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INTERNATIONAL ESTATE PLANNING: PLANNING FOR THE CROSS-BORDER FAMILY

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INTERNATIONAL ESTATE PLANNING: PLANNING FOR THE CROSS-BORDER FAMILY

I. INTRODUCTION AND CASE STUDIES

A. SCOPE OF OUTLINE

More and more of the clients who come to us for estate planning bring issues that involve other countries. A client may be subject to U.S. estate tax and married to a non-citizen spouse; a U.S. domiciliary with foreign property; a non-U.S. citizen, non-domiciliary with U.S. property; a U.S. citizen residing in a foreign country at death; or a U.S. citizen or domiciliary intending to make bequests to foreign beneficiaries or to foreign charities. This outline addresses estate planning for these individuals—that is, the transfer of property at or in anticipation of death. It does not address income taxation, gifting, expatriation, or the creation of *intervivos* trusts. This outline and its author provide no legal advice on laws other than those of the United States and Washington State.

B. HYPOTHETICALS

1. Robert Lowrey is an 80-year-old developer who cannot seem to retire. He and his wife, Betty, had a community net worth of approximately $20 million when they moved to Mexico five years ago. He has been developing property there ever since, through a Mexican corporation; hence, they are acquiring significant Mexican-situs property. Although they are both U.S. citizens, they obtained landed immigrant status in Mexico and spend more than 244 days there each year. The rest of the year, they spend in Washington State, where they still have property and all their grown children. They consider Mexico their home and have no definite present intent to leave there. Because their children are well off, Barbara would like to pass 10% of their estate to Fundacion Merced Queretaro, A.C., a Mexican community foundation.

2. Glen and Virginia Barrows are Canadian citizens happily retired and living on Bainbridge Island. All of their grown children are Canadian citizens, residing in Canada. They have a net worth of $20 million, all of which Glen earned while employed in British Columbia, and some of it still held in Canadian investments. They are not sure where they want to be living when they die, but they know they need some estate planning while they are "here".

3. Joel Knighton considers himself a citizen of the world. He was born in Canada to Polish immigrants and carries a Canadian passport. Last year, he met and married a French citizen, Gitta. They married in France. Gitta expects to inherit her family's summer island in the Baltic Sea and perhaps some cash. They have just moved to Singapore, although they kept their villa in the south of France. On the way to Singapore, they visited French friends on Bainbridge Island. Gitta fell in love with the island, and the couple purchased a home there. Gitta is not sure she likes Singapore; Joel loves it. They have come to you for estate planning advice.

II. DUE DILIGENCE

Proper estate planning for the international client requires careful inquiry into several issues:

- Scope of practice: Are we licensed to advise the client?
- Domicile versus Residence: Where IS this client, anyway? Where are the client's children residing? What is the citizenship of the client and of their children?
- Situs of Assets: Where are the client's assets located?
- Matrimonial Property Rights: Do we have to consider community property laws?
- Forced Heirship: What if the client's intended heirs are not his spouse and family?
- Domicile and Situs Wills: Can we draft just one Will to pass his worldwide estate?
- Can we use trusts?
- What do we have to know about transfer taxation in other jurisdictions?
- Do we have to consider the laws of other jurisdictions and treaties?
- Is the client is charitably inclined?

This outline provides a cursory overview of these issues.

III. NON-TAX ISSUES

A. SCOPE OF PRACTICE

As attorneys licensed in Washington, we must first determine that our license authorizes us to represent some of these far-flung individuals. Many clients approach us for advice on U.S. law, but we have no separate license as "U.S. attorneys." Many lawyers practicing in the area of federal estate and gift tax have special training in tax matters (L.L.M.), but such training is not in any way an exclusive license to practice "U.S. law."

Few of us have licenses to practice in foreign jurisdictions. If we, appropriately, advise our client to retain foreign counsel, we may be held responsible for both the selection and the supervision of foreign counsel. If we fail to obtain foreign counsel, we can, indeed, be held liable for unauthorized practice in a foreign jurisdiction.[1]

If a client has international issues, it is our responsibility to recognize questions of foreign law. If an individual has real property in Washington or if Washington State is the U.S. state with which the client has the closest nexus, it is my opinion that we may advise on U.S. matters and draft Washington documents. If the client has a closer connection to another U.S. state, we may advise on these general international issues, but must refer to counsel in another state for the drafting of testamentary documents. Always, for all clients with ties to other countries, our clients must retain counsel not only licensed to practice in those countries but also experienced in matters of international private client law.

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[1] *Hart v. Carro, Spanbock, Kaster & Cuiffo*, 620 N.Y.S.2d 847 (1995) (holding conduct of New York Law firm overseeing stock in Bahamian stock malpractice).

B. DOMICILE VERSUS RESIDENCE

Most clients who meet us in our Washington State offices mistakenly believe they are "here" for purposes of estate planning. This is often not the case. Our careful consideration of this issue of residence/domicile/citizenship may lead us to the conclusion that the client is or should not be domiciled in Washington. This is the core issue in international private client estate planning: Where should the client be domiciled? By working with our client's local accountant and foreign counsel, we may take steps to "domicile" the client elsewhere to great tax advantage as well as more favorable application of law.

Under the laws of some jurisdictions, an individual's citizenship brings with it certain rights and responsibilities. The United States and Germany, for example, have laws that "follow" their citizens around the world. The laws of most jurisdictions eschew the issue of citizenship and consider, instead, an individual's residence. "Residence" is defined differently under local law, so treaties often provide rules to solve conflicts of law. Many jurisdictions provide a definition of residence for tax purposes that differs from that for non-tax purposes. Finally, common law jurisdictions—the United States and the United Kingdom, for example—distinguish between "residence" and "domicile." While these jurisdictions define "domicile" differently, they both use the term to address "where the client is" at death.

1. United States Law

Under U.S. law, "residence" and "domicile" are not synonymous. An individual may be resident in the United States but domiciled elsewhere.

(a) U.S. Income Tax Residence

An individual is a U.S. resident for income tax purposes if: (a) a green card holder or other lawful permanent resident who is present in the U.S. for at least one day of a calendar year;[2] (b) she is present in the U.S. for 183 days in that year; or (c) she is present in the U.S. for at least 31 days for that year and has been present in the U.S. for an average of more than 121 days per year over that year and the two prior years.[3] An individual in the U.S. on a diplomatic or student visa is excluded from the definition of U.S. resident. An individual who is present in the U.S. for fewer than 183 days in the calendar year, but whose three-year average is greater than 121 days, can avoid U.S. residence status by demonstrating that she has a "closer connection" to a foreign country.[4]

(b) U.S. Estate Tax Domicile

"Domicile" is an estate tax concept. Domicile is established by residence in the United States plus the intent to remain in the United States indefinitely.[5] An individual may acquire domicile

[2] IRC § 7701(b)(1)(A).
[3] IRC § 7701 (b)(3)(A).
[4] IRC § 7701(b)(3)(B).
[5] Treas. Reg. § 20.0-1(b)(a); Treas. Reg. § 25.2501-(1)(b).

in the United States by living here even if only for a brief period of time if that individual had no definite present intention of later leaving. This intent is demonstrated by certain facts and circumstances, no one of which is determinative. They include:

- The length of time spent in the U.S. and abroad and the amount of travel to and from the U.S. and between other countries;[6]
- The value, size, and locations of the decedent's homes and whether she owned or rented them;[7]
- Whether the individual spends time in a locale due to poor health, for pleasure, to avoid political problems in another county, etc.;[8]
- The situs of valuable or meaningful tangible personal property;[9]
- Where the individual's close friends and family are situated;[10]
- The locales in which the individual has religious and social affiliations or in which she partakes in civic affairs;[11]
- The locales in which the individual's business interests are situated;[12]
- Visa status;
- The places where the individual states that she resides in legal documents;[13]
- The jurisdiction where the individual is registered to vote;
- The jurisdiction that issued the individual's driver's license; and
- The individual's income tax filing status.

2. Washington Estate Tax Residence

Chapter 83.100 of the Revised Code of Washington describes Washington's Estate Tax and Transfer Act (the "Washington Estate Act"). Under the Washington Estate Act, a "resident" is a "decedent who was domiciled in Washington at the time of death; . . . ."[14] The Washington Estate Tax Act does not define "domicile."

The new Washington Administrative Code provisions under the Washington Estate Tax Act (WAC 458-57-105 et seq.) also provide no definition of "resident", "nonresident" or "domicil[iary]". However, under WAC section 458-57-005 (3)(j), the provision applicable to deaths occurring before May 16, 2005, "nonresident" is defined. It is "a decedent who was domiciled outside of Washington at the time of death."

