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Dealing with International Assets in Estate Planning

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INTRODUCTION

Everyone will agree that the world is much smaller than it has ever been, and it continues to shrink. It is becoming more and more common for people of moderate means to own assets outside of the United States — being ''global'' is not just for the wealthy anymore. Thus, U.S. estate planners increasingly encounter clients who have questions about how to deal with foreign assets in their estate plan.

A trusts and estates practitioner whose practice historically focused on domestic estate planning might not know where to begin when a foreign asset is involved. Daunted by venturing into unfamiliar territory, some attorneys refer everything with an international flavor to lawyers who focus on international planning. Although it is certainly prudent to seek assistance from someone who specializes in offshore planning, every U.S. estate planner already has the base knowledge and tools in their planning toolbox to provide quite a bit of advice and assistance to these clients before calling in reinforcements.

As with any client who owns assets in multiple U.S. states, the primary question that the U.S. estate planner will need to ask when faced with a client who owns non-U.S. assets is whether probate/estate administration can be avoided in the foreign jurisdiction. Then local counsel should be retained to explore the options and the tax consequences, and to assist in implementing the plan. Counsel in the foreign jurisdiction is critical to avoid running down unnecessary rabbit trails or stepping on any land mines. Being an ''international estate planner'' does not mean that you should know the laws of foreign jurisdictions — instead, you are the U.S. advisor whose role is to coordinate with the non-U.S. advisor in devising and implementing a plan for the client that works across both jurisdictions.

That being said, there are numerous fact permutations and complex U.S. and foreign tax issues that are different for each client and will drive the client's specific planning. Therefore, this article will focus on providing a basic overview of the tools that are available for U.S. clients to avoid probate in a non-U.S. jurisdiction.

TRUSTS AND TRUST-LIKE VEHICLES

Revocable Management Trusts; Living Trusts

In certain states in the United States, the probate process is sufficiently expensive and burdensome that people frequently use fully funded revocable trusts as their primary estate planning vehicle in order to avoid an estate administration (for example, California's probate process is notoriously onerous and expensive).

The typical estate plan in such a jurisdiction involves establishing a revocable trust (sometimes also referred to as a ''revocable management trust'' or a

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''living trust'') and transferring all assets to the trust that would otherwise have to go through probate if they were owned outright. This includes real estate, bank accounts, investment accounts, and any other traditional ''probate assets.'' A brief pourover will is drafted to catch any probate assets that were not transferred to the revocable trust during the client's life, directing the assets to be transferred to the trustee of the revocable trust.

In the domestic-estate planning context, revocable trusts are also used for clients who own assets in multiple states. To the extent that the testator transfers title to all of such assets into the name of the trust during life, this avoids the need to open an ancillary probate administration in every jurisdiction where the assets are located.

This same theory can apply to foreign assets. If it is possible to use the client's existing revocable trust to hold title to foreign assets, the disposition of those assets can be handled under a single document. However, more often than not, using a revocable trust to hold non-U.S. assets is not an option. In many civil-law jurisdictions, the concept of a trust as we know it is generally not recognized, and so title either cannot be held in the name of someone ''as trustee,'' or the local law will view the trustee as both the legal and beneficial owner of the asset (thereby still requiring probate at the trustee-beneficiary's death). Additionally, in some jurisdictions (like the United Kingdom, for instance), a transfer of assets to a revocable trust can draw immediate inheritance taxation of approximately 40%.

For these reasons, we have found that it is rare to be able to use a typical revocable trust to directly hold non-U.S. assets during a client's lifetime as a way of avoiding probate in the foreign jurisdiction, but this option is always worth exploring.

Irrevocable and Testamentary Trusts

The use of an irrevocable gifting trust to hold foreign property might not work for the same reasons that transferring title to a revocable trust will not work. However, the goals of an irrevocable trust are generally different from the goals of a revocable trust, and so in jurisdictions that recognize trusts but which impose an inheritance tax or other transfer tax on the creation of a trust, gifting a foreign asset to an irrevocable trust might make sense in the client's overall estate plan. And even if the client cannot fund a trust during his lifetime, then at death, he might be able to direct assets to the trustee of his revocable trust (now a testamentary trust), thus avoiding probate, and possibly estate or inheritance taxation, of the asset in subsequent generations.

