

# INTERNATIONAL MARRIAGES – SPECIAL U.S. TAX CONCEPTS

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## INTRODUCTION

It is not uncommon for a U.S. citizen or tax resident to marry a person who is not a citizen or resident of the United States. It is also not uncommon for non-U.S. spouses to come to the United States, and for one or both to eventually become U.S. tax residents. While some spouses may wish to obtain U.S. citizenship or residence, not all may wish to do so or can do so.

Tax residence is an important concept, as the U.S. taxes its citizens and residents on worldwide income. A nonresident alien as to the United States is taxed only on U.S. source income.<sup>1</sup>

Marriage customs vary in other countries. Some countries and certain U.S. States permit civil unions or civil partnerships. These arrangements would not be treated as a marriage for U.S. tax purposes. Treasury regulations provide that two individuals who enter into a relationship denominated as marriage under the laws of a foreign jurisdiction are recognized as married for Federal tax purposes if the relationship would be recognized as marriage under the laws of at least one State, possession, or territory of the United States, regardless of domicile.<sup>2</sup>

The concept of marriage is also important, as the U.S. permits certain married individuals to file a joint income tax return, with more favorable tax brackets.

## SPECIAL RULE FOR COMMUNITY INCOME

Many jurisdictions outside the United States have some form of community property law determining the rights of each spouse to community income or marital income. The laws of the State or foreign country in which a couple is domiciled govern the determination of whether property is community property or separate property for Federal income tax purposes. Generally, community property is property

- that one spouse, or both, acquire during the marriage while both are domiciled in a community property State or foreign country,
- that both spouses agree to convert from separate property to community property, and
- that cannot be identified as separate property.

<sup>1</sup> For a discussion of tax residence, please see Stanley C. Ruchelman, “[Pre-Immigration Income Tax Planning, Part I: U.S. Tax Residence.](#)” *Insights* Vol 2, No. 3 (March 2015)

<sup>2</sup> Treas. Reg. §301.7701-18.

Community income is generally income from

- salaries, wages, and other compensation received for the services performed by one spouse or both during marriage while domiciled in a community property State or foreign country; and
- real estate that is treated as community property under the laws of the State or foreign country where the property is located.

Separate property is generally

- property that one spouse owned separately before the marriage;
- money earned while domiciled in noncommunity property State or foreign country;
- property that one spouse received separately as a gift or inheritance during marriage;
- property that one spouse bought with separate funds, or acquired in exchange for separate property, during marriage;
- property that both spouses converted from community property to separate property through an agreement valid under local law; and
- the part of property purchased with separate funds if part were purchased with community property funds and part with separate funds.

Lastly, income from separate property generally is the separate income of the spouse who owns the property.

If a Code §6013(g) election has not been made to treat a nonresident alien spouse as a U.S. tax resident (discussed below), a special tax rule provides for allocation rules in the case of a married couple one or both of whom are nonresident alien individuals and who have community income for the taxable year. The definition of community property for this special tax provision may differ from the above general rules.<sup>3</sup>

- Earned income (generally income from the performance of personal services), other than trade or business income and a partner's distributive share of partnership income, is treated as the income of the spouse who rendered the personal services.
- Trade or business income, and a partner's distributive share of partnership trade or business ordinary income, is generally allocated to the spouse carrying on the business or the spouse who is the partner.
- Community income not described in in the prior two bulleted paragraphs which is derived from the separate property (as determined under the applicable community property law) of one spouse is treated as the income of such spouse.
- All other community income is treated as provided under the applicable community property law.

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<sup>3</sup> Code §879 and the regulations thereunder. All Code sections refer to the Internal Revenue Code of 1986, as amended.

Income derived from property acquired as consideration for personal services performed is explicitly excluded in the regulations from the earned income treatment in the first bulleted paragraph, above, and is therefore treated as income described in the third bulleted paragraph, above. Such treatment will therefore apply to the sale of stock acquired by the exercise of stock options and other equity-based compensation. Income derived from the exercise of a compensatory stock option will be the income of the person who was granted the stock option alone, but the gain from the sale of the stock will be the income of the grantee spouse alone only if the property is treated as separate property under local law. Otherwise, the gain will be treated as income of both spouses if the other spouse has a proprietary vested interest in that income under local law. As a result, if the grantee of the equity-based compensation is a nonresident and applicable foreign law treats the spouse as having a proprietary vested interest in the gain from the sale of the underlying stock, 50% of the gain may have to be reported in the U.S. even if it is not otherwise reportable by the nonresident spouse. But sometimes, this rule can be beneficial when the grantee is the U.S. citizen spouse, and the nonresident spouse has a vested right in the gain under local applicable law. This can also affect the classification of a foreign corporation as a controlled foreign corporation (“C.F.C.”), requiring more than 50% U.S. ownership (as defined in Code §958).

