WIGGIN AND DANA

Advisory

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Connecticut Estate Tax Exemption Increased

Breaking news: The new Connecticut state budget, signed yesterday by Governor Malloy, increases the individual exemption from Connecticut estate and gift tax from its current level of $2,000,000 up to $2,600,000 in 2018, to $3,600,000 in 2019 and to match the federal estate and gift tax exemption in 2020.

Currently, the federal estate and gift tax exemption is $5,490,000. The exemption is indexed for inflation each year. Effective January 1, 2018, it will rise to $5,600,000, so as of that date, a married couple will be able to shield up to $11.2 million from federal estate tax. In addition, the annual exclusion amount for gifts will rise to $15,000 in 2018, after remaining at $14,000 since 2013. As a result, starting in 2018 gifts of $15,000 or less to any number of recipients (or $30,000 or less, if made by a married couple) in a calendar year will have no estate or gift tax consequences.

Whether we see a full or partial repeal of the federal estate tax is a topic of intense speculation. A full estate tax repeal is called for in the plans advanced by both the White House and Congressional Republicans, although Speaker Ryan has indicated that the proposed repeal might be phased in over a period of several years. However, several other tax reform items appear to have higher priority, such as a modification of individual and corporate tax rates. At this point in the process, in an effort to reduce the potential deficit effect of a tax reform package, there is talk of eliminating many popular income tax deductions that have broad appeal. Whether there will be a political appetite for eliminating the federal estate tax remains to be seen.

As with any change to the underlying tax environment, it is important to review your estate plan in light of these developments. If you have any questions on the current estate tax landscape and its potential effect on your estate plan, please contact your Wiggin and Dana attorney.

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Strategies For Owning Property In Multiple States

Ownership of property in multiple states can raise many estate planning issues. Whether you own property directly or through an entity (such as a trust or corporation) may have a dramatic impact on the settlement of your estate and the taxes due. Fortunately, there are numerous ways to structure ownership of property. Which way is best for you and your family will depend on your goals and interests.

KEY CONCEPTS

When determining how to hold real property, you should keep in mind a few concepts relating to domicile, probate and state estate taxes.

Domicile versus residence. Although the words domicile and residence are often used interchangeably in conversation, they are two distinct legal concepts. Your domicile is the place you intend to make your home. You may have more than one residence, but you have only one domicile. Domicile is determined by a number of factors, which can include the location of your principal residence, the length of time that you spend at a residence, where you file your income taxes and your subjective intent as to where your domicile is.

State Estate Taxes. For estates of substantial value, federal estate taxes are always a consideration (even at times, such as now, when there is a contemplated repeal of the federal estate tax). But the state in which your property is located may impose a separate state estate tax that should also be considered. Connecticut, New York, New Jersey, Massachusetts and Pennsylvania impose state estate tax; Florida does not. However, if, for example, a person domiciled in Florida owns property in New York, he or she may be subject to New York estate tax on the New York property. Fortunately, through careful planning, it may be possible for the Floridian to avoid this estate tax.

Probate. Probate is the process by which a court grants a person (an executor, personal representative or administrator) authority to deal with property owned by a now deceased individual as directed in the individual's will. During the probate process, beneficiaries and heirs may contest the validity of a will and may object to how an estate has been administered. While this may lead to litigation, probate is not necessarily a bad thing, as it provides a mechanism to resolve legitimate disputes. Nonetheless, probate can be costly, time consuming and stressful for surviving

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Strategies For Owning Property In Multiple States

family members. Contrary to a popular misconception, minimizing (or even completely avoiding) probate and minimizing estate taxes do not go hand in hand. More typically, estate taxes apply regardless of whether one or more state probate proceedings are required.

Ancillary Probate. Most individuals own property outright, and, upon death, a will controls the disposition of the individual's property. Typically, the executor named in the will initiates the required probate proceeding and the probate judge grants the executor authority to deal with the decedent's assets. If a decedent owns property in multiple states, the executor may have to apply to the probate court in each jurisdiction and request authority to deal with property in that place. These additional probate proceedings in other states are called "ancillary probate."

