"CROSS BORDER ESTATE DISPUTES – MINIMISE THE RISK"

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COMMON CAUSES OF CROSS BORDER ESTATE DISPUTES

[1] Proper personal law of deceased disputed.

In most common law countries, it is the domicile[1] of the deceased that determines the testamentary law to apply to that deceased estate. States of the USA, have adopted a form of domicile more akin to "habitual abode".

Most civil law countries have since Napoleonic times, adopted nationality as a test to determine the testamentary law to apply to a deceased estate of a national of a civil law country.

The ***Hague Convention on the Law applicable to Succession to the Estates of Deceased Persons* (1989),** seeks to overcome the mismatch as the law to apply to succession between common law and civil law, and other regimes, by relying on "habitual residence"[2]. Only four out of the 72 countries which are members of the Hague Conference on Private International Law, signed this particular Convention[3]. Apparently it has only entered into force in the Netherlands. Moves in the EU to harmonize succession law based on "habitual residence" as proposed in its 2005 Green Paper, have recently been rebuffed by the UK.

In most civil law countries and Islamic countries the testator is not entirely free to exercise testamentary power as he sees fit i.e. "forced heirship".

The Ango-Australian concept of domicile is still largely governed by the common law (e,g. ***Udny v Udny*** (1869) LR 1 HL 441; [L. R.] 1 Sc.&Div. 441), although in both Australia, and the UK (***Domicile and Matrimonial Proceedings Act 1973***), there are statutory amendments dealing with the domicile of married women and the domicile of dependent children. Section 10 of the Australian ***Domicile Act 1982*** codifies the common law to a certain extent, in that it provides:

> "The intention that a person must have in order to acquire a domicile of choice in a country is the intention to make his home indefinitely in that country."

Of course, in order to change one's domicile of choice, it would generally be necessary to have the legal capacity through visa status to "make his home indefinitely" or "ends one's days"[4] in the new country[5]. This would require the taxpayer to convert to permanent resident status, in the case of a UK domicile, at least 3 years before the date of death in order to avoid UK Inheritance Tax (IHT) on world-wide assets: **s267(1)(a)** ***Inheritance Tax Act 1984***.

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[1] Dicey Morris, and Collins **"The Conflict of Laws"** 14th ed Sweet & Maxwell, London (2006) Ch 6
Also see generally Nygh and Davies, **"Conflict of Laws in Australia",** 7th ed. Lexis Nexis Butterworths (2002)
[2] See generally, Alain Verbeke & Yves-Henri Leleu, **"Harmonisation of the Law of Succession in Europe",** being Ch 11 of "Towards a European Civil Code", Kluwer 2nd ed. (1998)
[3] Argentina, Luxembourg, Netherlands & Switzerland
[4] Or "until the end of his days unless and until something happens to make him change his mind": ***IRC v Bullock*** [1976] STC 409 at 415.
[5] Although see most recently ***Mark v Mark*** [2005] 3 All ER 912, which casts some doubt on the status of ***Solomon v Solomon*** (1912) WNNSW 68, and ***Puttick v A-G*** [1979] 3 All ER 463.

A British person may find it easier to have evidence accepted of his acquisition of a domicile of choice in a country which is not alien in terms of language, culture, religion etc, although it is always a question of fact[6].

If the country of domicile of the deceased has an estate or inheritance tax, and/or lifetime gift duties, the determination of domicile will have significant tax implications, as most countries which have an inheritance tax, tax persons domiciled (or deemed domiciled) in their jurisdiction, to inheritance tax on their world-wide assets, but only tax non-domiciled persons on their assets within the jurisdiction.

Australia abolished State and Federal Death and Gift Duties around 1980 and is now one of only four or so OECD countries without death duties.

Whilst a person may be a resident of two (or even more) countries at the same time, a person can only have one domicile[7].

There are essentially three types of domicile - the domicile of origin, the domicile of choice and the domicile of dependency.

Generally, the domicile of origin of an individual is the domicile of the father at the date of birth (or the mother if the child is illegitimate). Once the individual turns 18, he or she is able to change his domicile to a domicile of choice, but the cases indicate that this is much more difficult that merely changing tax residence: see ***Gains-Cooper v HMRC*** [2006] UKSPC 00568 before the Special Commissioners in the UK.

In order for an individual to acquire a domicile of choice there must be both the act and the intention to select a new jurisdiction as that individual's permanent home. HMRC has shown continual resistance to claims of loss of UK domicile of origin[8].

[2] Questions of ownership and control over assets where held by trusts or foundations.

Common Law Countries

From a common law perspective, generally assets held in discretionary trusts will not be part of the estate of the deceased. From a common law perspective, assets held by civil law structures may variously be regarded as held by companies or trusts, with different conclusions as to whether the estate has an interest in the assets held by the civil law structure.

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[6] As can be seen in ***Casdagli v Casdagli*** [1919] AC 145 at 156-157 and ***Qureshi v Qureshi*** [1971] 1 All ER 325 at 339-340.

[7] ***Udny v Udny*** [L. R.] 1 Sc.&Div. 441 at 448.

[8] see ***IRC v Bullock***; ***Re Clore (deceased)(No2), Official Solicitor v Clore & Ors*** [1984] STC 609; ***Anderson v IRC*** [1998] STC (SCD) 43; ***F v IRC*** [2000] STC (SCD) 1; ***Civil Engineer v IRC*** [2002] STC (SCD) 72; ***Moore's exec v IRC*** [2002] STC (SCD) 463; *Surveyor v IRC* [2002] STC 501. For a dispute between Australian and UK resident potential beneficiaries of the estate of the English born playwright, Anthony Shaffer, as to whether he had a domicile of choice in Queensland, see ***Morgan & Anor v Cilento & Ors*** [2004] EWHC 188 (Ch).

From a civil law perspective, assets held on trust may be regarded as owned by the trustee, and the beneficiaries' interest not recognized.

From a common law country's tax perspective, whether the deceased had a tax liability with respect to assets held in civil law structures will usually depend on the tax categorisation of the structure as equivalent to a trust or a company.

The Hague Convention On The Law Applicable To Trusts And On Their Recognition (1989), is important for common law countries, as Article 6 of the Convention specifies that a trust shall be governed by the law chosen by the settlor. The law chosen for the trust doesn't require a direct connection with the trust (Dicey Morris and Collins *op cit* ¶ 29-016), contrary to the position at common law: ***Augustus v Permanent Trust Co (Canberra) Ltd*** **(**1971) 124 CLR 245.

The Convention was signed by 13 of the 72 countries which are members of the Hague Conference on Private International Law, but its scope is wider as it was ratified by the UK on behalf of the Isle of Man, Bermuda, British Virgin Islands, & Gibraltar, amongst other Crown dependencies (excluding the Bahamas and Cayman Islands). It was also ratified by two non- member States, Liechtenstein and San Marino.

It is also important for the civil law countries for which this Convention has entered into force: Italy, Luxembourg, France, Monaco, Netherlands and Switzerland: see Marco Giacomo Bonalanza, "***The Swiss Confederation, the trust and the taxation of immigrants***", Vol 7, Issue 3 TQR (2009).

Under the current Australian tax law, there is no definitive conclusion as to the treatment of civil law foundations. That was identified as an "urgent issue" in 2004, but the current version of the CFC/FIF/Transferor Trust rules still does not yet deal with it[9].

