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Now About that Chalet in Grenoble?

International Estate Planning

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You just took a call from your client, a U.S. citizen, who was equal parts confused and concerned. His mother died and left him a ski chalet and bank account in Grenoble, France. What are the implications? Which country's tax and inheritance laws apply? How do you advise your client?

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International estate planning issues arise in a wide range of situations. Perhaps your client is one of the more than 20 million non-U.S. citizens who live in the United States. Perhaps she is the beneficiary of a foreign trust or wants to name foreign beneficiaries, trustees or executors in her own estate plan. She may even be a U.S. citizen who owns that chalet and bank account in France.

The range of possible issues is virtually limitless. Some arise because several foreign countries do not recognize trusts. This can wreak havoc with typical U.S. estate tax planning in which currently up to $3.5 million of assets can be sheltered from estate taxes through the use of a "bypass" trust for the surviving spouse. In addition, your client may not be permitted to transfer foreign real estate in trust. And distributions from a testamentary trust to a foreign beneficiary may be subject to higher foreign inheritance tax rates than would outright distributions

Whether or not a trust is involved, your client may not be allowed to leave certain foreign assets to a surviving spouse. Forced heirship laws of many civil code countries, such as France, may require that a portion of the assets pass to children, leaving the surviving spouse only the use of the property during his or her lifetime. In the U.S., one cannot easily disinherit a spouse, but in certain foreign countries, one cannot easily disinherit the children.

Determining which country's laws will apply is tricky. A foreign country's rules may direct that U.S. law be applied, while U.S. law may refer back to the laws of the foreign country. Moreover, U.S. tax compliance rules in the international arena are onerous and complex. This article cannot address all the international estate planning issues that can arise. It will, however, deal briefly with some common issues and pitfalls, and a companion article in this journal will discuss a few tax issues. *(see Paul* Marcotte's, "Mon *Dieu! -Your Client Is Now the Beneficiary of an Offshore Trust"* in this same issue).

A Few Basics: Residence, Domicile and Situs

A preliminary consideration whenever developing an estate plan is whether your client is subject to U.S. estate taxes. A U.S. citizen, whether or not living in the U.S., is subject to U.S. estate taxes on worldwide assets. With a non-citizen, however, one must determine the client's "domicile." Non-citizens domiciled here (i.e., U.S. residents for estate tax purposes) are also subject to U.S. estate taxes on worldwide assets and have the same $3.5 million exemption as U.S. citizens. Non-citizens who are not domiciled in the U.S. ("nonresident aliens" or "NRAs") are subject to U.S. estate taxes only on their U.S. situs assets but enjoy only a $60,000 exemption.

Determining situs is too complex to cover fully here, but this article provides some guidelines. Real estate and tangible personal property located in this country will usually have a U.S. situs. Certain assets that one might think would have a U.S. situs (e.g., demand deposits in U.S. banks, many debt instruments of U.S. entities and life insurance policies issued by U.S. carriers) do not. These exceptions are designed, *inter alia,* to encourage NRAs to invest in this country and purchase corporate and government debt instruments.

Importantly, stock issued by a U.S. corporation *will* have a U.S. situs. The Internal Revenue Code ("Code"), however, does not indicate whether partnerships and limited liability companies organized in the U.S. will have a U.S. or foreign situs.

The situs rules for gifts, moreover, differ from those for transfers at death, creating some significant planning opportunities. For example, an NRA's transfer of stock issued by a U.S. corporation gives rise to a U.S. estate tax liability but not a gift tax.

Bilateral gift and estate tax treaties may change the applicable situs rules. The U.S. has a large number of bilateral *income* tax treaties, but has only sixteen gift or estate tax treaties. *See* Cohn, Deborah A. "Foundations for International Estate Planning, *Beyond QDOTs: International Estate Planning for a Flat World/'* (Maryland Institute for the Continuing Professional Education of Lawyers 2008).

"Domicile" means the place where a person last resided and intended to stay permanently; it involves both physical presence and intent. Treas. Reg. §20.0-1 (b); *Estate of Pacfuette* v. *Comm'r,* 46 T.C.M. (CCH) 1400 (1983). Being a permanent resident (i.e., having a green card) is relevant, but not conclusive, in determining whether a person intended to remain in the U.S. permanently. Similarly, the G-4 visa, often held by foreign nationals who have come to work at international organizations, does not preclude the employee from being treated as domiciled in the United State. *Elkins v. Moreno,* 435 U.S. 647 (1978); *Toll v. Moreno,* 458 U.S. 1 (1982); Rev. Rul. 80-363, 1980-2 C.B. 249.