It may be crucial to determine the property law that is applicable to the married couple. In certain circumstances, it may not be the law of the place where the couple currently lives, but rather the laws of the place where the couple was married. As stated above, these rules do not apply for any taxable year for which an election under subsection (g) or (h) of Code §6013 (relating to an election to treat a nonresident alien spouse as a resident of the U.S.) is in effect.

## JOINT RETURNS

Ordinarily, the ability to file a joint return requires that both spouses be U.S. tax residents for the entire year. A joint return may be desirable if one spouse has little or no income, and the effective tax rate on joint income is less than it would be if separate returns had been filed. To illustrate, for 2023, the maximum ordinary income tax rate of 37% is reached at an income level of \$693,750 for a married couple filing jointly. It is reached at \$346,875 for spouses filing separately. A joint tax return may also be desirable as a means of combining capital gains and losses and of obtaining the benefits of foreign tax credits.

U.S. tax law provides some relief under those circumstances, permitting two types of elections.

### **Code §6013(g)**

Code §6013(g) provides in effect that if one spouse is a nonresident alien at the end of the year but the other is a citizen or resident alien, the couple may elect to treat the nonresident alien spouse as a resident alien for the entire year. The effect of the election is to continue to classify the couple as tax residents for all subsequent years in which either of them is an actual resident alien for any part of the year, although the election may be terminated by the couple in a subsequent year.

Revocation or suspension is available under several circumstances. Once revoked, the election cannot be made a second time. Once the couple reach a year in which

neither of them is an actual resident alien or citizen for any part of the year, however, the election will cease to have any effect and they will be classified as nonresident aliens for all of such year.

If the Code §6013(g) election is made for the first year in the United States and is not terminated with respect to their last year in the United States, the individuals will usually be classified as resident aliens up through the end of their last year in the United States (including all months during that last year after they have moved out of the United States).

### **Code §6013(h)**

Code §6013(h) applies to the first year of potential tax residence. It provides that if both spouses are resident aliens (or one is a resident alien married to a citizen) at the end of the year but either or both of them was a nonresident alien at the beginning of the year, each spouse that was a nonresident alien at the beginning of the year may elect to be a resident alien for the entire year. In contrast with the Code §6013(g) election, however, this election has no effect on the couple's U.S. tax status in any subsequent year and may be made only once during a person's lifetime.

### **Code §7701(b)(4)**

It is possible for a nonresident alien first arriving in the United States to fail to achieve residency status for the year if he or she arrived late in the year and has not been present in the United States for a sufficient number of days to meet the substantial presence test for residency. In such a case, it may be possible to achieve residency status by a special election.

Under Code §7701(b)(4) it is possible for a nonresident alien to elect resident alien status from the date of entry if a number of conditions are satisfied:

- The individual is not otherwise a resident alien for the calendar year (also referred to as the "election year").
- The individual was not a resident alien at any time in the calendar year immediately preceding the election year.
- The individual is a resident alien under the substantial presence test for the calendar year immediately following the election year (whether or not the individual is also a resident alien for that year under the green card test).
- During the arrival year the individual is present in the United States for 31 consecutive days and from the first day of that 31 consecutive day period to December 31 of that year, the individual is present in the United States for at least 75% of the time. For purposes of this day count, up to 5 days of absence can be disregarded and treated as days present in the United States.
- If by the due date for the individual's tax return for the election year (generally, April of the following year) he or she has not yet qualified as a resident alien for the following year, the individual pays tax for the election year as if he or she were a nonresident alien and files for an extension of time to file a return for the year. Once the individual becomes a tax resident under the substantial presence test in the following year, residence relates back to the year of arrival. The tax return for that year may be filed as if residence began in that year.