Fideicomisos

If a foreign civil-law jurisdiction does not allow trust ownership of property that is located in the jurisdiction, many civil-law jurisdictions in Central and South America have a statutory trust vehicle called a *fideicomiso* that can act much like a common-law trust and, if structured properly, it can avoid probate in the foreign jurisdiction. Depending on the terms of the *fideicomiso* and the fiduciary obligations imposed upon the trustee, a *fideicomiso* can be treated as a mere nominee relationship for U.S. tax purposes, or it can be classified as a foreign trust, with all of the attendant foreign-trust taxation and filing requirements.[1]

Foundations

Some foreign jurisdictions — such as Liechtenstein, Switzerland, Panama, and the Cook Islands — have statutory foundations, not to be confused with private foundations used for charitable purposes. A foundation is recognized in its home jurisdiction as an entity with its own separate legal personality (unlike a common-law trust) but it can function much like a trust. The founder can name a succession of beneficiaries, and the Foundation Board can be given various levels of discretion with respect to the distribution and management of the foundation's assets. For U.S. tax purposes, a foundation will generally be treated as a foreign trust, with all of the attendant foreign-trust taxation and filing requirements.[2]

ENTITIES

Whether or not a trust or a trust-like vehicle is an option for property ownership in the foreign jurisdiction, it may nonetheless make sense to title the foreign asset in the name of an entity, with the shares of the entity either held directly by the client (in which case, the client's U.S. will should suffice to control disposition of the entity) or in a trust (if possible). This way, the ownership of the property never needs to be changed again — only the ownership of the shares of the entity changes. Also, depending on whether or not the foreign jurisdiction looks through the entity for purposes of stamp duties and transfer taxes, this may be a way to avoid such taxes when ownership of the entity changes hands. However, in some jurisdictions (Mexico, for example), entity ownership draws unnecessary local taxation, which makes this option less desirable.

If entity ownership is a viable option, then ideally a U.S. client should hold non-U.S. property in a U.S. entity in order to avoid the taxation and reporting rules that apply to a U.S. person's ownership of a for-

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[1] *See* Rev. Rul. 2013-14, 2013-26 I.R.B. 1267; PLR 201245003.

[2] *See* AM 2009-012.

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eign entity (such as the "controlled foreign corporation" (CFC) and "passive foreign investment company" (PFIC) rules). However, the foreign country may not allow a company that is incorporated in another jurisdiction to own property located there. Thus, there may be no choice but to use a foreign entity to hold the property. In this case, the client will need to choose a form of foreign entity that can elect to be treated as a pass-through entity for U.S. tax purposes, and not a *per se* corporation,[3] to avoid the CFC and PFIC rules.

USUFRUCTS

Most civil-law jurisdictions have the concept of a usufruct as another option for avoiding probate of a foreign asset. A usufruct is an arrangement under which one person has the legal right to use and enjoy the fruits or profits of something belonging to another. Under a usufruct, one person transfers title in property to another person (the "naked title" owner), while reserving the current rights to use and enjoy the property for life in his or her capacity as the usufructory. Upon the cessation of the usufructory's interest at death, the full rights in the property will be reunited in the hands of the naked title owner.

The closest analog to a life-long usufruct under U.S. law is a life estate, whereby the life-estate owner has the right to use the property for his lifetime, and upon his death, fee-simple title to the property vests in another person. At first, this arrangement might seem like the perfect way to avoid probate in the foreign jurisdiction. However, because the creation of a usufruct is a transfer with a retained interest, it may have some unpalatable U.S. gift and estate tax consequences.

As for the U.S. gift-tax consequences, the person creating the usufruct will have made a completed gift of the naked title (i.e., the remainder interest) in the property because the usufructory has parted with dominion and control over the naked title and has retained no further power to change the disposition of the property.[4] The fair market value of a gift in which the donor retains an interest is the value of the property *less* the present value of the retained life estate interest, as determined using published Internal Revenue Service actuarial tables.[5]

For purposes of illustration, in an IRS Private Letter Ruling, a husband and wife owned their residence in joint tenancy, and, therefore, each was treated as owning 50% of the property. Subsequently, they transferred their residence to their child. In connection with the gift, the husband and wife were given the right to use and enjoy the property for the remainder of their lives. At the time of the transfer, the husband was 82 years old and the wife was 80. The IRS concluded that, based on the applicable actuarial tables, the present value of $1.00 at the death of the survivor of two persons aged 82 and 80 was $0.44906, and that "[t]his factor, when multiplied by the fair market value of the property, as of the date of transfer, will provide the value of [the] gift."[6] Thus, if the full fair market value of the property in this PLR had been $100,000, then the donors' gift of the remainder interest would have been $44,906.

