000. The transfer is a gift of a present interest in property under §2503(b). Additionally, the gift qualifies for the gift tax marital deduction but for the disallowance provision of §2523(i)(1). Accordingly, $100,000 of the $130,000 gift is excluded from the total amount of gifts made during the calendar year by D for gift tax purposes.

**Example:** In 1995, D, a resident alien, transfers property valued at $500,000 in trust to S, who is also a resident alien. The trust instrument provides that the trust income is payable to S at least quarterly and S has a testamentary general power to appoint the trust corpus. The transfer to S qualifies for the marital deduction under §2523 but for the limitations of §2523(i)(1). Because S has a life income interest in the trust, S has a present interest in a portion of the trust. Accordingly, D may exclude the present value of S’s income interest (up to $100,000) from D’s total 1995 calendar year gifts.

**Example:** The facts are the same as in the preceding example except that S does not have a testamentary general power to appoint the trust corpus. Instead, D’s child, C, has a remainder interest in the trust. If S were a U.S. citizen, the transfer would qualify for the gift tax marital deduction if a QTIP election were made under §2523(f)(4). However, because S is not a U.S. citizen,

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385 See also Regs. §25.2523(i)-1(c).

386 Regs. §25.2523(i)-1(d) (Example 1).

387 Regs. §25.2523(i)-1(d) (Example 3).
D may not make a QTIP election with respect to the property. Accordingly, the gift does not qualify for the gift tax marital deduction but for the disallowance provision of §2523(i)(1). Therefore, the annual exclusion under §2523(i)(2) is not available with respect to D’s transfer in trust, and D may not exclude the present value of S’s income interest in excess of $10,000 from D’s total 1995 calendar year gifts.388/

**Comment:** Interestingly, the conclusion reached by the IRS in the final regulations on these facts was the opposite of that reached in the proposed regulations. The IRS, applying a literal reading of the governing statute, reasoned that its original conclusion that the gift would qualify for the marital deduction was not consistent with the governing statute because the gift does not qualify for the marital deduction “but for” the application of §2523(i)(1). Instead, the gift only qualified for the marital deduction if the QTIP election were made. Because the election is unavailable if the donee spouse is not a U.S. citizen, the statutory requirement that only gifts that would have qualified for the marital deduction but for §2523(i) are eligible for the increased annual exclusion. This requirement (which is intended to ensure that only gifts that would be includible in the spouse’s gross estate at death qualified for the increased exclusion.389/

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388/ Regs. §25.2523(i)-1(d) (Example 4).

4. **Joint and Survivor Annuities**

Prior to TAMRA, the irrevocable designation of a beneficiary of a joint and survivor annuity was a taxable gift. Where the beneficiary was a spouse, no Federal gift tax marital deduction was available since the beneficiary’s survivorship interest was a terminable interest. TAMRA changed the law so that a surviving spouse’s interest in a joint and survivor annuity, where only the surviving spouse has a right to receive payments under the annuity before the death of the surviving spouse, will qualify as QTIP property unless the decedent spouse’s executor elects otherwise. For Federal gift tax purposes, the irrevocable designation of the surviving spouse as a beneficiary will be treated as a transfer of an interest that qualifies for the Federal gift tax marital deduction, provided that only the donor spouse and the surviving spouse have the right to receive payments under the annuity prior to the death of the survivor.

Because TAMRA repealed the Federal gift tax marital deduction where the donee spouse is a noncitizen, §2523(f)(6) only applies when the beneficiary spouse is a U.S. citizen. Under this rule, the irrevocable designation of a noncitizen spouse as the beneficiary of such an annuity would have resulted in a taxable gift, and since the gift is not a gift of a present interest, it would not qualify for the $100,000 annual exclusion. However, OBRA 1990 cured this problem by excluding from the operation of §2523(i) the “acquisition of rights under a joint and survivor annuity described in [§2523](f)(6).”

**Example:** Assume the donee, S, is D’s spouse and is not a U.S. citizen at the time of the gift. In 1993, D, a U.S. citizen, retires from employment in the U.S. and elects to receive a reduced retirement annuity in order to provide S with a survivor annuity upon D’s death. The transfer of rights to S in the joint and survivor annuity is a gift by D for gift tax purposes. However, under Regs. §25.2523(i)-1(b), the gift qualifies for the gift tax marital deduction even though S is not a U.S. citizen. 

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390 §2056(b)(7)(C).
391 §2523(f)(6).
392 See §2523(i)(1).
393 See §2523(i)(2); §7815(d)(1)(B) of OBRA.
394 §11702(g)(1) of OBRA 1990; Regs. §25.2523(i)-1(b).
395 Regs. §25.2523(i)-1(d) (Example 2).
Comment: The inapplicability of the gift tax marital deduction limitations to the creation of certain joint and survivor annuities may allow the proportioned spouse to transfer property through the designation of the non-citizen spouse as a survivor annuity beneficiary without the $100,000 annual gift tax limitation.

B. Federal Gift Tax Effects of Creation and Termination of Joint Tenancies

1. Reenactment of Pre-ERTA Rules

TAMRA reenacted the rules of §§2515 and 2515A of the 1954 Code repealed by §403(c)(3)(B) of ERTA, in determining whether and to what extent the creation and termination of a joint tenancy in real and personal property between a husband and wife constitute a taxable gift, where the donee spouse is not a U.S. citizen. The rules for determining the Federal gift and estate tax effects of the creation and termination of joint tenancies in different types of property under §§2515 and 2515A of the 1954 Code are discussed below.

Generally, §2515(a) of the 1954 Code provided that the creation of a joint tenancy between spouses in real property would not be a taxable gift, regardless of the amount of consideration furnished by each spouse. However, under prior law, provided the spouses with the right to elect to treat the creation of such tenancies in real property as a taxable gift to the extent the consideration furnished by one spouse exceeded that furnished by the other. That election is not applicable under §2523(i).

Prior to its repeal, §2515A of the 1954 Code provided that upon the creation of a joint tenancy between spouses in personal property, each

396 The term “joint tenancy” refers to titled property owned as joint tenants with right of survivorship or as tenants by the entireties. Caution should be applied in relying on the conclusions stated in this section regarding the Federal gift tax effects of creating and terminating spousal joint tenancies. The confusion in the legislative history, the lack of regulatory authority and the absence of judicial and regulatory interpretation of the pertinent provisions make certainty in this area difficult.

397 §5033(b) of TAMRA.

398 §2515(c) of the 1954 Code.

399 See Regs. §25.2523(i)-2(a).
spouse would be treated as the owner of one-half of the value of the property.400

The 1988 House Report stated:

Under the bill, a gift between spouses does not occur by reason of the creation of a tenancy by the entirety or a joint tenancy with a right of survivorship. Upon the expiration of such a tenancy, however, there is a gift to the extent that the proportion of the total consideration furnished by a spouse multiplied by the proceeds of the termination exceeds the value of the proceeds received by that spouse.401

A footnote to the House bill added this statement: “Thus, the bill applies the law in effect prior to 1982 with respect to a tenancy in the entirety, except that there is no election to treat the creation of such a tenancy as a gift.”402

This is correct only with respect to joint tenancies in real property; it is incorrect with respect to the creation of some tenancies in personal property. Given this inconsistency, therefore, it is unclear whether the creation of a joint tenancy in personal property gives rise to a gift at the time of creation and thereby reduces the amount of the $100,000 Federal gift tax annual exclusion remaining.

There is even greater confusion where, at the death of the contributing spouse, the surviving spouse is not a U.S. citizen. As was discussed in Section II.B., above, in applying §2040(b) with respect to any consideration provided after December 31, 1976 (the effective date of §2040(b)) and before July 14, 1988, the portion of joint tenancy property treated as a gift to the surviving spouse when the tenancy was created is treated as consideration furnished by the surviving spouse, and is therefore excluded from the decedent’s estate. The 1989 House Report describes the law after enactment of TAMRA but prior to OBRA 1989 as follows:

In determining estate tax, the value of gifts includible in the gross estate effectively is reduced by the value of the taxable gift when made. Thus

400 §2515A(a) of the 1954 Code.
402 Id., at n.193.
for a joint tenancy created after [July 14, 1988], the amount included in the estate effectively is reduced by the amount transferred when the tenancy was created.403

Given the confusion in the legislative history regarding the Federal gift tax effects of the creation of joint tenancies in personal property (or additional contributions to such a joint tenancy) after July 13, 1988, the amount of such property excludible from the estate of the decedent’s spouse is unclear.

2. Creation and Termination of Interests in Jointly Owned Property

a. Real Property

(1) Creation of a Joint Tenancy

Generally, the creation of a joint tenancy in real property before January 1, 1982, and after July 13, 1988, between a husband and wife will not be treated as a taxable gift, regardless of the consideration furnished by either spouse.404 With regard to such joint tenancies created before January 1, 1982, if the election available under §2515(c) of the 1954 Code was made, then there would have been a gift upon the creation of the tenancy to the extent that the retained interest of either spouse was less than the portion of the consideration furnished by that spouse.405

The Federal gift tax effects of the creation of a joint tenancy after December 31, 1981, and before July 14, 1988, depend on the rights accorded to the spouses under local law. If, under local law, the interests of the spouses may be unilaterally severed, then each spouse is treated as having a retained interest in one-half of the value of the property.406


404/ §2515(a) of the 1954 Code; Regs. §§25.2515-1(b); 25.2523(i)-2(b)(1); PLR 9151044 (September 26, 1991) (Purchase of residence in 1977, no §2515(c) election made).

405/ Regs. §25.2515-2(b).