Washington case law, prior to the Washington Estate Act, indicates that "domicile" is the place a person "intends a fixed and permanent home."[15] Personnel within the Washington State

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[6] *Paquette Est. v. Comr.*, T.C. Memo 1983-571.
[7] *Fokker Est. v. Comr.,* 10 T.C. 1225 (1948) and *Nienhuys Est. v. Comr*., 17 T.C. 1149 (1952).
[8] Id.
[9] *Farmers' Loan & Trust Co. v. U.S.,* 60 F.2d 618 (S.D.N.Y. 1932).
[10] *Nienhuys.*
[11] *Farmers' Loan* and *Nienhuys.*
[12] *Fokker.*
[13] *Fokker* and *Farmers' Loan.*
[14] RCW 83.100.020(9).
[15] *See In re Estate of Tolson*, 89 Wn. App. 21 (Div. I 1997) (discussing collateral estoppel effect of California court's determination of domicile in probate case).

Department of Revenue orally indicated to our office that prior Washington case law concerning domicile will be used to interpret the term "resident" under the Washington Estate Tax Act.

Note this definition includes an element of "intent." We may presume, in advising our clients, that the same facts and circumstances indicating intent under federal law will be used in interpreting the Washington Estate Tax Act.

3. Domicile and Residence under Foreign Law

(a) Singapore

Singapore law provides a two-fold definition of residence for individuals for income tax purposes: the qualitative nature of residence and the quantitative nature. The quantitative test applies to all individuals who are physically present or who are employed in Singapore for 183 days or more. The qualitative test of residence may apply to individuals who do not qualify under the quantitative test. This test considers whether the individual has family and economic ties in Singapore; whether she has an abode in Singapore; whether she is in Singapore or abroad for a temporary purpose and whether she has a permanent home abroad. Temporary absences away from Singapore will not render the taxpayer non-resident under the qualitative test. [16]

Domicile refers to the place where an individual has her permanent principal home to which she returns or intends to return. In determining the domicile of an individual, the main factor to be considered is with which country she has the closest connection. Residence in the country in question and the intention to make that country her permanent home are both important material facts.[17]

If an individual changes her place of domicile to Singapore, she will have to establish an intention to give up her original domicile and acquire a new domicile in Singapore. This may be shown by the purchase of Singapore property used as a permanent home, spending time regularly in a Singapore and marriage in Singapore, among other acts.[18] She may also set up permanent links like investments in Singapore or make substantial donations to charities in Singapore.

(b) Mexico

Mexican law does not distinguish between residence and domicile. "Residence" is defined in the federal fiscal code[19] and is established by an individual's acquiring her primary "dwelling house" in Mexico, demonstration of intent to stay in Mexico and subjecting herself to income taxation.

[16] Singapore Income Tax Act, Section 2.
[17] *Marshall v. Marshall* 1956 MLJ 122.
[18] Page 54, "Probate and Administration in Singapore and Malaysia" G. Raman, LexisNexis 2005.
[19] Código Fiscal de la Federación.

(c) Canada

Canadian law does not distinguish between "residence" and "domicile." Canadian courts have held the following:

- Residence is a question of fact;
- A person will be a resident of Canada if he or she has sufficient ties to Canada to warrant such a finding;
- Everyone must be resident somewhere;
- A person can be a resident of more than one place.[20]

For Canadian income tax purposes, an individual who is not otherwise deemed a Canadian resident by having these ties may nevertheless be deemed a Canadian resident if in Canada for more than 183 days in any calendar year.[21] The Canada-U.S. Tax treaty, while providing tie-breaker rules on the issue of Canadian versus U.S. residence, specifically does not apply those rules for estate tax purposes.[22]

(d) France

Under the French Civil Code, the domicile of an individual is the location of that individual's principal abode.[23] "Principal residence" is where she in fact resides permanently. In contrast, *residence* is the place where she lives at any moment. A minor is deemed to have *domicile* where the minor's parents are domiciled.

Under French tax law, the terms "*résidence fiscale*" and *"domicile fiscale"* are used interchangeably in connection with determination of tax liability. *Résidence fiscale* is found with respect to that individual who: 1) has her home (*foyer*) in France or the place of her principal abode; 2) has a professional activity in France, salaried or not, unless such activity is conducted on an ancillary basis; or 3) has the center of her economic interests in France.[24]

C. SITUS OF ASSETS

The location an individual's assets may seem straightforward to the individual—incorporating a notion something similar to the common law distinction between "movable" and "immovable" property, where movable property is deemed located wherever its owner is domiciled; and immovable property is deemed located within its physical geographical boundaries. The estate planner must carefully determine what assets will be under the jurisdiction of the trustee or personal representative in the documents to be drafted; and what assets must be addressed in foreign documents.

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[20] *See Thomson v. Minister of National Revenue*, 1945 C.T.C. 63. With respect to tax matters, Canada Revenue Agency's views on residency may be found in Interpretation Bulletin IT 221R3, Determination of an Individual's Residence status (2001).
[21] *See* Income Tax Act 250(1)(a).
[22] Article II 2(iv).
[23] Civil Code arts 102 *et seq.*
[24] Tax Code, art. 4B.

Local laws, international conflicts of law rules and treaties, however, all provide different interpretations of asset situs for purposes of the laws concerning taxation, succession and property rights. Therefore, once one determines that an individual's property is physically present in another jurisdiction (whether that be another U.S. state or a foreign country), the situs laws of that jurisdiction must be analyzed along with any treaty with the United States to determine if it is really "there."

1. United States Situs

As we will see below, a nondomiciliary alien decedent is subject to U.S. estate tax only on U.S.-situs assets.[25]

Under federal law, the following are U.S.-situs assets:

- Real property located in the U.S.;[26]
- Tangible personal property located in the U.S.[27] (including cash,[28] U.S. Treasury Bills, [29] cars, furniture, jewelry, artwork, etc.);
- Shares of stock issued by a U.S. corporation;[30]
- Subject to certain exceptions (set forth below), any debt obligation, the primary obligor of which is a U.S. person or the U.S., a state or any political subdivision of the U.S., or the District of Columbia, or any agency or instrumentality of any such government;[31]
- Property that is gratuitously transferred by a nonresident alien decedent while he or she is alive, by trust or otherwise, if (i) the nonresident alien decedent retained for his or her life (or for a period that cannot be ascertained without reference to his or her death) some type of possession, control, or enjoyment of said property or its income or the right to designate who will possess or enjoy the property, (ii) possession or enjoyment of the property could be obtained only by surviving the decedent and the decedent retained a reversionary interest in the property that exceeds 5% of the value of the property at the time of the decedent's death, (iii) said property was, on the date of the nonresident alien decedent's death, subject to his or her right to alter or revoke the transfer (or if such power was relinquished by the NRA decedent within three years of the date of his or her death), or (iv) if the decedent transferred within the three year period prior to his or her death an interest in property that would have been included in his or her estate under any

[25] A nonresident alien donor is exempt from gift tax on the gift of U.S. situs intangible property.
[26] Treas. Reg. §20.2104-1(a)(1).
[27] Treas. Reg. §20.2104-1(a)(2).
[28] *See* Treas. Reg. §§20.2104-1(a)(7)(ii) and 25.2511-3(b)(4)(iv), which provide that currency is not a debt obligation of the U.S., implying that it is tangible personal property. *See* also Rev. Rul. 55-143, 1955-1 C.B. 465, where the decedent died with funds which he had placed in a safe-deposit box, and the IRS held that "[s]ince the funds in the safe-deposit box on the date of decedent's death [did] not represent moneys deposited with a person carrying on the banking business within the meaning of section 863(b) of the Code, they [were] includible, for Federal estate tax purposes, in the decedent's gross estate situated in the United States." *See Blodgett v. Silberman*, 277 U.S. 1 (1928), where the Supreme Court held ". . . that money, so definitely fixed and separated in its actual situs from the person of the owner . . . is tangible property. . ." *See* also PLR 8138103 and PLR 7737063 (cash is tangible property).
[29] PLR 8138103.
[30] Code §2104(a) and Treas. Reg. §20.2104-1(a)(5).
[31] Treas. Reg. §20.2104-1(a)(7).

of the foregoing rules, and if the property so transferred was situated in the U.S. at the time of the transfer or at the time of the decedent's death;[32] and

- An interest in a partnership, if (i) the partnership does not qualify as a separate legal entity under the law of the jurisdiction where it was established or is dissolved on the death of one partner, and the underlying assets of the partnership are situated in the U.S.[33] or (ii) if the partnership is a separate legal entity under the laws of the jurisdiction where it was established and it survives the death of a partner and the partnership carries out its business in the U.S.[34]

Examples of assets that are deemed to be situated outside of the U.S. are:

- Shares of stock issued by a foreign corporation;[35]
- Deposits with persons carrying on the banking business, deposits or withdrawable accounts with federal or state chartered savings institution (if the interest on such accounts is withdrawable on demand subject only to customary notice requirements), and amounts held by an insurance company under an agreement to pay interest thereon, as long as, in each case, the interest on such deposits or amounts is not effectively connected with the conduct of a trade or business in the U.S. by the recipient thereof;[36]
- Deposits with a foreign branch of a domestic corporation or partnership engaged in the commercial banking business;[37]
- "Portfolio Debt Obligations", as long as the decedent was a nonresident alien for income tax purposes (a Portfolio Debt Obligation will be considered U.S. situs property if the decedent was a resident for income tax purposes, even if he or she was a nonresident alien for estate tax purposes);[38] and
- Proceeds from a life insurance policy on the nonresident alien decedent's life.[39]

The rules of §§2035 to 2038 (transfers with retained interests) will cause inclusion of assets formerly removed from U.S. situs. If the U.S.-situs asset had already been exchanged by the decedent for a non-U.S. situs asset prior to death, the value of the original asset will be included in the U.S. estate.

