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## Cross-Border Estate Planning

Barbara R. Hauser

Melissa Langa

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# BUSINESS TRANSACTIONS & DISPUTES

## Cross-Border Estate Planning

BARBARA R. HAUSER AND MELISSA LANGA\*

### I. Expatriation

During 2003, several bills were proposed to add additional tax penalties for individuals who expatriate. While none of those bills passed, some proposals are still pending that would impose a so-called mark-to-market tax, upon expatriation, on accrued and unrealized capital gains that exceed \$600,000.<sup>1</sup> Additionally, the proposals would amend certain Internal Revenue Code (I.R.C.) sections and other federal laws, including, for example, a revision of I.R.C. § 102 to include in a donee's income certain gifts and inheritances by donor or deceased expatriates and to amend the Immigration and Nationality Act to impose visa restrictions on individuals not in compliance with I.R.C. § 877(A). Further, for tax purposes, the proposals would treat expatriates who spend more than thirty days in the United States as residents. Also of interest is the 550-page report issued in February 2003 by the Joint Committee on Taxation, titled *Review of the Present-Law Tax and Immigration Treatment of Relinquishment of Citizenship and Termination of Long-Term Residency*.<sup>2</sup>

### II. Nonresident Alien Estate Deductions

In *Estate of Silver v. Commissioner*,<sup>3</sup> the deceased taxpayer was a citizen and resident of Canada. At his death, he had a net worth of over \$100 million, of which roughly \$500,000 was U.S. property.<sup>4</sup> His will provided for a gift to a Canadian charity, and his estate claimed a charitable deduction for the full amount paid to the charity on the estate's U.S. nonresident alien estate tax return.

The Tax Court denied the deduction, noting that the general rule of I.R.C. § 2106(a)(2)(A)(ii) is that a nonresident alien may deduct from the U.S. taxable estate

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\*Barbara R. Hauser, Cadwalader, Wickersham & Taft LLP, New York, New York; Melissa Langa, Bove & Langa P.C., Boston, Massachusetts.

1. See The Jumpstart Our Business Strength Act, S. 1637, 108th Cong. (2003); The American Jobs Creation Act, H.R. 2896, 108th Cong. (2003).

2. STAFF OF THE JOINT COMMITTEE ON TAXATION, *REVIEW OF THE PRESENT-LAW TAX AND IMMIGRATION TREATMENT OF RELINQUISHMENT OF CITIZENSHIP AND TERMINATION OF LONG-TERM RESIDENCY*, JCS-2-03 (2003), at <http://www.house.gov/jct/pubs03.html> (last visited May 15, 2004).

3. *Estate of Silver v. Comm'r*, 120 T.C. 430 (2003).

4. *Id.*

charitable gifts to a U.S. charitable entity.<sup>5</sup> In addition, the deduction is limited by the value of the transferred property, which is required to be included in the taxable estate per I.R.C. § 2106(a)(2)(D).<sup>6</sup> The taxpayer successfully argued that the 1995 Protocol to the United States-Canada Income Tax Treaty of 1980 (Protocol) had expanded the category of permissible charitable donees by including Canadian charities.<sup>7</sup>

Although the Tax Court agreed that the Protocol permitted a Canadian resident and citizen to make a deductible transfer to a Canadian charity at death, it emphasized that in this case the fatal flaw was that Silver's will did not direct that the payment be made out of U.S. assets and that, in fact, the gifts were made from non-U.S. assets. To qualify under the I.R.C. and the tax treaty for the full deduction, the charitable gifts would have to have been paid from U.S. assets that were subject to the U.S. estate tax. Therefore, the Tax Court agreed with the Internal Revenue Service (IRS or Service) determination of the allowable deduction as demonstrated by the following formula:

$$\text{VALUE OF U.S. ASSETS} \div \text{VALUE OF NON-U.S. ASSETS} \\ \times \text{AMOUNT TRANSFERRED TO CHARITY} = \text{U.S. DEDUCTION.}^8$$

### III. Income Tax Credit for Foreign Tax Not Unlimited

In *Kappus v. Commissioner*,<sup>9</sup> the D.C. Circuit Court affirmed the Tax Court and held that U.S. citizens living in Canada could not take a 100 percent credit against their U.S. income taxes for income taxes paid to Canada on their Canadian source income because I.R.C. § 59(a)(2) limits the credit to ninety percent of the taxpayer's alternative minimum tax liability. The Court held that although I.R.C. § 59 may conflict with the terms of the Canada-U.S. Income Tax Treaty, the I.R.C. section takes precedence because it was the last-enacted pronouncement on the issue.

