

The United States as a Tax Haven for Non-Citizens: QDOT s to the Rescue

13 Jul 2017

Now that Switzerland and other off-shore locations are not as attractive to those wishing to safeguard their funds, the United States has emerged as a tax haven, of sorts, with several states providing friendly incentives for investors who are not U.S. citizens. However, foreign investors need to be aware of their potential liability for estate taxes. U.S. property owned by an individual who is not a U.S. citizen is subject to U.S. estate tax at a rate of approximately 40% upon the death of that individual unless there is pre- or post-death tax planning.

Real estate located in the United States owned by a non-resident and noncitizen and his or her non-citizen spouse, is generally subject to estate taxes immediately upon the death of the first spouse. Unlike U.S. citizens, the unlimited marital deduction is not available when the surviving spouse is not a citizen of the U.S. and so the property does not automatically pass to the surviving spouse tax-free. However, the U.S. property may be transferred to a Qualified Domestic Trust (QDOT) after the death of the first spouse, as long as it is done prior to the filing date for the estate tax return. The surviving spouse would then gain the advantage of the unlimited spousal deduction, and the estate taxes would be deferred until the death of the surviving spouse. At that time, the 40% tax would be due, unless the surviving spouse qualifies for relief from one of the tax treaties in place between the U.S. and a limited number of foreign countries.

United States property consists of more than just real estate. Other property within that classification is stock of a U.S. corporation, including U.S. mutual funds. Also, a single member limited liability company (LLC) is disregarded for U.S. tax purposes, and so the situs of the property is determinative, not the location of the limited liability company.

The trustee of a QDOT is required to be a U.S. citizen or a U.S. corporation. If the QDOT holds property worth more than \$2 million, then the U.S. trustee must be a U.S. bank or a bond must be posted to cover the estate tax ultimately due. The U.S. trustee is the withholding agent upon any taxable event, and is personally liable for those taxes. If a distribution of corpus from the trust is made to the surviving spouse, that is a taxable event and estate taxes must be paid with the timely filing of Form 706-QDT. The limited exceptions include distributions of trust income and distributions in cases of hardship to the surviving spouse.

While the United States is an attractive haven for individuals who wish to protect assets, it is imperative that the investments are made with full knowledge of the rather complex estate taxing regime. Although a QDOT may be established post-death, it is just a deferment of the estate tax. It is important for foreign investors to understand the risks and rewards of U.S. investments.

Please contact [Nancy Ortmeyer Kuhn](#), head of our Tax Practice Group, with any questions.

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