Civil Law Structures

These entities have characteristics of both companies and trusts. Generally they will have legal personality, and exist in perpetuity, but do not have shareholders or members, and may exist for a purpose, or for persons, or both[10]. Generally, the founder will not have a property interest in such entities, so succession will not be governed by the testator's will, but in the documentation of the civil law entity itself.

The most well known of the civil law entities are the ***stiftung*** (foundation) and the ***anstalt*** (establishment)[11], created under the law of Liechtenstein. Some common law countries, for example, Malaysia, have also enacted legislation to allow for the creation of Foundations, (**Labuan Foundations Act, 2010**).

[9] The CFC provisions are in the process of over 5 years re-examination. The latest version of the Exposure Draft still has significant flaws (e.g. the control test & "disconnected income" test), and is unlikely to proceed in that form. It was supposed to be effective from 1 July 2012. This is now likely to be 1 July 2013 at the earliest. The only realistic way to proceed at present, is to ensure compliance with the current law, as the future law is too uncertain. The government has always said that the "reform" package will be enacted "subject to budgetary constraints". As the "reform" will cost the government revenue, there is a possibility that the measures might be shelved.

[10] See generally, Andreas Schurti, Chapter on Liechtenstein in "**Offshore Trusts**", Centre for International Legal Studies, Salzburg, Kluwer (1995) at pp228-230.

[11] Also see CCH "**International Offshore Financial Centres**", (looseleaf) ¶ LIE1-035 & 1-036.

The **stiftung** is similar in many respects to a Purpose Trust[12] although it is incorporated. The **stiftung** is managed by a Council of Members, which most often is originally appointed by the Founder. At least one person on the Council must be resident in Liechtenstein. The greatest use of the **stiftung** is probably not in holding significant assets, but rather as the holder of shares in domestic or offshore entities.

The Liechtenstein **anstalt** is an entity, which has no members, participants or shareholders, and is a sort of hybrid between a corporation and a **stiftung**. An **anstalt** can have beneficiaries. The principal practical difference between an **anstalt** and a **stiftung** is that an **anstalt** can conduct all kinds of business activities[13].

Foundations of the civil law type have also existed for some time in Austria, Cyprus, Italy, Finland, Germany, the Netherlands (**Stichting**), Netherlands Antilles, Spain, Sweden (**Stiftelse**), Switzerland, Panama (1975), and more recently in St Kitts (2003), Nevis (2004), Bahamas (2005), Anguilla (2006), Antigua and Barbuda (2006), Malta (2006), Jersey (2009), and Labuan, Malaysia (2010).

Memec Plc v IRC [1998] STC 754 dealt with the UK tax characterisation of a German silent partnership. The approach taken was to analyze the characteristics of the civil law entity, and to equate it as closely as possible to the common law entity that it most closely resembles[14].

Dreyfus v CIR [1929] 14 TC 560 held a French "***Societe en Nom Collectif***" (SNC), to be a company for UK tax purposes[15].

Ryall (Inspector of Taxes) v Du Bois Co Ltd [1933] 18 TC 431 held a German "**Gesellschaft mit beschraenkter Haftung**" (GmbH) to be a company for UK tax purposes[16].

The ATO has shown a marked reluctance to tackle this issue. As far as we can find they have not sought to deal in detail[17] with foreign civil law foundations[18]. In relation to Dutch **stichtings**, ATO ID 2007/42 reaches the conclusion they are trusts, based on ***Harmer v FC of T*** 89 ATC 5180. In relation to **Anstalts**, there is no ruling available but PS LA 2007/7 says at example 2, that an **Anstalt** "limited by shares", will be a company[19].

Recently, the Canadian Federal Court of Appeal concluded that an Austrian private foundation was a company and not a trust: ***The Queen v Sommerer*** 2012 FCA 207 (13 July 2012) at [42], but then went on to address Revenue Canada's arguments that were based on it being a trust. The taxpayer in *Murray and Commissioner of Taxation* [2012] AATA 557 at [32] seems to have conceded that a

[12] HMRC TDSI mailshot 6- 17 May 2004 says for UK tax purposes, they will be treated as trusts. Also see "Beneficiaries of Trusts and Foundations", Philip Baker, Vol VII No 3 ITPA Journal (2007).

[13] HMRC TDSI mailshot 6- 17 May 2004 says for UK tax purposes, they will be treated as companies. The US has released a letter ruling AM2009-012 on 16 Oct 2009, which says that generally, a Liechtenstein anstalt will be treated as a business entity (corporate), whereas a Liechtenstein stiftung will be treated as a trust.

[14] As observed by Prof. Burns "**Harmonization of Australian's Anti-Deferral Regimes**", presented to IFA Melbourne, 12 June, 2007. Also see Dicey Morris and Collins *op cit* ¶ 30-010. ***Memec*** was recently applied in ***Swift v Revenue & Customs*** [2010] UKFTT 88 (TC), to find contrary to HMRC's long standing position, that a US LLC was transparent for UK tax purposes. HMRC appealed successfully, reported as: ***HMRC v George Anson*** [2012] UKUT 59 (TCC).

[15] See particularly, pp 576-7. Tax Bulletin, Dec 2000 now treats an SNC as transparent for UK tax purposes.

[16] Which status it is also treated under Tax Bulletin, Dec 2000.

[17] By the issue of a public ruling i.e. Taxation Ruling or Determination.

[18] refer generally "The Private Foundations Handbook" M Grundy ed., ITPA, 2007.

[19] Whilst the conclusion is the same as HMRC, these days, most **anstalts** are not "limited by shares". The Board of Taxation identified the characterization of **anstalts** as an "urgent issue" in 2004.

Liechtenstein Foundation was a trust (real name is apparently Dr Henry Mulerin, as per SMH 2 Sept 2012).

In Private Ruling 77367 the ATO conclude that a Dutch Co-op is a corporate entity from which s23AJ dividends may be available[20]. They also note that a German **Kommanditgesellschaft** (German AG) referred to in ATO ID 2007/47 is a "foreign hybrid limited partnership" under Div 830 of the 1997 Act[21].

Islamic Trusts and Foundations

For the third of a Muslim's estate, which can be the subject of a will, the Islamic law recognizes that that part of the estate can be settled on an "Islamic trust".

Islamic law recognizes two types of quasi-trusts, the **waqf al Ahli (family waqf),** and the **waqf al-Khayri (welfare waqf)**[22].

Under Islamic or Shariah Law, there is no stipulation as to whom property may be gifted *inter vivos*, save that the gift must be outright, as gifts with reservation of rights to the donor may be treated as remaining within the deceased's estate. Subject to the donor's view, the donor may settle property on an *inter vivos* common law trust, with the only proviso from an Islamic perspective, that the donor has made the gift outright.

Some countries have enacted specific legislation to provide for Islamic Trusts and/or Islamic Foundations. For example, in Malaysia, section 105 of the **Labuan Islamic Financial Services and Securities Act, 2010 ("LIFSSA")** expressly provides for the creation of Labuan Islamic Trusts, which are established in compliance with Shariah principles, and are entitled to all of the asset protection benefits of the **Labuan Trusts Act, 1996** (as to which, see below). Similarly, section 106 of the **LIFSSA** expressly provides for the creation of Labuan Islamic Foundations, which are established in compliance with Shariah principles, and are subject to the provisions and benefits of the **Labuan Foundations Act, 2010.**

[3] Claims by creditors or trustee in bankruptcy, against the deceased estate.