### IV. Suspicious Activity Report Held Not Discoverable in Civil Proceeding

In *International Bank of Miami v. Shinitzky*,<sup>10</sup> the Florida Court of Appeals considered whether a Suspicious Activity Report (SAR)<sup>11</sup> was discoverable in a civil action alleging investment fraud, conspiracy, and civil theft. In a *per curiam* decision, the Florida Court noted that the law creating the duty to file a SAR creates a corresponding strict duty of confidentiality of the report to protect both the person who files the SAR from reprisals and to protect the person who is the subject of the SAR. A lower court's order compelling disclosure was quashed.

5. *Id.*

6. *Id.*

7. *Id.* at 433. Article XXIX-B provides: "Where the property of an individual who is a resident of a Contracting State passes by reason of the individual's death to an organization referred to in paragraph 1 of Article XXI (Exempt Organizations), the tax consequences in a Contracting State arising out of the passing of the property shall apply as if the organization were a resident of the State."

8. *Id.*

9. *Kappus v. Comm'r*, 337 F.3d 1053 (D.C. Cir. 2003).

10. *Int'l Bank of Miami v. Shinitzky*, 849 So. 2d 1188 (Fl. Dist. Ct. App. 2003) (*per curiam*).

11. See 31 U.S.C.A. § 5318 (2004) (SARs are filed by financial institutions (banks, etc.) with FinCEN pursuant to 31 U.S.C. § 5318(g)); see also 31 C.F.R. § 103.18(a)(1) (2004).

## V. Marital Deduction Not Available for Nonresident Alien Failing Disclosure of Worldwide Assets

In *Estate of Hon Hing Fung v. Commissioner*, a cursory opinion by the Ninth Circuit affirmed the prior decision of the Tax Court that a nonresident alien decedent was not entitled to the marital deduction because the estate failed to provide sufficient evidence of the value of the non-U.S. property.<sup>12</sup> Without such valuation, the Court could not determine whether the U.S. property received by the surviving spouse in settlement of her right under the will to three-eighths of the estate was property that passed to the surviving spouse from the decedent, or instead was property that passed to the surviving spouse as a result of a settlement agreement among the estate's beneficiaries.

## VI. Income Tax Treaties and Protocols

### A. UNITED KINGDOM

On March 4, 2003, the Treasury Department issued technical explanations of both the proposed U.K.-U.S. income tax treaty signed on July 24, 2001, and a related protocol signed on July 22, 2002.<sup>13</sup> On March 5, 2003, the Joint Committee on Taxation issued its explanation of the proposed treaty and protocol.<sup>14</sup> The Senate consented to the treaty and proposed protocol on March 13, 2003.<sup>15</sup>

### B. AUSTRALIA

On March 13, 2003, the protocol to the Australia-U.S. income tax treaty was ratified,<sup>16</sup> and it became effective as of May 12, 2003. The Treasury Department issued its technical explanation on March 5, 2003.<sup>17</sup> Contemporaneously, the Joint Committee on Taxation issued its explanation of the proposed protocol.<sup>18</sup>

12. *Estate of Hon Hing Fung v. Comm'r*, No. 02-70492, 2003 U.S. App. LEXIS 4053 (9th Cir. 2003); for the Tax Court's opinion, see *Estate of Hon Hing Fung v. Comm'r*, 117 T.C. 247 (2001).

13. DEP'T OF THE TREASURY, TECHNICAL EXPLANATION OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL GAINS (Mar. 4, 2003), at <http://www.treas.gov/offices/tax-policy/library/teus-uk.pdf>.

14. STAFF OF THE JOINT COMMITTEE ON TAXATION, EXPLANATION OF PROPOSED INCOME TAX TREATY BETWEEN THE UNITED STATES AND THE UNITED KINGDOM, JCS-4-03 (2003), at <http://www.house.gov/jct/pubs03.html> (last visited May 15, 2004).