2. Situs under U.S. Treaty

The United States has transfer tax treaties with 16 other countries.[40] Generally, these treaties apply to reconcile instances of unlimited estate or inheritance taxation by more than one country. They apply to U.S. citizens and domiciliaries of a treaty country. In some instances, they apply to citizens of a treaty country who are domiciled in the United States. Once an estate planner has determined a treaty to apply, a careful delineation of asset situs under treaty rules will indicate

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[32] Code § 2104(b).
[33] *Sanchez v. Bowers*, 70 F.2d 715 (2d Cir 1934).
[34] Rev. Rul. 55-701, 1955-2C. B. 836 and GCM 18718, 1937-2 C. B. 476.
[35] Code §2104(a) and Treas. Reg. § 20.2105-1(f).
[36] Code § 2105(b)(1) and Treas. Reg. § 20.2105-1(h).
[37] Code § 2105(b)(2) and Treas. Reg. § 20.2105-1(j).
[38] Code § 2105(b)(3) Portfolio Debt Obligations are bonds, debentures, notes or other forms of debt which meet specific requirements under Code § 871(h).
[39] Code § 2105(a).
[40] The income tax treaty with Canada provides a 17th treaty, but it is not a transfer tax treaty.

which assets should be passed by non-U.S testamentary documents. A second analysis must be taken to determine what assets are subject to foreign death taxes. Coordination with counsel in treaty countries is essential.

The older treaties negotiated by the United States from 1951 to 1956 seek to avoid double taxation by defining the situs of various assets. These treaties generally confirm that real and tangible property located in the United States is sited in the United States, as are shares of stock in U.S. corporations. The treaties vary with respect to the situs rules for debts of U.S. obligors and deposits in U.S. bank accounts. Any instances of double taxation by virtue of application of these rules are dealt with by tax credits. The United States has treaties of this type with Australia,[41] Finland, Greece, Ireland, Italy,[42] Japan, Norway, South Africa and Switzerland.

Treaties entered into after 1966 focus on the domicile of the decedent rather than careful delineation of situs. Generally, they grant to the country of domicile (and, sometimes, citizenship) the right to tax the assets of the decedent on a worldwide basis. These treaties more specifically address treatment of partnership interests, and they usually provide specific marital deduction provisions. The United States has treaties of this type with France, Germany, Austria, Denmark, Netherlands, and the United Kingdom.[43]

Some treaties have no rules governing situs. In those instances (e.g., Switzerland and Canada), the rules of the Internal Revenue Code apply.

The United States has no transfer tax treaties with Singapore or with Mexico.

3. Situs under Washington Law

Washington imposes a stand-alone estate tax on "every transfer of property located in Washington." [44] The situs of property is a crucial question, then. There is no filing threshold, either: If a decedent dies with a gross estate exceeding $2 million and that gross estate includes Washington-situs property of *any* value, a Washington estate tax return must be filed. The threshold question for every estate is whether the decedent has "property located in Washington."

The Washington Estate Tax Act, the Washington Administrative Code and prior Washington case law provide some definitions. Subsection 458-57-125(4) of the Washington Administrative Code provides:

> When is Property Located in Washington? A decedent's estate may have either real property or tangible personal property located in Washington at the time of death.
>
> (a) All real property physically situated in this state, with the exception of federal trust lands, and all interests in such property, are deemed "located in" Washington. Such interests include, but are not limited to:
>
> (i) Leasehold interests;

[41] Australia currently has no death tax so the treaty is moot.
[42] Italy reinstated its inheritance tax in 2007.
[43] Sweden abolished its estate tax in 2005, so the U.S.-Swedish treaty is moot.
[44] RCW 83.100.040.

(ii) Mineral interests;
(iii) The vendee's (but not the vendor's) interest in an executory contract for the purchase of real property;
(iv) Trusts (beneficial interest in trusts of realty); and
(v) Decedent's interest in jointly owned property (e.g., tenants in common, joint with right of survivorship).

(b) Tangible personal property of a nonresident decedent shall be deemed located in Washington only if:

(i) At the time of death the property is situated in Washington; and
(ii) It is present for a purpose other than transiting the state.

Prior Washington case law provides some definitions still relied upon by the Washington Department of Revenue.[45] This older Washington case law suggests that, for estate tax purposes, intangible personal property has its situs at the domicile of the owner. Under the Washington Estate Tax Act, any intangible property owned by a resident decedent is deemed to be located in Washington for estate tax purposes" [46]

At issue for estate planners is the situs of an interest in a Limited Liability Company. Washington law defines this as intangible personal property: "[a] limited liability company interest is personal property. A member has no interest in specific limited liability property." [47]

While the above rules may incline a practitioner to advise a Washington nonresident to convert otherwise Washington-situs property to an L.L.C. interest consequently sited at the domicile of the owner, the Washington Department of Revenue maintains that the L.L.C. will be disregarded unless it has a business purpose.[48] The Department of Revenue takes this position even though our Washington Limited Liability Company statute does not require a Washington L.L.C. to have a business purpose.[49]

4. Situs under Foreign Law

(a) Singapore

Singapore taxes income using a territorial basis of income taxation. Only income accruing in or derived from Singapore ("sourced" in Singapore), or received in Singapore from outside Singapore, is subject to tax.[50] The estate tax was repealed in February of this year. That system codified a distinction between "moveable" and "immovable" property that may still be applied in questions of domicile.

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[45] *See*, e.g., *In re Eilermann's Estate*, 179 Wash. 15, 16, 35 P.2d 763 (1934) *See* id; *see* also *In Re Estate of Grady*, 79 Wn.2d 41, 483 P.2d 114 (1971); *In re Estate of Plasterer*, Wn.2d 339, 301 P.2d 539 (1956).
[46] RCW 83.100.040(a).
[47] RCW 25.15.245(1).
[48] Oral conference with Department of Revenue, January 2008.
[49] RCW 25.15 allows the formation of a Washington LLC for any 'lawful business or activity.'
[50] Section 10(1)(a), Singapore Income Tax Act (Cap. 134).

(b) Mexico

Mexican law defines the situs of property for income tax purposes. Immovable property located in Mexico has Mexican situs as do shares issued by a Mexican legal entity or shares in a non-Mexican entity more than 50% of the assets of which is Mexican real property.[51]

(c) Canada

Canadian law defines "taxable Canadian property" to include Canadian real estate, shares of private Canadian businesses, and shares of public corporations which were previously Canadian private corporations and where the shareholder (together with non-arm's length persons) held 25% or more of any class of shares within the past five years. If taxable Canadian property is exchanged in a rollover transaction, the property received on the exchange will be deemed to be taxable Canadian property.[52]

(d) France

French law provides an elaborate definition of situs for purposes of French taxation. French-situs assets include real property and moveables in France, shares of a French company, shares issued by a French company, debts owed to a French resident, and bank accounts in a French bank or a French branch of a non-French bank.[53]

The French treaty with the United States overrides this definition of situs with respect to United States persons and property. The treaty (significantly updated in 2007) provides
real properties are taxed in the State where they are situated; assets used in or held for use in the conduct of the business of a permanent establishment are taxed in the State where the permanent establishment is situated; tangible movable property (with the exception of currency) is taxed in the State where it is situated, with an exception for tangible movable property owned by an individual and used for his normal personal use or that of his family which is taxed in the State in which the individual was domiciled. All other assets including shares in a company, debt, other intangible property, and currency are taxed in the country where the deceased or the donor is domiciled.