Executors of estates are personally liable for the liabilities of the deceased at the date of death if they distribute the estate assets without discharging the liabilities pro-rata the estate assets e.g. if the estate is distributed when the deceased had attributable income from a CFC or TT, which the executor knew about, but did not deal with. The ATO has stated that it won't hold an executor personally liable if he didn't know about the offshore entity.

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[20] As noted in "**Foreign Entities- Characterisation and Treatment for Australian Tax Purposes**", Watkins & Rodi, TIA NSW Div, International Tax Masterclass, 18 Sept 2008

[21] In ATO ID 2008/61 the conclusion is reached that an Irish CCF is a trust; and in ATO ID 2006/91 reached the conclusion that a Korean Japja Hoesa was a limited partnership but could not satisfy the requirements to be a "foreign hybrid limited partnership", and then changed their minds and concluded that it was a company in ATO ID 2010/27 and withdrew the earlier ruling.

[22] See "**Sharia'a charitable 'trusts'**", Gary Envis, STEP Journal, Nov 2008; For comment on drafting an Islamic Trust, see "**Care and Consideration**", Gary Envis, STEP Journal, Jan 2009

In ***Trustees of the Property of John Daniel Cummins v Cummins*** [2006] HCA 6; (2006) 224 ALR 280; (2006) 80 ALJR 589, in dealing with the question of whether there had been a fraudulent disposition in 1987, to which s121 of the *Bankruptcy Act* refers, the High Court were content to infer, without evidence before the Court, that a senior counsel who had not lodged a tax return since 1955, must have been insolvent due to unpaid tax in 1987, even when there was no evidence of his income or expenses up to 1987. The law was changed in 2006 so that absence of books of account, creates a rebuttable presumption of insolvency[23].

Asset protection concerns from the use of Australian discretionary trusts started with ***Australian Securities and Investments Commission in the Matter of Richstar Enterprises Pty Ltd (ACN 099 071 968) v Carey (No 6)*** [2006] FCA 814, a decision of French J (as he then was).

In that case a receiver was appointed over various trust assets on the basis that the defaulting debtor as a beneficiary and as in effective control of the trustee, had an interest in the assets, entitling the appointment of a receiver over them under the Corporations Act. This has caused considerable consternation[24], as the case didn't even refer to ***Re Burton; Wily v Burton* or *Dwyer v Ross***. For a display of some restraint after ***Richstar*, see *ASIC v Burnard*** [2007] NSWSC 1217, particularly at ¶ 69-71 and 76-78. Also see ***Public Trustees v* Smith** [2008] NSWSC 397 and ***Farr v Hardy*** [2008] NSWSC 996. However, ***Dwyer v Ross*** was distinguished in ***Rafferty v Time 2000 Waste Pty Ltd (No.9)*** **[**2011] FCA 1483 at [58] to allow a freezing order to continue over trust property.

However, the uneasiness is still there, as high profile insolvencies darken the public and judicial mood, when the blameworthy individuals seem to have "salted away" assets for themselves[25].

[4] Forced heirship claims.

There is forced heirship within the UK, in Scotland, in Japan, in Canada in Quebec, and in the US, in Louisianna. The case of ***Abdel Rahman v. Chase Bank (CI) Trust Company Limited***, a decision of the Jersey Royal Court reported at [1991] JLR 103, involved the challenge to a Jersey trust by the wife of a Lebanese husband settlor.

Civil law countries that are parties to **the Hague Convention on the Recognition of Trusts** will need to recognize common law or equitable trusts, but there may be issues as to whether the distribution by the deceased during his or her life, can be "clawed back". Often the forced heirship laws will

[23] see Schurgott *op cit* pp8-9.

[24] See "**Trust Practices under threat- Discretionary trust interests: the Westpoint Litigation"** Ron Jorgensen & Renuk Somers, TIA Vic Div 13 Sept, 2006 and Halperin *op cit*. But apparently no consternation to Justice Branson "**The Bankrupt, His or Her Spouse ant the Family Trust- A Consideration of Part VI Div 4A of the Bankruptcy Act",** ITSA 2006 Bi-Annual Conv.

[25] Also see "**Trust me –I don't own anything!",** Michael Lhuede, TIA Vic State Conv, Oct 2008. "**Claims against the Estate (Warnings for Executors)",** Craig McKie, TIA Estate & Succession Planning Intensive, WA Div 24 Sept, 2008 pp14-15. Also see other cases referred to in "**Modern Day Trust Structures**", Daniel Smedley, TIA Vic State Convention, Oct 2008 pp19-20 including ***Kawaski (Australia) Pty Ltd v Arc Strang Pty Ltd*** [2008] FCA 461 at ¶ 75, reference to ***Lygon Nominees Pty Ltd v Commissioner of State Revenue*** (2005) 60 ATR 135 at [58]. Also see Schurgott, *op cit* pp4-5 and "**Trusts and Asset Protection Best Practice**", Ken Schurgott, TIA National 24-25 September 2011.

attempt to do so if the deceased has gifted the property within a specified period before death, 10 years in Germany and France.

In Latin America, the only country which does not have forced heirship is Panama, where it should be noted, the Panamanian private – interest foundation law rejects the enforcement of foreign order of forced heirship [26].

Islamic Forced Heirship

Islamic law requires two-thirds of the deceased's estate to be distributed to heirs under Islamic law. The testator is free to leave one-third of the estate pursuant to a will, including to non-Muslims[27].

However, there is no stipulation as to whom property may be gifted *inter vivos*, save that the gift must be outright, as gifts with reservation of rights to the donor may be treated as remaining within the deceased's estate. Subject to the donor's view, the donor may settle property on an *inter vivos* common law trust, with the only proviso from an Islamic perspective, that the donor has made the gift outright.

Italian Forced Heirship

The law applicable to succession in Italy is the law of nationality of the deceased, with the exception that the deceased can indicate in a will as the governing law of succession the law of the country where the deceased is resident, if at the time of death, the deceased still resides in the country of the chosen law[28].

Under Italian succession law certain members of the family - "forced heirs" - are automatically entitled to a share of the deceased's assets at the time of death. This compulsory share or forced heirship is called ***legittima***.

Minimum Statutory Share: If A Person Dies Leaving -

Only one child and no spouse: to the child 1/2 of the Estate

Two or more children but no spouse: To the children in equal shares a total of 2 / 3 of the Estate

One or more "***Ascendenti***" (generally parents) but no spouse and no children: 1/3 of the Estate

Only a surviving spouse: 1/2 of the Estate

A surviving spouse and a child: to the surviving spouse 1/3 of the Estate
to the child 1/3 of the Estate

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[26] see Nicolas Malumian, "**Recognition of foreign trusts**", STEP Journal, June 2010.

[27] See generally, "**Islam: its law and society**", Jamila Hussain, 2nd ed. Federation Press, Sydney (2004) Ch 9; & "**Shari'a succession**", Gary Envis, STEP Journal, Sept 2008. ***Ghafoor & Ors v Cliff & Ors*** [2006] EWHC 825 (Ch) is an English case on touched on Islamic forced heirship in Pakistan. ***Murakami v Wryadi*** (2006) NSWSC 1354 is an Australian case which touched upon Islamic forced heirship in Indonesia.

