

# International Private Client

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## I. Major Change in Taxation of Trusts in the United Kingdom

A raft of controversial changes to the U.K. inheritance tax (IHT) treatment of trusts went into effect during 2006.<sup>1</sup> Radically changing the tax treatment of trusts established by U.K. domiciled settlers or that hold assets situated in the United Kingdom, most trusts will now be subject to a charge of up to 6 percent tax every ten years and a proportionate charge (currently up to 6 percent) will be levied when assets leave the trust.<sup>2</sup>

An individual can become domiciled in the United Kingdom for IHT purposes whether or not they are treated as domiciled in the United States for estate tax purposes. Simply by being resident in the United Kingdom for seventeen out of the last twenty years an individual is deemed to be domiciled in the United Kingdom.<sup>3</sup>

Unless reliefs are available, it is no longer possible for U.K. domiciled settlers to create new lifetime trusts in excess of the nil rate band (NRB) (currently £285,000) without an immediate IHT charge of 20 percent.<sup>4</sup> Likewise, it is no longer possible for non-U.K. domiciled settlers to create trusts of U.K.-situated assets in excess of the NRB without an IHT charge.<sup>5</sup>

This has an impact on many non-U.K. domiciled settlers who settle property on themselves for domestic succession and tax planning purposes. This was previously a nonevent for U.K. IHT purposes but now will result in a 20 percent tax charge on any value over the prevailing NRB.

It is still possible to create, by will, a limited range of interest in possession (IIP) trusts and trusts for those under twenty-five years old without the full rigors of the new regime

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1. The Finance Act 2006 received Royal Assent on July 19, 2006.

2. Finance Act, 2006, c. 25, § 156 (Eng.); Inheritance Tax Act, 1984, c. 51, §§ 58-69, 267 (Eng.).

3. Inheritance Tax Act, § 267.

4. Schedule 20 of the Finance Act 2006 amended many provisions of the Inheritance Tax Act 1984, with the result that most trusts are taxed under Part III Chapter II of the Inheritance Tax Act 1984, which formerly only applied to discretionary trusts.

5. There are, however, some transitional provisions to protect existing interest in possession (IIP) trusts (trusts where a particular beneficiary or beneficiaries are entitled to income as it arises from the trust assets) and accumulation and maintenance trusts (trusts established for one or more young people who become entitled to the income on or before the age of twenty-five).

applying. There are also important exceptions for certain trusts for disabled people.<sup>6</sup> Bare trusts are broadly unaffected by these changes and still provide planning opportunities.

As an overview, the underlying principle has been to bring most forms of trust into the same IHT regime. IIP trusts and Accumulation & Maintenance (A&M) trusts are, for most purposes, now taxed in the same way as discretionary trusts.<sup>7</sup>

Most new trusts (those created on or after March 22, 2006) will be subject to the new regime. In addition, the following three new categories of trusts are expressly outside the new rules. It is essential to note that these apply only where the trust is created by will or intestacy.

For an immediate post-death interest trust (IPDI), which is a life interest trust for a single life tenant, the old IIP tax treatment continues to apply.<sup>8</sup> There will, therefore, be no IHT charge on a capital distribution to a life tenant, and IHT will be charged on the life tenant's death (with a capital gains tax base cost uplift).<sup>9</sup> An IPDI granted to a spouse continues to benefit from the spouse exemption.<sup>10</sup> It will be possible to continue to hold the assets in trust after the death of the life tenant without the new regime applying if the successive interests are the favored trusts for bereaved minors or Age 18 to 25 regimes discussed below, or a disabled person's trust.

A trust for a bereaved minor (TBM) is a trust that can only be created by a parent (which includes a stepparent and anyone who has parental responsibility for a child), either under a will or intestacy.<sup>11</sup> TBMs may be IIP or discretionary trusts (and the trustees may have the power of advancement of capital to the minor), but all trust capital and income must vest absolutely in the bereaved minor at the age of eighteen.