A spouse contributing more than one-half of the consideration for such property has therefore made a gift to the other spouse of such excess. If, however, such a severance is not allowable, as is often true of tenancies by the entirety, then the value of the retained interest of each spouse (and, therefore, the value of any gift) is made by determining the actuarial value of the respective spouse’s interests, based on their ages and the IRS actuarial tables.\textsuperscript{407} The actuarial factors to be used are those in effect at the date of creation of the tenancy.\textsuperscript{408}

With respect to a joint interest where any amount was treated as being received from the decedent as a gift to a noncitizen spouse before July 14, 1988, it is treated as consideration furnished by such donee spouse for purposes of applying §2040(a) (upon the death of the contributing spouse).\textsuperscript{409}

(2) Termination of Spousal Joint Tenancy in Real Property

Generally, upon the termination of a joint tenancy in real property, other than by reason of the death of one of the joint tenants, a spouse is treated as having made a taxable gift to the extent that the portion of the total consideration furnished by such spouse, multiplied by the proceeds from the termination, exceeds the value of such proceeds received by such spouse.\textsuperscript{410}

With respect to joint tenancies in real property created prior to January 1, 1982, or after July 13, 1988, where the creation of the tenancy was not treated as a gift from the contributing spouse to the noncontributing spouse, there will be a gift to the extent that the noncontributing spouse receives an amount greater than the proceeds of the termination (that is, the value of the property at the date of

\textsuperscript{407} Regs. §§ 25.2515-2(b)(2) and (c).

\textsuperscript{408} Id.

\textsuperscript{409} See Section II.B., above.

\textsuperscript{410} §2515(b) of the 1954 Code. Regs. §25.2523(i)-2(b)(2).
termination) multiplied by the percentage of the consideration the noncontributing spouse provided in the purchase or improvement of the property.\textsuperscript{411/} Thus, if one spouse provided all the consideration for the purchase of the joint tenancy property, that spouse will be treated as having made a gift to the extent that the noncontributing spouse receives any proceeds upon termination.\textsuperscript{412/} Any amount received by a noncitizen spouse in excess of that spouse’s portion of the proceeds will be a gift by the other spouse against which the $100,000 annual exclusion will be applied.\textsuperscript{413/}

If a joint tenancy was created after December 31, 1981, and before July 14, 1988, or if the election under §2515(c) of the 1954 Code was made with respect to the creation of the joint tenancy prior to January 1, 1982, then the determination of the interest of the noncontributing spouse is dependent on local law.\textsuperscript{414/} Where under local law the interests of the joint tenants were unilaterally severable, then each of the joint tenants is treated as having provided one-half of the consideration for the purchase of the joint tenancy property; therefore the receipt by either of them of more than one-half of the proceeds on termination will be a taxable gift by the other joint tenant.\textsuperscript{415/} On the other hand, where the interests of the joint tenants are not unilaterally severable, the interests of the joint tenants in the property is determined using actuarial factors based on the respective ages of the joint tenants at the date of the severance.\textsuperscript{416/} Amounts received on termination of the joint tenancy in excess of their actuarial interest in the property (as determined at the time of termination of the tenancy) will be a gift by the other spouse.

\textsuperscript{411/} Regs. §25.2515-3(a).

\textsuperscript{412/} Id.

\textsuperscript{413/} See Regs. §25.2523(i)-2(b)(2)(i).

\textsuperscript{414/} See Regs. §§25.2523(i)-2(b)(2)(ii); 25.2515-2.

\textsuperscript{415/} Regs. §25.2515-3.

\textsuperscript{416/} Regs. §25.2515-4(b).
b. **Personal Property--General Rule**

(1) **Gift at Creation of Joint Tenancy in Personal Property**

Subject to the special rules described in Section IX.B.3.a., below, the creation of a joint tenancy in personal property after December 31, 1953 is treated as a gift.

With respect to joint tenancies in personal property created prior to January 1, 1977, if the tenancy can be severed unilaterally by either tenant, there was a gift to the extent that the amount contributed by one of the spouses exceeds one-half the value of the property. Where no such unilateral severance is possible, the size of the gift was based on the excess of the consideration furnished over the actuarial value of the interest retained by the donor contributing spouse.

The value of the gift for joint tenancies created in personal property after December 31, 1976, and prior to January 1, 1982, is governed by §2515A of the 1954 Code, and is treated as a gift by the contributor spouse of one-half of the consideration furnished by that spouse. Thus, if each spouse contributes one-half of the consideration, no gift will occur at the creation of the joint tenancy. This rule for post-1976 gifts applies regardless of whether the interest is unilaterally severable, since §2515A(b) of the 1954 Code eliminated the need for actuarial computations except where values could not be reasonably ascertained without reference to the respective ages of the spouses. With respect to such tenancies created after December 31, 1981, the availability of the unlimited Federal gift tax marital deduction eliminated any adverse gift tax effects.

Under the regulations, in the case of the creation (either by one spouse alone or by both spouses where at least one of the spouses is not a U.S. citizen) of a spousal joint tenancy in personal property, or additions to the value thereof in the

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417 SeeRegs. §25.2511-1(h)(5).

418 §2515A(a) of the 1954 Code.
form of improvements, reductions in the indebtedness thereof, or otherwise, the retained interest of each spouse, solely for purposes of determining whether there has been a gift by the donor to the spouse who is not a U.S. citizen at the time of the gift, is treated as one-half the value of the joint interest.419

The “half-half” rule does not apply with respect to any joint interest in property if the fair market value of the interest in property (determined as if each spouse had a right to sever) cannot reasonably be ascertained except by reference to the life expectancy of one or both spouses. In these cases, the determination of the gift tax consequences of the transaction may require use of actuarial principles.420

3. Effect of Termination of Joint Tenancy in Personal Property

Section 2515A of the 1954 Code contains no provisions for determining the Federal gift tax effects of a termination of a joint tenancy in personal property. Some commentators have concluded that the regulations under §2515 of the 1954 Code apply.421 The IRS has taken this point of view on at least one occasion.422 If the IRS applies the §2515 regulations, then, where the interests of the tenants are severable under state law, there should be no gift upon the termination of the tenancy if the proceeds are divided evenly, regardless of the actual consideration furnished by the respective spouses. If, however, the interests of the spouses were not unilaterally severable under state law, there will be a gift to the extent that the proceeds received by one joint tenant are less than the actuarial value (determined at the time of termination) of his or her interest in the proceeds.

419 Regs. §25.2523(i)-2(c).

420 Regs. §25.2523(i)-2(c)(2).


422 See PLR 7941046 (July 13, 1979).
a. Special Rules for Certain Types of Personal Property

(1) Joint Bank Accounts

The creation of joint bank accounts, where each spouse has the opportunity to withdraw funds without an obligation to repay such amounts does not result in a taxable gift upon the creation of the joint tenancy.\textsuperscript{423} The IRS has examined this issue several times, reaching different conclusions.\textsuperscript{424} Under the rules relating to the Federal gift tax effects of the creation and termination of joint tenancies in personal property, there will be a gift at the termination of the account or at the time of a withdrawal from the account to the extent that either spouse receives a greater portion of the account balance than he or she contributed and there is no legal obligation to make a payment to the contributor spouse.

(2) Joint Brokerage Accounts

This same rule applies with respect to certain joint brokerage accounts, where the account assets are held in the name of a nominee. Where, under the terms of the brokerage account agreement, each spouse can withdraw property held in the account unilaterally, and each spouse can direct the nominee to sell securities in the account and turn over the proceeds to either joint owner in his individual capacity, there is no gift upon the creation of the account.\textsuperscript{425} There is a gift, however, where one spouse withdraws amounts in excess of that spouse’s contributions.

\textsuperscript{423} See Regs. \S 25.2511-1(h)(4).

\textsuperscript{424} Compare GCMs 36647 (March 23, 1976) (concluding that, under New York law, the creation of a joint bank account gives rise to a gift to the noncontributing spouse to the extent of one-half the value of the property contributed), GCM 37310 (November 2, 1977) (revoking GCM 36647, and holding that, under New York law, no gift occurs until the noncontributing spouse withdraws property from the account with no obligation to repay), and GCM 37869 (February 27, 1979) (proposing to revoke GCM 37310 and reinstate GCM 36647, but closing the project without opinion).

\textsuperscript{425} See \textit{e.g.}, PLR 9151044 (September 26, 1991).
to the account and the spouse has no legal obligation to make a repayment to the contributor spouse. There is also a gift upon termination of the account, after the death of one of the spouses, where one of the spouses receives a proportion of the proceeds in excess of that spouse’s contribution to the account and there is no legal obligation on the spouse to make a repayment to the contributor spouse. Where securities are held in nominee form and not in the special type of account described above, or if they are held certificated form, rather than in nominee name, the general rule with respect to personal property will be applied.

X. EFFECT OF CHANGES IN THE FEDERAL GIFT AND ESTATE TAX MARITAL DEDUCTION ON EXISTING UNITED STATES TAX TREATIES

A. Existing U.S. Transfer Tax Treaties

The U.S. currently has bilateral transfer tax treaties in effect with 16 countries: Australia, Austria, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, Sweden, South Africa, Switzerland, and the United Kingdom. In addition, protocols to the U.S.-Canada income tax treaty contain provisions governing the imposition of transborder death taxes. Generally, the purpose of these treaties is to prevent or minimize the double taxation of lifetime transfers and transfers at death by domiciliaries of the two contracting states. This is usually accomplished either by giving one country priority in taxing the property deemed by the treaty to be located in that country or by giving one country priority to tax the estate or the gifts of an individual, based on a determination of the decedent’s or the donor’s fiscal domicile. Where application of the treaty gives rise to the imposition of a tax in both contracting states, a credit mechanism is usually adopted to minimize the burden of the double tax.

The imposition of taxes under more recent U.S. bilateral transfer tax treaties, such as the Danish and the Swedish estate and gift tax treaties, is also often limited by “nondiscrimination” provisions. These provisions typically require that the U.S. refrain from imposing different or more burdensome taxes on treaty-country citizens than those imposed on U.S. citizens. For instance, the estate and gift tax treaty with Denmark provides:


427 Regs. §25.2511-1(h)(5).
Citizens of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which citizens of that other state in the same circumstances are or may be subjected.\textsuperscript{428}

Some of the transfer tax treaties provide a marital deduction against the U.S. estate tax imposed on property passing from a decedent spouse who is not domiciled in the U.S.