15. Tax Department, Orrick, Herrington & Sutcliffe, L.L.P., *Tax Law Update* (Aug. 5, 2003), at <http://www.orrick.com/fileupload/200.pdf>.

16. DEP'T OF THE TREASURY, TECHNICAL EXPLANATION OF THE PROTOCOL BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF AUSTRALIA SIGNED AT CANBERRA ON SEPTEMBER 27, 2001 AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND AUSTRALIA WITH RESPECT TO TAXES ON INCOME SIGNED AT SYDNEY ON AUGUST 6, 1982 (March 13, 2003) (note that the protocol had been signed on September 27, 2001), at <http://www.treas.gov/offices/tax-policy/library/teaustra.pdf>.

17. *Id.*

18. STAFF OF THE JOINT COMMITTEE ON TAXATION, EXPLANATION OF PROPOSED PROTOCOL TO THE INCOME TAX TREATY BETWEEN THE UNITED STATES AND AUSTRALIA, JCS-5-03 (2003), at <http://www.house.gov/jct/pubs03.html> (last visited May 15, 2004).

## C. MEXICO

On March 5, 2003, the Treasury Department issued its technical explanation of the proposed protocol to the Mexico-U.S. income tax treaty.<sup>19</sup> The new protocol amends the 1992 Mexico-U.S. Income Tax Treaty. Contemporaneously, the Joint Committee on Taxation issued its explanation of the proposed protocol.<sup>20</sup> The Senate consented to the proposed protocol on March 13, 2003.<sup>21</sup> By an exchange of instruments on July 3, 2003, the protocol between the United States and Mexico entered into force.

## VII. New Currency Transaction Report

Institutions and individuals must adhere to regulations promulgated by the Secretary of the Treasury pursuant to the Bank Secrecy Act of 1970 (BSA),<sup>22</sup> which imposes reporting requirements for the collection of data that would be highly useful in controlling criminal, tax, regulatory, intelligence, money-laundering, and counter-terrorism matters. The Treasury's Financial Crimes Enforcement Network (FinCEN) in the past has delegated much of the collection of this data to the IRS.<sup>23</sup> Effective December 31, 2003, new FinCEN Form 104, which must be filed within fifteen calendar days of the transaction, replaces Form 4789 although Form 4789 may continue to be used until August 31, 2004.<sup>24</sup> Although the IRS form has been superceded, BSA forms will continue to be processed at the IRS Detroit Computing Center. In a recent report, the Treasury Inspector General for Tax Administration (TIGTA) reported that Form 4789 accounted for over ninety percent of BSA documents filed at the Detroit Center, or approximately 12.3 million documents.<sup>25</sup>

## VIII. International Grant-Making by Domestic Non-Profits

In Announcement 2003-29, the IRS sought public comment on its effort to provide guidelines for non-profits that wish to engage in international activities and at the same time seek

19. DEP'T OF THE TREASURY, TECHNICAL EXPLANATION OF THE PROTOCOL BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED MEXICAN STATES SIGNED AT MEXICO CITY ON NOVEMBER 26, 2002 AMENDING THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND MEXICO WITH RESPECT TO TAXES ON INCOME SIGNED AT WASHINGTON ON SEPTEMBER 18, 1992 ALONG WITH A PROTOCOL AND AN ADDITIONAL PROTOCOL THAT MODIFIES THE CONVENTION SIGNED AT MEXICO CITY ON SEPTEMBER 8, 1994 (March 5, 2003), at <http://www.treas.gov/offices/tax-policy/library/temexico.pdf>.

20. STAFF OF THE JOINT COMMITTEE ON TAXATION, EXPLANATION OF PROPOSED PROTOCOL TO THE INCOME TAX TREATY BETWEEN THE UNITED STATES AND MEXICO, JCS-6-03 (2003), at <http://www.house.gov/jct/pubs03.html> (last visited May 15, 2004).