Age 18 to 25 trusts can be modified to have an effect similar to the old A&M trusts, provided that the beneficiary takes an absolute interest by the age of twenty-five.<sup>12</sup> Between the ages of eighteen and twenty-five, a proportionate IHT charge applies and is payable if the beneficiary dies or receives trust capital.<sup>13</sup> The maximum charge over the seven-year period at current rates is 4.2 percent of the value of the trust assets.<sup>14</sup> This may be considered by some parents to be a price worth paying for deferring the time when the child becomes entitled until a more responsible age. This is the other key concession won by lobbyists. Like TBMs, such trusts can only be created with a will by parents, stepparents, and anyone with parental responsibility for a child.

Crucially, and with the exception of bare trusts, grandparents can no longer establish tax-efficient lifetime trusts for their grandchildren. With the exception of bare trusts and IPDIs, grandparents cannot create tax efficient will trusts. If the wills of grandparents, other relatives, and godparents (except those *in loco parentis*) express any age at which the

6. Inheritance Tax Act, §§ 49(1), 42(2), 71(1), 71(4), 89.

7. See Finance Act, sched. 20.

8. Inheritance Tax Act, § 49(1).

9. Taxation of Chargeable Gains Act, 1992, c. 12, § 72 (Eng.).

10. Inheritance Tax Act, §§ 5, 18.

11. *Id.* § 71(1).

12. *Id.* § 71(4).

13. *Id.* § 71(6).

14. *Id.*

children are to receive their gifts, the gifts will fall into the new charging regime from the outset.

Some transitional provisions have been made for trusts created before March 22, 2006, including the following:

- (a) *Existing IIP trusts.* The old IIP treatment continues to apply (i) for so long as the current life tenant retains his or her current interest; or (ii) if a transitional serial interest (TSI) is created between March 22, 2006, and April 6, 2008.<sup>15</sup> A TSI is essentially a new life interest created in substitution for the life interest that subsisted immediately before March 22, 2006. It can only be substituted once. Accordingly, it will be possible to accelerate a successive life interest in some cases. The creation of a TSI is a Potentially Exempt Transfer<sup>16</sup> (and, if in favor of a spouse or civil partner, will therefore be exempt from IHT).
- (b) *IIP trusts with successive life interest to spouse/civil partner.* If the current life tenant dies after April 6, 2008, and the spouse or civil partner of that current life tenant takes a successive life interest, that successive life interest will be subject to the old IIP treatment and not the new rules.<sup>17</sup> In other words, tax will be deferred until the death of the successor life tenant.
- (c) *A&M trusts.* The existing rules continue until April 6, 2008.<sup>18</sup> Even after that date, if the terms of the trust dictate that the capital will vest absolutely at age eighteen, there will not be any charge. Trustees might, therefore, consider amending the trusts to ensure vesting at age eighteen or making capital advances. Alternatively, if the capital will vest absolutely before age twenty-five, the A&M trust will be converted into an Age 18 to 25 trust, and the property will only be subject to the new regime between the ages of eighteen and twenty-five (meaning a maximum IHT charge at current rates of 4.2 percent if the capital is held to age twenty-five).<sup>19</sup> Failing this, the new regime will apply from April 6, 2008. Trustees will have to decide whether the consequent IHT charges will be preferable to acceleration of capital entitlements.
- (d) *A&M followed by IIP trust.* Previously, it was common for beneficiaries of an A&M trust to receive only an IIP when they became entitled to their share of capital of an A&M trust (typically at age twenty-five). Any such IIP trust will fall within the new regime if the beneficiary's IIP began on or after March 22, 2006.<sup>20</sup> Unless A&M trusts are amended so that beneficiaries become entitled to an absolute interest, and not merely an IIP, upon attaining an age no older than twenty-five, such trusts will fall within the full rigors of the new regime.

It is important to emphasize that trusts are not dead, despite the somewhat heavy-handed treatment meted out to them by the Chancellor of the Exchequer. The continued availability of reliefs and exemptions (including the NRB), and the ability of non-U.K. domiciliaries to create excluded property settlements, mean that trusts will often continue

15. Inheritance Tax Act, § 49(2).

16. *Id.* § 3(1).

17. *Id.* § 49(4).

18. *Id.* § 71.

19. *See id.* § 71(6).

20. *See* Inheritance Tax Act, § 71.

to be a useful way of holding assets. Lifetime bare trusts are also unaffected and can offer planning opportunities.