[28] Articles 456 to 564 of the Civil Code

A surviving spouse and children: to the spouse 1/4 of the Estate to the children in equal shares a total of 1/2 of the Estate

A surviving spouse and "***Ascendenti***" but no children: to the spouse 1/2 of the Estate to the "***Ascendenti***" 1/4 of the Estate

Thus it can be seen that even through a will, at least one quarter (¼) of an Italian estate can be left at the testator's discretion. Gifts given during the deceased's life time may risk being "clawed back" if the "forced heirs" make a claim, but obviously, the practical success of such a claim may depend on who the gift was made to, and whether the property is in Italy.

It should be noted that forced heirship jurisdictions may notionally take into account amounts transferred to defeat forced heirship claims, by giving a greater shares of the domestic estate to such claimants, than would otherwise be the case[29].

Community Property

It has been observed[30] that throughout Latin America and continental Europe, and in nine US states, marriage will, as a general rule, convey joint property rights on the spouse. As Italy largely taxes income according to ownership, the existence of community property is quite different to the position in Australia and Britain, where marriage does not affect ownership, at least until the exercise of rights on breakdown or a "binding financial arrangement" entered into under the **Family Law Act 1975.**

The significance of community property, is that a donor to an *inter vivos* trust may not have title to settle on a trust. This issue is blocked by specific legislation in several tax havens[31].

[29] McWeeney *id* pages 16-17.
[30] Jennifer Wioncek, "**Handling community property laws in international tax and estate planning**", Vol 8, Issue 3 TQR (2010). She then analyses the US tax position particularly focusing on the fact that US tax will usually follow ownership.
[31] See the discussion of the Cayman Island decision in ***Lemnos v Coutt & Co*** 1992-93 CILR 460 (CA) especially Kerr JA at 506, as reported by Sean McWeeney, "The effectiveness of statutory provisions outlawing forced heirship claims", 10th Annual STEP Caribbean Conference , Panama, May 5-7, 2008, pp 8-10. However, as observed by Mark Hicken & Elaine Reynolds, "**Trusts and the Conflict of Laws**", Continuing Legal Education Society of British Columbia, April 2006 at pp11-13, US cases such as ***FTC v Affordable Media LLC*** 179 F. 3d 1228 (9th Cir., 1999) and ***In re Stephen J Lawrence*** 279 F. 3d 1294 (11th Cir., 2002), achieve enfocement by incarcerating the settlor as being in contempt, until he complies with the court's order.

HOW TO MINIMISE THE RISK OR IMPACT OF CROSS BORDER ESTATE DISPUTES BY PLANNING

[1] During lifetime disposal of existing assets;

a. **to individuals at least 3 years before death;**

b. **to domestic trusts;**

c. **to offshore trusts in jurisdictions with asset protection laws.**

For UK IHT purposes, a gift to a spouse or civil law partner who is UK domiciled is not subject to gift tax, as the asset will in due course fall into the estate of the donee. A gift of assets to other individuals domiciled in the UK will be a potentially exempt transfer ("PET") if the donor lives for more than 7 years, and the liability shades out if the donor dies between 3-7 years of making the gift.

Gifts within a certain period of becoming a bankrupt can be set aside under domestic bankruptcy laws.

It is worth noting that the testamentary trust, even onshore, may still have significant asset protection advantages, because assets left by a deceased to children or grandchildren who are professional persons, or directors of companies that may be at risk of trading while insolvent, may be "gobbled up" by the beneficiaries' creditors after the death of the deceased. That is, the deceased whole life's accumulation of wealth may be wasted e.g. by professional negligence of one's professional partners[32], if the liability is uninsured.

Whilst a debtor may be found to have had an intention to defeat his creditors at any time he makes a related party undervalue disposal, if he was solvent immediately after the disposal and does not become insolvent for some time, it is far less likely that the disposal would be caught by the Bankruptcy Act.

b. To domestic trusts

Since 2006 a gift by a UK domicile to a domestic discretionary trust will always be subject to 20% gift tax and also require disclosure to HMRC. Gifts to domestic trusts are necessarily easier for creditors to unwind than gifts to offshore trusts. Such gifts, dispositions and settlements are subject to the domestic bankruptcy and family laws.

[32] Including at the extreme, the collapse of a whole world-wide firm e.g. Arthur Andersen, which apparently required a payout by all worldwide partners, and by each Australian partner of at least $500,000.

c. To offshore trusts in jurisdictions with asset protection laws

Some offshore jurisdictions have laws specifically drafted to make actions against them particularly difficult. There are many such laws, and we will use one as an example, from the common law country of Malaysia.

The island of Labuan is a Federal Territory of Malaysia, an attractive International Business and Financial Centre ("IBFC"), has a common law system, with English as the business language, is in the same time zone as Hong Kong, Shanghai and Singapore, is also outside the **EU Savings Tax Directive**[33] and has not entered into **agreements for Mutual Enforcement of Tax Judgments**[34].

The ***Labuan Trusts Act*****, 1996 ("LTA")**[35] provides for the regulation of Labuan Trusts and confers statutory benefits on Labuan trusts[36].

A Labuan Trust is taxed as a Labuan Company i.e. no tax on investment income, and on trading income, tax of 3% of audited profit, or a flat tax of RM 20,000 (about US$6,600), by election.

Under **the *Hague Convention on the Law Applicable to Trusts and on Their Recognition* (1989)**, the specification in the trust deed, that the law of the trust will be that of Labuan, Malaysia, must be recognised by signatories to the Convention: Article 6.

Sections 10 & 11 of LTA contain some of the most important benefits provided to Labuan Trusts, by putting up barriers to enforcement of foreign claims.

Section 10(1) specifies that no foreign law or judgment in relation to marriage, succession rights, or insolvency (except as allowed under s11), will be enforceable against the Labuan Trust.

Section 11(1) places the onus of proof, beyond reasonable doubt, on any claimant against a Labuan Trust, to prove that the settlor created, registered or disposed of property to a Labuan Trust, with an intent to defraud that creditor of the settlor, and that transaction rendered the settlor insolvent, or without property to meet that claimant's debt.

Section 11(4) specifies that the creation, registration or disposition shall not be fraudulent if that happens before the creditor's cause of action against the settlor accrued. Section 11(3)(a) does likewise where the creation, registration or disposition occurs more than 2 years after the creditor's cause of action accrues.

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[33] Council Directive 2003/48/EC has applied since 1 July 2005. It applies throughout the EU, in 5 other European countries, and in various tax haven dependencies of the UK and the Netherlands. It requires payers of interest to automatically report identity to the beneficial owner's country of residence tax authority, or during the transition phase, for Belgium, Austria, and Luxembourg to withhold at 20% up to 30 June 2011, and at 35% thereafter, instead of exchanging information. Council Directive 77/799/EEC has required wholesale exchange of information on a request basis, between member states since 1977. It now also provides for spontaneous exchange of information in specified circumstances.

[34] Unlike the position in Europe (Council Directive 2001/44/EC), Australia has so far only entered into a few treaties allowing Australia to collect tax on behalf of other countries revenue authorities i.e. New Zealand, Finland, Norway, South Africa and France

[35] The legislation is available at http://www.ectrustco.com/documents/legislation/LabuanTrustsAct1990.htm

[36] For commentary see http://www.ectrustco.com/documents/contents/whitepapers/offshoretrusts.htm, & on the amendments effective 11 Feb 2010, see "**Twenty first century trusts**", Mark Lea, STEP Journal, Feb 2010. The benefits of LTA do not require registration with the Labuan authority, but registration may avoid arguments about the date of creation, or status as a Labuan Trust.