Case Study: To see how effective estate planning can reduce taxes and estate administrative costs, consider the following hypothetical.

Assume you are domiciled in Connecticut, and that you own a primary residence in Connecticut, a summer home in Massachusetts and a winter home in Florida. You also own a commercial property in New York. Further assume that your estate planning consists only of a simple will, leaving all of your assets outright to your spouse, or if you have no spouse, to your children or other family members.

In this scenario, in the event of your death, your executor will need to initiate probate proceedings in four states: Connecticut, New York, Massachusetts and Florida. Your executor will likely need an attorney in each jurisdiction to help with the probate process and to transfer the real estate. Your estate will owe state estate tax in Connecticut, New York and Massachusetts. There will be no state estate tax on your Florida property because that state does not impose a state estate tax.

STRATEGIES FOR AVOIDING ANCILLARY PROBATE

Is there a way to minimize the administration costs involved in multiple ancillary probate proceedings? Yes, by holding the property jointly with another person or by transferring it to a revocable grantor trust.

Joint Property (with right of survivorship). One of the simplest ways to minimize probate, and therefore reduce administration costs, is to own property jointly with another individual who is given a right of survivorship. For example, if you owned the Massachusetts property noted above jointly with your spouse, then upon your death the property would pass to your spouse by operation of law and no probate proceeding would be required to transfer the property. Nonetheless, this approach may be not the best solution.

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Strategies For Owning Property In Multiple States

Jointly held real property is also often associated with tangible personal property (such as household furnishings and vehicles) that can themselves trigger the need for an ancillary probate proceeding. There can also be gift tax issues, and by holding property jointly you may lose the opportunity to make more tax efficient use of the property for estate tax purposes. Thus, the advantages gained by minimizing probate and the related administrative costs through the use of joint property can be lost when weighed against the estate tax consequences.

Revocable Trust. If, instead of owning property outright or jointly, you were to transfer your property to a revocable trust (sometimes known as a "living trust"), probate of the assets in your trust after your death usually will not be required, because the trust owns the property, not you individually. And despite the trust's ownership, you can still have full access to the assets by acting as the trustee during your lifetime.

For example, assume you execute a revocable trust and are the sole trustee during your lifetime. You transfer all of your property to the revocable trust, including your primary residence in Connecticut, your summer home in Massachusetts, your winter home in Florida and your interest in the commercial property in New York. Upon your death, the successor trustee named in your trust agreement succeeds to the position of trustee. Probate is not required to transfer your properties, as they are already owned by the revocable trust. Probate costs and transaction costs will be reduced. However, your estate will still be responsible for paying state estate tax to Connecticut, Massachusetts and New York.

STRATEGIES FOR MINIMIZING ESTATE TAX

Use of a revocable trust is one way to avoid probate while still owning property. The revocable trust may also include provisions to establish trusts after your death to take advantage of your estate tax exemptions (federal and state). To achieve further estate tax savings, you may need to consider other options, including irrevocable trusts and corporate entities or partnerships, as described below.

QPRT
A Qualified Personal Residence Trust, or "QPRT," may be an appropriate planning technique, especially if you own residential property that is not subject to a mortgage. With a QPRT, you would transfer residential property, such as the Massachusetts summer home in our example, above, to an irrevocable trust. You may continue to use the residence rent-free for a fixed number of years specified in the trust instrument (the "fixed term"), which should be a period that you are likely to survive.

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Strategies For Owning Property In Multiple States

During the fixed term, you would continue to pay the real estate taxes, insurance, and expenses for maintenance and repairs, and may continue to deduct real estate taxes on your tax return. When the fixed term ends, the residence may be held in further trust for the named beneficiaries (presumably family members) or distributed outright to them.

Even after the fixed term ends, you may continue to use the residence. For example, by relying on a further trust, the residence may be retained for a spouse's lifetime and you may use the home together. Alternatively, you may lease the residence from the trust for its fair market value rent. Subject to the terms of the lease, you may be able to use the residence for as long as you wish.