While the recent and well-publicized changes to the IHT treatment of trusts came as something of a shock to the trust industry, the changes to the income and capital gains tax (CGT) treatment of trusts have been widely debated and introduced over a number of years.<sup>21</sup> The government's objective was to achieve "a tax system for trusts that does not provide artificial incentives to set up a trust but, equally, avoids artificial obstacles to using trusts where they would bring significant non-tax benefits" and to reduce the administrative burden on trustees of small trusts.

To date, the following changes have been implemented:

- Harmonization of the definitions of (i) settler,<sup>22</sup> (ii) settled property,<sup>23</sup> and (iii) the test for the residence of trustees;<sup>24</sup>
- Restriction of hold-over relief for transfers into and out of settler-interested trusts;<sup>25</sup>
- New tax regime for trusts for the most vulnerable;<sup>26</sup>
- Introduction of a standard rate band;<sup>27</sup>
- Introduction of a sub-fund election;<sup>28</sup> and
- Consequential amendments following the introduction of the changes to the IHT treatment of trusts brought in by Finance Act 2006.

## II. Same-Gender Marriages

### A. CANADA

The definition of a spouse is relevant for many important issues, including inheritance rights and favorable tax treatment for gifts or bequests to a spouse. In Canada, where many provinces began recognizing same-gender marriages, there is now a national law recognizing same-gender marriages.<sup>29</sup>

21. A number of discussion papers were issued by HM Revenue & Customs (HMRC) in December 2003, which were followed by "Modernisation of the Tax System for Trusts" (HMRC's Consultation paper published in August 2004) and a further discussion paper issued in March 2005.

22. Taxation of Chargeable Gains Act, § 68; Income and Corporation Taxes Act, 1988, c. 1, § 685(2) (Eng.).

23. Taxation of Chargeable Gains Act, § 68; Income and Corporation Taxes Act, § 685(1).

24. Taxation of Chargeable Gains Act, § 69; Income and Corporation Taxes Act, § 685(5).

25. Taxation of Chargeable Gains Act, § 169(2).

26. Finance Act, 2005, c. 7, §§ 23-45 (Eng.).

27. Income and Corporation Taxes Act, § 686(4).

28. Taxation of Chargeable Gains Act, sched. 4(Z)(A).

29. In July 2005, The Civil Marriage Act (full title: "An Act Respecting Certain Aspects of Legal Capacity for Marriage for Civil Purposes") was introduced as Bill C-38 in the first session of the 38th Canadian Parliament on February 1, 2005. It passed the House of Commons on June 28, 2005, and the Senate on July 19, 2005. The Act became law when it received Royal Assent on July 20, 2005.

## B. ENGLAND

In England (and Wales), in December 2005, the new Civil Partnership Act 2004 (CPA) came into effect. Instead of following the marriage approach of Canada, the Netherlands, Belgium, and Spain, England and Wales adopted the civil partnership approach, although it is recognized in all relevant aspects on the same terms as is a marriage.<sup>30</sup> To register as civil partners, two people of the same sex must be over sixteen and not already married or in a civil partnership. As with marriage, people who are closely related, such as parents, siblings, and grandparents, may not form civil partnerships. The parties' domicile, nationality, and residence is unimportant. Interestingly, the CPA recognizes unions formed in other countries to be equivalent to marriage even though they may not receive that full treatment in the original jurisdiction.<sup>31</sup> In fact, even if there is no specified relationship, but the relationship meets the general conditions that the parties are not already married or in a registered partnership, the relationship is of an indeterminate duration, and the effect of their partnership is that they are treated as a couple or as married, then they will be treated as civil partners, unless there is a public policy justification for not recognizing the relationship.

## C. AUSTRALIA

As reported by Richard Krever of Monash University in *Tax Analysts*, an Australian gay couple that married outside of Australia filed taxes for several years claiming certain spousal benefits. When Australia revised its income tax form to require disclosure of the gender of a spouse, the same-sex disclosure prompted the Australian Tax Office's rejection of the spousal benefits claim. To date, it appears that the couple has refused to re-file, triggering a public debate on gay marriages.