Domicile is distinguishable from "residence," which is primarily an income tax concept. Absent green card status, U.S. residence is generally determined based on the number of days per year a person is physically present in the United States. A person's residence and domicile need not be identical, and an individual may be a U.S. resident for estate tax purposes, but not for income tax purposes.

Domicile is relevant principally for two reasons. First, the law of a person's domicile will, subject to certain exceptions, govern many issues relating to the disposition of his or her estate. Typically, but not universally, the law of domicile governs the disposition of personal property (e.g., bank accounts and securities), while the law of physical location or "situs" governs the disposition of real property. Characterizing property outside the U. S. as real or personal can be difficult, particularly in certain civil law countries. Second, domicile is one basis certain countries use for imposing inheritance, gift or estate taxes. Other bases may include residence, situs of assets and citizenship.

Basic Succession Law Concepts

The succession law of most U.S. states, the U.K. and many British Commonwealth countries is generally based on common law principles. In contrast, the succession law of much of continental Europe and the countries with legal systems influenced by those powers are based on civil law principles.

One major difference between common and civil law jurisdictions is the right of surviving family members to a share of the estate of a deceased spouse or parent. In the U.S., statutory law often allows the surviving spouse to opt for an elective share and, thus, override the decedent's will, but does not provide similar protection for children.

Public policy in civil law countries takes the opposite approach. Statutes in those jurisdictions, codified in forced heirship rules, often favor children over spouses.

Typically, the decedent's children are afforded a certain percentage of the estate, the spouse is afforded the *use* of certain property during his or her lifetime, and the decedent's will can dispose of only that part of his or her estate not allocated by law to the children.

A second major difference is that civil law countries often do not utilize a probate process for payment of creditors and distributions to heirs or beneficiaries. Rather, the decedent's assets may pass directly to a "community of heirs" who arrange distribution among themselves and, if they accept an inheritance, become liable for the decedent's debts, even in a bankrupt estate.

Planning from Only A U.S. Perspective

The most common mistake made by the practitioner who is not familiar with international estate planning is designing the estate plan solely from the U.S. perspective. By failing to take into account relevant foreign laws, the lawyer may create significant problems overseas. While this problem can arise in many contexts, perhaps the most frequent is the inappropriate use of a revocable trust or testamentary trust.

Assume your client, a U.K. national, is living in Maryland but is not domiciled in the U.S. for estate tax purposes. You use a revocable trust, rather than a will, as the primary estate planning vehicle in order to minimize the assets passing through Maryland probate. Your client transfers her home in Bethesda and her U.S. bank accounts to the trust and later moves to London.

She sells her Bethesda home and deposits the proceeds in her London bank account. She closes her U.S. bank accounts and reinvests the proceeds in equities in European corporations. All of her assets remain titled in her revocable trust, and since she is an NRA, you expect all her assets will qualify as non-U.S. situs assets, resulting in no federal estate tax.

Later, you read Code Section 2104(b) and discover that property the decedent transferred, by trust or otherwise, will have a U.S. situs if the property was situated in this country either at the time of transfer or at the time of death. Your client should terminate the U.S. revocable trust when she returns to the U.K. The likelihood that she consults you before leaving the U.S. is minimal. As a result, your initial recommendation of a revocable trust may not have been in her best interest.

The second common U.S.-centric mistake is passing *in trust* personal property for a foreign beneficiary or foreign real estate for any beneficiary. In certain circumstances, using trusts creates no problems. Yet many jurisdictions do not recognize trusts and have no domestic law of trusts. Additionally, Germany imposes higher tax rates on inheritances in trust compared with certain outright distributions. Moreover, onerous tax regimes may apply to remainder beneficiaries who are U.S. persons.

The *Convention on the Law Applicable to Trusts and on Their Recognition* (July 1, 1985, 1664 U.N.T.S. 28620 to 28634) tried to provide for the validity of common law trusts in civil law countries. The Convention, however, has not obtained a significant number of signatories. Moreover, the Convention allows signatory countries to reserve several substantive sections, undermining the goal of encouraging recognition of common law trusts. More recently, several civil law jurisdictions have shown greater acceptance of trusts created by non-residents in common law countries, even though those civil law jurisdictions still do not recognize domestic trusts.