Where the creditor's cause of action accrues within 2 years of the creation, registration or disposition, it shall not be fraudulent if the creditor fails to commence action in Labuan, within one year of the creation, registration or disposition: s11(3)(b). This is a very strict, severe limitation period, which would defeat most potential litigants.

Section 11(5) specifies that a settlor will not have imputed to him an intent to defraud a creditor, because he has created or registered an offshore trust or disposed of property to it, within 2 years from the date of the creditor's cause of action accruing, or because the settlor is a beneficiary of the trust.

Section 11(1)(b) specifies that a successful claim may only be met out of the property of the trust the subject of that fraudulent transaction, but otherwise leaves the Labuan Trust intact.

Thus, aside from being required to discharge a criminal burden of proof, the creditor's claim will not put the other assets of the Labuan Trust at risk and no such claim could void the creation or resettlement of the Labuan trust. This stands in stark contrast to the usual range of equitable remedies in such cases, which would, save for sub-section 11(1), include a declaration that the trust is void, orders against the trustee to account, and equitable damages.

It should also be observed that the Malaysian ***Reciprocal Enforcement of Judgements Act 1958*** does not name Australia as a jurisdiction from which judgments will be able to be registered under that Act. Accordingly, a party to for instance, a family law dispute will need to claim enforcement of the Australian judgment under common law principles in Malaysia. One ground for refusal will be Malaysian public policy[37], and the provisions of LTA will prevail[38].

These issues have arisen in Jersey in relation to English divorce courts ordering amendments to Jersey trusts. It should be noted that Jersey has a Reciprocal Enforcement of Judgments Act which allow registration of English High Court judgments. However, s9 of the Trusts (Jersey) Law 1984 was amended in 2006 so as to read: … (4) No foreign judgment with respect to a trust shall be enforceable to the extent that it is inconsistent with this Article irrespective of any applicable law relating to conflicts of law…*Mubarik v Mubarik* [2007] EWHC 220 (Fam) was the English case giving rise to recent Jersey Royal Court case of *In the Matter of the The IMK Family Trust (Mubarak v Mubarik and others)* [2008] JRC 136; 2008 JLR 250. The English judgment purported to amend the terms of a Jersey trust. The trust deed did not empower the trustees to make the amendment ordered by the English divorce court. The Royal Court of Jersey held referring to the 2006 amendments:

(a) There were two sorts of "variation", the first category being where the court is doing something which the trustee itself has no power to do (a departure from the terms of the trust deed)(the Royal Court defined this sort of variation as an "alteration") and the second where the court is doing something which the trustee had the power to do itself (a variation in the strict sense).

(b) On the facts of the case, the English order amounted to an alteration of the trust (the Trustee did not have the power to revoke the Husband's exclusion of the wife as a beneficiary) and therefore

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[37] See Dicey Morris and Collins *op cit* Rule 44, and the reference at ¶ 14-143 to ***Mayo-Perrot v Mayo-Perrot*** [1958] I.R. 336.

[38] See generally, ***Jupiters Ltd (trading as Conrad International Treasury Casino) v Gan Kok Beng & Anor*** [2007] 7 MLJ 228. Also see generally, "**Enforcement of Non-Monetary Foreign Judgments in Australia**", Kim Pham, Sydney Law Review, Vol 30 (2008) at 663 and Dicey Morris and Collins *op cit* Ch 14.

the Royal Court could neither enforce the English order nor direct the trustee under Article 51 to comply with it: see "Alteration or variation? Mubarak v Mubarak in the Royal Court of Jersey", James Gleeson, Vol 6 Issue 4 TQR (2008).

Consequently, the Jersey Court of Appeal did not have to deal with that issue: see "**Aaliya Mubarak v Iqbal Mubarik** [2008] JCA 196", Zillah Howard, and "**Mubarak, a Guernsey viewpoint**", Andrew Laws, both in Vol 7 Issue 1 TQR (2009).

[2] Acquisition of new assets in countries without inheritance tax, preferably by companies owned by trusts.

Some of the problems with onshore asset protection trusts, are likely to see the emergence of the greater use of trustees in offshore jurisdictions.

The use of an offshore company owned by an offshore trust, will often be administratively simpler, as the principal can be a director of the company. Under the **Labuan Trusts Act (s 46F),** the trustee of a Labuan Special Trust has no responsibility to interfere in the management of a Labuan company owned by the Special Trust (similar to a BVI VISTA).

An offshore trust may have nothing to do with Australian or other investor country tax planning[39], e.g. estate or inheritance tax planning in the investee country, with the principal content to pay the home country tax attributable to them as "settlor", as long as the assets in the trust are protected, or not to be distributed according to forced heirship rules in their "home" country. ***Abdel Rahman v. Chase Bank (CI) Trust Company Limited,*** was a notable example of failure to implement correctly.

If the settlor's concern is asset protection and they want to protect their capital from potential creditors, a trust formed under the ***Labuan Trusts Act*** **(Malaysia),** or similar regime, such as Jersey, would fit the bill. Based on ***Ross v Dwyer*** (1992) 34 FCR 463 and ***Re Burton; Wily v Burton*** (1994) 126 ALR 557*,* an Australian court should not allow the substitution of the Australian resident controller's trustee in bankruptcy, for the appointor, to vest the trust in favour of the bankrupt's creditors.

[3] Acquisition of new assets by foreign companies or trusts in countries with inheritance tax.

Generally speaking, an estate tax is on the estate of the deceased, whereas an inheritance tax is on the beneficiary. The UK & US have estate taxes[40], whereas France, Germany & Italy have inheritance taxes. Gift taxes are usually a back-up to prevent during lifetime gifts being used to escape estate & inheritance taxes.

[39] Almost all common law jurisdictions treat the place of residence of the trustees as a test for tax residence of the trust, however, the Supreme Court of Canada in *Fundy Settlement v The Queen* [2012] SCC 14 has focused on the place of "central management & control" of the trust, without any statutory direction to do so, such as s95(2)(a) of the 1936 Act.

[40] Even though the UK legislation is termed **Inheritance Tax Act 1984** and the estate tax referred to as inheritance tax (IHT).

UK world-wide IHT is based on UK domicile or deemed domicile. Other countries use various combinations, or one of, residence, ordinary residence, nationality[41] or domicile, as the test for their world-wide IHT. Due to the potential for double taxation, the OECD has a *Model Double Taxation Convention on Estates and Inheritances and on Gifts* (1982). It contains a tie breaker to resolve different national rules relating to "fiscal domicile". For instance, the UK has entered into 10 estate tax treaties[42].

As only individuals die, foreign estate & inheritance taxes have generally been overcome by holding assets in "entities", such as companies and trusts, which may exist in perpetuity (modern legislation such as the Labuan Trusts Act 1990 repeal the rule against perpetuities). Alternatively, debt secured over "taxable" assets may be used to reduce the value of the estate subject to IHT.

The French, have recently enacted law to attack such tax planning. The British have announced far reaching changes in relation to UK residences with a value of £2M or more.

UK IHT & Gift Tax

Non-domiciles of the UK, who reside in the UK for 17 out of 20 years before their demise, are deemed domiciles, subject to UK IHT on their world-wide property[43]. The concept of deemed domicile is only relevant to IHT, and not to income or capital gains tax.