## D. NEW YORK

In July 2006, the New York Court of Appeals ruled that a state law defining marriage as between a man and a woman is constitutional. The Court found that any new meaning for such an old institution would have to be written by the state legislature, not the courts.<sup>32</sup>

## E. NEW JERSEY

On October 25, 2006, the New Jersey Supreme Court ruled that under the equal protection guarantee of the New Jersey Constitution, "committed same-sex couples must be afforded on equal terms the same rights and benefits enjoyed by opposite-sex couples

30. The Civil Partnership Act 2004 contains numerous provisions that amend existing legislation and seek to give civil partners equivalent legal rights to those of spouses.

31. Overseas partnerships may be recognized under the Civil Partnership Act 2004 if they fall within a specified list of recognized relationships or meet the general conditions. The specified relationships include, among others: France's life pact; Germany's life partnership; civil unions formed in Vermont or Connecticut; Massachusetts same-sex marriages; and domestic partnerships formed in California, Maine, and New Jersey.

32. See, e.g., Amy Goldstein, *Same-Sex Marriage Ruled Out in New York, Georgia*, WASHINGTON POST, July 7, 2006, at A4, available at <http://www.washingtonpost.com/wp-dyn/content/article/2006/07/06/AR2006070600544.html>.

under the civil marriage statutes.”<sup>33</sup> The court instructed the legislature to “either amend the marriage statutes or enact an appropriate statutory structure within 180 days of the date of this decision.”

### III. Trusts and Divorce in England

Big money divorce cases have been hitting the headlines in the United Kingdom (*Miller v. Miller* and *McFarlane v. McFarlane*<sup>34</sup>) and the trends shown in other high profile divorce cases (*Minwalla v. Minwalla*<sup>35</sup> and *Charman v. Charman*<sup>36</sup>) indicate that trusts will be subject to closer and closer judicial scrutiny. In the *Miller* and *McFarlane* cases, the High Court judge drew a distinction between matrimonial property and non-matrimonial property (i.e., those assets brought into the marriage by gift or inheritance), with the yardstick of fairness and equality (in the division of the assets on divorce) applying more to the former than the latter (particularly in shorter marriages). The House of Lords rejected the notion of hopes and expectations and the conduct of either party as a basis on which to assess future financial needs (except where it would be inequitable to disregard the behavior of one party who has clearly been much more to blame than the other), although the principle of acknowledging one party’s special contribution remained.

In *Minwalla*, the Family Division of the High Court treated the husband’s professed motives for setting up a Jersey trust with such skepticism that, based on the evidence, the court found that the supposed trust was a sham and the underlying trust assets should be considered marital assets. This is typical of the somewhat heavy-handed approach of the Family Court in relation to trusts. In the *Charman* case, part of the dispute over financial settlement related to money held in a Bermuda Trust. The Bermudian courts had initially refused to entertain a letter of request for disclosure for use in the English courts. But the High Court judge in Family Division refused to leave the trust assets out of account. The message must be that placing your assets in a trust will not take them out of the equation when the court looks to make a financial order on divorce.

### IV. Treaty Updates

*Protocol to Finland-United States Income Tax Convention.* The 1989 Finland-United States Income and Capital Tax Convention was amended by a protocol (FUSP) signed on May 31, 2006.<sup>37</sup> Noteworthy changes include the definition of resident under Article 4. The FUSP exempts from the definition of “resident of a Contracting State” any person who is taxed in that State only due to “profits attributable to a permanent establishment in that State.” Further, the new Article 4 no longer contains the following reference to estates and trusts: “in the case of a partnership, an estate, or a trust, this term applies only to the

33. *Lewis v. Harris*, 908 A.2d 196 (2006).

34. *Miller v. Miller*, [2006] UKHL 24 (appeal taken from Eng.).

35. *Minwalla v. Minwalla*, [2004] EWHC 2823 (Fam.) (Eng.).

36. *Charman v. Charman*, [2006] EWHC (Fam.) (Eng.).