To eliminate the planning technique to convert real property into an intangible interest by transferring it to a corporate structure, the recent Protocol to the treaty adds the following definition to real property:

> The term "real property" shall also include shares, participations and other rights in a company or legal person the assets of which consist, directly or through one or more other companies or legal entities, at least 50% of real property situated in one of the Contracting States or of rights pertaining to such property. These…shall be deemed to be situated in the Contracting State in which the real property is situated. [54]

[51] *See* www.cddhcu.gob.mx for Mexican federal law.
[52] Income Tax Act, subsection 128.1.
[53] Article 750 Code General des Impôts.
[54] Protocol to Convention between the United States of America and the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to taxes on Estates, Inheritances, and Gifts. Article Fifth.

D. MARITAL PROPERTY RIGHTS

1. In General

Every jurisdiction has laws concerning the rights and obligations of a married individual with respect to ownership of property and the succession of that property at death. Most jurisdictions have a codified definition of "marriage" and all have legal requirements concerning legal solemnization of the marriage. Several jurisdictions allow same-sex marriages.[55] Other jurisdictions recognize same-gender partnerships with specific codified rights that do not comprise the full rights of marriage.[56] These legal relationships provide property rights that vary among jurisdictions.

Many civil law jurisdictions have community property laws (e.g., Netherlands, Norway, Portugal, Spain, Sweden, South Africa and Mexico). Generally, the rules of these countries ascribe to a spouse ownership of half of the property acquired while domiciled in a community property jurisdiction or thereafter acquired. In separate-property jurisdictions (e.g. Singapore, Germany), the husband and wife are each entitled to own property independent of the other; but the surviving spouse is generally afforded elective rights or a forced heirship (see section E below) to the decedent's property. Some jurisdictions (e.g., British Columbia, Mexico France) allow a couple to elect from among more than one marital property regime. This election may or may not apply to transfers at death. In France, the election does apply at death. In British Columbia, the election applies only upon dissolution of the marriage.

Unfortunately, an added complexity is the distinction between the law governing the marriage and the law governing disposition of property at death. If a couple is married in a separate-property jurisdiction (for example, Germany), and is domiciled in a community-property jurisdiction (for example, South Africa) in which one of them dies leaving all property to the spouse, the governing law must first be determined before property rights can be established. If the laws of the country of their marriage apply, the surviving spouse will be deemed to have inherited the property from the decedent. If the laws of their country of domicile apply, the surviving spouse will be deemed to own half the property. As can be expected, courts tend to apply local law.[57]

Fortunately, many courts recognize the validity of a governing law provision in a Will. Because U.S. courts enforce such provisions, inclusion of a "laws of Washington and the United States, excluding its conflicts of law" provision in an international Will is essential.

A premarital agreement entered into by clients domiciled in these jurisdictions may abrogate these rules and will be honored by U.S. courts. In some countries, premarital agreements are not legally binding (but may be, as in the United Kingdom, "influential").

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[55] At the time of the writing of this outline, some jurisdictions that recognize same-sex marriages are France, Germany, Belgium, Ontario, British Columbia, South Africa and Spain.
[56] England and Wales Civil Partnership Act 2004.
[57] *See Frankel's Estate v. The Master,* 1950(a) SA 220 (AD), applying South African law.

2. Washington Marital Property

Washington State's martial property laws are powerful. Section 26.16.030 Revised Code of Washington provides the definition we are familiar with. Recent law extends community property rights at death to a same-sex partner and to common law marriages between individuals over the age of 55.[58] Furthermore, a Washington personal representative is authorized to administer the entire community estate and to make a non-pro rata allocation of community assets between the decedent and the surviving spouse.[59]

Washington law also addresses the issue of conflicts of law. Absent a valid marital agreement, Washington's Quasi-Community Property statute will convert property acquired in a common law jurisdiction to community property if the property would have had a community property character had the couple been domiciled in Washington upon its acquisition.[60] A conflicts of law situation may still arise if a Washington-domiciled non-U.S. citizen domiciliary attempts to apply Washington community property principals to property located in a another jurisdiction or to property acquired while domiciled in a civil law jurisdiction with a different marital property regime.

The estate planner should consider the application of these competing legal principals when drafting the Will or Wills and should include governing law provision in favor of Washington law to override competing matrimonial property laws of other jurisdictions.

E. FORCED HEIRSHIP

In many civil law jurisdictions, a testator's Will (and transfers into trust) will be overridden in favor of specific classes of persons who are entitled to a claim against the estate (a "forced share" or "forced heirship") under the law of that jurisdiction. Generally, that class of persons includes the surviving spouse and children and sometimes the testator's parents. Absent proper planning, U.S. estate is generally subject to the forced heirship rules of a domiciliary (and sometimes citizen) of that jurisdiction.

1. Conflicts of Law

A forced share under a particular jurisdiction may only be asserted over property within that jurisdiction, as determined by conflicts of law principles. Personal property is ordinarily controlled by the law of domicile; so domicile is a key issue in determining whether the law of a jurisdiction which creates a particular forced share entitlement applies to the personal property of that decedent. Real property is generally controlled by the law of the property's situs, and such property's exposure to a forced share claim is more easily determined.

Sometimes it is not clear which law will apply when more than one jurisdiction is involved. A U.S.-domiciled decedent may wish to bequeath property in a manner that differs from the forced share laws of his country of citizenship. If the country of citizenship still asserts jurisdiction over

[58] Second Substitute House Bill 3104, Chapter 6, Laws of 2008.
[59] RCW 11.02.070.
[60] RCW 26.26.250.

the decedent (by virtue of his citizenship, e.g., Germany), a conflict is inevitable. Strong public policies prevail on this issue.

A choice of forum clause in the Will is crucial: A U.S. court will be more likely to support testamentary freedom; a civil law court will enforce the forced heirship rights of that jurisdiction. Those individuals entitled to a forced share in the country of citizenship will likely seek to contest the Will in that foreign jurisdiction and would likely win. A U.S. court must enforce the judgment, under the principles of *res judicata*. If the matter were litigated in a U.S. court, on the other hand, a U.S. court would apply the laws of the decedent's domicile (U.S.). The Will would be upheld and the forced share defeated.[61]

The use of separate Situs and Domiciliary Wills may help segregate assets located in a jurisdiction with forced heirship laws while maintaining complete dispositive power over assets located in non-forced heirship jurisdictions. A clear understanding of "situs" under local law, foreign law and applicable treaty must precede the decision to pass property by more than one Will, and delineation of the property passing under the Will must be clear and explicit. It should be noted that, as a practical matter, it is almost impossible to acquire title to real property subject to a forced heirship in a foreign jurisdiction.

2. Governing Law

Fortunately, for the international estate planner, a simple governing law provision in the Will (and sometimes, the use of domiciliary/situs Wills) can defeat most forced heirship claims. A testator may modify basic conflicts of law rules by specifically designating the controlling substantive law in the Will. The testator may cut off forced share rights, even as to rights within her domicile. That is, even if a testator is domiciled in a country with forced heirship laws, property sited in the U.S. and passing pursuant to a U.S. Situs Will will avoid forced heirship claims if the Will applies the law of a particular U.S. state.

The U.S. Supreme Court has indicated that if a Will clearly indicates that the law of a jurisdiction other than that which would normally apply is to control the disposition of certain assets under the Will (for the purposes of circumventing forced heirship rights), that intent will control..[62] The courts of Washington agree: If a Washington. court assumes jurisdiction over the Will, it will recognize that position either based upon legislation or judicial decision.[63] As a general principal, U.S. courts have consistently refused to recognize forced heirship claims over assets under the court's jurisdiction.[64]

The governing law provision must be drafted carefully, however. If the draftsman fails to exclude the conflicts of law rules of the governing law, those laws may provide a *renvoi* -- a look back – to the law of an asset's situs. Such a *renvoi* may result in re-incorporating the forced share rights even under the chosen law.

[61] *See* Estate of Renard, 108 Misc. 2d 31, 437 N.Y.S.2d 860 (1981).
[62] *Harrison v. Nixon*, 34 U.S. 483 (1835).
[63] *In re Chappell's Estate*, 124 Wash. 128 (1923).
[64] *See,* e.g., *Sanchez v. Sanchez de Davila*, 547 So.2d225 (Fla Dist. Ct. App. 1989).

3. Examples of Foreign Forced Heirship

(a) French Forced Heirship: *La Réserve*

Recent reform of French Succession laws (effective January 1, 2007) modified the terms of French forced heirship. French law allows a testator the freedom to dispose of only a portion of his estate. The rest ("*la réserve*") is reserved for certain privileged heirs. The *réserve* that must be passed to children is half the estate if the testator has one child; two-thirds, if two children; and three-fourths, if three or more children. If the decedent has no descendants, the surviving spouse is entitled to one quarter. The 2006 reform abolished any *réserve* for ascendants (grandparents), but allows the parents of a decedent who died without descendants to recover from the estate one-quarter of the assets they had given to the decedent during life. A future heir may renounce his or her share during lifetime. An heir wishing to assert a claim to *la réserve* must do so within 10 years of the decedent's death.