While the initial transfer of the residence to the trust is a taxable gift to the ultimate trust beneficiaries, the value of the gift is less than the then-current fair market value of the residence, because the value of the gift is reduced by the value of the retained right to live in the residence for the fixed term. Thus, the amount of the taxable gift will be substantially less than the fair market value of the residence.

Assume you transfer the Massachusetts summer home to a QPRT and retain the right to live in the residence for a 10-year term. During the 10-year term, you continue to use the property as you have in the past. At the expiration of the term the property is transferred to a continuing trust for the benefit of your children, and you then rent the residence from the trust at the fair market value. Because you no longer own the property, at your subsequent death there is nothing to probate and there is no property on which to pay Massachusetts estate tax. You would have made a taxable gift when you initially transferred the property to the QPRT, but the value of the gift would have been reduced because of your retained right to live in the property during the initial 10-year term.

There are some downsides to a QPRT. Most notably, to obtain the estate tax benefits described, above, you have to give the property away. Even if you can continue to use the property, you would not own the property. Also, you would need to survive the fixed term to achieve the estate tax savings. This is especially crucial for a Connecticut resident who transfers Connecticut real property to a QPRT, because if the donor does not survive the QPRT term, Connecticut may assess a gift tax at the time the QPRT is established and an estate tax on the property at the donor's death. (Federal law allows a credit for the gift tax in this situation, so only the estate tax would apply.) Assuming you survive the QPRT term, because the transfer to the ultimate beneficiaries is by gift, their tax basis in the property will be the same as yours – a "carry-over" basis; the beneficiaries will not get a "step up" in basis upon your death.

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Strategies For Owning Property In Multiple States

Nevertheless, a QPRT has proven to be a powerful estate tax savings vehicle for many families, especially if the hope is that the property will stay in the family for future generations.

Business Entities
Even if you choose to hold on to your property and not give it away during your lifetime, there may be ways to avoid incurring state estate taxes by holding properties in an LLC, corporation or partnership.

If you were to transfer your interest in the commercial property in New York to a Connecticut LLC, you would no longer own real estate in New York, and, instead, would own a membership interest in an LLC that owns New York commercial real estate. While states impose estate tax on real property held in the state, an interest in a business entity, like an LLC, is "intangible" property that is usually considered to be held in the state of one's domicile. In this example, it maybe asserted that your interest in a Connecticut LLC is Connecticut property for state estate tax purposes.

Please note, however, that the law is not entirely settled on whether business entities holding real property are properly characterized as intangibles for state estate tax purposes. Recent developments in New York estate tax law cast some doubt on this, and, in some instances, New York may impose a state estate tax on an LLC or other corporate entity which owns real property in New York, if you are the sole member of the entity, if you control the entity, or if there is no legitimate business purpose for the entity. It is also not clear whether states other than New York will take this position. Planning opportunities using business entities may still be available but the planning analysis has become more complex, so you will want to review this issue with your estate planning attorney.

FINAL THOUGHTS

If you own property in multiple states, it is wise to plan to avoid unnecessary probate, as well as state estate taxes. To achieve these goals, revocable trusts, irrevocable trusts (including QPRTs) and ownership of property through entities can be very useful tools. Consider speaking with your Wiggin and Dana attorney to determine how best to structure your holdings to minimize estate administration and tax costs.

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Domicile and Residence

Though the words are often used interchangeably in casual conversation, domicile and residence are two distinct legal concepts. Your domicile is the place you intend to make your home. You may be a resident of more than one state, but you are domiciled in only one state. Domicile is determined by a number of factors, which can include the location of your principal residence, bank accounts and motor vehicles, your driver's license and voter registration, and membership in local organizations. Residence is usually determined primarily by the amount of time you spend at a given place. In most cases, you are a resident of the state in which you are domiciled. But you might also be a resident of another state if you spend enough time there during the year. For example, California and Arizona presume that your intention is to become a resident, and be taxed as such, if you are there for more than nine months during a one-year period.

