For Trusted Advisors
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Estate planning for non-citizens.

The federal gift and estate tax laws that apply to non-United States citizens (aliens) are different from those for citizens. Further, there are different rules for resident aliens and non-resident aliens. Whether a non-citizen is a resident for transfer tax purposes depends on his "domicile." The domicile test considers several factors, including how long the non-citizen has been in the United States, how frequently he travels abroad, and especially his intent to remain in the country.

Resident and non-resident aliens.

Resident aliens are subject to United States gift and estate taxes on their entire estates wherever situated. Non-resident aliens are subject to gift and estate taxes as follows:

Gift tax — Non-resident aliens are subject to gift tax on gifts of property situated in the United States and generally are not taxed on gifts they make of intangible property even though it may be considered located in the United States.

Intangible U.S. property includes U.S. bank accounts (provided the account is not connected with a U.S. trade or business), cash in U.S. brokerage accounts, bonds issued in the United States, and stock in domestic corporations. The categorization of interests in partnerships or LLCs is less clear.

Estate Tax — This may apply to transfers of both tangible and intangible property situated or deemed situated in the United States upon a non-resident alien's death. However, certain intangible assets—such as stock in foreign corporations and proceeds for a policy insuring the life of a non-resident alien—are not considered to have a U.S. situs. Several countries have tax treaties with the United States that govern where property is considered to be located.

Taxation.

The table below summarizes the amounts in 2016 that can be transferred gift and estate tax-free. It is important to consider not only the status of the transferor, but also that of the transferee.

The use of a Qualified Domestic Trust (QDOT) may be appropriate for a married couple when one of the spouses is a non-citizen. A QDOT allows a decedent's estate to defer estate tax on property passing to a non-citizen spouse until the non-citizen spouse's death. Accordingly, it ensures that the QDOT property will eventually be subject to federal estate tax.

Estate tax is imposed on distributions of principal made during the surviving spouse's lifetime and on the value of all property remaining in the trust on the surviving spouse's death. The tax is also imposed if a person other than a U.S. citizen or domestic corporation becomes a trustee of the trust, or if the trust otherwise ceases to meet requirements of a QDOT. There is an exception allowing for tax-exempt "hardship" distributions, i.e., in response to an immediate and substantial need relating to the health, education, maintenance, and support of the spouse or anyone the spouse is legally obligated to support.

The amount of estate tax is the additional amount that would have been due had the property been included in the decedent spouse's estate. The basis of property is adjusted to the date of death value. However, basis in a taxable distribution is adjusted upward to account for estate tax paid on the growth in value of the property occurring after the first spouse's death.

Gift Tax Considerations	To Citizen	To Resident or Non-Resident Alien
From Citizen or Resident Alien	**Spouse:** Unlimited marital deduction **Non-Spouse:** Annual exclusion–$14,000 Lifetime exclusion–$5,450,000	**Spouse:** Annual exclusion–$148,000 Lifetime exclusion–$5,450,000 **Non-Spouse:** Annual exclusion–$14,000 Lifetime exclusion–$5,450,000
From Non-Resident Alien (U.S. situs property)	**Spouse:** Unlimited marital deduction **Non-Spouse:** Annual exclusion–$14,000 Lifetime exclusion–N/A	**Spouse:** Annual exclusion–$148,000 Lifetime exclusion–N/A **Non-Spouse:** Annual exclusion–$14,000 Lifetime exclusion–N/A
Estate Tax Considerations	**To Citizen**	**To Resident or Non-Resident Alien**
From Citizen or Resident Alien	**Spouse:** Unlimited marital deduction **Non-Spouse:** Applicable exclusion–$5,450,000	**Spouse:** Applicable exclusion–$5,450,000* **Non-Spouse:** Applicable exclusion–$5,450,000
From Non-Resident Alien (U.S. situs property)	**Spouse:** Unlimited marital deduction **Non-Spouse:** Applicable exclusion–$60,000	**Spouse:** Applicable exclusion–$60,000* **Non-Spouse:** Applicable exclusion–$60,000

* Assets passing to a Qualified Domestic Trust are generally eligible for the unlimited marital deduction.

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Social Security Talking Points for 2016

There are several important things happening with Social Security benefits in 2016 that may impact many Americans who are at or near retirement age.

Here are a few of the key points.

There won't be a Cost of Living Adjustment (COLA) for 2016 – so benefits will remain the same.

- This is unusual, since it's only the third time in the past 40 years that there has not been an increase (the last time was 2011). But, COLA increases are based on inflation and there wasn't enough this past year to trigger a rise in benefits.
- COLAs never go down, yet when there is no COLA increase combined with an increase in the national average wage index, the maximum possible Social Security benefit can decrease slightly.
- Because there wasn't a COLA increase, the maximum amount of earnings subject to the Social Security portion of the payroll tax also will not change in 2016 – remaining at $118,500.
- In addition, the earnings limit for those who work and also get Social Security benefits remains the same as in 2015.