Main residences are not exempt from IHT, even though they are for UK CGT. Business assets[44] are excluded, as is agricultural property[45].

Non-domiciles of the UK, who reside in the UK for less than 17 out of 20 years before their demise, are subject to UK inheritance tax (IHT) only on their UK *situs* property.

The threshold value of a net estate[46] to become liable to IHT for 2011-12 is £325,000 (the so-called "nil rate band"). For estates over the threshold, the IHT is at a flat 40% rate! Transfer from domiciled or deemed domiciled, spouse to spouse, or civil law partner to civil law partner is exempt from IHT[47]. However on the demise of the later spouse or civil law partner, the second estate is subject to IHT. The threshold for IHT on the second estate is £650,000 for 2011-12).

A non-UK-domicile, who has UK *situs* property (with certain exemptions mainly for government bonds) will pay IHT on that property.

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[41] Austria, Germany, The Netherlands & Sweden.

[42] See generally, "**Inheritance and Wealth Tax Aspects of Emigration and Immigration of Individuals**", 56th IFA Congress, Oslo (2002) Vol 27a.

[43] s 267(1)(b) IHTA 1984

[44] s104 IHTA 1984

[45] s116 IHTA 1984

[46] Debt secured over assets other than Excluded Assets is taken into account in calculating the value of the net estate: s5(3) & 162(5) IHTA.

[47] s18 IHTA

To prevent avoidance of IHT by emigrating near death, there is a provision deeming domicile if the deceased dies within 3 years of being domiciled in the UK[48].

To back up the IHT regime on death, the IHTA also deals with gifts while alive, to non-spouse or non-civil law partners. Gifts to non-spouse or non-civil law partners who are individuals totalling up the "nil rate band" can be made while alive, in any 7 year period, without being added back into the value of the deceased estate. Such gifts over the "nil rate band" may still fall outside the IHT net, as long as the donor lives for 7 years after making the gift (a so called "potentially exempt transfer" - PET)[49]. If the donor dies between 3 and 7 years after making the PET, the IHT liability shades out. Gifts over the "nil rate band" to trusts in the UK or outside the UK, are usually not PETs, and will make the gift liable to an immediate 20% IHT liability[50].

The 2012 Budget announced the increase in Stamp Duty Land Tax from 7% to 15% on the purchase of UK residential houses with a cost of £2M or more by non-natural persons (principally companies), together with an annual charge (dubbed the "Mansions Tax"). Also, only such properties will become subject to CGT in the hands of a non-resident non-natural person. The indirect effect of these measures is that non-doms will find it less attractive to buy and hold such properties in foreign non-resident companies. This will increase the attractiveness of such properties being owned by natural persons, or trustees of offshore settlements, but purchased with borrowings secured over the property, either from financial institutions or related non-resident individuals or entities, to reduce the value of the UK *situs* estate subject to IHT.

US Estate & Gift Tax

The position for calendar 2011 & 2012 is that the top rate of estate & gift tax is 35% with a threshold of US$5M (for citizens & domiciliaries). This was a compromise to get a law passed rather than the sunset provision of the 2001 law cause reversion to 2001 tax rates of up to 55% with a threshold of US$1M. In fact, the compromise resulted in there being no Federal estate tax for those dying in 2010 unless the estate elected[51]. As the current law again sunsets at the end of the 2012 calendar year, US estate tax planning is highly uncertain, except that the current threshold of gift tax may make it wise to make up to US$5M lifetime gifts before the end of 2012, as the threshold is very generous[52]. There are also some state based estate & gift taxes.

US citizens and domiciliaries are subject to Federal estate tax on their world-wide estates. Non-citizens and non-domiciliaries are only subject to estate tax on their US *situs* assets, and the threshold for them is only US$60,000.

[48] s267(1)(a) IHTA
[49] s 3A IHTA
[50] The gift tax is generally payable by the donee, within 6 to 12 months of the gift, depending on when the gift is made. For gifted land & buildings, it may be payable over 10 years.
[51] which would allow a step-up in the cost base of the assets in the hands of the beneficiaries, which otherwise would not apply.
[52] As at the date of writing, the Obama administration has indicated its support for continuation of the Bush era tax rates except for the wealthy. As there is a Presidential election in November this year, the position of the candidates is likely to be clearer before then.

Domicile for US purposes has been described as like "habitual abode"[53], in contrast to tax residence, which is a more formulistic test of counting days in the US. US domicile is essentially living in the US with an intent to remain in the US indefinitely i.e. a very subjective test. The holding of a "green card" (or resident alien status) would be one of the relevant facts.

A US domicile will not be lost until a new domicile has been established[54], and absent a relevant treaty, the person may be exposed to US and another country's estate tax due to different rules in each.

To avoid a loss of estate tax by passing assets to grandchildren rather than children, there is a back-up Generation Skipping Tax.

US *situs* property includes US real estate, tangible property physically located in the US, and equity interests in US entities, but generally not US bank accounts or debt securities.

Accordingly, planning for non-citizens and non-domiciliaries involves holding US *situs* property in foreign entities. Where such a person is moving to the US, consideration should be given to a pre-immigration trust owning the foreign entity to own the US *situs* property. Unlike the UK, non-domiciliaries can only deduct debt in determining the value of their net US *situs* estate, limited in proportion of their US assets to their world-wide assets.

ASIA

In contrast to the US, UK, France, Germany & Italy, estate, inheritance & gift taxes are now relatively uncommon in Asia, having been abolished in countries which formerly had them. For instance, there are currently no such taxes in India, China, Hong Kong SAR[55], Malaysia[56] & Singapore[57].

MINIMIZATION OF ESTATE DUTIES – PLANNING

Generally speaking, as only individuals die, estate & inheritance taxes are usually sought to be overcome by foreigners holding assets in "entities", such as companies and trusts, which may exist in perpetuity [58].

Estate planning for residents of countries with estate or inheritance tax e.g. the UK, may involve wealthy Britons first becoming temporary tax residents of countries with which the UK has a DTA, and eventually adopt a domicile of choice outside the UK. This does not require them to renounce

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[53] Dicey Morris, and Collins "**The Conflict of Laws**" 14th ed Sweet & Maxwell, London (2006) ¶ 6-133

[54] As to new exit rules for losing that status to avoid income and inheritance tax, see: "**Winners and losers**", G Warren Whitaker, STEP Journal Sept 2008; "**Expatriation: time to go**", Paul A Sczudlo, STEP USA, Oct 2008; "**Giving up US citizenship – at what cost**?", Marshall Langer, Offshore Investment, Dec 2009/Jan 2010.

[55] abolished 11 Feb 2006.

[56] abolished 1 Nov 1991.

[57] abolished 15 Feb 2008.

[58] Note that the rule against perpetuities has been abolished in South Australia and several offshore jurisdictions have abolished the rule against perpetuities and accumulations e.g. Jersey, Cayman, and Labuan, Malaysia (from 11 Feb 2010).

citizenship of the UK, unlike e.g. Italy, where inheritance tax is based on nationality. In the case of a UK domicile, it is necessary to convert to permanent resident status, at least 3 years before the date of death in order to avoid UK IHT on world-wide assets: s267(1)(a) *Inheritance Tax Act 1984*.

Even though Australia currently imposes no estate or inheritance taxes, estate planning for some wealthy Australians may involve becoming a non-resident of Australia for tax purposes.