For example, the French estate and gift tax treaty provides that “[i]n the case of an individual who was domiciled in France there shall, for purposes of determining the United States tax, be allowed the same marital deduction in effect on” November 24, 1978 (the effective date of the treaty).\textsuperscript{429} The available marital deduction is thus limited to the greater of $250,000 or 50% of the decedent’s adjusted gross estate, and the QTIP election is not available.\textsuperscript{430}

The transfer tax treaty with Germany, prior to the negotiation of the 1999 Protocol, discussed below, provided that transfers of certain types of noncommunity property to a spouse by a citizen or domiciliary of one contracting state may be subject to tax by the other state only to the extent that the value of the property passing to the spouse exceeds 50% of the total value of the property subject to the tax in that other state.\textsuperscript{431} Also, Article 10(1) of the Netherlands estate and gift tax treaty provides the same marital deduction contained in the German treaty, but it is only available for property owned by a decedent who is a Dutch domiciliary or citizen under the treaty, which passes to the decedent’s spouse and is subject to the U.S. estate tax.

Thus, where under the treaty, a decedent is domiciled in or a citizen of the Netherlands, the U.S. estate tax will be imposed on bequests of U.S.-situs property to the surviving spouse only to the extent that such bequests exceed 50% of the property’s value.

\textsuperscript{428}  Article 11(1) of the Denmark estate and gift tax treaty. See also Article 10(1)(a) of the United Kingdom estate and gift tax treaty.

\textsuperscript{429}  Article 11(2) of the French estate and gift tax treaty. A Protocol to the treaty, discussed below, was signed in December 2004.

\textsuperscript{430}  See §2056(c) of the 1954 Code, repealed by §403(a)(1)(A) of ERTA.

\textsuperscript{431}  Article 10(4) of the Germany estate and gift tax treaty. See PLR 9411023 (December 16, 1993), discussing the marital deduction provisions of the Germany-U.S. treaty.
of the value of the property subject to U.S. estate tax. Similarly, Article 8(8) of
the Swedish estate and gift tax treaty provides that the U.S. estate tax imposed on
noncommunity property transferred by a Swedish domiciliary to his or her
surviving spouse shall be included in the U.S. estate tax base but only to the
extent that the value of such property exceeds 50% of the value of the property
subject to U.S. estate tax.

Under the United Kingdom treaty, property passing from a domiciliary or national
of the United Kingdom which is subject to U.S. tax qualifies for the U.S. marital
deduction to the extent that a marital deduction would have been allowable if the
decedent had been a U.S. domiciliary and the gross estate had been limited to the
property subject to U.S. tax.\textsuperscript{432} Likewise, where the donor or decedent is a U.S.
domiciliary or national, transfers to a spouse that are subject to tax in the United
Kingdom are entitled to an exemption equal to 50% of the value of the property
transferred, provided that (1) the recipient spouse is not domiciled in the United
Kingdom and (2) the transfer would have been eligible for the United Kingdom
marital deduction had the spouse been domiciled there.\textsuperscript{433}

Under the Danish estate and gift tax treaty, property which passes from a decedent
who, under the treaty, is domiciled in Denmark qualifies for the U.S. marital
deduction in computing the Federal estate tax liability on the U.S.-situs prop-
erty.\textsuperscript{434} Likewise, if the surviving spouse elects, U.S. decedents are entitled to
compute their Danish death taxes under the provisions of the Danish law
regulating matrimonial rights that are applicable to such property.\textsuperscript{435}

The legislative history of OBRA 1989 notes that where there is a conflict between
a later statute and an earlier treaty provision, the statute prevails, even absent an
explicit statement of congressional intent to override the treaty provision.\textsuperscript{436}
Therefore, except as provided by the three-year rule described in Section X.B.3.,
below, the changes to the marital deduction provisions enacted in TAMRA and
OBRA 1989 will override conflicting provisions of earlier treaties.

\textsuperscript{432} Article 8(2) of the United Kingdom estate and gift tax treaty.

\textsuperscript{433} Id., at Article 8(3).

\textsuperscript{434} Article 9(2)(a) of the Danish estate and gift tax treaty.

\textsuperscript{435} Article 9(2)(b) of the Danish estate tax treaty.

(1988).


The legislative history of TAMRA states the conclusion of Congress that the TAMRA provisions do not violate any provision of an existing U.S. treaty, including any nondiscrimination provisions. This is so, because the nondiscrimination provisions are triggered only where the tax treatment imposed by one contracting state on a domiciliary of the other contracting state is more burdensome than the treatment imposed by that state on a domiciliary of that state. The changes to the marital deduction are based on the citizenship of the donor’s or the decedent’s spouse; therefore, since the tax is imposed without regard to the decedent’s nationality, there is no discrimination. Further, as the 1988 House Report points out, the nondiscrimination provisions would not apply even if the treaty focused on the citizenship of the transferee spouse since beneficiaries who are U.S. citizens (and are thus subject to Federal estate tax on their worldwide assets) are not similarly situated to noncitizen beneficiaries (who are subject to Federal estate tax only on their United States situs assets).

2. Effect of Marital Deduction Changes on Property Passing from Nonresident Aliens

Section 7815(d)(14) of OBRA 1989 provides that in the case of the estate of, or a gift by, a nonresident alien who was a resident of a country with which the U.S. has a tax treaty with respect to estate, gift, or inheritance taxes, the TAMRA amendments, as amended by OBRA 1989, shall not apply -- and thus, the treaty provisions continue to apply -- to the extent the legislative changes would be inconsistent with the provisions of any such treaty relating to the estate, gift, or inheritance marital deduction.

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438/ Id.

439/ Id. Compare the nondiscrimination provision of the Swedish estate tax treaty, which states that “for purposes of United States taxation, United States citizens who are not residents of the United States are not in the same circumstances as citizens of Sweden who are not residents of the United States. . . .” Article 10(1)(a) of the Swedish estate and gift tax treaty.
Citing the French and German treaties, the 1989 House Report states that those treaties were negotiated on the assumption that property passing to a surviving spouse from a nonresident alien donor or decedent did not, but for the treaty provisions, qualify for the marital deduction, and that with respect to bequests by nonresident aliens to noncitizen surviving spouses, TAMRA did not change that assumption. Therefore, there is no conflict between the treaty provisions and the amendments, and the treaty provisions should continue to apply. The legislative history concludes that with respect to property passing from nonresident aliens domiciled in a treaty country, the TAMRA amendments to the marital deduction should not apply to the extent inconsistent with the treaty provision.\footnote{1989 House Report, at p. 1435.}

Query whether a determination that the provisions of TAMRA, as amended, do not apply by virtue of the treaty override provisions of §7815(d)(14) of OBRA 1989 renders the provisions of TAMRA, as amended, that are beneficial to nonresident aliens with noncitizen spouses (e.g., the allowance of the gift tax marital deduction provided under §2523(a) of the Code and the $100,000 annual exclusion for gifts to noncitizen spouses under §2523(i)(2) of the Code) unavailable? Note that the final regulations take the position that where both a treaty marital deduction and the QDOT provisions are available to provide the estate with a marital deduction, the estate must choose either, but not both procedures.\footnote{Regs. §20.2056A-1(c). See also PLR 9521031.}

3. **Effect of Marital Deduction Changes on Property Passing from United States Persons**

The result of the above analysis is different with respect to U.S. donors and decedents. The denial of the marital deduction for property passing from a U.S. person to a noncitizen spouse is inconsistent with the assumptions on which such treaties were negotiated. Because conflicts between treaty provisions and subsequent statutes are to be resolved in favor of the statutes, the legislative history states Congress’ conclusion that this change in U.S. internal laws should not “be frustrated by treaty provisions that when adopted provided a marital deduction no better than that available under U.S. internal law.”\footnote{1989 House Report, at p. 1435.} However, in order to provide the Treasury with time to renegotiate treaties where such conflicts exist, the 1988 repeal
of the marital deduction with respect to property passing from a U.S. person to a noncitizen spouse does not apply to override a treaty provision until December 19, 1992, the date three years after the date of enactment of OBRA 1989.

4. Application of Treaties and QDOT Requirements

a. Decedent is a U.S. Citizen or Resident

Where, under a treaty, a decedent with a noncitizen surviving spouse is determined to be a U.S. citizen or resident, it seems clear, subject to the three-year rule discussed below, that property passing to the surviving spouse must be transferred to or irrevocably assigned to a QDOT. This is so, since the changes to the U.S. marital deduction are inconsistent with the assumptions on which these tax treaties are based, and in case of such conflict, the provisions of the new legislation will be applied. However, as noted above, the treaty provisions will continue to be applied until December 19, 1992, the date three years after enactment of OBRA 1989.

b. Decedent is a Foreign Domiciliary

If, however, the decedent is determined to be a nonresident alien with respect to the U.S. estate tax, but has property deemed to be U.S.-situs property under the treaty (as would normally be the case with U.S. business property or U.S. real property), the marital deduction provisions of the treaty would control. Therefore, if the decedent is domiciled in Denmark, the full value of property passing to the surviving spouse will qualify for the Federal estate tax marital deduction on the same terms as it would if the decedent were a U.S. citizen. If under the applicable treaty the decedent is domiciled in Germany, Sweden, or the Netherlands, then only 50% of the U.S.-situs property would qualify for the Federal estate tax marital deduction. Likewise, if the decedent is domiciled in France, the decedent’s estate would be entitled to Federal estate tax marital deduction of the greater of $250,000 or one-half of the value of the U.S.-situs property, and no QTIP election would be available. Under the United Kingdom treaty, U.S.-situs property shall qualify for the U.S. marital deduction to the extent that a marital deduction would have been allowed had the decedent

443\ See PLR 9411023 (December 16, 1993).
spouse been a U.S. citizen; therefore, if the surviving spouse is not a U.S. citizen, the decedent would have to transfer assets to a QDOT in order to qualify for the marital deduction.

c. Recent Trends in Treaty-Based Marital Deductions

Negotiations have produced protocols to the U.S.-Canada income tax treaty, U.S.-German estate and gift tax treaty, and the U.S.-France estate and gift tax treaty that provide limited relief against the hardship caused by the elimination of the Federal estate tax marital deduction. Under Article 19 of the Revised Protocol to the U.S.-Canadian income tax treaty,\textsuperscript{444} relief from the marital deduction limitations is provided in two ways. First, the estate is given a unified credit against U.S. estate tax, in an amount bearing the same ratio to the maximum available unified credit as the total value of the gross estate issued in the U.S. bears to the total gross estate.\textsuperscript{445} In addition, the treaty, as amended by the Revised Protocol, also allows a “marital credit,” equal to the lesser of (i) the unified credit allowed to the decedent’s estate and (ii) the amount of the U.S. estate tax (exclusive of state death taxes) that would otherwise be imposed by the U.S. on the marital deduction property (based in the assumption that no QDOT election were made).\textsuperscript{446} In order to claim the “marital” unified credit, the estate must irrevocably waive the right to make the QTIP and QDOT elections.\textsuperscript{447}

The protocol to the U.S.-German Estate and Gift Tax Treaty\textsuperscript{448} adopts a similar approach. In addition to providing the estate of decedent domiciled in Germany with a pro rata portion of the unified credit, determined by reference to the portion of the estate


\textsuperscript{445} Article XXIX B(2).