The "File and Suspend" strategy.

This strategy has been used for years to help retired couples – particularly those with one spouse who was the only (or primary) breadwinner – maximize benefits.

Here is how it worked in the past:

- The primary earner spouse would file for Social Security benefits at full retirement age (usually 66) and then immediately suspend them, at which time the other spouse would file for spousal benefits equal to half what the primary's benefits would have been. The primary earner's benefits would then grow by 8% each year until age 70, at which time he or she would remove the suspension and have a much higher benefit amount.

The new rule:

- Under the new rule, which goes into effect May 1, 2016, if the primary earner suspends Social Security benefits, a spouse or child who are receiving benefits based on the primary's earnings history can no longer receive any benefits. Thus, suspending the benefits of one, suspends them for everyone.
- Those who file for suspension prior to May 1, 2016, are grandfathered in, and their eligible family members can still apply for and receive Social Security benefits beyond that date.

The "Filing as a Spouse" strategy.

This strategy allowed couples to have one spouse initially file a restricted application for spousal Social Security benefits, resulting in higher overall benefits for the couple down the line.

Here is how it worked in the past:

- Once someone reaches full retirement age, they would file for a restricted application to only receive Social Security benefits as the other's spouse. If only one files, they are entitled to receive the greater of their own retirement benefit or that of their spouse, thus the first to file always gets the higher amount. Their own benefit would then earn delayed retirement credits up until age 70. This strategy only worked if you waited until full retirement age to file for benefits, since if either filed before that time you were treated as having filed for benefits for both spouses.

The new rule:

- The new rule, which goes into effect May 1, 2016, moves the age from 66 to 70, effectively eliminating the ability of one spouse to file for spousal benefits without triggering his or her own.
- Even though the new rule goes into effect next year, a person who turned 62 by the end of 2015 is grandfathered under the old rule, though will still have to wait until at least age 66 to take advantage of it.

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Charitable planning considerations.

This article discusses a sampling of ways to use charitable gifts or bequests to help a client achieve estate planning objectives.

Charitable deduction.

Gifts or bequests of cash or property to or for the use of a qualified charity are generally entitled to a 100% deduction when calculating transfer taxes, such as gift, estate, and generation-skipping transfer taxes. This is in contrast to the charitable income tax deduction, which is limited to certain percentages and subject to phase-out for high income taxpayers. It is the deductibility of the gift for income or transfer tax purposes that makes charitable gifts and bequests so important when developing estate planning strategies.

A sampling of charitable planning strategies.

Charitable planning strategies permit an individual to reduce his taxable estate by making lifetime or testamentary transfers to charity, often coupled with a wealth replacement strategy using life insurance in trust for benefit of his or her family.

Charitable gifts may include outright gifts, charitable gift annuities, charitable lead trusts (CLT), charitable remainder trusts (CRT), qualified conservation easements, pooled income funds, and charitable gifts of a remainder interest in a personal residence. Except for outright gifts, most of these methods allow a donor or his or her beneficiary to retain an interest in the gifted property, while transferring an income or remainder interest to charity. These techniques often provide a tax deduction for the portion of the gift that passes to charity.

Here are some charitable planning strategies to consider:

Gift of real property: X owns real estate that he does not occupy, nor does he have plans to develop it. Each year, he pays taxes, insurance, and maintenance, yet the property is not increasing in value. To reduce the outward cash flow, he could donate the property outright to charity, thereby eliminating his expenses and indirectly increasing his cash flow. Assuming he owned the property for more than a year, X would not have to recognize any capital gains, nor would he experience any change in lifestyle. By using a wealth replacement trust, he could restore the value of the gifted property for the benefit of his family after his death.

Leave IRA or qualified plan assets to charity: At death, IRA or qualified plan benefits may be subject to income and estate taxation. One way to avoid the significant taxation that may occur would be to bequeath the plan benefits to charity or designate a charity as beneficiary of the plan. These qualified benefits would not be subject to taxation in the decedent's estate but would be reflected by the charity.[1] In anticipation of this strategy at death, a wealth replacement trust could be previously established to restore to the family the amount bequeathed to charity.

Leverage charitable gifts with life insurance: One way for a charitably minded person to leverage his or her charitable gifts would be for the charity to purchase permanent life insurance on the donor's life. The donor would pay the premiums with annual, deductible contributions. Any cash buildup in the policy would be available for use by the charity, and the death proceeds could be used for any charitable purpose or for a specific use agreed upon with the donor.