FRANCE

The concept of the trust has recently been addressed in relation to French tax, and is viewed with deep suspicion by the French authorities as a vehicle for tax avoidance.

Inasmuch as it relates to a non-resident settlor, where the beneficiaries are also non-resident, the French inheritance, gift & wealth taxes can apply to such a trust with non-resident trustee holding French *situs* property, for instance, on the death of the settlor, inheritance tax would from 2011, be payable where the trustee is resident in a "non-cooperative State"[59]. Also, in relation to wealth tax, the non-resident trustee holding French *situs* property will have an annual liability.

COMPANIES

Shares in a company formed under the law of the country where the assets are to be situated is less likely to avoid the local IHT, as the shares are themselves likely to be treated as local *situs* property.

In recent times, due to a slump in US real estate prices, a lot of individuals have had marketing addressed to them for US real estate e.g. apartments in Florida. Agents often suggest ownership through an US LLC, which seems to leave many overseas individuals exposed to US inheritance tax on his membership interest in the LLC (if held personally), as the threshold for non-citizen non-domiciliaries is only US$60,000.

Ownership of US realty through an offshore resident company or unit trust might be preferred.

[4] During lifetime change of personal law e.g. adopt domicile of choice in suitable country

One desirable feature of a proposed new country is the absence of any State or Federal death or gift duty, so that retirees or other wealthy migrants from countries with inheritance tax may adopt a domicile of choice, to escape the clutches of their country of origin inheritance tax[60].

The disposal of a permanent house in the UK and the acquisition of one overseas in a country with a DTA with the UK, would be one of the steps that could be taken by a UK domicile. Firstly, to ensure that dual residence is resolved in favor of the other DTA country under the 'tie breaker" in the

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[59] Being one which has not entered into an exchange information sharing treaty.

[60] This topic was explored by Robert Gordon in some detail for a paper "**Protecting Family Wealth: Retiring In Australia**" presented at Legal Week "**Private Client Legal Forum**" Villa d'Este, Lake Como, Italy 9-11 November, 2006 ", which can be found at http://www.robertgordontax.com/documents/articles/Protecting-Family-Wealth4-Retirement-Aus.doc. Also see in relation to income tax: Rijkele Betten, "**Income Tax Aspects of Emigration and Immigration of Individuals**", IBFD (1998)

relevant double tax agreement (DTA), and secondly, as an assistance on the path to acquiring a domicile of choice for UK IHT purposes.

Ironically, non-domiciles of the United Kingdom, find it attractive to reside but not adopt a domicile of choice in the UK, in order to make use of the remittance basis of taxation applicable to non-UK domiciles. The *Finance Act 2008* makes reliance on the remittance basis of taxation less attractive, after seven years of residence in any nine year period, by requiring the payment of £30,000 tax per annum just for the privilege[61].

Australian residence at the time of death, or for a period before death, and citizenship (or dual citizenship), may be relevant to the question of the deceased's domicile at the time of death, but only domicile in an Australian jurisdiction, determines the proper law to be applied to the estate.

[5] <u>During lifetime change of residence to a low tax country</u>

Estate planning for the wealthy may involve ceasing to be a tax resident of their high tax jurisdiction.

There is a wide-spread myth that leaving Australia for as short a period as two years, will necessarily suffice to become a non-resident for tax purposes. This has arisen due to para 25 of IT 2650 which actually only says that an absence of 2 years "would generally be regarded by this Office as a substantial period for the purpose of a taxpayer's stay in another country". IT 2650 discusses ***Applegate*'s case**[62], where the taxpayer was only out of Australia for two years. However, in that case he left the country indefinitely, and only returned from Vila, in two years, due to ill health.

The importance of establishing residence in a particular foreign country can be seen from the case of the physiotherapist on a working holiday for 5 years, who was found to have remained a tax resident of Australia throughout that period: ***AAT Case 12,511*** (1998) 37 ATR 1263.

Whilst ***Applegate*'s case** was said to be applied in ***FC of T v Jenkins*** 82 ATC 4098 at 4101, Mr Jenkins did not leave Australia with the intention to be out of Australia indefinitely, but for three years, which was enough on the facts of that case, to mean that he had a "permanent place of abode" in Vila, as his presence there was not "temporary".

More certainty of outcome can be achieved for tax planning, by the use of a suitable double tax treaty (DTA)[63], which contains a dual residence "tie-breaker".

For such a person, there is no point going to be resident in another high tax country, and so a country with a territorial system of taxation which also has a DTA with a "tie-breaker" fits the bill.

[61] Increasing to £50,000 tax when resident in at least 12 of the previous 14 years (for 2012-3); s809H Income Tax Act 2007

[62] 79 ATC 4307, followed by a statement about an absence of anything less than two years being "transitory" in IT2650 at ¶ 27.

[63] This will help avoid the result that occurred for the taxpayer in the UK case of *Gains-Cooper v HMRC*, who unsuccessfully argued that he had established tax residence in the Seychelles, to the exclusion of the UK. The UK does not have a DTA with the Seychelles.

In South East Asia, the more predictable results may follow in Singapore or Malaysia, which have excellent business infrastructure. As Hong Kong does not have many DTA's, it is usually not suitable. Singapore is well known as an expensive place to live, although the tax position is quite positive[64]. Malaysia is a lot cheaper, and on closer examination, may well be the best choice on the tax front as well.

There is no CGT in Malaysia. Whilst a Malaysian resident individual will pay a top marginal rate of 25% once taxable income reaches RM100,000, directors fees from a Labuan company are exempt for non-citizens/expats. There is also a 65% exemption from tax on managerial salaries from a Labuan company. Further, if the individual controls the Labuan company, there is nothing to compel them to pay themselves a taxable salary, as they can receive tax free dividends as well as tax free directors fees.

Dual residence is resolved in Article 4 "tie-breaker" of the OECD Model DTA (Australia/Malaysia DTA), in the same terms at the Australia/UK DTA tie breaker -

"2. Where by reason of the preceding provisions an individual is a resident of both Contracting States, then his status shall be determined in accordance with the following rules:

> *(a)* ***he shall be deemed to be a resident solely of the Contracting State in which he has a permanent home available to him;***
>
> (*b) if he has a permanent home available to him in both Contracting States, or if he does not have a permanent home available to him in either of them, he shall be deemed to be a resident solely of the Contracting State in which he has an habitual abode;*
>
> *(c) if he has an habitual abode in both Contracting States, or if he does not have an habitual abode in either of them, he shall be deemed to be a resident solely of the Contracting State with which his personal and economic relations are the closer.*

3. In determining for the purposes of paragraph 2 the Contracting State with which an individual's personal and economic relations are the closer, the matters to which regard may be had shall include the citizenship of the individual."

If the dual resident taxpayer can use the first tier of the tie-breaker i.e. "**permanent home available to him**" in Malaysia and no "**permanent home available to him**" in the other DTA country, then he ***shall be deemed to be a resident solely of Malaysia.*** If the old family home was rented out, it would not be a "**permanent home available to him**".

Under Malaysian tax law, the taxpayer doesn't need to be in Malaysia for all of the 183 days in the first calendar year he moves there (or any other), as he can travel on business (in the employ of his own Labuan company), so as to be "temporarily absent"[65] and count those days as "in" Malaysia for

[64] For instance, the top marginal rate of tax for a Singapore resident individual is 20%, and is not incurred until the individual's taxable income reaches S$320,000, compared to 45% in Australia, once taxable income reaches A$180,000. Singapore does not have a CGT but speculative profits are treated as income.