Single Will or Several: The Debate Continues

If your client owns property in more than one country, you will need to consider whether he or she should have a single will applicable to worldwide property or separate wills for each country. There are good arguments to support both approaches, and equally competent professionals may provide different advice.

Multiple wills increase expense and complexity. The various wills need to be coordinated to ensure that one does not revoke the other, that the provisions are mutually consistent, and that the wills, taken together, dispose of all of the client's assets. Indeed, a foreign will may have to be produced in a U.S. probate proceeding to demonstrate that the foreign will did not revoke the U.S. will. Using separate "situs" wills, however, creates several advantages: probate administration does not need to be coordinated among multiple jurisdictions, coordination among competing legal systems becomes unnecessary and the formal requirements of an international will not need to be satisfied.

Among the issues that need to be addressed in connection with an international will are formal validity, substantive validity (i.e., compliance with local succession law) and authenticity.

International Wills Help Establish Formal Validity

Most states in this country recognize the formal validity of wills executed in another state if the formal requirements of a will were satisfied in the jurisdiction in which the will was signed. Problems can arise, however, when trying to have wills accepted as valid as to form in another country. International conventions address the issue of formal validity and reduce the need for multiple wills. The *Washington Convention* (also known as the *Convention Providing a Uniform Law on the Form of an International Will* (October 26, 1973, Hein's No. KAV 2317) sets out requirements that, if satisfied, ensure recognition as to form by the signatory countries. Moreover, under traditional conflicts of laws rules, the Convention can often apply in non-signatory countries. *See* Plantard, Jean-Pierre, "Explanatory Report on the Convention Providing a Uniform Law on the Form of an International Will," *Uniform Law Review* (1974).

The Convention provides that a will shall be valid as to form, irrespective of the place where it is made, the location of assets or the nationality, domicile or residence of the testator, if it is made in the form of an international will that meets several requirements. The principal difference from a purely domestic will is that an international will must be witnessed by a person authorized by state law to act in connection with international wills in addition to the two witnesses typically required. In addition, the Convention specifies certain formalities that create uniformity but that are not required to establish formal validity.

The United States has signed but not ratified the *Washington Convention.* Some states have adopted the *Uniform International Wills Act,* effectively adopting the provisions of the Convention. The District of Columbia and Virginia, for example, have enacted such legislation, but Maryland (as of 2009) has not.

The Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions (Oct. 5, 1961, 510 U.N.T.S. 176), which preceded the *Washington Convention,* resolved the formal validity issue through a uniform choice of law rule, rather than a uniform substantive procedure. Although the U. S. is not a party to this Hague Convention, several states have accepted its choice of law rules to address the formal validity of a will.

Conflicts of Laws – The Difficulty Of Establishing Substantive Validity

The Convention on the Law Applicable to Succession to the Estates of Deceased Persons (Aug. 1, 1989, 28 I.L.M. 146), which was designed to resolve conflicts of laws problems, has not won wide acceptance. The public policy differences between forced heirship jurisdictions and common law jurisdictions have proven too significant.

The substantive validity of the dispositive provisions of a will thus depends upon the rules in both the U.S. and the foreign jurisdiction regarding conflicts of law. The result in certain jurisdictions may depend upon the type of property involved and the nationality or domicile of the decedent. Resolving these conflicts is inherently complex.

Authentic or Bogus? Establishing Authenticity

Demonstrating the authenticity of the will was simplified by the *Convention Abolishing the Requirement of Legalization for Foreign Public Documents (Oct.* 5, *1961, 527 U.N.T.S. 190).* This Convention allows the government of one jurisdiction to use a standard certificate, called an apostille, to authenticate the signature of the government official attesting to the authenticity of the docqument and the capacity in which the official has acted. For non-signatory countries, the authenticated will to which the apostille is attached must be further authenticated by the U.S. Department of State.

Conclusion

The issues that can arise in an international estate plan are varied and complex. This article discussed just a few of the non-tax planning and administration considerations when a client or beneficiary is not a U.S. citizen or when the estate or trust includes foreign assets. Depending upon the values at stake, your clients may wisely choose not to spend the money to resolve all of the legal problems raised in the planning context. However, as their attorney, you need to alert them to these issues and advise them how best to proceed.

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