\textsuperscript{446} Article XXIX B(3) and (4).

\textsuperscript{447} This is similar to the rule of Regs. §20.2056A-1(c), requiring the estate to elect either the treaty marital deduction or the QDOT provisions.

\textsuperscript{448} Protocol to the Convention Between the United States and Germany For the Avoidance of Double Taxation With Respect to Taxes on Estates, Inheritances, and Gifts (1999).
located in the U.S.,\footnote{Protocol, Article 3.} the 50\% marital deduction provided under the prior treaty is revised. Specifically, the estate is allowed to elect a marital deduction equal to the lesser of the value of property passing to the spouse that would have qualified for the Federal estate tax marital deduction under U.S. domestic law if the surviving spouse were a U.S. citizen and all applicable elections (e.g., QTIP election) had been made and (ii) the decedent’s unified credit exclusion amount.\footnote{Id.} A Protocol to the United States-France Estate and Gift Tax Treaty incorporates similar changes.\footnote{Protocol Amending the Convention Between The United States and The French Republic For the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Estates, Inheritances, and Gifts (2004).} In addition, the Protocol to the French treaty allows for the exclusion from the U.S. gross estate 50\% of noncommunity property of the estate of a French domiciliary taxable by the United States solely on the basis of situs (e.g., U.S. real estate).\footnote{Id., amending Article 11, Paragraph 2 of the Treaty.}

\section{XI. EFFECTIVE DATE PROVISIONS}

\subsection*{A. Effective Dates of Statutory Provisions}

The general rule disallowing the marital deduction applies to the estates of decedents dying after November 10, 1988.\footnote{\$5033(d) of TAMRA.} However, the marital deduction will be available if the surviving spouse becomes a U.S. citizen after the death of decedent spouse and prior to the date on which the decedent spouse’s Federal estate return is made, if the surviving spouse was a resident of the U.S. at the date of death of the decedent spouse and at all times thereafter until attaining U.S. citizenship.\footnote{See \$2056(d)(5); Regs. \$20.2056A-1(b).}

\begin{enumerate}
\item \textbf{Transitional Rules.}

TAMRA did not include any grandfathering provisions or transitional rules for application of §§2056(d) and 2056A. However, the legislative
history to OBRA 1989 clarified that a surviving spouse or the decedent’s executor could create a QDOT after the death of the decedent spouse. In addition, OBRA 1989 allows the decedent’s executor to initiate reformation proceedings to amend a trust so as to qualify as a QDOT. But the ability to reform a trust to ensure its qualification as a QDOT may be dependent on local law and the terms of the governing instrument, and relief may not be available. Further, the reformation provisions would not appear to provide relief where the marital bequest is in a form which (i) would not have met the requirements for the marital deduction, other than the QDOT provisions or (ii) which is an outright bequest to the noncitizen spouse, because the provision is stated in terms of changing “such trust.” However, if the noncitizen surviving spouse has received the property outright (whether as probate or nonprobate property), presumably he or she could create a QDOT to which a timely transfer of the property could be made.

2. Irrevocable Trusts.

Under this statute, no relief is available for persons who created irrevocable trusts prior to the enactment of the marital deduction amendments. If these trusts are includible in the decedent’s estate, the absence of any transitional relief may subject them to the QDOT requirements and potential Federal estate tax many years after their execution.

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455 See §2056(d)(4); Regs. §20.2056A-4(a).

456 §2056(d)(5)(A)(ii).

457 In PLR 9017015 (April 27, 1990), the decedent bequeathed one-half of his estate outright to his surviving spouse, who was not a U.S. citizen. Rather than having the executor create a trust that qualified as a QDOT, the executor petitioned the local probate court and obtained a reformation of the will itself. As reformed, the bequest to the noncitizen spouse was instead made to a testamentary trust created under the will that qualified for the marital deduction under §2056A(a). As of the due date of the decedent spouse’s estate tax return, the bequest to the surviving spouse met the requirements of §§2056(d)(2) and 2056A(a). Therefore, the marital deduction was allowed. It should be noted that this request was filed prior to enactment of OBRA 1989, although the Service’s analysis describes the provisions of §§2056 and 2056A as if the OBRA 1989 legislation were enacted at the time of the ruling request.
B. Effective Date Provisions for Final Regulations.

1. General Effective Date Provisions for QDOT Regulations.

The final regulations are effective with respect to estates of decedents dying after August 22, 1995.\(^{458}\) Presumably, with respect to estates of decedents dying on or before such date, taxpayers may rely on any reasonable interpretation of the statutory provisions.\(^{459}\) In fact, the Service has ruled that a QDOT created in 1992, prior to the issuance of any regulations or other guidance, the terms of which met the statutory requirements of §2056A(a), “is not required, ..., to meet the requirements of section 20.2056-1 through 13 of the estate tax regulations.”\(^{460}\)

2. Effective Date Provisions Regarding Payment of the QDOT Tax

Transition rules for reporting and paying the QDOT Tax imposed under §2056A(b)(1) are contained in Announcement 90-39,\(^{461}\) and Announcement 91-58.\(^{462}\) Announcement 90-39 provided that the due date for any QDOT Tax otherwise due on April 15, 1990 was extended indefinitely, due to the unavailability of Form 706-QDT. Following the release of the Form 706-QDT, the Service released Announcement 91-58, which provided that the reporting date for taxable events occurring after November 10, 1988, and before January 1, 1991, would be September 16, 1991. For taxable events in years beginning after December 31, 1990, Form 706-QDT is due by April 15 of the year following the year in which the taxable event occurred.

\(^{458}\) Regs. §20.2056A-13(a).


\(^{460}\) PLR 9826028


a. General Rule

There are special effective date rules governing application of the Security Requirements for collection of the QDOT Tax. Generally the regulations are effective for estates of decedents dying after February 19, 1996, the effective date of the temporary and proposed regulations. The rules do provide some relief from the extensive governing instrument requirements included in the special provisions for the collection of the QDOT Tax in the case of incompetency and irrevocability.

b. Incompetency

A revocable trust or a testamentary trust is deemed to meet the governing instrument requirements of the Security Requirements notwithstanding that all provisions are not contained in the governing instrument, if the trust instrument (or will) was executed on or before November 20, 1995, and:

1. The testator or settler dies after February 19, 1996;
2. The testator or settlor is, on November 20, 1995, and at all times thereafter, under a legal disability to amend the will or trust instrument;
3. The will or trust instrument does not provide the executor or the U.S. Trustee with a power to amend the instrument in order to meet the requirements of §2056A; and
4. The U.S. Trustee provides a written statement with the decedent spouse’s Federal estate tax return that the trust is being administered (or will be administered) so as to be in actual compliance with the requirements of Regs. §20.2056A-2(d) and will continue to be administered so as to be in actual compliance for the duration of the trust. This statement must be binding on all successor trustees.

Regs. §20.2056A-2(d)(6)(ii). The effective date was 180 days after issuance of these regulations.
c. **Irrevocable Trusts**

An irrevocable trust is deemed to meet the governing instrument requirements ofRegs. §20.2056A-2(d) notwithstanding that all required provisions are not contained in the governing instrument if the trust was executed on or before November 20, 1995, and:

1. The settlor dies after February 19, 1996;
2. The trust instrument does not provide the U.S. Trustee with a power to amend the trust instrument in order to meet the requirements of §2056A; and
3. The U.S. Trustee provides a written statement with the decedent spouse’s Federal estate tax return that the trust is being administered in actual compliance with the requirements ofRegs. §20.2056A-2(d) and will continue to be so administered, for the duration of the trust. This statement must be binding on all successor trustees.\(^{465}\)

C. **Effective Dates of Gift Tax Provisions**

The regulations implementing the provisions of §2523(i), disallowing the marital deduction for interspousal transfers where the donee spouse is not a U.S. citizen, and the gift tax effects of the creation and termination (other than by death) of spousal joint tenancies, are effective in the case of gifts made after August 22, 1995.\(^{466}\) Presumably, any reasonable interpretation of the statutory provisions is allowed with respect to gifts made prior to the publication of final regulations.


\(^{466}\) Regs. §25.2523(i)-3.
XII. PLANNING FOR THE MARITAL DEDUCTION FOR NONCITIZEN SPOUSES

A. Lifetime Planning

1. Domicile Planning

It may be beneficial for persons who are not citizens but who have significant U.S.-situs property (and who do not have significant non-U.S. situs property) to take steps to establish U.S. domicile. Although by doing so they subject their worldwide estate to U.S. estate tax, they will be entitled to a full unified credit, rather than the $13,000 credit available to nonresident aliens.\textsuperscript{467} Obviously, the desirability of establishing U.S. domicile must be determined on a case-by-case basis.