(b) Singapore Provisional Forced Heirship

Forced Heirship rules apply in Singapore only to Muslims domiciled in Singapore.[65] With respect to a non-Muslim domiciled in Singapore or any nondomiciliary, the forced heirship rules do not apply.

In addition, Singapore law gives the Singapore courts the power to order payments out of the estate of a deceased individual for the benefit of his surviving spouse or children, so long as the court is of the opinion that there was no reasonable provision for their maintenance from the estate[66]

(c) Mexican Law

Mexican law does not provide a forced heirship right. The Mexican courts, however, may change the provisions of a Will that does not provide support for the decedent's dependents.[67]

(d) Canadian (British Columbia) Law

Like matrimonial property rights, forced heirship rights in Canada are governed by provincial law. British Columbia has no forced heirship right, *per se*, but under the Wills Variation Act, a court may revoke a Will in favor of the spouse or descendants. This power is reserved to probate assets, however, and may be easily avoided by transfer of property by means of joint tenancy with right of survivorship or by trust.[68]

[65] Administration of Muslim Law Act (Cap. 3, Statutes of Singapore).
[66] Section 3, Inheritance (Family Provision) Act (cap. 138).
[67] Código Civil Federal.
[68] Section 2 of Wills Variation Act R.S.B.C. 1966 Chapter 490.

F. RECOGNITION OF TRUSTS

1. In General

A significant portion of our U.S. estate planning, and planning in other common-law jurisdictions, involves the creation of trusts. The concept of "trust", however, is generally not a part of the law of civil law jurisdiction (countries such as France, Germany, Spain, Italy and Japan). Thus, if a trust is created under U.S. law, the trustee will be deemed to have either have full legal and equitable title to the trust corpus (as in Germany) or will only be considered an agent of the beneficiaries (as in Japan). In these countries where the trust is simply ignored, the beneficiaries or "trustee" as the case may be will be taxed as the legal recipients of the property.

Failure to recognize the legal relationship of the trust can result in a decedent's heirs becoming fully liable for all the debts of the decedent or to a higher rate of inheritance tax due to the trustee's lack of familiar relationship to the decedent (in those jurisdictions whose inheritance tax rates are a function of the heir's relationship to the decedent).

The Hague Convention on the Law Applicable to Trusts and their Recognition (the "Hague convention") was entered into to enable civil law jurisdictions to recognize the concept of trusts.[69] Only a few nations, however, have ratified the Hague Convention. The United States, the United Kingdom, Canada, Australia, Italy, the Netherlands and Luxembourg have signed the Hague Convention, but only the United Kingdom, Canada, Australia and Italy have ratified it. Under the Hague Convention, the trust assets and the assets of the trustee are recognized as separate, and the trustee may register as titleholder of only the legal and not the beneficial interest.

It is advisable to avoid creating trusts funded (or to be funded) with assets in civil law jurisdictions that have not ratified the Hague Convention unless the law of the jurisdiction affords some protection to the trust beneficiaries. Many jurisdictions utilize a contractual notion based on the laws of agency to interpret a common law trust. Such an analogy may not protect against claims to ownership by the trustee, however. In the event of claims made by the trustee, the beneficiaries have recourse only to a lawsuit.

Other civil law jurisdictions have passed special legislation to deal with trusts validly created under another jurisdiction. German law recognizes *intervivos* trusts created in a foreign jurisdiction; and although it does not recognize a testamentary trust, the named trustee may be granted extended authority (as a *Testamentvollstrecker*) to manage the estate of the decedent in a manner most in accordance with the decedent's wishes. Recent reforms to French law allow for the recognition of foreign trusts (only those not holding French real property) but have not removed the great difficulty inherent in dealing with a trust in France.

2. Trusts in Canada

U.S. estate planning practice frequently involves the use of a revocable *intervivos* trust that is initially funded with the client's major assets, along with a "pourover" Will that transfers to the

[69] *See* Underhill and Hayton, *Law Relating to Trusts and Trustees*, 936-54 (Butterworth, London 1995).

trust any assets remaining in the client's own name at death. This procedure has two serious problems.

Canadian law imposes a capital gains tax at death upon the world-wide estate of an individual resident in Canada and upon the Canadian property of a non-Canadian resident decedent. Further, almost any *inter vivos* disposition of Canadian property will trigger a capital gains tax.[70] Various Canada Revenue Authority rulings have indicated that the transfer of Canadian property into a revocable trust is a disposition of property for Canadian capital gains tax purposes. There will be a capital gains tax, then, on the transfer of Canadian property to a U.S. revocable trust. Such a transfer, then, should be avoided.

In addition, a revocable trust is incorporated by reference into a "pourover" Will such that the trust may be amended without the formalities required for the execution of Wills. Such authority is clarified in the United States by a state's adoption of the Uniform Testamentary Additions to Trusts Act, which validates this pourover arrangement.[71] Unfortunately, no Canadian province has adopted this type of legislation. Many Canadian estate planners are of the opinion, then, that the passing of Canadian property under the provisions of a U.S. pourover Will is invalid. Canadian property, then, should be transferred pursuant to a properly drafted Canadian-situs Will, with careful carving out of the property from the U.S. Will; or in a U.S. Will that passes the Canadian property as a specific bequest.

G. WILLS AND ESTATE ADMINISTRATION

Not all jurisdictions recognize the right of an individual to execute a document (a "Will") expressing her testamentary wishes. In some countries (such as China), an individual is not treated as the owner of property of which she can dispose. Other countries (such as Japan) outline by statute the heirs to real property. Even if the right to make a testamentary disposition by Will is recognized, the matrimonial property rights, forced heirship, court-ordered redistribution, described above, and even the prohibition against foreign ownership serve to override an individual's testamentary wishes.

1. Procedural Matters

(a) Execution Formalities

Some countries may respect an individual's right to dispose of property by Will, but may assert local formalities regarding execution. Fortunately, certain international laws provide us guidance. When drafting a U.S. Will to pass property in a foreign jurisdiction, one should always consult with counsel in that jurisdiction regarding execution formalities. If time is of the essence, comply with both the Hague Convention and the Washington Convention to provide greater likelihood of acceptance under foreign law.

[70] *See* paragraph e of the definition of "disposition," section 54 Canadian Income Tax Code.
[71] Scott on Trusts, 4th Ed., 1987, Section 54.3.

(i) Hague Convention - Testamentary Dispositions

Many countries (38) have ratified the Hague Convention on the Conflict of Laws Relating to the Form of Testamentary Dispositions (October 5, 1961). Although the United States has not ratified the convention, we U.S. practitioners can benefit from its recognition in other jurisdictions. The convention provides (with some local exceptions) that a testamentary instrument is valid if it complies with the local law of any of:

- The place where the testator made it;
- The nationality of the testator either when he or she made it or at his or her death;
- The place of domicile of the testator either when he or she made it or at his or her death;
- The place of "habitual residence" either when he or she made it or at his or her death; or
- For immovables, the place where they are physically located.

(ii) Washington Convention

A second convention regarding Wills was ratified by the United States in 1991, but enabling legislation has not been enacted in any state. Again, it provides some guidance regarding the enforcement of a U.S. Will in a foreign jurisdiction. The Convention Providing a Uniform Law on the Form of an International Will (the "Washington Convention") has been ratified or acceded to (with enabling legislation enacted under local law) by several countries.[72]

To be valid under this convention:

- The Will must be in any form of writing, including typewritten and handwritten and may be in any language;
- The testator must declare in the presence of two witnesses and a person "authorized to act in connection with an international Will" that the Will is the testator's Will and that he or she knows the contents of the Will;
- The testator must sign the Will in the presence of the witnesses and the authorized person or, if the testator has already signed it, acknowledge his or her signature to the witnesses and the authorized person;
- The witnesses and the authorized person must "there and then" attest to the Will by signing it in the presence of the testator;
- All signatures must be at the end of the Will. If the Will has more than one page, the testator must sign each page. Each page must be numbered.
- The date of the Will must be "noted" at the end of the Will by an "authorized person."
- The authorized person must attach a certificate to the end of the Will that provides that the procedures for the execution of an international Will have been complied with.

[72] Sierra Leone, the United States, Laos, Holy See, Belgium, Ecuador, the United Kingdom, Czechoslovakia, Canada (with respect to a few provinces), Bosnia-Herzegovina; Cyprus, Libya, Niger, Portugal, Slovena, Iran Laos, Russian Federation.

(iii) Uniform International Wills Act.