37. Protocol Amending the Convention Between the Government of the United States of America and the Government of the Republic of Finland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, U.S.-Fin., May 31, 2006, available at [http://www.ustras.gov/press/releases/reports/js4298\\_attachment\\_finnishprotocol06.pdf](http://www.ustras.gov/press/releases/reports/js4298_attachment_finnishprotocol06.pdf).

extent that the income derived by such partnership, estate, or trust is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.” Finally, Article 10 (Dividends) was extensively amended and expanded, with significant emphasis placed on the taxation of REITs.

*Protocol to Sweden-United States Income Tax Treaty.* On March 31, 2006, Congress gave its advice and consent to the Sweden-United States Protocol (SUSP) signed in September 2005,<sup>38</sup> such that the SUSP has entered into force, applying to tax years commencing January 1, 2007. The SUSP is a general modernization of the 1994 treaty.<sup>39</sup>

*United States and Isle of Man Agreement to Exchange Tax Information Enters Into Force.* In October 2002, the Isle of Man and the United States agreed to exchange tax information regarding all U.S. federal taxes (including estate and gift tax) and Isle of Man income and profits taxes. Such an exchange was to take place regardless of whether the information was being requested to investigate a criminal matter, but subject to the requested party having the right to decline under certain circumstances set forth in Article 7 of the Agreement, including the right to decline if the disclosure of the information would be against public policy (Article 7-3).<sup>40</sup> This Agreement entered into force on June 26, 2006.

*United States and Guernsey Agreement to Exchange Tax Information Enters Into Force.* Also in 2002, Guernsey and the United States agreed to exchange tax information, an Agreement that entered into force in March 2006.<sup>41</sup> While similar to the Agreement with the Isle of Man, the Guernsey Agreement is somewhat more restrictive. For example, Article 3-3 specifically excludes information exchange if the underlying action is barred by the applicable statute of limitations.<sup>42</sup> Article 7-1(b) permits a request to be declined if the requesting party has not “pursued all means available” within its own jurisdiction to obtain the information.<sup>43</sup>

## V. U.S. Internal Revenue Service (IRS)

*New Form 8898—Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession.* The American Jobs Creation Act of 2004 added to the Internal Revenue Code Section 937,<sup>44</sup> which sets forth reporting requirements for bona fide residents of U.S. possessions. On April 18, 2006, the IRS released Form 8898, “Statement for Individuals

38. Protocol Amending the Convention Between the Government of the United States of America and the Government of Sweden for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, U.S.-Swed., Sept. 30, 2005, RIA Int'l Tax Treaty 5355, available at <http://www.treas.gov/press/releases/reports/protocoljs2959.pdf>.

39. Convention Between the Government of the United States of America and the Government of Sweden for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, U.S.-Swed., Sept. 1, 1994, KAV 3979, available at <http://www.irs.ustreas.gov/pub/irs-trty/sweden.pdf>.

40. Agreement Between the Government of the Isle of Man and the Government of the United States of America for the Exchange of Information Relating to Taxes, U.S.-Isle of Mann, Oct. 3, 2002, available at <https://www.gov.im/lib/docs/treasury/incometax/pdfs/notices/TIEA.pdf>.

41. Agreement Between the Government of the United States of America and the Government of the States of Guernsey for the Exchange of Information Relating to Taxes, U.S.-Guernsey, Sept. 19, 2002, KAV 7577, available at [http://www.gov.gg/ccm/cms-service/download/asset?asset\\_id=3966022](http://www.gov.gg/ccm/cms-service/download/asset?asset_id=3966022).

42. *Id.* at art. 3.3.

43. *Id.* at art. 7-1(b).

44. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 188 Stat. 1418, § 908 (2004).

Who Begin or End Bona Fide Residence in a U.S. Possession.”<sup>45</sup> Form 8898 must be filed for tax years beginning in 2001 by individuals who have worldwide gross income in excess of \$75,000 and meet one of three tests, all of which look to whether the taxpayer is claiming bona fide resident status or claiming relinquishment of such status. Failure to file a correct and complete Form 8898 may result in a \$1000 penalty, as well as criminal penalties.

