CHAPTER 32

Non-Citizen Spouses and the Qualified Domestic Trust (QDOT)

MATT MCCLINTOCK (Oklahoma City, Oklahoma)

The unlimited marital deduction does not generally apply to property passing to a surviving spouse who is not a citizen of the United States.[1] Marital transfers to a special "qualified domestic trust" or QDOT,[2] however, enable a decedent spouse to set aside property for the surviving non-citizen spouse without incurring immediate estate tax liability.[3]

The reason for not allowing the marital deduction for transfers to non-citizen spouses is to prevent the surviving spouse from receiving assets free of the federal estate tax regime and then expatriating those inherited assets to a jurisdiction that does not have an estate tax treaty with the United States. Rather than allow for a distribution to or for the surviving spouse free of estate tax, the QDOT provides a structure that merely defers the estate tax otherwise due at the decedent spouse's date of death (and at the decedent spouse's applicable estate tax rate) until the property is actually distributed free of the trust.[4]

In order to qualify as a QDOT, the trust must meet several strict requirements. Failure of any of these will cause the trust to fail and will make the entire balance of the QDOT immediately subject to estate taxation in the decedent spouse's estate if the Trustee and beneficiaries do not reform the trust to comply with these requirements before the filing deadline for the deceased spouse's federal estate tax return.

- First, the QDOT must require that at least one of the Trustees of the QDOT be a citizen of the United States or a domestic corporation as the "U.S. Trustee";[5]
- The Trustee may not distribute any cash or property from the QDOT unless the U.S. Trustee is empowered to withhold the estate tax attributable to the principal distribution;[6]
- The deceased spouse's fiduciary must irrevocably elect to treat the property as marital deduction property on the deceased spouse's federal estate tax return;[7] and
- If the fair market value of the assets distributed to the QDOT exceed

> $2 million (a fixed value, not adjusted for inflation), the trust must meet additional requirements designed to provide adequate security to ensure payment of the estate tax liability imposed on the transferred property.[8]

In addition to these special requirements, the structure of the QDOT must otherwise meet the requirements of a trust that will qualify for the marital deduction.[9]

STRUCTURING THE MARITAL SHARE TRUST

The options for designing the Marital Share trust have some common elements. To qualify for the marital deduction, the trust must state that the spouse is entitled to receive all of the income from the trust at least annually. In addition, the spouse must be able to compel the Trustee to convert any non income-producing property to income-producing property. Whether the spouse has the ability to appoint the Marital Trust property in favor of other beneficiaries is a function of the particular design of the trust. Recall that a "general appointment trust" requires that the surviving spouse hold either a lifetime or testamentary power of appointment; the QTIP trust or QDOT trust may or may not grant a power of appointment. (Remember that the spouse cannot hold any lifetime power of appointment over a QTIP trust.[10]) Aside from these requirements, the Marital Trust may have other features that limit or expand the surviving spouse's access to the Marital property.

The trust need not give the surviving spouse access to trust principal to qualify for the marital deduction. Depending on the client's objectives, however, it may be desirable to allow for distributions of principal to the surviving spouse to augment the spouse's income interest. Because the value of the Marital Trust is already included in the surviving spouse's gross estate, allowing distributions of principal from the Marital Trust to the surviving spouse is estate tax neutral. Nevertheless, granting access to principal can have other significant consequences you must explore with an estate planning attorney during your counseling and plan design process.

Matthew T. McClintock is Co-Executive Director of WealthCounsel, LLC, an attorney membership organization dedicated to providing the best knowledge and tools to estate planning attorneys.

1. I.R.C. § 2056(d).
2. I.R.C. §§ 2056(d)(2), 2056A.
3. For a general discussion on QDOT requirements and administration, see Stephens, Maxfield, Lind, Calfee & Smith, *WG&L Estate Planning Treatises Federal Estate and Gift Taxation – Part II The Estate Tax,* Chapter 5: "The Taxable Estate" ¶5.07. Section 2056A. Qualified Domestic Trusts.
4. I.R.C. § 2056A(b).
5. I.R.C. § 2056A(a)(1)(A), Treas. Reg.§20.2056A-2(c).
6. I.R.C. § 2056A(a)(1)(B). See I.R.C. § 2056A(b)(1)(A). Note that not all distributions of principal trigger estate tax liability. See Stephens, et al., *WG&L Estate Planning Treatises Federal Estate and Gift Taxation – Part II The Estate Tax* Chapter 5: "The Taxable Estate" ¶5.07[4][a][i].
7. I.R.C. § 2056A(a)(3).

8. Treas. Reg. § 20.2056A-2(d)(1).
9. Treas. Reg. § 20.2056A-2(b)(1). Although this requirement is not apparent in the text of I.R.C. § 2056A, it is contained in the legislative history. HR Rep. No. 101-247, 101st Cong., 1st Sess. 1431 (1989). It is also a logical extension in the context of I.R.C.§§2056(d)(2)(A) and 2056(a).
10. Remember that no one can be permitted to distribute property to anyone other than the surviving spouse in a QTIP trust. See the discussion in Chapter XX.