Domicile is established, for Federal estate tax purposes, by establishing physical presence in a place without the present intention of moving from that place.\textsuperscript{468} The subjective aspect of domicile, that dealing with the intention to move, is based on an examination of all circumstances. The Service will examine the duration of the individual’s stay in the U.S., the location of family and friends and important personal belongings, the center of the person’s financial and business interests, and the size and location of the person’s home.\textsuperscript{469}

Although there are practical limits on the extent to which some of these features can be beneficially arranged, certain steps can be taken to increase the likelihood that the person will be treated as a U.S. domiciliary. For example, foreign bank accounts can be closed and the proceeds placed in a U.S. bank. If the person maintains homes both in the U.S. and in his home country, tangible property and other special personal items should be kept in the U.S. home. Revised U.S. wills, powers of attorney, advance medical directives, and other estate planning documents, each declaring that the individual is a U.S. domiciliary, should also be prepared and executed. In addition, the execution of an affidavit of U.S. residency, although arguably self-serving, could help demonstrate the intent of the individual to be treated as a U.S. domiciliary.

\textsuperscript{467} Compare §§2010(a) and 2102(c).

\textsuperscript{468} Regs. §20.0-1(b)(1).

2. Unified Credit Planning

a. General Planning Considerations

The limitation on the availability of the marital deduction for transfers to noncitizen spouses does not alter the need for each spouse to have sufficient property in his or her own name before a spouse dies in order to utilize both spouse’s respective unified credits. (This is less of a problem in community property states if there are sufficient community assets.) This planning requirement remains critical where one or both of the spouses is a not a U.S. citizen. Where both spouses are U.S. citizens, the process of rearranging the couple’s assets, whether by outright gifts between spouses or by severance of jointly owned property, is relatively simple, since the unlimited marital deduction eliminates any adverse Federal estate tax consequences. However, the elimination of the unlimited Federal gift tax marital deduction for transfers to noncitizen spouses, its replacement with a $100,000 annual exclusion for such gift transfers, the reenactment of the rules of §§2515 and 2515A of the 1954 Code, and the uncertainty surrounding the law as to the amount of a gift when an old joint tenancy is severed, require careful planning in rearranging the couple’s assets.

b. Planning for Larger Estates

Where the spouses’ combined assets are less than or equal to the spouses combined available exemption equivalents of their unified credits, the estates of the two spouses should, from a tax prospective, generally be equalized. However, when the combined assets exceed this amount, it may be beneficial to rearrange the spouses’ assets so that the noncitizen spouse has more than one-half of the property.

The more assets that the noncitizen spouse holds in his or her sole name, the less that will have to be placed in a QDOT at the death of the citizen spouse. Further, if the noncitizen spouse expects to leave the U.S. after the death of the first spouse to die, less property will be subject to the QDOT Tax. Also, if the noncitizen spouse remains in the U.S., his or her estate will be able to take advantage of the unified credit and graduated Federal estate tax brackets. Finally, if the other spouse is a U.S. citizen, the noncitizen spouse can freely transfer assets to him or her through the unlimited marital deduction (without the use of a QDOT), if
necessary, during life or at death without the imposition of the Federal gift tax.\footnote{470}

c. **Generation-Skipping Transfer Tax Considerations**

Where the spouses have combined assets in excess of $7 million, it is important, if generation-skipping transfers may be involved in the estate plan, that each spouse have sufficient assets in his or her sole name before the first spouse dies to utilize the $3.5 million exemption from the GSTT.\footnote{471} By doing so, the uncertainties created by the QDOT provisions regarding the identity of the transferor for purposes of allocating the generation-skipping transfer exemption\footnote{472} are minimized, and multigenerational transfers of property can be protected.

d. **Lifetime Gift-Splitting**

Often, the spouse holding the greater amount of assets is reluctant to make outright gifts of property to the noncitizen spouse. However, the noncitizen spouse’s unified credit and GSTT exemption can still be utilized through inter vivos gift-splitting by the spouses. If the spouse with the greater amount of assets is willing to make significant inter vivos gifts to third persons, such as the children and grandchildren of the marriage, the spouses can elect under §2513 to have the gifts treated as being made one-half by each spouse, thereby utilizing the noncitizen spouse’s unified credit and Federal estate tax brackets. In addition, if the gift is made to children in trust or to grandchildren, the $3.5 million generation-skipping transfer exemption of the noncitizen spouse can also be allocated to one-half of these gifts. However, unless a gift tax treaty provides to the contrary, gift splitting is not available where one of the spouses is a nonresident alien for gift tax purposes.\footnote{473}

\footnote{470} See PLR 9309023 (December 3, 1992) discussing the tax effects of an inter vivos QTIP trust created by a noncitizen spouse for the benefit of her citizen spouse, the terms of which included a QDOT for the benefit of the donor spouse if the donor spouse survived the donee spouse.

\footnote{471} See §2631(a).

\footnote{472} See Section VIII.E., above.

\footnote{473} §2513(a) (first sentence).
Special Considerations Where First Spouse to Die is U.S. Citizen or Resident

Notwithstanding the various asset strategies discussed above, when one of the spouses is a U.S. citizen or resident who plans to remain in the U.S. and if the other, noncitizen spouse plans to remain in the U.S., it may be beneficial to have more, rather than less, assets held in the QDOT if the spouse who is a citizen or resident of the U.S. dies first. Because the QDOT Tax is a tax imposed upon the estate of the first spouse to die, more property held in the QDOT will allow for a greater use of the first spouse’s Federal estate tax brackets.

When both spouses are U.S. citizens, the unified credit and Federal estate tax brackets can only be utilized when there is a Federal estate tax paid at the death of the first spouse to die. Therefore the QDOT Tax presents an opportunity to use these brackets with the imposition of a tax upon a taxable event. However, in order for this strategy to be effective, the noncitizen surviving spouse must have sufficient assets in his sole name so as to utilize his unified credit and Federal estate brackets. In community property states, this is less of a problem since the surviving spouse will own his share of the community property assets. Further, the surviving spouse must not intend to leave the U.S. after the death of the citizen spouse.

Calculations must be performed to determine whether holding a larger amount of assets in the QDOT is advantageous after taking into account the fact that the QDOT may also be taxed in both estates with an offsetting §2013 credit, which may only be a partial offset due to the state death tax credit in the surviving spouse’s estate. If the first spouse’s unified credit was used against the QDOT rather than against a trust that will not be includible in the estate of the surviving spouse (such as a credit shelter trust), the first spouse’s unified credit will probably be wasted. This is so because while the property will be taxed in the surviving spouse’s estate, there will effectively be no offsetting §2013 credit for tax on prior transfers with respect to that property because the first spouse paid no tax with respect to such property.
f. Selecting Assets for Interspousal Transfers

In selecting assets to transfer to the noncitizen spouse, the estate planner must determine whether a QDOT would be particularly unsuited or impractical for certain assets. In particular, real estate and business interests that the noncitizen spouse may wish to retain control over rather than having to share control with U.S. Trustee, should be transferred to the noncitizen spouse prior to the death of the other spouse. Further, it may be desirable to transfer to the noncitizen spouse during his life foreign-situs property that cannot, under the laws of the situs country, be transferred to a trust or which may not be held by a U.S. Trustee\textsuperscript{474}. Similarly, the transfer of foreign real estate to the noncitizen spouse may allow a Small QDOT to comply with the Foreign Real Property Requirement of the QDOT Security Requirements.\textsuperscript{475}

3. Use of the Annual Exclusion

Only $100,000 of assets\textsuperscript{476} can annually be transferred to the noncitizen spouse. For gifts after June 29, 1989, these transfers must be in a form that otherwise qualifies for the marital deduction.\textsuperscript{477} The legislative history of the technical corrections provisions included in OBRA 1990 indicates that only $90,000 of the $100,000 annual exclusion gift needs to qualify for the marital deduction, but the entire $100,000 must be a present interest.\textsuperscript{478} Where the spouse with more property has significant sole name assets that can be easily divided and which can be accurately valued, such as traded securities or real estate, a program of annual $100,000 gifts to the noncitizen spouse is the easiest method by which sufficient sole

\textsuperscript{474} §2056A(c)(3) authorizes the IRS to issue rules governing alternative arrangements for holding assets located in jurisdictions where trusts are not recognized. See Section V.J., above. However no such relief has not yet been made available, and given the legislative history of the provision, it may be very narrow in scope.

\textsuperscript{475} See Section III.D., above.

\textsuperscript{476} As noted above, the amount of this annual exclusion is indexed for inflation. For transfers made in 2010, the exclusion is $134,000.

\textsuperscript{477} See §2523(i)(3), Regs. §25.2523(i)-1(c)(1) and §7815(d)(1) of OBRA 1989.

name property may be placed in the name of the noncitizen spouse. If the spouse then contributes these sole name assets to a joint brokerage account, the respective contributions of the spouses should be easily determinable.\(^{479}\) In order for transfers in trust to qualify, the trust must be in a form that (a) but for the TAMARA limitations, qualifies for the Federal gift tax marital deduction and (b) qualifies as a present interest under §2503(b).

A general power of appointment marital trust would appear to satisfy this requirement. However, the regulations indicate than an inter vivos QTIP trust for the benefit of the noncitizen spouse would not qualify since this trust does not, but for the provisions in §2523(i)(1), qualify for this gift tax marital deduction.\(^{480}\)

4. Qualified Transfers

Transfers which constitute “qualified transfers” for purposes of §2503(e) are not treated as transfers of property by gift. Such transfers include amounts paid on behalf of an individual which are either tuition payments made directly to the educational institution or payments made directly to the provider of medical care.\(^{481}\) Because there does not appear to be any restriction on the identity or citizenship of the individual on whose behalf such payments are made, such payments could be made for the benefit of the noncitizen spouse over and above the annual exclusion limitation.

5. Jointly Owned Property

a. General Considerations in Making Gifts of Jointly Owned Property

Often a large portion of the couple’s estate will be owned as joint tenants with right of survivorship or as tenants by the entireties. As discussed in Section IX.B., above, the termination of such joint tenancies may have adverse Federal gift tax consequences. In order to efficiently divide such assets, the estate planner must ascertain:

\(^{479}\) See e.g., PLR 9151044 (September 26, 1991).