Unfortunately, the gift-tax valuation of the donor's retained interest at the time of the gift will not be taken into account for purposes of determining the value of the property for estate tax purposes. Instead, the date-of-death value of the "entire property," not just the retained usufruct interest, is subject to U.S. estate tax at the donor's passing. Under the estate tax rules, when a person retains the right to possession or enjoyment of gifted property (e.g., a life estate or a usufruct), the value of the entire property is included in the decedent's estate, not just the value of the retained life estate.[7]

In summary, the creation of a usufruct is a completed gift to the extent of the naked title that is gifted to the donee, and it will use up the donor's unified credit. The annual exclusion (currently, $14,000 per donor, per donee) is not available to reduce the taxable gift because it is a gift of a future interest (only gifts of present interests qualify for the annual exclusion). Then, when the donor dies, the value of the entire property is brought back into the donor's estate at its full date-of-death value, which results in a wasting of the unified credit that was depleted at the time of the gift. If it is any consolation, though, the property will receive a full basis adjustment (hopefully, a step-

[3] *See* Reg. §301.7701-2. For example, in Mexico, the S. de R.L. de C.V. (Sociedad de Responsabilidad Limitada de Capital Variable) is a foreign eligible entity and an election can be made to treat the entity as a partnership, whereas the S.A. (Sociedad Anonima) is a *per se* corporation and cannot elect pass-through treatment.

All section references ("§") are to the U.S. Internal Revenue Code, as amended, or the Treasury regulations thereunder.

[4] *See* PLR 201032021, whereby the IRS concluded that a transferor made a "completed gift" when retaining a "usufruct" interest and transferring the "naked title" to the donor's children and grandchildren.

[5] *See* §2512(a); Reg. §25.2512-5.

[6] *See* PLR 9008042.

[7] *See* Reg. §20.2036-1(c)(1)(i), §20.2036-1(c)(1)(ii) ("D transferred D's personal residence to D's child (C), but retained the right to use the residence for a term of years. D dies during the term. At D's death, the fair market value of the personal residence is includible in D's gross estate under section 2036(a)(1) because D retained the right to use the residence for a period that did not in fact end before D's death.").

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up) in the hands of the naked title holder at the death of the usufructory, thereby eliminating any unrealized gain in the asset.

That being said, this gift and estate tax whipsaw should not cause practitioners to entirely rule out usufructs as a planning option. With the unified credit now at a combined amount of nearly $11,000,000 for married couples, many clients may not exceed their unified credit, even with the depletion of their unified credit and full inclusion of the gifted asset in their estates.

WILLS

Generally

As a final resort, if probate cannot be avoided by using trusts, trust-like vehicles, entities, or usufructs, then disposition of the client's foreign assets will need to be governed by a Last Will and Testament.

Probating a U.S. Will in a Foreign Jurisdiction

It is always preferable to have the client's estate plan addressed in a single document to avoid confusion and to minimize complication. Jurisdictions that have signed on to the Hague Convention on the Conflict of Laws relating to the Form of Testamentary Dispositions of 5 October 1961 (the ''Convention'')[8] will recognize a validly executed U.S. will. In non-signatory jurisdictions, however, the internal laws of the foreign jurisdiction will need to be explored to determine whether the jurisdiction will recognize a client's U.S. will without excess cost and hassle.

Multiple Wills in Each Jurisdiction

In most cases, even in countries that have signed on to the Convention, counsel in the foreign jurisdiction will advise that executing a local will is nonetheless preferable. For example, although Australia is a signatory to the Convention, we have had a number of Australian lawyers advise our clients that executing an Australian will to dispose of Australian assets creates much less cost and fewer headaches in the long run because the form and execution of an Australian will is so simple as compared to probating a U.S. will under the Convention.

If a local will is warranted, then the client's U.S. will and non-U.S. will should reference each other's existence in order to ensure that one does not inadvertently revoke the other. In keeping with our Australian example, below is the language that we would use in the recitals for a client's U.S. will and Australian will.

For the U.S. Will:

> I, Nicole Kidman, residing and domiciled in Nashville, Tennessee, U.S.A., make this my Last Will and Testament (referred to herein as this ''Will'') to govern the disposition of all of my property and assets situated outside of Australia. I have executed a will under the laws of Australia to dispose of my property situated within Australia (my ''Australian Will''), and this Will is not intended to revoke my Australian Will (nor any codicils thereto). I hereby revoke all my former wills and codicils executed under the laws of any state of the United States.

For the Australian Will:

> This is the Last Australian Will and Testament of Nicole Kidman. I, Nicole Kidman, residing and domiciled in Nashville, Tennessee, U.S.A., make this my Last Will and Testament (referred to herein as this ''Will'') to govern the disposition of all of my property and assets situated within Australia. I have executed a will under the laws of Tennessee, U.S.A. (my ''Tennessee Will''), to dispose of my property situated outside of Australia. This Will is not intended to revoke my Tennessee Will (nor any codicils thereto).