The Uniform Probate Code contains the Uniform International Wills Act (which may be adopted as a separate Act). This U.S. law provides grounds to establish the validity of a Will executed in another jurisdiction. It must be adopted into state law, however. The State of Washington has not yet enacted it nor have Washington courts yet ruled on the admissibility of a foreign Will.

(b) Estate Administration

When an individual dies resident in, with property in, or with heirs in a foreign country, that country will assert jurisdiction over its persons or its property. Estate administration procedures vary tremendously. Indeed, most civil law jurisdictions do not even treat the estate as a separate legal entity, and there is no formal administration (probate) at all.

As a general rule, it is never possible to avoid dealing with the authorities in a civil law jurisdiction by means of a probate-avoidance mechanism like a revocable trust. In common law jurisdictions that recognize trusts and do (may or may not) have the notion of an estate, it may be possible to avoid certain cumbersome probate-like administration procedures by means of transferring assets to a trust during lifetime, but some sort of administration of local-situs property cannot be avoided.

Another convention entered in to at The Hague, Netherlands attempted to deal with one portion of the complex administration issue: Who is entitled to administer the moveable assets of a decedent? The Hague Convention Concerning the International Administration of Estates of Deceased Persons (October 2, 1973) has only been ratified by three countries.[73]

2. Will Drafting

For some clients, it may be advisable to have more than one concurrent Will: a “domiciliary” Will for assets in the primary jurisdiction (the client’s intended residence at death) and a “situs” Will for assets elsewhere. When using either one Will, to pass a client’s world-wide estate, or multiple Wills, competent foreign counsel must be consulted. If the multiple-Will approach is taken, the U.S. attorney must be closely involved with the drafting of the foreign Will. A properly devised plan may be easily defeated by language in a foreign Will that does not properly coordinate with the United States Will.

Following are some of the issues to consider when undertaking international drafting:

(a) <u>Recitation of Domicile in Will</u>

Whether or not a client ends up with one Will or two (or more), it is important in all international Wills that the document make no recitation as to residence or domicile. Recall, “domicile” for U.S. estate tax purposes includes an element of intent. A statement regarding residence in a U.S. Will may be construed as evidence of intent to be domiciled in the United States at death, and it is best to let the issue be established at death. If domicile in a particular jurisdiction is desired,

[73] Czech Republic, Portugal, Slavakia (although signed by Italy, the Netherlands, and the United Kingdom).

however, and there is some ambiguity as to its interpretation, it may be beneficial to make an affirmative statement to establish that intent.

(b) Drafting of the Situs or Domiciliary Will

The purpose of executing two Wills is generally to segregate certain assets from exposure to the laws of a certain jurisdiction. It is important in drafting the United States Will (whether it be a "situs" or a "domiciliary" Will) that the relevant law and assets be properly described.

(c) Description of Property Circumscribed by Will; Situs of Assets

The property to be disposed of by the U. S. Will should be expressly described at the Will's outset in a separate paragraph. One should also avoid a broad residuary clause and, instead, limit the residue to assets specifically defined in the definition paragraph of the Will. The U.S. Will should grant the personal representative the power to determine what property is governed by the U.S. Will.

(d) Revocation of Prior Wills

The Will should be careful to revoke only that Will which disposes of property covered by the new Will and not property covered by a Will disposing of assets in a different jurisdiction.

(e) Governing Law; Conflicts of Law; Forum

One may attempt to override the law of situs in the Will and, indeed, should do so when the law of an asset's situs would subject that asset to a forced heirship contrary to the testator's intent. Although one will want to specifically choose the forum for estate administration, one may wish to grant to the personal representative the power to change administration to another jurisdiction.

(f) Payment of Taxes

One should determine which taxes will be paid by which property and give the personal representative discretion to choose to pay or not to pay taxes in a jurisdiction outside of the purview of the United States Will. There is no legal requirement that a United States personal representative pay foreign death taxes from assets located in the United States, and no U.S. court has yet ordered payment of foreign taxes from property passing under a U.S. situs/domiciliary Will.[74]

(g) Choice of Personal Representative; Probate Jurisdiction

Choose a personal representative familiar with the laws of the situs jurisdiction, provide for original probate in Washington, and provide for ancillary probate in any other country, state, or other jurisdiction where it may be necessary or advisable to probate the Will.

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[74] *See, e.g., Her Majesty in the Right of the Province of British Columbia v. Gilbertson,* 597 F.2d 1161 (9th Cir. 1979).

(h) Payment of Foreign Claims

One may grant the personal representative the power to pay, as an expense of administration, debts and expenses owed to creditors outside of the United States. Again, no U.S. court has yet ordered payment of foreign claims out of U.S. property covered by a properly drafted U.S. situs/domiciliary Will. So for a U.S. domiciliary facing ambiguous, potentially large claims from another jurisdiction, one should specifically not give the personal representative this power; or, in the alternative, should give the personal representative discretion to pay or not to pay foreign claims.

IV. TRANSFER TAX ISSUES

Most countries in the world levy a tax on the transfer of assets from a decedent. A particular country's jurisdiction over the assets of a decedent will be expressed in local law. Jurisdiction may be based upon the citizenship, residence or domicile of the decedent, or upon the existence of assets located within that jurisdiction. Generally, the laws of each country provide a tax threshold (and a filing threshold). Most countries provide reduced or eliminated taxation on assets that pass to a surviving spouse. Many countries provide a reduction in the rate of taxation based upon the familiar relationship of a particular heir to the decedent.

While a decedent's gross estate may be below the filing/taxation threshold for U.S. estate tax purposes, some or all of the estate may be subject to estate tax in a foreign country by virtue of that country's assertion of jurisdiction over the estate. Only a few tax treaties provide relief from the possible conflicts of law. Thus, proper international estate planning requires a comparative analysis of the transfer tax systems of the United States and other jurisdictions, an understanding of property situs and valuation distinctions from jurisdiction to jurisdiction, and a review of any tax treaty between the United States and other jurisdictions.

A. TRANSFER TAX SYSTEMS

1. Estate Tax Systems

Jurisdictions with English common law legal systems generally have estate tax systems similar to the United States with formal estate administration. Luxembourg, the Philippines, South Africa and Zimbabwe have such systems. Taxation is levied on the decedent's estate prior to distribution to the heirs. Jurisdiction is based upon the domicile/residence of the decedent.

2. Inheritance Tax Systems

Jurisdictions with civil law legal systems usually have inheritance tax systems that do not involve formal estate administration. Instead, a decedent's estate immediately vests in his statutory heirs, who take both assets and liabilities. Tax is levied on the heir, and usually a higher tax rate applies the more remote the beneficiary is from the decedent.

Some jurisdictions will levy a tax based upon the citizenship or residence of the heir rather than that of the decedent. The recipient is taxed on all property received, regardless of its situs and regardless of the domicile or citizenship of the decedent. A decedent may have no nexus with such a jurisdiction; but an heir with residence or citizenship there will be required to pay inheritance tax. Jurisdictions with this system include Austria, Finland, Germany, Japan and Spain.

In other inheritance tax jurisdictions, taxation is based upon the citizenship or residence of the decedent and not of the heir. Consequently, an heir—resident anywhere--is taxed in these jurisdictions on property (regardless of situs) from a resident or citizen decedent. Jurisdictions that follow this approach include Belgium, Chile, Greece, France, Norway and Italy.[75]

3. Other Systems

The United Kingdom, although a common law country, has an inheritance tax system. Unlike most inheritance tax jurisdictions, however, there is formal estate administration. Taxation is based upon the domicile of the decedent and situs of assets. Like the United States, the United Kingdom distinguishes between domicile and residence of an individual.[76]

Canadian law taxes a deemed capital gains at death—a tax which does not fit within the definition of "death taxes" for purposes of the Internal Revenue Code § 2013 credit for foreign death taxes paid. Article Fourteen of the U.S.-Canada treaty provides a pro-rata credit against U.S. estate tax.

4. No Death Tax

Some countries impose no tax upon death. These include Australia, New Zealand, Sweden, Israel, Mexico, India, China, Hong Kong and Singapore. Hong Kong repealed its death tax in 2007. Singapore repealed its death tax in February 2008. Mexican law levies an income tax *mortis causa* on assets that pass upon death to a beneficiary other than a spouse or descendants.

B. UNITED STATES ESTATE TAX SYSTEM, IN GENERAL

1. United States Citizen

The U.S. estate tax applies to a U.S. citizen's worldwide property, regardless of situs and regardless of the citizen's domicile.[77]

2. Domiciliary Alien

An alien (non-U.S. citizen) domiciled in the United States (resident here with the intent to remain permanently) is subject to estate tax on worldwide property.[78] If an alien is resident in the United States, but has demonstrated intent to return home, she will not be a domiciliary alien for U.S. estate tax purposes.