*Revisions to Regulations Relating to Withholding of Tax on Certain U.S. Source Income Paid to Foreign Persons and Revisions of Information Reporting Regulations—TD 9253.* Final regulations were issued on March 13, 2006,<sup>46</sup> that substantially adopted the proposed regulations of March 30, 2005,<sup>47</sup> with two modifications. The first modification concerns the requirement of a tax identification number for a foreign grantor trust with five or fewer grantors. Currently there is no need to state a taxpayer identification number on an otherwise valid withholding certificate executed on or before January 1, 2001, and provided to a qualified intermediary or withholding agent. The proposed regulations had used December 31, 2003, as the cut-off date. The second modification concerns the reporting of a treaty-based position. Certain exemptions for reporting have been made clear, including the IRS position that reporting under Reg. Section 301.6114-1(b)(4)(ii) is waived unless specifically required by Reg. Section 301.6114-1(b)(4)(ii)(A), (B), (C), or (D).

*Qualified Foreign Corporations and Reduced Dividend Rates (Notice 2006-101).* Certain advantageous dividend capital gains tax rates granted under the Jobs and Growth Tax Relief and Reconciliation Act of 2003<sup>48</sup> have been extended to Barbados (for dividends paid after December 19, 2004), Sri Lanka (for dividends paid after July 11, 2004), and Bangladesh (for dividends paid after August 6, 2006) in Notice 2006-101, issued on October 30, 2006.<sup>49</sup>

*Determination of Housing Cost Amount Eligible for Internal Revenue Code § 911 Exclusion or Deduction (Notice 2006-87).* In a pro-taxpayer move, the IRS, on October 6, 2006, issued Notice 2006-87,<sup>50</sup> which provides some relief from the limitations on the Internal Revenue Code (IRC) Section 911 deductions imposed by the Tax Increase Prevention and Reconciliation Act of 2005.<sup>51</sup> U.S. taxpayers living in Hong Kong, Milan, Paris, London, and Geneva are the big winners under Notice 2006-87.

*Procedures for Requesting Competent Authority Assistance Under Tax Treaties (Revenue Procedure 2006-54).* Taxpayers must often request assistance when attempting to gain benefits under a tax treaty. On November 17, 2006, the IRS issued extensive guidance on how a

45. See I.R.S. Announcement 2006-25, 2006-18 I.R.B. 871.

46. Revisions to Regulations Relating to Withholding of Tax on Certain U.S. Source Income Paid to Foreign Persons, 71 Fed. Reg. 13,003 (Mar. 14, 2006), *corrected by*, 71 Fed. Reg. 25,747 (May 2, 2006) (to be codified at 26 C.F.R. pt.1).

47. Revisions to Regulations Relating to Withholding Tax on Certain U.S. Source Income Paid to Foreign Persons and Revisions of Information Reporting Regulations, 70 Fed. Reg. 16,189 (proposed Mar. 30, 2005) (to be codified at 26 C.F.R. pts. 1, 301).

48. Jobs and Growth Tax Reconciliation Act of 2004, Pub. L. No. 108-27, 117 Stat. 752 (2003).

49. I.R.S. Notice 2006-101, 2006-47 I.R.B. 930.

50. I.R.S. Announcement 2006-87, 2006-44 I.R.B. 822.

51. Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, 120 Stat. 345 (2005).

taxpayer may request such help.<sup>52</sup> New Revenue Procedure 2006-54 supersedes the guidance contained in old Rev. Proc. 2002-52.<sup>53</sup>

## VI. Miscellaneous Estate Tax Cases

### A. EUROPEAN UNION

*Heirs of M.E.A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst.*<sup>54</sup> Mrs. van Hilten-van der Heijden was a Dutch national who resided in the Netherlands until 1988, when she moved to Belgium. She lived in Belgium until 1991, when she moved to Switzerland and remained there until her death in 1997. At death, Mrs. van Hilten-van der Heijden owned: 1) immovable property in the Netherlands, Belgium, and Switzerland; 2) securities in the Netherlands, Germany, Switzerland, and the United States; and 3) bank accounts in the Netherlands and Belgium. The Netherlands sought to apply a Dutch law to the estate whereby a Dutch national that moves outside of the Netherlands and dies within ten years thereafter is still considered to have been residing in the Netherlands at the time of death for purposes of inheritance tax, subject to relief in respect of inheritance taxes imposed by other States. The first issue addressed by the European Court of Justice was whether an inheritance is a movement of capital within the meaning of the EC Treaty. Finding that it was, the question then was whether the Dutch law was a restriction on the movement of capital prohibited by Article 56 (ex. 73b) of the EC Treaty. In holding that the law was not a prohibited restriction, the Court noted that the law was in line with model conventions established by the Organisation for Economic Cooperation and Development (OECD).