WHY DO DOMICILE AND RESIDENCE MATTER

Where you are domiciled has important estate planning consequences because your state of domicile will assert primary authority to tax your estate. As a result, because the states have different gift, estate and succession taxes, your choice of domicile may affect the amount the beneficiaries of your estate ultimately receive. The states also have different laws regulating other estate issues that may be important to you, such as who is eligible to be appointed as your executor. For example, Florida limits executor appointments to Florida residents, nonresident relatives and resident banks.

For many people, residence is most important for income tax purposes, although residence may also affect other rights and privileges, such as professional or recreational licenses and access to state land. The states have different income tax rates and certain states (e.g., Florida and Texas) have no state income tax.

CHANGING DOMICILE OR RESIDENCE

If you will be living in more than one state for any period of time during the year, you should consider whether this will affect the determination of your residence or domicile. If the move is temporary, or if property is maintained in your original home state, it may not be appropriate to change your domicile or to establish resident status in the new state. However, if a

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Domicile and Residence

change in domicile or resident status may be advantageous, you might want to take steps to establish domicile or residence in the new state.

With no income tax, no estate tax and the recent abolishment of the tax on intangibles, Florida has become an especially appealing state in which to be domiciled. As a resident of Florida, you may also be able to obtain some relief from the state's increasing property taxes (which have increased, in part, because of the lack of income and estate tax revenue).

Checklist for Changing Domicile.
Domicile is a subjective concept in that it depends on your intent. However, when disputes arise over a person's domicile, courts look at a number of objective factors to aid them in determining a person's domicile. The following list contains some of the factors courts have considered as indicative of an intent to establish domicile in a new state.

- Obtain a Driver's License in the New State and Register Cars and Boats in the New State. Obtain license plates in the new state. If you keep any licenses from your prior home state, make sure they reflect that you are a nonresident.
- Buy or Lease Property. Particularly if you are you going to keep property in your old domicile state, you should purchase a residential home in the new domicile state. Your new home should be furnished as a permanent home, not as a vacation place. If you rent a residence, the term of your lease should be for at least one year.
- Spend More than 183 Days Per Year in the New State. Limit return trips to your prior home and keep a record of where you spend your time when you are not in the new state.
- Register to Vote in the New State. In some states, it is possible to register to vote when you apply for a driver's license. Some states even allow you to register to vote online. In addition to registering to vote in the new state, write to your registrar of voters at your prior home, mentioning your change of domicile, and ask that you be removed from voting lists.
- File Declaration of Domicile. In some states, like Florida, it is possible to file a declaration of domicile with the county clerk.
- Move Bank Accounts and Safe Deposit Boxes to the New State.
- Declare a Change of Address. Send notification of your change of address to family, friends, business associates, professional organizations, credit card companies, brokers, insurance companies and magazine subscription offices.
- Use the New State as a Home Base. When you travel, try to return to the new state. When you make large purchases, make them in the new state. Keep your family heirlooms, furniture and keepsakes in the new state.

CONTINUED ON NEXT PAGE

Domicile and Residence

- Change Legal Documents to Reflect Residency in the New State. Update your will and trusts. Make sure that these documents do not identify you as a resident of another state.
- File Taxes Returns in the New State. Provide your new address on Federal returns and make sure to comply with any state or local filing requirements of the new domicile.
- Develop Local Affiliations. Join local organizations in the new state, such as clubs and religious groups, and participate in local charitable activities.
- If it Exists, Apply for the Homestead Exemption in the New State. In some states, like Florida, the homestead exemption will be counted against your real estate taxes.

It is important that your domicile and resident status are clear. If a decedent's domicile is not clear, more than one state may try to claim the decedent as a domiciliary and assess death taxes. Confusion about resident status can also result in complicated income tax problems, particularly if care is not taken to preserve the right to claim a deduction for income taxes paid to another state. In either case, clear and consistent action now can avoid expensive difficulties later.