[75] Italy has an inheritance tax, again. New Italian law taxes estates over € 1 million, at the rate of 4% for "direct relatives" and 8% for non-relatives.
[76] Recent (April 2008) changes to UK law brought in sweeping changes regarding the taxation of UK resident nondomiciliaries
[77] IRC §§ 2001(a), 2031(a).
[78] IRC §§ 2001(a), 2031(a).

3. Non-domiciliary Alien

A non-domiciliary alien decedent is subject to U.S. estate tax only on property located in the United States at the decedent's date of death (*i.e.* property with a U.S. situs).[79]

C. UNIFIED CREDIT

1. United States Citizen

A U.S. citizen, regardless of domicile, is entitled to a credit against U.S. estate tax that is currently equal to the measure of tax on $2,000,000.[80] Under current law, that amount will increase to $3.5 million in the year 2009. This exemption is subject to various increases and decreases in subsequent years.

2. Domiciliary Alien

A domiciliary alien is entitled to the full unified credit.[81]

3. Non-domiciliary Alien

Generally, the estate of a non-domiciliary alien is entitled to a credit against U.S. estate tax of $13,000 (*i.e.* the measure of tax on $60,000). If the decedent was a domiciliary of a possession of the United States (*i.e.* Puerto Rico, Guam), his estate is entitled to the greater of that figure or a fraction, where the numerator is the value of his U.S. property and the denominator is the value of his worldwide estate.[82]

4. Coordination with Treaties

Section 2102 (c)(3) of the Internal Revenue Code specifically defers to any unified credit authorized by treaty. This provision also dictates by what terms any such treaty shall be negotiated. The amount of the treaty credit will be limited to a fraction of the unified credit available to a domiciliary or citizen, where the numerator is the value of the decedent's U.S.-situs property and the denominator is the value of the decedent's worldwide estate.

Treaties negotiated on the basis of this provision are the Canadian, German and French treaties. All these treaties increase the unified credit otherwise available to a non-domiciliary subject to U.S. estate tax to this pro rata unified credit. Thus, the estate of a decedent who was resident in any of these treaty countries is entitled to unified credit greater than the $13,000 available to decedents from non-treaty countries.

[79] IRC §§ 2101, 2103.
[80] IRC § 2102.
[81] Id.
[82] IRC §2102(c)(2).

D. CREDIT FOR FOREIGN DEATH TAXES PAID

1. U.S. Citizen or Domiciliary Alien

Generally, Section 2014 of the Internal Revenue Code allows the estate of a U.S. citizen or domiciliary to claim a credit for foreign death taxes actually paid to another country with respect to property located in that country. The credit applies to death taxes "substantially equivalent" to "an estate, inheritance, legacy, or succession tax" and is allowed only on property sited either in that foreign country or the United States and subject to taxation by both nations. No credit is allowed for property sited outside of the country imposing the tax.

The regulations under section 2014 provide that a foreign death tax is eligible for credit if it is imposed with respect to: 1) property situated within the foreign jurisdiction to which the tax is paid; 2) property included in the decedent's gross estate; and 3) the decedent's U.S. estate.[83] The credit is limited. Section 2014(b) limits the amount of credit to the lesser of: 1) the amount of foreign death tax attributable to foreign property; or 2) the amount of federal estate tax attributable to the foreign property.

Situs is determined under U.S. situs rules. Therefore, if U.S. rules site the property in the U.S., no credit will be available under the first limitation even if foreign law sites the property in the foreign country and, thus, imposes a tax within that country. In order to obtain this credit, all assets within the decedent's worldwide estate must be disclosed.

2. Non-domiciliary Alien

Section 2014 does not apply to the estate of a non-domiciliary alien. Thus, absent a treaty provision to the contrary, the estate of a non-domiciliary alien decedent subject to U.S. estate tax is not entitled to a deduction against U.S. estate tax for death taxes paid to a foreign jurisdiction. Depending upon the laws of the decedent's primary taxing jurisdiction, a non-domiciliary alien may or may not be entitled to a credit against tax by that jurisdiction on U.S.-situs property. [84]

3. Coordination with Treaties.

The seventeen estate tax treaties[85] entered into by the United States are specifically designed to remedy double taxation. An estate is entitled to elect the greater benefit under treaty or §2014. Because the United States imposes estate tax on the worldwide assets of its citizens and domiciliaries and most other countries impose death tax on the basis of residence, double taxation frequently results. The estate tax treaties attempt to remedy this problem.

Some treaties have specific definitions of asset situs so as to determine which country may tax an asset. For example, under the French treaty, the United States cannot tax the U.S. stock owned

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[83] Treas. Regs. §20.2014-1(a).
[84] IRC §§ 2104 and 2105.
[85] Australia, Austria, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, South Africa, Sweden, Switzerland, the United Kingdom and Canada (transfer on death provisions in Canada-U.S. income tax treaty).

by a French-resident decedent.[86] With respect to real property, the treaty affords primary taxing jurisdiction to the country in which the property is located. The recent Protocol to the French treaty (effective 2007) includes within the definition of "real property" shares in entities at least 50% of which is real property located in either the United States or France. This addition eliminates the planning technique of converting real property into an intangible asset for the purpose of avoiding taxation on that real property.

4. Domiciliary Alien from Nonreciprocal Nation

Section 2014(h) allows the President of the United States to "proclaim" that a credit against foreign death taxes not be made available to the estates of citizens of a country that does not provide a similar credit against U.S. estate taxes for U.S. citizens domiciled in that country.

E. MARITAL DEDUCTION

1. The Marital Deduction; Internal Revenue Code

(a) U.S. Citizen Surviving Spouse

Section 2056 of the Internal Revenue Code allows a deduction from the taxable estate in the amount of the value of any property passing to a U.S.-citizen surviving spouse.

(b) Alien Surviving Spouse

Whether the decedent be a citizen, a domiciliary or a non-domiciliary alien, since TAMRA (the Technical and Miscellaneous Review Act of 1988), the marital deduction is not available to a non-U.S. citizen surviving spouse, under the Internal Revenue Code, unless the property passes to the surviving spouse in a Qualified Domestic Trust ("QDOT") under IRC § 2056A.[87]

(c) QDOT or Treaty Election

Certain treaties allow variations on the marital deduction in the form of either a credit or a deduction against estate tax for property passing to the surviving spouse. Section 20.2056A-1(c) of the Treasury Regulations requires an estate to elect either the treaty marital deduction provisions or the QDOT provisions—not both.[88]

(d) Qualified Domestic Trust Requirements

The statutory and regulatory rules governing a qualified domestic trust are extensive. The trust must satisfy the marital deduction rules of IRC § 2056.[89] An election to establish a QDOT must

[86] Article 8, Convention between the United States of America and the French Republic for the Avoidance of Double taxation and the Prevention of Fiscal Evasion with respect to Taxes on Estates, Inheritances and Gifts.
[87] Treas. Reg. §§ 20.2056A-l through 13.
[88] Even if a return is not otherwise required, the Personal Representative's claim for ANY benefits under a treaty must be disclosed to the IRS. IRC § 6114 requires disclosure of a treaty-based return position on Form 8833.
89 Treas. Reg. § 20.2055A-2(b).

be made on the date of the last filed estate tax return, including extensions.[90] The trust must be controlled by a "U.S. trustee" that is either an individual who is both a U.S. citizen and resident or a U.S. domestic corporation.

Various security requirements are prescribed in the Treasury Regulations which vary depending upon the size of the estate.[91] When principal distributions are made from the trust, the trustee must withhold the deferred QDOT tax—a tax that is equivalent to the estate tax that would have been paid on that amount had a QDOT election not been made.[92] Distributions must be reported on Form 706-QDT.

For a QDOT created in the decedent's Will, a generation-skipping tax allocation over trust property may be made to the decedent, as a reverse qualified terminable interest property ("QTIP") election.[93] If the decedent has failed to establish a QDOT in her Will, the executor may establish the QDOT at the filing of the final estate tax return, including extensions.[94] If the surviving spouse has received the property outright, and then transfers the assets to a QDOT, the surviving spouse is the deemed transferor for GST tax purposes. A reverse QTIP election under IRC § 2652 (a)(3) is not available.

The Treasury Regulations provide an exemption from the Section 2056A tax in the event of distribution of principal to the surviving spouse on account of "hardship." The definition of "hardship" is defined in the regulations to allow distributions to the spouse from the QDOT in response to "an immediate and substantial financial need relating to the spouse's health, maintenance, education or support, or that of any person the surviving spouse is legally obligated to support." [95] A distribution is not exempt if the amount distributed may have been obtained from other sources that are reasonably available to the spouse, *e.g.*, the sale of publicly traded stock. Assets such as closely held business interests, real estate and tangible personal property are not considered "reasonably available." A hardship distribution must be reported on Form 706-QDT.