\(^{480}\) See Regs. §25.2523(i)-1(d) (emphasis added).

\(^{481}\) See §2503(e)(2)(A) and (B). See also Regs. §25.2503-6.
1. What types of property are available to be divided? Real property, bank and brokerage accounts are property commonly titled jointly with right of survivorship. However, significant items of tangible personal property, such as artwork and antiques, may also be available.

2. When was such property purchased?

3. Did the couple elect to treat the creation of the tenancy as a gift?

4. Who provided the consideration for the original purchase of the property, and if it was purchased with joint tenancy assets, who provided the consideration for that joint property?

5. How conclusive is the evidence of such consideration, and could the taxpayer meet the burden of proof if challenged by the Service on the issue?

6. Who paid for improvements and the reduction of any indebtedness secured by the property, especially real estate?

In addition, the division of certain assets, especially the marital home, can have adverse consequences regarding probate, taxes, creditors’ rights, homestead exemptions and divorce and separation that must be explained to the clients when selecting assets for interspousal transfers. For instance, jointly owned property is not included in the probate estate and is therefore not subject to probate. However, the conversion of a joint tenancy to a tenancy in common will subject each spouse’s portion of such property to probate, unless it is transferred to a revocable trust prior to death. Also, conversion of jointly owned property to tenancy in common property removes the protection provided to certain joint tenants under state law against the creditors of only one joint tenant. Further, such divisions necessarily allow each tenant to dispose of his or her share of the property, and may cause such property to be treated as sole name property in a subsequent marital dissolution.

To the extent a portion of the marital home is held in a QDOT after the death of the decedent spouse, if the noncitizen surviving spouse sells the home, the $250,000 exclusion provided under §121(a) will be unavailable unless the surviving spouse is treated as the owner of the trust property.
under the grantor trust rules of §§671-678. As a practical matter, however, the effect of this depends on the appreciation between the death of the first spouse to die and the time of the sale, since, under current law, the portion of the home held in the QDOT will have received a step up (or down) in basis at the death of the first spouse.

Finally, couples may be reluctant, for purely psychological reasons, to sever a joint tenancy in certain assets, such as the marital home or securities accounts intended for use during retirement.

b. Severance of Joint Tenancies in Making Gifts to the Noncitizen Spouse

(1) Tracing Considerations

The need, in many cases, to trace the consideration used to purchase jointly owned property is perhaps the most onerous requirement of the marital deduction limitations. Because tracing has not been required in the past, records are often difficult to reconstruct. In addition, where the proceeds of one joint tenancy are rolled over into a new purchase also owned by the couple as joint tenants, one must examine the source of the consideration for the earlier purchase. Therefore, especially in the case of the marital home, the rules may effectively require tracing of consideration back to the beginning of the marriage. And while this task may be easier when one spouse was the sole income earner during the entire marriage, this is not usually the case.

To the extent that the spouses believe that they can demonstrate a division of the source of the consideration for jointly held property, be it through transactions in bank and brokerage accounts, inheritances, or earnings histories of the couple, records supporting this conclusion should be

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482 Grantor trust status may arise where the surviving spouse transferred the residence to the QDOT in accordance with the provisions of §2056(d)(2)(B) and is, therefore, treated as the transferor for all other tax purposes. See Regs. §20.2056A-4(b)(1). But see §672(f), which limits the application of the grantor trust rules in certain cases where the grantor is not a U.S. citizen or resident.

collected, and affidavits should be prepared accurately reflecting how the consideration was provided. In addition, accurate appraisals of the property to be gifted, especially where real estate or artwork is involved, can be critical for withstanding a later challenge by the Service.

(2) Filing Federal Gift Tax Returns

Although it appears that the filing of a Federal gift tax return will be unnecessary when the amount of annual gifts to a noncitizen spouse does not exceed $100,000,\textsuperscript{484} there may be situations where the taxpayer wishes to disclose the gift and file a return. This is especially true when the property that is the subject of the spousal gift is a severed interest in jointly held property and there remains some doubt as to exactly how much of the consideration was furnished by each spouse. Prior to TRA 1997, the filing of a Federal gift tax return started the running of the three-year statute of limitations.\textsuperscript{485} If the Federal gift tax return omitted items includible in the total gifts which exceeded 25% of the total amount of gifts stated in the return, the statute of limitations was six years.\textsuperscript{486} However, disclosure of the particular gift on the gift tax return was not required to commence the statute of limitations.

Under §2504(c), prior to TRA 1997 the running of the statute of limitations on a prior year’s gift barred revaluation of that gift for purposes of determining the gift tax assessed or payable for any subsequent period, but only if a gift tax was assessed or paid in such prior year. Thus, if the donor spouse filed a gift tax return and the amount of gift tax due was less than his available unified credit, the gift tax was not treated as having been paid for purposes of §2504(c). In this situation, while the IRS could not assess additional tax for the year of the gift after the statute of limitations had passed, it could increase the gift in determining the gift tax due on a transfer in a later year.

\textsuperscript{484} As indexed for inflation. See §6019(a) and instructions to Form 709.

\textsuperscript{485} §6501(a).

\textsuperscript{486} §6501(e)(2).
Where no Federal gift tax return was filed for the year of the transfer, the statute of limitations did not begin to run and the Federal gift tax could subsequently be imposed at any time.

Under TRA 1997\textsuperscript{487}, subject to the rule discussed in below, a post-August 5, 1997 gift for which the limitations period has passed cannot be revalued for purposes of determining the applicable gift and estate tax bracket and available unified credit even where the value of the gift as shown on the return does not result in any gift tax being assessed or owed (e.g., through use of the unified credit).\textsuperscript{488} In order to revalue a gift that has been adequately disclosed on a gift tax return, the IRS must issue a final notice of redetermination of value (a “final notice”) within the statute of limitations applicable to the gift for gift tax purposes (generally, three years).\textsuperscript{489}

However, this treatment is available only where the gift is adequately disclosed on the gift tax return. Thus, the statute of limitations will not run on an inadequately disclosed transfer made in calendar years ending after the date of enactment, regardless of whether a gift tax return was filed for other transfers in that same year. Regulations describe in detail the disclosure requirements.\textsuperscript{490} However, the filing of a return may “red-flag” the transfer for the Service.

6. Applying for United States Citizenship

One option that clearly avoids all the issues raised by TAMRA is for the noncitizen spouse to apply for and obtain U.S. citizenship. The process takes some time, and it is unlikely that it could be completed prior to filing

\textsuperscript{487} §506 of TRA 1997.

\textsuperscript{488} Technical correction legislation to TRA 1997 will likely clarify that this would be the case for gifts made after August 5, 1997 with respect to the value of prior gifts -- even though the prior gifts preceded August 6, 1997.

\textsuperscript{489} §§2504(c) and 6501(c)(9).

\textsuperscript{490} See Regs. §301.6501(c)-1(f), setting out the requirements for adequate disclosure of gifts.
the Federal estate tax return of the decedent spouse if not initiated prior to his death. However, the option of relinquishing citizenship of one’s country of origin is not, in many cases, a viable alternative, especially when suggested solely for tax purposes.

7. Retirement Plan Assets

Qualified retirement plan benefits present some of the challenging issues when planning for a noncitizen surviving spouse. The potential application of both income taxes and the QDOT Tax to payments from such plans, combined with the complexities surrounding qualification for the estate tax marital deduction of plan benefits payable to a trust, require careful analysis of the client’s priorities and the tax consequences. Available alternatives include designating a marital trust that also qualifies as a QDOT as the beneficiary of the plan benefits; designating the noncitizen spouse as the plan beneficiary and relying on her to roll over the plan assets into a QDOT that qualifies as an IRA; having the surviving spouse assign an inherited IRA to a QDOT; or leaving the plan benefits in a form that does not qualify for the marital deduction and paying estate tax at the first spouse’s death. In addition, where the benefits are not assignable (or, in the case of an IRA where the surviving spouse elects to treat the plan as nonassignable\(^{491}\)), the surviving spouse can avail herself of the Roll Over and Current Tax Methods of §20.2056A-4(c) in order to qualify the payment for the marital deduction.\(^{492}\) As with many aspects of estate planning for the noncitizen spouse, practical issues may dominate the decision-making process, including the desirability of the spousal rollover, the level of control the decedent spouse wishes to retain over plan payments, the size of the plan, the ability to find a qualified trustee who will also serve as an IRA custodian, and the likelihood that the surviving spouse will become a U.S. citizen.

\(^{491}\) See Regs. §20.2056A-4(c)(1).

\(^{492}\) For an excellent analysis of these alternatives, see Natalie Choate, *Life and Death Planning for Retirement Benefits* (4th Ed. 2002).
8. **Miscellaneous Planning Issues**

a. **Treaties**

As outlined in Section X, above, the planner must assess the effect of the provisions of any estate and gift tax treaty in existence with a client’s country of citizenship. The treaty may be important in determining whether the client and his or her spouse will be treated as citizens or nonresident aliens of the U.S. for purposes of the Federal estate tax. In addition, marital deduction provisions contained in those treaties may override the provisions of the Federal marital deduction.\(^{493}\) For example, the French estate tax treaty provides to a French domiciliary the marital deduction available on November 24, 1978. Therefore, a QTIP trust will not qualify as a marital deduction vehicle.

The final QDOT regulations also make clear that in the case of a decedent who is neither a U.S. resident nor citizen, where the QDOT provisions do not override the marital deduction provided under any such treaty, the estate may choose between the marital deduction provisions of the treaty and the marital deduction provisions of §§2056(d) and 2056A.\(^{494}\) Furthermore, the specific provisions of the protocols to the U.S.-Canada income tax treaty and the U.S.-Germany and U.S. France estate and gift tax treaties, discussed above, may obviate the need for a QDOT in certain cases.

b. **Life Insurance**

Except when the decedent-insured is a nonresident alien, proceeds of insurance policies on the life of the decedent over which the decedent retained incidents of ownership are included in his gross estate.\(^{495}\) And even though such proceeds are non-probate property, where the noncitizen surviving spouse is designated as the beneficiary, the proceeds will have to be transferred or assigned to a QDOT in order to qualify for the marital deduction.