*“Once the couple reach a year in which neither of them is an actual resident alien or citizen for any part of the year, however, the election will cease to have any effect and they will be classified as nonresident aliens for all of such year.”*

This election is helpful as it permits the spouses to file the Code §6031(g) election (if one spouse qualifies) or (h) election (if both spouses qualify). Recognizing that the Code §6031(g) election may be more flexible.

## GIFT AND ESTATE TAX ISSUES

Gifts between U.S. citizen spouses do not attract gift tax. A gift to a noncitizen spouse does not qualify for the unlimited marital deduction and may be subject to Federal gift tax. However, a citizen spouse (or a resident spouse determined for gift tax purposes (domicile in the U.S.)) may gift up to \$175,000 per year (for 2023) to a noncitizen spouse.

The creation of a joint interest may under certain circumstances be treated as a gift. However, a creation of a joint bank account or joint brokerage account may not be treated as a gift until the noncontributing joint owner draws on the account.<sup>4</sup> The creation of a joint tenancy in real property, any additions to the value of this tenancy in the form of improvements, reductions in indebtedness on the property, and similar arrangements are not deemed to be transfers of property for gift tax purposes.<sup>5</sup>

If a married couple, neither of whom is a U.S. citizen nor a U.S. resident, is contemplating a move to the U.S., it would be worthwhile to consider making transfers of foreign situs real property and U.S. situs intangible property prior to establishing U.S. residence. If achieved at that time, U.S. gift tax issues are not relevant, although foreign inheritance tax laws must be taken into account.

We have used the term “U.S. resident” throughout this article, for both income, gift, and estate tax purposes. However, the term is defined differently for income tax purposes than it is for gift and estate tax purposes. Residence for the latter purpose is generally referred to as domicile and looks to the place a person intends as a permanent home.

A person may be a U.S. tax resident for income tax purposes but a nondomiciliary for estate and gift tax purposes. Typically, this occurs where an individual is present in the United States for a temporary period and holds a visa other than a permanent resident visa, commonly known as a “Green Card.” As a result, gifts made by such individual will be subject to the same rules applicable to other noncitizen nonresidents for gift and estate tax purposes, which generally impose estate tax on U.S. situs property only, and impose gift tax only on U.S. situs property that is tangible personal property such as jewelry, works of art, and automobiles situated in the U.S. or U.S. situs real property.

Under community property laws, since each spouse has a vested right in half of marital property, only half would be subject to U.S. estate tax, upon the death of one of the spouses. As a result, if the deceased spouse was domiciled in the U.S. or was a U.S. citizen, only 50% of the assets will be subject to U.S. estate tax. If the deceased spouse is not domiciled in the U.S. at the time of death but the surviving spouse is a U.S. citizen, no property will be subject to U.S. estate tax to the extent transferred to the surviving spouse.<sup>6</sup> This spousal estate tax deferral is available

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<sup>4</sup> Treas. Reg. Sec. 25.2511-1(h)(4). Rev. Rul. 69-148, 1969-1 C.B. 226.

<sup>5</sup> Treas. Reg. Sec.2523(i)(b)(1).

<sup>6</sup> Code §2056.

only when the surviving spouse is domiciled in the U.S. In that fact pattern, a testamentary bequest to a qualified domestic trust (“Q.D.O.T.”) established for the sole benefit of the surviving spouse may allow deferral until capital is distributed during the lifetime of the surviving spouse or the conclusion of her lifetime.<sup>7</sup>

If neither spouse is a U.S. citizen or a U.S. resident at the time of death, and the estate holds U.S. situs property, a presumption exists that the deceased spouse is the owner of the entire property owned by the couple, making the entire property subject to U.S. estate tax. This presumption may be rebutted by showing the surviving spouse participated in the acquisition with his or her own funds, or by using community property law rules if applicable to the marriage.

## PLANNING CONSIDERATIONS SUMMARY

It is most important when advising a married couple to determine whether the couple will be treated as married for U.S. tax purposes. Once that status has been ascertained, it is important to understand whether one or both persons will be subject to U.S. taxation on a worldwide basis as a U.S. citizen or resident. If one, but not both, will be subject to U.S. tax, it would be important to ascertain whether the foreign community property laws would apply, and whether those laws operate to reduce or increase the income subject to tax by the U.S. Finally, it should be explored whether the couple would have a tax advantage if the couple were permitted to file a U.S. joint tax return and whether that should or could be an on-going or a one-year election.



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<sup>7</sup> Code §2056A.