Section 20-2056A-4(b)(4) of the Treasury Regulations provides, with respect to the assignment of assets into a QDOT that have not been specifically directed there by specific bequest:

> i) If the assignment is expressed in the form of a pecuniary amount (such as a fixed dollar amount or a formula designed to reduce the decedent's estate tax to zero), the assignment must specify that . . .
>
> …
>
> ii) the assets actually transferred to the QDOT be fairly representative of appreciation or depreciation in the value of all property available for transfer to the QDOT between the valuation date and the date of actual transfer to the QDOT.. . .

[90] Treas. Reg. § 20.2056A-3.
[91] Treas. Reg. § 20-2056A-2(d).
[92] Treas. Reg. § 20.2056A—5.
[93] IRC § 2652 (a)(3).
[94] Treas. Reg. § 20.2056A-3.
[95] Section 20.2056A-5.

Note that these funding requirements make no distinction between liquid and illiquid assets. Thus, a Washington personal representative may utilize Washington non-pro rata allocation laws to allocate illiquid assets to the spouse and liquid assets to the QDOT, thus freeing the future QDOT trustee to make hardship exemption distributions, free of QDOT tax.[96]

2. The Marital Deduction; Treaty Variations

(a) Pre-TAMRA Treaties

When the United States amended its marital deduction provisions under TAMRA in 1988, most of the treaties that the United States currently had were already ratified, and thus, enforceable by both countries. Subsequent U.S. law (Section 7815(d)(14) of the Revenue Reconciliation Act of 1989 ("RRA") confirmed that the changes enacted under TAMRA did not supersede existing treaty obligations with respect to non-U.S. domiciliaries (in conformance with general principles of international diplomacy); but RRA explicitly abrogated treaty marital deduction rights with respect to U.S.-domiciliary decedents.

This legislation was necessary given IRC Section 7852(d). Section 7852(d) provides a "later in time" rule with respect to statute and treaty. That is, if a statute is enacted after a treaty, the statute supersedes the treaty; similarly, if a treaty is ratified after a statute, the statute supersedes the treaty:

> For purposes of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or law.

The treaty with Sweden is an example of a pre-TAMRA treaty. This treaty provides that the non-community property passing to the surviving spouse is included within the gross estate of the decedent only to the extent it exceeds 50% of all property included in the U.S. gross estate. Thus, a marital deduction is available for up to 50% of the gross estate. Although this provision formerly applied to domiciliaries of either Sweden or the United States, RRA stripped this treaty right from U.S. domiciliaries. The 50% marital deduction provided under the treaty now only applies to non-U.S. domiciliary decedents.

(b) Post-TAMRA Treaties

The United States has entered into three treaties post-TAMRA and RRA. Consistent with the "later-in-time rule" of Internal Revenue Code Section 7852(d), any marital deduction provisions under these treaties supersede Internal Revenue Code Section 2056A. These treaty marital deduction provisions apply even to the estates of U.S. domiciliary decedents.

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[96] Under Washington law, the personal representative (or trustee, as the case may be) has authority to administer the entire community estate of the decedent and surviving spouse (RCW 11.02.070). The personal representative may allocate assets to the decedent's share or the surviving spouse's share in a non-pro rata manner, and may satisfy non-specific bequests in a non-pro rata manner. Under RCW 11.98.070 (15), a trustee (or personal representative) "may select any part of the trust estate in satisfaction of any partition or distribution, in kind, in money or both and may make non-pro rata distributions of property in kind; allocate particular assets or portions of them or undivided interests in them to any one or more of the beneficiaries without regard to the income tax basis of specific property allocated to any beneficiary and without any obligation to make an equitable adjustment."

These treaties are Article 14 of the Protocol Amending U.S.-Canada Income Tax Convention (ratified November 9, 1995); the Protocol Amending United States-Germany Estate and Gift Tax Treaty (ratified December 14, 2000); and the Protocol to the U.S.-France Estate and Gift Tax Convention (ratified December 21, 2006).

(i) Canadian Treaty

The Canadian treaty provides a "marital credit" for a non-U.S. citizen equal to the applicable exclusion amount available to the decedent. If the decedent was a U.S. domiciliary, the full applicable exclusion amount applies. If the decedent was a Canadian domiciliary, the fractional applicable exclusion amount available under the treaty applies. The decedent's estate is entitled, in effect, to two applicable exclusion amounts—whether full or pro rata.

The treaty protection applies when: 1) the decedent was at the time of death a citizen of the United States or a resident of either Contracting State; 2) the surviving spouse was at the time of the decedent's death a resident of either Contracting State; 3) both the decedent and the surviving spouse were residents of the United States at the time of the decedent's death, and one or both was a citizen of Canada; and 4) the executor of the decedent's estate elects the benefit of the treaty and waives irrevocably the benefits of any estate tax marital deduction that would be allowed under the law of the United States on a U.S. Federal estate tax return filed for the decedent's estate by the date on which a qualified domestic trust election could be made under the law of the United States.[97]

Thus, the treaty applies, for example, when the decedent was a U.S. citizen domiciled in the United States, leaving an estate, consisting entirely of U.S. property, to the decedent's Canadian-citizen surviving spouse.

(ii) French Treaty

Article VI of the 2004 Protocol to the French treaty (ratified December 21, 2006) adds a new paragraph 3, allowing a marital deduction in connection with transfers satisfying five conditions: 1) the property must be "qualifying property"; 2) the decedent must have been domiciled either in France or in the United States or a citizen of the United States; 3) the surviving spouse must have been domiciled either in France or the United States; 4) if both the decedent and the surviving spouse were domiciled in the United States, at least one of them must have been a citizen of France; and 5) the personal representative is required to elect the benefits of the treaty and waive the benefits of any marital deduction available under U.S. law.

"Qualifying property" is property that passes to the surviving spouse within the meaning of U.S. law and for which a marital deduction would have been available, had the surviving spouse been a U.S. citizen. The amount of the marital deduction allowed is equal to the lesser of: (i) the value of the qualifying property, and (ii) the applicable exclusion amount available to the decedent *without regard to any gifts previously made.*

Note that, just as under the Canadian treaty, any property for which this treaty election has been made will NOT be included in the surviving spouse's gross estate under Internal Revenue Code

[97] Article 14, Section B(3) of the 1995 Protocol.

§§ 2044 (marital deduction inclusion), 2056A (qualified domestic trust) or 2519 (dispositions of certain life estates). This marital deduction, then, is an additional "marital exclusion."

The protocol allowed a brief period to request a refund for U.S. Federal estate tax paid after November 10, 1988 (TAMRA) and before December 21, 2006. That period ended December 31, 2007.

F. CHARITABLE DEDUCTION

Because much of our planning involves testamentary charitable bequests, it is essential that the practitioner be aware of any limitations with respect to the deductibility of those bequests in other jurisdictions and to the deductibility of those bequests under the U.S. estate tax.

The definition of "charitable organization" varies widely from jurisdiction to jurisdiction. Absent specific treaty provisions, counsel to a U.S. domiciliary who wishes to bequeath foreign-situs property to a private foundation (U.S. or foreign) must delve into the laws of that jurisdiction to ensure that a bequest to such a private foundation qualifies for a charitable deduction against foreign death tax.

1. Charitable Deduction: Internal Revenue Code

Section 2055(a) of the Internal Revenue Code provides U.S. citizens or domiciliary decedents a deduction for bequests to domestic or foreign charitable organizations. Section 2106(a)(2) limits the charitable deduction available to a non-domiciliary alien only to gifts to U.S. charitable organizations.

2. Charitable Deduction Under Treaty

The German, French Swedish, Danish and Canadian treaties have special provisions with regard to charitable deductions. The German treaty provides the estate of a German domiciliary decedent a charitable deduction for a bequest to a German charity equivalent to a U.S. 501(c)(3).[98] The French treaty allows a charitable deduction against U.S. estate tax imposed upon a French domiciliary only for a bequest to U.S. or French public charities. A bequest to a private foundation, then, is not deductible.[99]

The Canadian treaty also expands the charitable deduction available to U.S. and Canadian domiciliaries. A non-U.S. citizen, Canadian domiciliary is entitled to a deduction against U.S. estate tax for bequests to U.S. charities or Canadian registered charities. A U.S. domiciliary is entitled to a deduction against U.S. estate tax for bequests to a Canadian registered charity as well as a U.S. 501(c)(3).

[98] U.S.-German Convention, Art. 10(2).
[99] U.S.-French Convention, Art. 10.