Lifetime transfers of IRA assets to charity: The Protecting Americans from Tax Hikes ("PATH") Act of 2015 made permanent a provision that allows individuals over the age of 70½ to exclude from gross income up to $100,000 that is paid directly from their IRA to a qualified charity. This Qualified Charitable Distribution can be used to satisfy any required minimum distribution that the individual must otherwise withdraw from his or her IRA.

Although no charitable income tax deduction is allowed, this planning opportunity allows the IRA owner to reduce his or her estate each year without recognizing income or using any annual or lifetime gift tax exclusions.

Comments.

Charitable planning strategies are seemingly infinite. Funding of a wealth replacement trust will vary depending upon which charitable technique is used. In most cases there will be income tax savings that can provide an excellent funding source. Some techniques, such as a CRT or charitable gift annuity, provide an income stream; and some techniques, such as an outright gift of real property, provide savings from no longer having to pay certain expenses.

However it is funded, a wealth replacement trust in combination with a desired charitable gift can provide significant benefits for the charity and the family.

1 See PLRs 9818009, 200002011, and 200652028.

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Retirement Planning

Should you leave your IRA to a trust?

Weighing the potential benefits of leaving assets in trust for surviving spouses, children or other beneficiaries should never be overlooked. Trusts can protect assets from a beneficiary's creditors, unwise spending habits or future ex-spouses. They can ensure that assets pass according to the client's wishes, even where the assets are made available to a surviving spouse for his or her lifetime, and they can facilitate asset management, especially for minor or incapacitated beneficiaries.

Given the significant benefits of trusts, advisors may be inclined to recommend naming trusts as IRA beneficiaries. This strategy, however, can present significant pitfalls especially where a trust was not drafted with retirement assets in mind. Leaving assets to a trust may result in acceleration of IRA distributions, acceleration of tax liabilities and other unexpected results. The following key points should be considered.

No designated beneficiary.

Although an IRA owner may generally name anyone as beneficiary, usually only individuals will qualify as a "designated beneficiary." A charity, the participant's estate, and certain trusts, for example, will not qualify.

As a result, if the named beneficiary fails to qualify as a designated beneficiary, the IRA will be distributed under the no-designated-beneficiary rule. This rule exists because only individuals have a life expectancy that can be used to calculate the required minimum distributions after the participant's death; it generally provides that an IRA must be distributed (i) within 5 years of the participant's death if the participant died before his or her required beginning date, or (ii) over what would have been the participant's life expectancy, if the participant died after his or her required beginning date.

Although not a "designated beneficiary" for stretch purposes, distributions to a charity would not be subject to taxation because of its tax-exempt status.

See-through trust.

If a trust qualifies as a "see-through trust," the life expectancy of the oldest beneficiary may be used to calculate required minimum distributions.[1] A see-through trust may allow more deferral than would be possible under the no-designated-beneficiary rule.

To qualify as a see-through trust, (i) the trust must be valid under state law, (ii) the trust must be irrevocable, or by its terms, become irrevocable, (iii) the beneficiaries must be identifiable, (iv) certain documentation must be provided to the plan administrator, and (v) all trust beneficiaries must be individuals.[2]

With respect to some of these requirements, it's easy to determine whether they have been met. Other requirements, however, may be more difficult to ascertain and often result in unexpected outcomes. What if a charity is a beneficiary or a contingent beneficiary? This may force distribution under the no-designated-beneficiary rule. Many well-drafted trusts include an elaborate list of successor and contingent beneficiaries. Which beneficiaries count? Who is the oldest beneficiary? There are no easy answers.

Conduit trust.

A conduit trust is a type of see-through trust that can generally ensure that only the conduit beneficiary or beneficiaries will be counted, and all other beneficiaries may be disregarded as "mere successors." The conduit beneficiary is essentially treated as the sole designated beneficiary for purposes of determining the designated beneficiary.[3] To be treated as a conduit trust, the trust must distribute all IRA distributions it receives after the owner's death to the conduit beneficiary during his or her lifetime. The trustee of a conduit trust will have no power to accumulate distributions the trust receives from a retirement plan for possible distribution to the beneficiaries at a later time. Where more than one conduit beneficiary exists, accumulation is not permitted for as long as any member of the conduit group is living.

Given the complexities, leaving an IRA to a trust is not an area that should be navigated without an attorney experienced in drafting the proper trust. The pitfalls are numerous, and a lifetime of savings could be absorbed by needless taxes. For these as well as other reasons, many advisors will recommend only naming individual IRA beneficiaries in the absence of compelling, non-tax circumstances that would necessitate a trust.

1 If distributions are desired for each of multiple beneficiaries based on his or her own life expectancy, "separate accounts" can also be considered. To create separate accounts, it is generally not sufficient to create separate trust shares within a single funding trust.
2 Treas. Reg. 1.401(a)(9)-4.
3 But not for other purposes such as rollovers.

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