### B. UNITED STATES

*Arnett v. Commissioner.*<sup>55</sup> Over one hundred taxpayers were left out in the cold when the Tax Court agreed with the IRS Commissioner that a U.S. citizen's wages earned in Antarctica are not excludable as income earned in a foreign country under IRC Section 911 because Antarctica is not a foreign country but, rather, is a sovereignless region as determined under the Antarctica Treaty of 1959.<sup>56</sup> In so doing, the Tax Court reaffirmed its prior holding in *Martin v. Commissioner*,<sup>57</sup> and distinguished the holdings of other courts which have treated Antarctica as a foreign country under different statutes.<sup>58</sup>

*IRS Finds Deductions Hard to Swallow.* In *Swallow Holding v. Commissioner*,<sup>59</sup> the Tax Court held that a foreign corporation that owned U.S. real estate could deduct its ex-

52. Rev. Proc. 2006-54, 2006-49 I.R.B. 1035.

53. Rev. Proc. 2002-52, 2002-2 C.B. 242.

54. Case C-513/03, *Heirs of M.E.A. van Hilten-van der Heijden v. Inspecteur van de Belastingdienst*, 2006 E.C.R.

55. *Arnett v. Comm'r of Internal Revenue*, 126 T.C. 89 (2006).

56. The Antarctica Treaty, Dec. 1, 1959, 12 U.S.T. 794.

57. *Martin v. Comm'r of Internal Revenue*, 50 T.C. 59 (1968).

58. See, e.g., *Smith v. United States*, 507 U.S. 197 (1993) (holding that Antarctica is a foreign country for purposes of the Federal Tort Claims Act); *Smith v. Raytheon*, 297 F. Supp. 2d 399 (D. Mass. 2004) (holding that Antarctica is a foreign country for purposes of the Fair Labor Standards Act).

59. *Swallows Holding, Ltd. v. Comm'r of Internal Revenue*, 126 T.C. 96 (2006).

penses on an untimely filed return. The IRS had argued that such a deduction was precluded by IRC Section 882(c)(2).

## VII. European Commission Green Paper on Succession Law

In 2005, the European Commission (EC) issued a green paper<sup>60</sup> entitled “Succession and Wills.”<sup>61</sup> In its prefatory remarks to the paper, the EC acknowledges that there have been substantial problems due to the differing laws that apply in this area: “The growing mobility of people in an area without internal frontiers and the increasing frequency of unions between nationals of different Member States, often entailing the acquisition of property in the territory of several [European ]Union [EU] countries, are a major source of complication in succession to estates.”<sup>62</sup>

In May, 2006, the European Parliament issued a draft report on the EC’s green paper.<sup>63</sup> One of the recitations in the draft report highlights the difficulties faced by the EU in attempting to harmonize inheritance laws across civilian and common law jurisdictions:

[W]hereas, when dealing with the subject of succession and wills, it is essential to uphold certain fundamental tenets of public policy, such as the principle that a portion of the estate must necessarily be reserved for the closest relatives of the deceased, and that the testator is, therefore, subject to those constraints when drawing up his will (the “reserved portion” principle).<sup>64</sup>

The European Parliament’s draft report calls on the Commission to offer a proposal, consistent with its comments, sometime during 2007.

## VIII. Status of Hague Convention on Trusts

The Hague Convention on the Law Application to Trusts and on Their Recognition,<sup>65</sup> which has been ratified by three civil law countries (Italy, the Netherlands, and Luxembourg), and acceded to by Malta, has now been acceded to by Liechtenstein and San

60. A green paper is the first step towards considering legislation. As explained by the EC, green papers are “discussion papers published by the Commission on a specific policy area. Primarily they are documents addressed to interested parties—organisations and individuals—who are invited to participate in a process of consultation and debate. In some cases they provide an impetus for subsequent legislation.” European Union Documents, [http://europa.eu/documents/comm/index\\_en.htm](http://europa.eu/documents/comm/index_en.htm) (last visited Feb. 20, 2007).