21. Mark E. Dicus, Gary M. Friedman, Peter F.G. Schuur & Keeey Westwell, *Senate Ratifies New Tax Treaty with the U.K. and Protocols Australia and Mexico* (Mar. 18, 2003), at <http://www.debevoise.com/publications/pubsdetail.asp?pubid=161353182003&typeid=4>.

22. Congressional Findings and Declaration of Purpose, 12 U.S.C. § 1951 (2004).

23. Currency Transaction Report, IRS Form 4789, available at <http://www.irs.gov/pub/irs-pdf/ffc104.pdf> (last visited May 15, 2004). For example, IRS Form 4789 required financial institutions to report certain transactions in currency involving more than \$10,000.

24. FinCEN Form 104, available at [http://www.fincen.gov/reg\\_bsaforms.html](http://www.fincen.gov/reg_bsaforms.html) (last visited May 15, 2004).

25. Memorandum from Gordon C. Milbourn, Acting Deputy Inspector General for Audit, for Commissioner, Small Businesses/Self-Employed Division (Mar. 9, 2004), available at <http://www.ustreas.gov/tigta/2004reports/200430070fr.html>.

to safeguard against the unlawful support of terrorist activities.<sup>26</sup> For a comprehensive response to Announcement 2003–29, see the comments of the ABA Section of Taxation.<sup>27</sup>

### IX. Revised Publication 515

In response to the enactment of the new income tax treaty between the United States and the United Kingdom, and the new protocols for the income tax treaties between the United States and Mexico and Australia, the IRS issued a revised Publication 515 (Withholding of Tax on Nonresident Aliens and Foreign Entities—For Withholding in 2003).<sup>28</sup>

### X. Offshore Insurance Companies Under Scrutiny

The IRS issued Notice 2003–34 as a warning to taxpayers who seek to invest in offshore insurance companies to defer the recognition of income and/or transform ordinary income into capital gain.<sup>29</sup> Notice 2003–34 reiterated that the exception to the passive foreign investment company (PFIC) rules requires that the insurance company be “active.” Notice 2003–34 does not provide a safe-harbor for the determination of active status.

### XI. PFIC Interest Ruled a Qualified Electing Fund

In a taxpayer friendly ruling, the IRS permitted a domestic limited partnership to treat its ownership interest in a PFIC as a qualified electing fund (QEF) because the taxpayer, having failed to make a proper QEF election, had nonetheless substantially complied with the election requirement.<sup>30</sup>

### XII. Proposed Form for Foreign Disregarded Entities

The IRS has proposed a new annual reporting requirement, Form 8858, to be filed by an owner of a foreign disregarded entity, such as a single member limited liability company.<sup>31</sup> Once Form 8858 is finalized, the IRS will require it to be filed for tax years beginning January 1, 2004.<sup>32</sup>

### XIII. Tax Haven (“Offshore Financial Centers”) Updates

#### A. BARBADOS

In Notice 2003–69, 2003–42 IRB 851, the IRS cast doubt upon whether a Barbados corporation is a “qualified foreign corporation” pursuant to I.R.C. §1(h)(11)(C)(i)(II)

26. International Grant-Making and International Activities by Domestic 501(c)(3) Organizations: Request for Comments Regarding Possible Changes, 2003–1 C.B. 928 (2003).

27. Committee on Exempt Organizations of the ABA Section of Taxation, Comment, *Comments in Response to the Internal Revenue Service Announcement 2003–29 Regarding International Grant-Making and International Activities by Domestic 501(c)(3) Organizations*, 57 TAX LAW. 195 (2003).

28. Internal Revenue Service, *Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities—For Withholding in 2004* (Feb. 2004), at <http://www.irs.gov/publications/p515/>.

29. Applicable Date Under § 645 With Respect to Trusts and Estates of Decedents Dying Before December 24, 2002, 2003–1 C.B. 990 (2003).

30. Priv. Ltr. Rul, 2003 (March 24, 2003).

31. David R. Tillinghast, *IRS Wants Information Reporting on Foreign Disregarded Entities* (2004), at [http://www.bnatax.com/tm/insights\\_ForeignDisregardedEntities.htm](http://www.bnatax.com/tm/insights_ForeignDisregardedEntities.htm).