[65] ***Re Young*** (1875) 1 TC 57, ***Rogers v Inland Revenue*** (1879) 1 TC 225, ***Reed v Clark*** (1985) 58 TC 528, ***Shepherd v IRC*** [2006] STC 1821, ***Barrett v Revenue & Customs*** (2007) UKSPC SPC00639, ***Revenue & Customs v***

the 183 day test, especially if he is physically present in Malaysia on 31 December and 1 January [66]. There is a lot more flexibility in moving to Malaysia to achieve the overall objectives than available with other countries[67].

The issue of common law residence[68] was considered in ***Gains-Cooper v HMRC*** [2006] UKSPC 00568 before the Special Commissioners in the UK, where the law was analyzed, and as the stakes were very high, the case was argued with considerable resources[69]. As the appeals were limited to errors or law, and the appeal courts found none, the Special Commissioners decisions stood. HMRC also had success in subsequent cases[70]. In recent years, Australian cases dealing with residence of individuals, have not moved past the AAT[71].

Mr Gains-Cooper was found by the Special Commissioners to have remained a resident of the UK[72], whether or not he had become resident in the Seychelles, with which the UK does not have a DTA.

The fatal error and main lesson to be learnt from ***Gains-Cooper v HMRC***, is that you should migrate to a DTA country, not to a country with no **relevant** DTA.

[6] During lifetime reduction in control of trusts without abandoning control e.g. appointors and professional trustees.

Due to many developments in the law of bankruptcy, family law, IHT and estate taxes, the use of *inter vivos* trusts with independent trustees have become more widespread, and the use of such trustees in suitable offshore jurisdictions, an expected response.

As a discretionary trust can last at least 80 years, it is inherently more flexible than holding assets personally, as the party to benefit from the holding of the asset can be changed from time to time, as circumstances change, through a number of generations. Generally speaking, the beneficiaries who are mere "discretionary objects" of such trusts have no "interest" in the trust assets which can become devisable property on the bankruptcy of the individual, and so traditionally, trusts have

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Grace [2008] EWHC 2708 (Ch). Also see the Australian case previously referred to: ***FC of T v Jenkins*** 82 ATC 4098 at 4101

[66] s7(1)(b)(i) of the **Income Tax Act 1967**

[67] For more detail see: http://www.ectrustco.com/documents/AUSTRALIANS-2.doc.

[68] For a discussion of the relevant matters that the ATO will take into account in determining whether a person is resident according to ordinary concepts see Taxation Ruling TR98/17.

[69] Also see ***Shepard v HMRC*** [2005] UKSPC 00484

[70] ***Barrett v HMRC*** [2007] UKSPC 00639; ***Grace v HMRC*** [2009] EWCA Civ 1082; ***Genovese v HMRC*** [2009] STC (SCD) 373; ***Hankinson v* HMRC** [2009] UKFTT 284 (TC); ***Tuczka v HMRC*** [2010] UKFTT 52 (TC); ***Turberville v HMRC*** [2010] UKFTT 69 (TC); ***Broome v HMRC*** [2011] UKFTT 760 (TC); ***Ogden v HMRC*** [2011] UKFTT 212 (TC); ***Kimber v HMRC*** [2010] UKFTT 107 (TC)(8 Feb 2012).

[71] ***Mynott and the Commissioner of Taxation*** [2011] AATA 539; ***Iyengar and the Commissioner of Taxation*** [2011] AATA 856; ***Sneddon and the Commissioner of Taxation*** [2012] AATA 516; ***Murray and the Commissioner of Taxation (No 3)*** [2012] AATA 557; ***Boer and the Commissioner of Taxation*** [2012] AATA 574; ***Sully and the Commissioner of Taxation*** [2012] AATA 582 (31 Aug 2012).

[72] His substantive appeals to the High Court [2007] EWHC 2617 (Ch), and the Court of Appeal were dismissed [2008] EWCA Civ 1502. His administrative appeal was dismissed by the Supreme Court of the UK, reported as ***Davies & Anor v HMRC*** [2011] UKSC 47.

been valuable asset protection vehicles. They may also protect the particular structure from the application of the general tax anti-avoidance provisions as the dominant purpose of the structure may be seen to be asset protection: ***FC of T v Mochkin*** [2002] FCAFC 15.

Nor should the client who is in the position of an appointor of an Australian discretionary trust going to find the trustee in bankruptcy stepping into his shoes. In a decision directly on the point in Australia, Davies J in the Federal Court in ***Re Burton; Wily v Burton*** (1994) 126 ALR 557, found on the basis that the power of appointment was a personal right, and therefore not "property", it was therefore not capable of being "devisable property" for bankruptcy purposes, and so the trustee in bankruptcy could not obtain the power of appointment so as to change the trustee to a party controlled by the trustee in bankruptcy, who might vest assets of a discretionary trust in favour of the bankrupt, and therefore for the bankrupt's creditors[73].

A District Court in Florida has found the exact opposite in relation to the power of appointment of an American over trustees of tax haven trusts in Bermuda and Jersey: ***United States of America v Raymond Grant and Arline Grant*** (S.D.Fla. 06/17/2005). The order in that case was that Arline Grant (the survivor of the defendants) use her power of appointment to substitute the tax haven trustees, with US trustees, or in the alternative to otherwise repatriate the assets held in the trusts. As Arline Grant was more than a mere discretionary object, indeed, she had the right to call on the trustees to provide her maintenance in the sum she said she required, the alternative order is more clearly understood. In that case the IRS was owed over US$36M by the defendants.

An added safeguard when drafting a trust deed, is to have successor appointors, in the case of bankruptcy of an appointor.

As to whether a family discretionary trust will be able to be attacked by a party to an Australian family law dispute, the position still depends on the circumstances, and is no less easier to decide following the High Court of Australia decision in ***Kennon v Spry*** [2008] HCA 56 in which Gummow & Hayne JJ observed (at ¶ 89):

> *"the term 'property' is not a term of art with one specific an precise meaning. It is always necessary to pay close attention to any statutory context in which the term is used. In particular it is, of course, necessary to have regard to the subject matter, scope and purpose of the relevant statute".*

The problem in ***Kennon v Spry,*** is that the majority differed as to how they reached their conclusion. It should first be observed that the dissenter, Heydon J reached the conclusion that neither the husband nor the wife had "property" in the trust as a matter of general law (referring to ***Gartside v IRC*** [1968] AC 553) at ¶ 56), and that the position was no different for family law purposes under s79 (at ¶ 187).

Of the majority, none mentioned ***Gartside v IRC*** directly, although French CJ noted that the husband's power as trustee to appoint assets or income to the wife "may not be property according to the general law" (at ¶ 79).

Needless to say, the problems in ***Kennon v Spry*** would not have arisen if the husband had appointed an independent, licensed, professional trustee company, as trustee of the trust.

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[73] See James Kessler & Michael Flynn, "**Drafting Trusts & Will Trusts in Australia**", Thomson (2008) ¶ 6.175. ***Dwyer v Ross*** [1992] 34 FCR 463 discussed the issue, but in fact, did not have to decide (at 468), and in any event was also decided by the same judge, two years earlier than *Re Burton*.

DISCLAIMER

This paper does not constitute advice. It should not be relied on as such.

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