61. *Commission Green Paper on Succession and Wills*, COM (2005) 65 final (Mar. 1, 2005), available at [http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005\\_0065en01.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0065en01.pdf).

62. *Id.* at 3.

63. European Parliament, Committee on Legal Affairs, *Draft Report on Succession and Wills*, 2005/2148 (INI) (May 10, 2006), available at [http://www.europarl.europa.eu/meetdocs/2004\\_2009/documents/pr/614/614735/614735en.pdf](http://www.europarl.europa.eu/meetdocs/2004_2009/documents/pr/614/614735/614735en.pdf).

64. *Id.* at 4.

65. Convention on the Law Applicable to Trusts and on Their Recognition (July 1, 1985), available at [http://www.hcch.net/index\\_en.php?act=conventions.text&cid=59](http://www.hcch.net/index_en.php?act=conventions.text&cid=59). See generally, David Hayton, *The Hague Convention on the Law Applicable to Trusts and on Their Recognition*, 36 Int’l & Comp. L.Q. 260 (1987).

Marino, both effective in 2006.<sup>66</sup> In December, 2005, the Swiss Federal Council formally tabled a proposal to ratify the Convention.<sup>67</sup>

## IX. New trust law in Dubai and Bahrain

In late 2005, Dubai passed its first trust law.<sup>68</sup> In September, 2006, the Dubai Financial Services Authority (the regulator for the Dubai International Financial Centre) received a recognition award from the Society of Trust and Estate Practitioners for the “Best Government Initiative of the Year” for its new trust legislation.<sup>69</sup>

In August, 2006, the Bahrain Monetary Agency (BMA) announced the enactment of a new trust law for Bahrain.<sup>70</sup> The new trust law provides for a trust to be established for a maximum duration of 100 years. It also requires the trust to be registered with the BMA (which will be kept confidential). The trust property may comprise any form of property, moveable or immoveable, tangible or intangible.

## X. Tax Information Exchange

In January 2006, the OECD Committee on Fiscal Affairs released a new “Manual on the Implementation of Exchange of Information for Tax Purposes.”<sup>71</sup> Modules of note include information on tax examinations abroad (Module 6) and country profiles (Module 7).

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66. Convention on the Law Applicable to Trusts and on their Recognition, Oct. 20, 1984, 23 I.L.M. 1389.

67. Press Release, Swiss Federal Department of Justice and Police, Greater Legal Certainty for the Trust Business, Federal Council Adopts Opinion on the Ratification of the Hague Trust Convention (Dec. 5, 2005), available at <http://www.ejpd.admin.ch/ejpd/en/home/dokumentation/mi/2005/2005-12-05.html>.

68. Trust Law, DIFC Law No. 11 (2005) (Dubai), available at [http://www.difccourts.ae/legislation\\_and\\_rules/DIFCLaws/Law%20No%2011%20of%202005.pdf](http://www.difccourts.ae/legislation_and_rules/DIFCLaws/Law%20No%2011%20of%202005.pdf).

69. See, e.g., Lorys Charalambous, Dubai’s Trust Laws Win International Recognition, LAW AND TAX-NEWS.COM, Sept. 26, 2006, <http://www.lawandtax-news.com/asp/story.asp?storyname=25015>.

70. Regarding the Regulation of Financial Trusts, Law No. 23 (2006) (Bahr.), available at [http://www.cbb.gov.bh/cmsrule/media/pdf/Financial\\_Trust\\_Law.pdf](http://www.cbb.gov.bh/cmsrule/media/pdf/Financial_Trust_Law.pdf).

71. Organisation for Economic Cooperation and Development, Committee on Fiscal Affairs, MANUAL ON THE IMPLEMENTATION OF EXCHANGE OF INFORMATION FOR TAX PURPOSES (Jan. 23, 2006), available at <http://www.oecd.org/dataoecd/16/23/36647823.pdf>.