COMMUNITY PROPERTY VERSUS COMMON LAW PROPERTY

One often overlooked implication of changing your domicile involves the classification of property. There are two different systems for classifying marital property in the United States: the common law property system and the community property system. Most states, including Connecticut and New York, utilize the common law property system. Under this system, property acquired by a married person during marriage is the property of that person separately, unless the person agrees with his or her spouse to hold the property jointly. By contrast, nine states are community property states – Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Additionally, in Alaska and Tennessee, spouses can opt into the community property system. Generally speaking, under the community property system, property acquired by either spouse while married becomes community property. Property acquired before marriage, as well as property inherited or received as a gift during the marriage, is generally considered separate property.

Whether property is classified as community property or as common law property affects rights of ownership, rights to income from property, rights and duties of management and control, rights to make lifetime gifts, property rights in the event of divorce and rights of disposition at death.

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Domicile and Residence

Moving from a Common Law State to a Community Property State. Community property states have different systems for treating the property of spouses who have migrated from common law states. Usually assets acquired in community property states are community property and assets acquired in common law states are separate property. However, some community property states, such as California, have a system of quasi-community property, which convert into community property any property that would have been community property had it been acquired in that state. Other community property states, such as Texas, do not change the classification of property that was acquired while living elsewhere.

Whether or not a community property state reclassifies property acquired elsewhere may be of great significance, especially with respect to a spouse who does not work. Because property acquired by a spouse is considered separate property in common law states, most common law states, including Connecticut, have statutes providing for an elective or forced share in the deceased spouse's estate to protect the other spouse from being involuntarily divested of all property acquired during a marriage. This means that in the event of the death of a spouse, the surviving spouse may claim an interest in the estate regardless of what the deceased spouse stated in his or her will. When a couple from a common law state moves to a state like California, property acquired by either spouse during the marriage becomes quasi-community property, and a surviving spouse is entitled to half of the quasi-community property in a deceased spouse's estate. In moving to a state like Texas, however, the classification of property acquired by a spouse during the marriage does not change, even though Texas does not have statutes to protect a surviving spouse from being divested from property acquired during the marriage. Thus, in such a case, if one spouse died, the other spouse would have no statutory right to claim property acquired by the deceased spouse prior to the relocation, and could be disinherited under the deceased spouse's will.

Community property states differ in other ways as well. For example, in some states, income from separate property remains separate property, while in other states, income from separate property becomes community property. States with quasi-community property systems also disagree as to whether a spouse is entitled to one-half of the value of the total quasi-community property or to one-half of each asset.

Moving to a Common Law State from a Community Property State. Generally, common law states, like Connecticut and New York, treat property acquired during marriage in a community property state as jointly-held property in which each spouse has an undivided one-half interest.

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Domicile and Residence

However, to the extent the common law state also has an elective or forced share statutory right in a surviving spouse, that right usually will not extend to the undivided one-half interest deemed to be owned by the deceased spouse.

Given the significant differences between community property states and common law states, it is important to understand how a state's particular system will affect you before you move. It is also important to find out to what extent the state law system can be overridden by the provisions of a properly executed will or other testamentary disposition.

RESIDENCE AND DOMICILE ISSUES FOR NON-CITIZENS

Estate and gift taxation of non-U.S. citizens is based on residence. For estate and gift tax purposes, an individual is a resident of the U.S. if he or she is domiciled in the United States. A facts and circumstances test is used to determine domicile and takes into consideration the following factors:

- Statements of intent (in visa applications, tax returns, wills, etc.)
- Length of U.S. residence
- Whether the person has a green card
- Style of living in U.S. and abroad
- Ties to former country
- Country of citizenship
- Location of business interests
- Place where club and church affiliations, voting registration and driver licenses are maintained.

A person is considered a non-U.S. resident (i.e., a non-resident alien) for estate and gift tax purposes if he or she is not considered a domiciliary under the facts and circumstances test described above.

Notably, residency for estate and gift tax purposes is determined differently than residency for income tax purposes. Thus, you may be a resident alien for income tax purposes, but a non-resident alien for estate and gift tax purposes.