This multi-jurisdictional planning process was so intriguing to one of our Australian clients that he launched a business that provides Australian will packages for clients and encourages Aussies living in America to seek U.S. estate planning advice. See https://australianwills.com/.

Brussels IV

For clients with assets in Europe, an option is to include a choice-of-law clause as provided in the new Brussels IV regulation. Due to the significant variation between the inheritance laws of countries in continental Europe and the United Kingdom, the European Union passed the European Succession Regulation (July 4, 2012, no. 650/2012), commonly referred to as ''Brussels IV.'' Effective August 17, 2015, the regulation allows nationals of any state, including non-EU states and even EU states who have opted out of the regulation (such as the United Kingdom), to make a choice in their will to apply their own national law to assets located in an EU state. For example, U.S. nationals can elect for U.S. law to apply to prop-

[8] https://www.hcch.net/en/instruments/conventions/status-table/?cid=40.

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erty located in Switzerland, which would otherwise be subject to Swiss forced heirship laws. This enables the U.S. person to leave Swiss assets entirely to a spouse or all to the children, and to elect for the succession laws of the person's home state to apply, thereby avoiding the application of forced heirship.

In effect, Brussels IV is a choice-of-law regulation that allows a person to choose to apply the succession laws of his home country, rather than being forced to use the law of the jurisdiction in which the asset is located. If no choice-of-law language is included in the will, the law applicable to succession will be the law of the decedent's ''habitual residence'' at the time of death (except where the decedent was manifestly more closely connected to another state, perhaps by virtue of having recently moved from there to the new habitual residence). However, the law of the habitual residence may state that the local law applicable to the asset applies in matters of succession rights concerning that asset. In other words, a U.S. person with French real estate must elect to have the law of their U.S. state apply in the will; otherwise, U.S. state laws generally provide that French law governs the succession rights concerning the disposition of land in France.

For example, Brad Pitt's estate planning attorney should consider including a provision in his California will which states that California law governs the succession rights and disposition in and to his home at Château Miraval, located in Correns, France. This will allow him to leave the French property to Angelina Jolie or any other devisee of his choice, and he will thereby avoid the imposition of France's forced heirship laws, which might compel the disposition of a portion of the property to his children.

One important choice-of-law complication addressed by the Brussels IV regulation is the concept of *renvoi*. *Renvoi* (from the French, meaning to ''send back'') applies when a forum court is directed to consider the law of another state, and may refer the case back to the other state's court. For example, the court in the forum state may apply the conflict-of-laws principles of a foreign state, which provide for the forum state to send the case back to the foreign state for consideration. But the foreign state's law may provide that the original forum state's law must be applied to the case, so then it sends it back to the forum, a process called double renvoi. This becomes problematic when it results in a never-ending cycle of deliberation. Often the inquiry comes down to this: Does the court apply the *whole law* of the state, or only the state's *choice-of-law rules* to determine whose law applies? The Brussels IV regulation precludes the application of *renvoi* altogether, alleviating the arduous inquiry that previously bogged down courts in the EU.[9]

International Wills

The Brussels IV choice-of-law option assists with planning as it relates to property located in EU states. For clients who own assets or live in other jurisdictions, an international will might be a helpful alternative.

The Uniform International Wills Act (hereafter, the ''Act'') was enacted by the UNIDROIT[10] ''Convention Providing a Uniform Law on the Form of an International Will'' as part of the Washington Convention in 1973. The United States signed the Washington Convention in 1973, formally adopting the Act, and it was added to the Uniform Probate Code in 1977. However, it is a state-by-state determination whether or not to honor an international will.

The purpose of the Act is to provide a uniform method of executing a will with testamentary formalities that will be accepted in all jurisdictions that are signatories to the Act. This ''international will'' permits a testator to execute a will in his jurisdiction of residence, and if he follows the execution formalities required by the Act, the courts of the signatory jurisdictions will permit the will to be probated in that jurisdiction, even though it was not originally executed there. Some clients are migratory, or are at a point in their lives at which they need to implement an estate plan, but they may not know where their permanent residence will be in the future. To avoid executing a new will every time they move to a new jurisdiction, these clients may be able to use this international will, which ensures that they are covered in multiple jurisdictions.