32. *Id.*

because the 1984 Barbados-U.S. income tax treaty grants to Barbados certain tax benefits which are now considered unjustified due to Barbados's general existence as a tax haven.<sup>33</sup> To qualify under I.R.C. §1(h)(11)(C)(i)(II) the foreign corporation must be "eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of this provision and which includes an exchange of information program."<sup>34</sup> As a result of this Notice, representatives of Barbados and the United States met in Washington during October of 2003 to confer regarding revisions to the existing treaty.<sup>35</sup>

#### B. BRITISH VIRGIN ISLANDS AND BEARER SHARES

In 2002, the British Virgin Islands issued new regulations regarding British Virgin Islands companies that issue bearer shares.<sup>36</sup> Briefly, issued bearer shares must be deposited with approved custodians by December 31, 2004, and companies that issue bearer shares will pay higher annual fees to the government. At the end of 2003, the British Virgin Islands government announced a 2004–2011 transition period during which existing companies that do *not* have bearer shares outstanding may amend their Memoranda and Articles of Association to include a prohibition against bearer shares. A declaration that the company has no outstanding bearer shares must be filed with the Registry of Corporate Affairs at the time of the amendment. If the amendment is completed before 2008, the British Virgin Islands company will avoid a proposed increase in the annual license fee.

#### C. COOK ISLANDS AND THE FINANCIAL ACTION TASK FORCE

In June of 2000, the Cook Islands was one of several countries placed on the Non-Cooperative Countries and Territories List issued by the Financial Action Task Force (FATF).<sup>37</sup> In a coordinated effort to seek removal from the list, the Cook Islands enacted a suite of legislation in 2003 including: The Banking Act of 2003; The International Companies Amendment Act of 2003; The Crimes Amendment Act of 2003; The Criminal Procedure Amendment Act of 2003; The Extradition Act of 2003; The Financial Supervisory Commission Act of 2003; The Mutual Assistance in Criminal Matters Act of 2003; The Proceeds of Crime Act of 2003; and The Financial Transactions Reporting Act of 2003.<sup>38</sup> To date, the Cook Islands remains on the list pending review of the legislation by the FATF.

### XIV. Asset Protection Trusts

In *Nastro v. D'Onofrio*,<sup>39</sup> a debtor had transferred stock certificates evidencing ownership in several Connecticut corporations to an irrevocable spendthrift trust settled in Jersey,

33. Notice 2003–69, United States Income Tax Treaties That Meet the Requirements of Section 1(h)(11)(C)(i)(II) (2003), at <http://www.unclefed.com/Tax-Bulls/2003/not03-69.pdf> (last visited May 15, 2004).

34. *Id.*

35. Press Release, Office of Public Affairs, Renegotiation of U.S.-Barbados Tax Treaty, JS-945 (Oct. 27, 2003), at <http://www.treas.gov/press/releases/js945.htm>.

36. Guy Eldridge, *British Virgin Islands Proposes Legislative Steps to Regulate Issuing and Transferring of Bearer Shares* (Jan. 8, 2003), at <http://www.cdp.bm/bvi/article.cfm?ArticleID=224>.

37. Financial Action Task Force Blacklist (Aug. 1, 2002), at <http://www.afil.co.uk/blacklist.htm>.

38. *Legislative Update: Cook Islands-2003*, ASSET PROTECTION NEWS, Aug.-Sept. 2003, at <http://protectyou.com/apn12-2-fr.html> (last visited May 15, 2004).

39. *Nastro v. D'Onofrio*, 263 F. Supp. 2d 446 (D. Conn. 2003).

Channel Islands. The transfer arguably violated the applicable law regarding fraudulent transfers. The creditor, in an attempt to reach the stock, was able to achieve service on the offshore trust, although both the trust and the trustee never responded to the complaint and were ultimately dismissed from the suit because the court held that it lacked personal jurisdiction over the offshore parties. The court also held that it did not have *quasi-in rem* jurisdiction over the stock certificates because the securities were “certificated” and thus the sites of the certificates were in Jersey. Nonetheless, in an end run around the debtor, the court held that it did have jurisdiction over the domestic corporation and ordered the corporation through its officers to cancel the stock held in the offshore trust and to issue new certificates as equitable relief for the fraudulent transfer.