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\(^{493}\) See OBRA §7815(d)(14).

\(^{494}\) See Regs. §20.2056A-1(c).

\(^{495}\) See §§2105(a) and 2042(a).
If, however, ownership of the insurance policy is transferred to the noncitizen spouse during the life of the insured spouse, and if the insured spouse lives for three years from the date of the transfer, the transfer of the proceeds to a QDOT will be unnecessary. On the other hand, if the insured transfers any incidents of ownership in a life insurance policy within three years of the insured’s death, the proceeds of the policy are included in the estate of the decedent.496

A gift of an existing insurance policy to the noncitizen spouse may be an effective use of the annual Federal gift tax exclusion, since the Federal gift tax value of such a transfer is the cost of a comparable contract from the issuer, or, if that is not readily ascertainable (as when the policy has been in force for some time and premiums remain to be paid), then the value of the policy for Federal gift tax purposes is the interpolated terminal reserve value of the policy (which approximates the policy’s cash value) plus a portion of the unearned premium.497 Future premium payments by the donor spouse/insured will be gifts to the noncitizen spouse, and will count against the annual exclusion. Of course, if the noncitizen spouse remains in the U.S., and if he or she still has the proceeds at death, then they will be included in his or her gross estate. Nevertheless, such a transfer eliminates the need to hold the proceeds in a QDOT.

Further, the inclusion of the proceeds in the surviving spouse’s estate could be avoided, regardless of whether he or she remains in the U.S., if the policy is transferred to an irrevocable life insurance trust rather than outright to the noncitizen spouse, and the transferor spouse lives three years from the date the policy is transferred.498 Such a trust should not, however, utilize the annual exclusion for gifts to the noncitizen spouse. That exclusion requires the spouse to have a nonterminable interest, thereby including the property in the donee spouse’s estate. Alternatively, the noncitizen spouse could apply for and purchase a policy of insurance on the life of the citizen spouse. If the noncitizen spouse uses his own assets to pay policy premiums, and if he is not viewed

496 See §2035(a)(2).

497 See Regs. §25.2512-6.

498 See §2035(a)(2).
as the agent of the insured, the application of the three-year rule should be avoidable.⁴⁹⁹ If the noncitizen spouse predeceases, he should bequeath the insurance policy to someone other than the insured, since the insured will have to again transfer the policy and live 3 years in order to avoid inclusion of the proceeds in his estate.⁵⁰⁰ If the insured spouse predeceases and the noncitizen spouse remains in the U.S., any portion of the policy proceeds not covered by the surviving spouse will be included in his estate.

If a noncitizen spouse does not want to have property held in a QDOT, and is willing to pay the additional Federal estate tax that will result at the death of the first spouse, the ownership of life insurance policy by the noncitizen spouse on the life the other spouse will provide the surviving spouse with a ready source of liquidity with which to pay the estate taxes arising at the death of the first spouse to die.

c. Charitable Trust Planning

The regulations make clear that a marital trust that meets the requirements of §2056(b)(8) can qualify as a QDOT.⁵⁰¹ §206(b)(8) provides an exception to the terminable interest rules of §2056(b) where the surviving spouse is the only noncharitable beneficiary of a qualified charitable remainder trust described in §664.⁵⁰²

PLR 9244013 (July 30, 1992) describes the interplay of the QDOT rules and the provisions of §2056(b)(8) in connection with an inter vivos charitable remainder unitrust. In the ruling, the unitrust amount was payable to the grantor for his life, and, upon his death, to his spouse, if she survived him. The spouse was not a U.S. citizen. The surviving spouse’s interest included provisions consistent with the QDOT requirements, including a provision that


⁵⁰⁰ Of course, if the insured spouse is a nonresident alien, he can exclude the proceeds of the policy from his estate under §2105(a).

⁵⁰¹ See Regs. §20.2056A-2(b)(1).

⁵⁰² See PLRs 9845015 (August 7, 1998), 9845016 (August 7, 1998).
required the trustee to withhold the amount of any QDOT Tax imposed on any distribution to the spouse. The ruling concluded:

- Any portion of a unitrust payment made from trust corpus would be subject to the QDOT Tax.
- The requirement that the trustee withhold from the amount of any distribution to the spouse the amount of any QDOT Tax imposed on the distribution will not conflict with the provisions of §664, since the trustee is merely withholding a portion of the unitrust payment payable to the spouse; and
- The estate tax charitable deduction will be available in computing the QDOT Tax imposed at the death of the surviving spouse.\textsuperscript{505}

d. \textbf{Advance Private Letter Ruling}

The National Office of the IRS will issue private letter rulings on proposed transactions involving QDOTs and on completed transactions before the return is filed.\textsuperscript{504} However, no such prospective ruling will be issued on computations of tax, actuarial factors and factual matters for prospective estates. Thus, the IRS is willing to issue a prospective ruling on whether the provisions of a trust will qualify as a QDOT.\textsuperscript{505} Of course, if there is a change in the law subsequent to the issuance of the ruling, the ruling will no longer bind the IRS.\textsuperscript{506}

\textbf{B. Planning for a Noncitizen Surviving Spouse After the First Spouse’s Death}

Upon the decedent’s death, if the surviving spouse is not a U.S. citizen, the executor and the surviving spouse must determine what action needs to be taken

\textsuperscript{503} See Regs. §20.2056A-6(b)(3), making clear that where the surviving spouse’s interest in a QDOT is in the form of a trust meeting the requirements of §2056(b)(8), the provisions of §2056A(b)(10)(A) apply in determining the allowance of a charitable deduction in computing the QDOT Tax, even though the QDOT is not includible in the surviving spouse’s estate.

\textsuperscript{504} See, e.g., Section 5.08 of Rev. Proc. 2010-1, 2010-1 I.R.B. 1, 12 (January 4, 2010).

\textsuperscript{505} See, e.g., PLR 9003030 (October 24, 1989).

\textsuperscript{506} See §11 of Rev. Proc. 2010-1.
in order to qualify property passing to the surviving spouse for the marital deduction.

1. **Spouse Becomes U.S. Citizen**

   The most basic option open to the surviving spouse is to become a U.S. citizen prior to the date on which the decedent’s Federal estate tax return is made. By doing so, no restrictions are imposed on property passing to the surviving spouse, provided the property is bequeathed and devised in a form that otherwise satisfies the requirements of the Federal estate tax marital deduction. If naturalization procedures have not been commenced prior to the decedent’s date of death, however, it may be very difficult to complete them prior to the due date of the decedent’s Federal estate tax return, even with extensions (assuming an extension would be granted for that purpose). Further, the relinquishment of citizenship may be an unpalatable solution for the surviving spouse. Of course, if the surviving spouse attains U.S. citizenship after the date of the decedent spouse’s Federal estate tax return, the imposition of the QDOT Tax can be eliminated in accordance with the conditions of §2056A(b)(12).

2. **No QDOT Created by Decedent**

   Where the decedent failed to create a marital trust, as where the marital bequest was an outright bequest to the surviving spouse, the decedent’s executor or the surviving spouse must create a QDOT prior to the date on which the decedent’s Federal estate tax return is made and must transfer or irrevocably assign the marital bequest property to the trust prior to such date. The post-mortem creation of a QDOT will also be necessary where the decedent spouse created a QDOT but the surviving spouse or the decedent’s executor wish to place certain assets in a separate trust or a trust having different terms. In addition, where the decedent spouse’s will provides for an outright bequest to a noncitizen surviving spouse, the executor may be able to initiate proceedings to reform the will and create a QDOT under that instrument.

   Under the regulations, if the property passing to the surviving spouse qualified for the estate tax marital deduction but for the marital deduction limitations of §2056(d)(1)(A), then the QDOT created by the surviving spouse need not meet the marital deduction requirements of Regs.

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[^507]: See §2056(d)(2)(B); Regs. §20.2056A-2(b)(2).

[^508]: See PLR 9017015 (April 27, 1990) discussed above at Section IV.A.
§20.2056A-2(b). Thus, for example, the QDOT need not provide that the surviving spouse receive all -- or, for that matter, any -- of the QDOT income, as would be required if the QDOT needed to satisfy the requirements for a QTIP or a general power of appointment marital trust. However, because the regulations treat the surviving spouse as the transferor of the property transferred or assigned to a QDOT for all purposes other than §2056(d), the surviving spouse must use care in drafting the QDOT to avoid or minimize adverse tax effects of the transfer or assignment.509

3. Decedent Created QDOT

If under the decedent’s will or other estate planning documents, property passing to the surviving spouse passes into a trust that meets the requirements of the marital deduction, but which fails to satisfy §2056A(a) and the regulations, the executor of the decedent’s estate or the trustee of the QDOT should reform the trust, if the terms of the trust expressly allow for reformation, or, if the terms of the trust do not allow for reformation, then initiate judicial proceedings to reform the trust. Such proceedings must be initiated prior to the due date of the decedent’s Federal estate tax return, determined with extensions of time to file.510 Such reformations are limited to those necessary to qualify the trust as a QDOT and not to meet the other requirements of §2056(a). If such proceedings are initiated, the statute of limitations cannot expire prior to the date one year after the executor notifies the Secretary of the Treasury that the trust has been changed or that the proceeding has been terminated.511

509 See Section V.H., above.
510 See §2056(d)(5); Regs. §20.2056A-4(a)(2).
511 See §2056(d)(5)(B); Regs. §20.2056A-4(a)(3).
4. **Assignments of Property to a QDOT**

Probate and non-probate property and property passing outright to the surviving spouse must be transferred or irrevocably assigned to a QDOT prior to the date on which the decedent’s Federal estate tax return is made. Formula assignments and protective assignments, where permissible, should be considered. Further, when such assignments cannot be completed, a letter ruling seeking approval of an alternate arrangement should be considered.