Because countries apply different standards to determine domicile, it is possible that two or more countries will consider a person to be a domiciliary. In that case, the person could be subject to estate tax in more than one country. Proper planning, taking into account governmental tax and treaties and foreign tax credits, may eliminate or minimize double taxation.

Estate Tax Issues. Non-citizen U.S. residents are taxed on the value of their worldwide assets owned at death in the same manner as U.S. citizens. Non-citizen, non-U.S. residents are taxed only on the value of their U.S. "situs" assets. Generally, U.S. situs assets include real and tangible personal property located in the U.S. and stock of U.S. corporations. Significantly, bank accounts held by U.S. banks are not considered to be U.S. situs assets for this purpose.

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Domicile and Residence

Applicable exemption amounts are available against gift and estate tax for U.S. residents; the estate and gift tax exemptions are currently $5,490,000 (rising to $5,600,000 in 2018). Non-U.S. residents are generally allowed a reduced estate tax exemption amount, which permits only $60,000 of U.S. situs assets to be transferred free of U.S. estate tax.

If your surviving spouse is a U.S. citizen, there is an unlimited marital deduction allowing for deferment of any estate tax owed until the death of the surviving spouse. In other words, an unlimited amount of assets can pass to a U.S. citizen spouse without being subject to U.S. estate tax. However, if your surviving spouse is not a U.S. citizen, a marital deduction is generally not allowed unless U.S. property is held in a Qualified Domestic Trust (QDOT) for the benefit of the non-U.S. citizen spouse. A QDOT must be designed to comply with specific requirements which allow the trust to qualify as a QDOT and an election to claim the deduction must be made by the executor of the decedent's estate on the U.S. estate tax return.

In addition, some governmental estate and gift tax treaties allow for some form of a marital deduction in cases where such a deduction would not normally be available. The U.S. currently has estate and gift tax treaties with the following eighteen countries: Australia, Austria, Belgium, Canada, Denmark, Federal Republic of Germany, Finland, France, Greece, Ireland, Italy, Japan, Netherlands, Norway, Republic of South Africa, Sweden, Switzerland and the United Kingdom.

Gift Tax Issues. U.S. gift tax is imposed on "taxable gifts" (total gifts less exclusions and deductions) made by non-U.S. citizens, as follows:

- U.S. residents are subject to gift tax on all transfers of property, regardless of where the property is located.
- Non-residents are subject to U.S. gift tax only on transfers of tangible personal property and real property situated in the U.S. Gifts of intangible property (such as stocks and bonds), regardless of where located, made by a non-citizen non-resident are not subject to U.S. gift tax.

A non-citizen U.S. resident donor is entitled to the tax exclusions, deductions and credits relating to the gift tax that are available to U.S. citizens for transfers to U.S. citizen spouses. An unlimited amount can be given to a spouse who is a U.S. citizen pursuant to the unlimited marital deduction. However, for gifts to a non-citizen spouse, there is an annual marital deduction which is limited to $149,000 in 2017 (rising to $152,000 in 2018). (A QDOT may not be used in order to obtain an unlimited marital deduction for transfers made to a non-U.S. citizen spouse during life.) You should be particularly wary of this rule when creating a joint tenancy with a non-citizen spouse.

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Domicile and Residence

If the U.S. citizen spouse contributes the bulk of the consideration for the property that is titled jointly in survivorship with a non-citizen spouse, unanticipated gift tax consequences may be triggered.

There is a gift tax annual exclusion available which currently exempts up to $14,000 per donee per year of "present interest" gifts from U.S. gift tax (rising to $15,000 in 2018). United States citizens can "gift split," which, in effect, allows a married donor to double the annual exclusion amount by characterizing the gift as having been made one-half by the spouse. However, if either spouse is a non-U.S. resident, gift splitting is not permitted.

FINAL THOUGHTS

An individual's domicile and residence status can have a substantial impact on his or her estate planning. Because these are complex, case-by-case analyses, consider consulting with your Wiggin and Dana attorney if you spend significant time in another state, or if you are contemplating a move.