To meet the Act's requirements, a will must be in writing (handwritten or typewritten) and can be in any language. The testator must sign and acknowledge the will in the presence of two witnesses and an ''authorized person.'' For purposes of the Act, an ''authorized person'' is not simply a notary public; it should be an attorney licensed in the jurisdiction where the will is executed. Both witnesses and the authorized person must sign in the presence of the testator. A certificate signed by the authorized person must be attached to the will (an example certificate is attached as Exhibit A at the end of this article). Both the authorized person and the testator must retain copies of the certificate.

The following countries and U.S. jurisdictions have adopted the Act as signatories to either the Act or to

[9] U.S. courts generally ignore the concept of *renvoi* and apply the U.S. forum court's conflict-of-laws rule.

[10] International Institute for the Unification of Private Law.

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the Washington Convention, or have otherwise consented to be bound:[11]

Signatories of the Act	U.S. States and Territories [12]
Belgium*+	Alaska
Bosnia-Herzegovina+	California
Canada+	Colorado
Croatia+	Connecticut
Cyprus+	Delaware
Ecuador*+	District of Columbia
France*+	Illinois
Holy See*	Hawaii
Iran*	Maryland
Italy+	Michigan
Laos*	Minnesota
Libya+	Mississippi
Niger+	Montana
Portugal+	Nevada
Russian Federation*	New Hampshire
Sierra Leone*	New Mexico
Slovenia+	North Dakota
United Kingdom*	Oklahoma
United States*	Oregon
	Pennsylvania
	Virginia
	U.S. Virgin Islands

* Signature + Consent to be bound

TREATY CONSIDERATIONS

If a U.S. client is also considered a tax resident of a country with a highly developed tax regime (e.g., the United Kingdom, France, Canada), it is paramount to obtain tax advice in that other country to ensure that any U.S. planning does not have negative tax consequences in the other country. If the other country is a treaty partner with the United States, double taxation can be reduced or eliminated by treaty.

Currently, the United States has income tax treaties with over 60 countries and estate and gift tax treaties with only 15 countries. The countries with which the United States is party to estate and/or gift tax treaties are Australia, Austria, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, the Netherlands, South Africa, Switzerland, and the United Kingdom.

Further information can be found on the IRS website at the following URLs:

- http://www.irs.gov/Individuals/International-Taxpayers/Tax-Treaties
- https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estate-&-Gift-Tax-Treaties-International

[11] http://www.state.gov/documents/organization/209142.pdf. Czechoslovakia signed the Convention in 1974 but ceased to exist on December 31, 1992. Neither of its two successor independent states, the Czech Republic and the Slovak Republic, has indicated whether the Act shall apply.

[12] http://www.uniformlaws.org/Narrative.aspx?title=Why%20States%20Should%20Adopt%20UIWA.

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EXHIBIT A

CERTIFICATE OF AUTHORIZED PERSON
UNIFORM INTERNATIONAL WILLS ACT §2-1005
CONVENTION OF OCTOBER 26, 1973

I, _________*Attorney Name*_________, an attorney licensed in ______*State*________, practicing with the law firm of ________________*Law Firm Name*_____________________, located at _____________________*Firm Address*____________________________________, a person authorized to act in connection with international wills, certify that:

1. on this ________ day of ______________________________, 20___, at ____________________*Firm Address*______________________________, _________*Testator Name*_________, as Testator, (born _______*DOB*_________, in ____________*Place of Birth*_________________, and presently residing at ____________________*Testator Address*______________________________), in my presence and that of the witnesses, _________*Witness 1*_________, (born _______*DOB*_________, in ____________*Place of Birth*_________________, and presently residing at _______________*Witness 1 Address*_______________________), and _________*Witness 2*_________, (born _______*DOB*_________, in ____________*Place of Birth*_________________, and presently residing at _______________*Witness 2 Address*______________________), has declared that the attached document is his/her will and that he/she knows the contents thereof;

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2. in my presence and that of the witnesses, the Testator has signed the will or has acknowledged his/her signature previously affixed;

3. the witnesses and I have signed the will;

4. each page of the will has been signed by _________*Testator Name*_________, as Testator, and numbered;

5. I have satisfied myself as to the identity of the Testator and of the witnesses as designated above;

6. the witnesses met the conditions requisite to act as such according to the law under which I am acting; and

7. per Testator's request, I have placed the original Last Will and Testament of _________*Testator Name*_________ at _______*Location/Address of Original Will*_____, for safekeeping.

Subscribed and sworn to before me by the said _________*Testator Name*_________, Testator, and by the said _________*Witness 1*_______ and _________*Witness 2*_______, witnesses, this _____ day of ____________________, 20____.

____

_____*Attorney Name*____, Authorized Person

__________*Firm Address*___________

U.S.A.

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