5. **Appointment of Designated Return Filer**

If more than one QDOT is created for the surviving spouse, the executor of the decedent spouse’s estate must appoint a Designated Return Filer. As noted in VII.C.4, above, the Designated Return Filer must be a U.S. Trustee of the QDOT. The appointment of the Designated Return Filer must be made on either the decedent spouse’s Federal estate tax return or on the first Form 706-QDT that is due and is filed by its prescribed date, including extensions. Although the will or other estate planning documents may not contemplate more than one QDOT, multiple QDOTs may be arise where the surviving spouse creates a separate QDOT to hold nonprobate property or a separate trust is utilized to hold retirement plan or other annuity payments due to the surviving spouse. The failure to effectively appoint a qualified Designated Return Filer will cause any QDOT Tax to be imposed at the highest marginal federal estate tax rate in effect at the date of the decedent spouse’s death and prevent qualification of the hardship distribution allowance provided under §2056A(b)(3)(B).

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512\* §2056(d)(2); Regs. §20.2056A-4(b).


514\* Id.

515\* §2056A(b)(2)(C)

516\* See §2056A(b)(3)(B).
6. **Disclaimers**

Consideration should be given to the use of qualified disclaimers under §2518. If the noncitizen surviving spouse has sufficient assets prior to the death of the decedent spouse, a disclaimer of some portion or all of the property passing to the surviving spouse at the decedent’s death may minimize or eliminate the need to transfer property to a QDOT. Also, disclaimers by beneficiaries of a trust created by the decedent spouse may enable a trust to meet the requirements of §2056(b) and thereby allow the executor to make the QDOT election.\footnote{517}

Finally, the decedent spouse’s will could provide that a disclaimer of property otherwise passing under the will outright to the surviving spouse passes into a QDOT for the surviving spouse’s benefit. This use of the disclaimer allows the decedent spouse to be treated as the transferor of the property for all tax purposes, and the treatment of the surviving spouse as the transferor of the property for purposes other than the QDOT rules, should be avoided.\footnote{518}

7. **Section 9100 Relief**

a. **Standards for Relief**

The IRS in its discretion, may grant a reasonable extension of time within which to make a regulatory election, provided the taxpayer demonstrates that (1) the taxpayer acted reasonably and in good faith, and (2) granting relief will not prejudice the interests of the government.\footnote{519} For these purposes, a regulatory election refers to those elections and applications for relief from tax whose deadline is prescribed by regulations published in the Federal Register, or a revenue ruling, revenue procedure, notice or announcement published in the Internal Revenue Bulletin. Under the regulations, an extension will be granted only if the taxpayer provides evidence, including affidavits, to establish that the taxpayer acted

\footnote{517 See, e.g., PLR 9151044 (September 26, 1991).}

\footnote{518 See Regs. §20.2056A-4(b)(5).}

\footnote{519 Regs. §301.9100-3(a).}
reasonably and in good faith, and that granting relief will not prejudice the interests of the government.520

b. Late QDOT Elections

Section 2056A(d) provides that the election to treat a trust as a qualified domestic trust ("QDOT") "shall be made by the executor on the return of tax imposed by section 2001. . . . No election may be made under this section on any return if such return is filed more than one year after the time prescribed by law (including extensions) for filing such return." The regulations governing the QDOT election, which are similar to those for the QTIP election, provide that the QDOT election is to be made by the executor on the last Federal estate tax return filed by the executor before the due date of the return, or, if a timely return is not filed, then on the first return filed after the due date.521 Given the language of the regulations, then, it would seem likely that the QDOT election would not be viewed as an election the time for which is expressly provided for by statute. Therefore, where the provisions of Section 2056(d) and 2056A of the Code are complied with and the estate tax return claims a marital deduction for the value of the property transferred to a QDOT but the executor fails to elect to treat the trust as a QDOT, an extension of time to make the election under Section 2056A(d) of the Code has been granted.522

Moreover, an extension of time may be available even where the return as filed, failed to claim a marital deduction, provided that the election is made and the property with respect to which a marital deduction is claimed is transferred or assigned to the QDOT within the one-year period following the due date of the decedent’s Form 706.523

520 Regs. §301.9100-1(b).


522 See, e.g., PLRs 200910019 (November 20, 2008), 200821030 (January 9, 2008), 200448027 (November 26, 2004), 200211021 (March 15, 2002), 200146015 (November 16, 2001), 9718018 (January 30, 1997), 9623044 (March 11, 1996), and 9547006 (August 9, 1995).

523 See, e.g., PLRs 200712010 (November 20, 2006), 9803020 (October 20, 1997).
In the past, the Service ruled that the QDOT election is a statutory election with respect to the one-year limit of Section 2056A(d). As a result, Section 9100 relief was not available to extend the time within which to make the QDOT election when the one-year period has passed.\footnote{\textit{PLR} 9843030 (July 24, 1998)}

However, in the preamble to final regulations regarding the alternate valuation date election of Section 2032,\footnote{T.D. 9172, published January 4, 2005} which contain a similar one-year rule under Section 2032(d)(2), the Service announced that Section 9100 relief would be available to extend the time within which to make a QDOT election, provided that the estate tax return itself was filed no later than one year after the due date, including extensions of time actually granted. Of course, statute of limitations must be checked carefully.

c. Assignments of Property to a QDOT

In order to be treated as passing from the decedent into a QDOT (and therefore eligible for the QDOT election), property passing to the surviving spouse must be transferred to a QDOT "before the date on which the return of tax imposed by this chapter is made," or irrevocably assigned to the trust on or before such date.\footnote{See Section 2056(d)(2)(B) of the Code; Treas. Reg. §20.2056A-3(b)(1).} In that connection, the Service has granted requests for an extension of time within which to make an assignment of property should be permitted as an application for relief from tax.\footnote{See, \textit{e.g.}, PLRs 200910019 (November 20, 2008), 200821030 (January 9, 2008), 200712010 (November 20, 2006), 200211021 (March 15, 2002), 200146015 (November 16, 2001), 9803020 (October 20, 1997), 9718018 (January 30, 1997), 9623044 (March 11, 1996), 9547006 (August 9, 1995), and TAM 9228001 (February 20, 1992). See also PLRs 200448027 (November 26, 2004) and 9834013 (May 21, 1998), ruling that when an extension of time within which to assign property to the QDOT is granted and the surviving spouse subsequently becomes a U.S. citizen, the IRS can waive the requirement for actual assignment of the property to the QDOT.}

d. Notification of U.S. Citizenship
Under Section 2056A(b)(12), if the surviving spouse becomes a U.S. citizen, and certain other conditions are met, then the QDOT Tax imposed under Section 2056A(b)(1)(A) of the Code will not apply to taxable events occurring after that date. Regulations provide that the QDOT will no longer be subject to the imposition of the QDOT tax if the surviving spouse becomes a U.S. citizen, and certain other conditions are satisfied. One of these conditions is that the U.S. trustee of the QDOT notifies the Service and certifies in writing that the spouse has become a U.S. citizen. Such notice is to be made by filing a final Form 706-QDT on or before April 15 of the calendar year following the year in which the surviving spouse becomes a U.S. citizen, unless an extension of time for filing the return is granted under Section 6081. The Service has determined that the filing of the notification is equivalent to an application for relief from tax; therefore, it has granted an extension of time within which to file the notification.

**e. Bond and Letter of Credit Requirements**

As discussed above, the Security Requirements imposed under §2056A(a)(2) require the trust instrument governing a Large QDOT can provide that the U.S. Trustee furnish a bond in favor of the IRS in an amount equal to 65% of the fair market value of the trust assets, as finally determined, or furnish an irrevocable letter of credit issued by a bank in an amount equal to 65% of the fair market value of the trust assets, as finally determined. The regulations provide that both the bond and the letter of credit must be filed with the decedent’s Form 706 or 706NA, unless an extension for filing the bond or the letter of credit “is granted under Section 301.9100 of this chapter.” Therefore, since the reference to Section 9100 relief is expressly contained within the Regulations, it seems certain that extensions of time within which

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529/ Treas. Reg. §20.2056A-10(a).

530/ See PLRs 200949009 (August 13, 2009), 200719002 (January 25, 2007), 200648022 (August 10, 2006), 200451024 (December 17, 2004); 200132013 (August 10, 2001), and 9624021 (March 18, 1996).

531/ SeeRegs. §§20.2056A-2(d)(1)(i)(B) and (C).

to file the bond or the letter of credit requirement are clearly contemplated by the Service.\footnote{532}{See, e.g., PLR 9803017 (October 17, 1997) (extension of time to file bond).}

f. Nonassignable Plans and Annuities—Special Rules

Under the QDOT rules, in the case of a plan, annuity, or other arrangement which is not assignable or transferable (or is treated as such), the property passing under the plan from the decedent is treated as passing in the form of a QDOT if the requirements of Treas. Reg. §20.2056-4(c)(2) are satisfied.\footnote{533}{Treas. Reg. §20.2056A-4(c)(1).} In order to satisfy these requirements, (i) the noncitizen surviving spouse must agree to pay on an annual basis, the estate tax imposed under Section 2056A(b)(1) due on the corpus portion, as defined in section Treas. Reg. §20.2056A-(c)(4), of each nonassignable annuity or other payment received under the plan or arrangement; (ii) the executor must with the estate tax return, the Information Statement described in Treas. Reg. §20.2056A-4(c)(5); (iii) the executor must file with the estate tax return the Agreement To Pay Section 2056A Estate Tax described in Treas. Reg. §20.2056A-4(c)(6); and (iv) the executor must make the election under section 2056A(d) with respect to the nonassignable annuity or other payment.\footnote{534}{See Treas. Reg. §20.2056A-4(c)(2)(i)-(iv).} The Service has granted an extension of time within which to file the Agreement to Pay Section 2056A Estate Tax and the Information Statement required under these provisions.\footnote{535}{See PLRs 200821030 (January 9, 2008) and 200445010 (July 12, 2004).}