Initial Estate Planning Considerations for Dual Residents

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ESTATE PLANNING CONSIDERATIONS FOR DUAL RESIDENTS

Presented by Anthony F. Vitiello, Esq.

I. INITIAL ESTATE PLANNING CONSIDERATIONS FOR DUAL RESIDENTS

A. Main Legal Systems of the World

1. ***Overview***. Once it is determined that the client is a dual resident, the next step is to understand that the legal systems in which the dual resident's heirs reside and/or assets are located may have restrictions (*e.g.*, control over asset disposition or trust recognition) that can cause even a basic estate plan and the achievement of its essential goals to become totally ineffective. A basic U.S. estate plan is generally centered around the following two estate planning documents: *(1)* a ***last will and testament*** ("Will"); and *(2)* a ***revocable trust***.

(i) Will. In the U.S., every client must at least have a Will to: *(i)* provide for disposition of his or her probate assets according to his or her wishes; *(ii)* appoint executors who can control the assets and carry out the disposition of the client's assets after his or her death in order to avoid intra-family disputes after death; and *(iii)* name guardians and their successors.

(ii) Revocable Trust. Revocable trusts in the U.S. are utilized for a client who wishes to: *(i)* avoid probate proceedings after death and public disclosure of his or her assets; *(ii)* ensure the professional management of the assets after his or her death, especially in the event the surviving spouse has no experience; *(iii)* protect the inheritance of a client's children (especially those from a prior marriage) from dissipation by the surviving spouse (by placing property into trust for the spouse); *(iv)* protect the inheritance from the spouses of children; or/and *(v)* provide asset protection for his or her spouse and/or children from various creditors upon death. A revocable is sometimes referred to as a testamentary substitute because it typically includes the dispositive provisions of a client's assets upon death that are otherwise includible in a Will. When a revocable trust is part of an estate plan, the client's Will serves to pour over any assets which are outside the trust into the trust upon the client's death ("Pour-over Will").

(iii) Irrevocable Trusts. Estate planning for more sophisticated clients with extensive holdings may require creation of ***irrevocable trusts*** to achieve various estate planning goals, such as asset protection planning, business succession planning, planning to minimize transfer or income taxes, life insurance and retirement planning.

2. ***Property Located in Another Country***. Before designing an estate plan involving property located in another country, it is important to consider not only that country's legal system, but also the degree of flexibility the dual resident client has over of the disposition of his or her assets. Generally, there are three main legal systems in the world: *(1)* common law systems; *(2)* civil law systems; and *(3)* Islamic law systems.[1]

(i) Common law systems. Common law is based on the hierarchical doctrine of precedents. Common law systems give more interpretive power and discretion to their courts to apply

[1] There are other religious laws, such as Jewish law (based on Halakha), Hindu law and Canon law. In contrast to Shariah law, these religious laws generally are ***not*** recognized as the official laws of the countries in which they operate (except for few exceptions, such as Vatican City State, the legal system of which is based on the Canon law of the Catholic Church). No country is fully governed by Halakha, but Israeli people may decide to be bound by Halakha.

legislation and legal precedents. Thus, statutes tend to be more concise. The common law countries include, but are not limited to, the U.S., Canada, the U.K., Ireland, Australia, New Zealand, India and Hong Kong.

In a common law jurisdiction, the client is typically afforded considerable discretion and flexibility in designing how to pass his or her wealth before and after death. Given this flexibility, the client's Will and revocable trust are the primary methods for passing the client's assets. If the decedent fails to execute a valid Will, the applicable state ***intestacy*** laws will govern the distribution of the decedent's property. In most common law jurisdictions, it is the decedent's estate that pays estate and other death taxes (***not*** the decedent's heirs).

(ii) Civil law systems. Civil law systems are based on Roman law that leaves little interpretive power and discretion to courts. Judicial decisions have no binding authority, so legislation is the only source of law. Thus, statutes, codes and regulations tend to be very long and detailed. The civil law countries generally include the majority of Latin American and European Countries, Russia, China and Japan.

In a civil law jurisdiction, the client's discretion and control over the disposition of his or her asset can be restricted by "forced heirship rules". The inheritance and other death taxes are generally imposed on the decedent's ***heirs*** at the time the distribution is received.

(iii) Islamic law systems. Islamic law systems are driven by Shariah law, which is based on *(i)* Quran and Sunnah, as the primary sources of law; and *(ii)* Islamic jurisprudence (or "fiqh"), as the subordinate sources of law and the methods used to discover and apply law. While the main principles of Shariah law are not subject to amendment, the fiqh-based law can be changed as circumstances arise. Islamic law is enforced in over 30 countries including Saudi Arabia, Sudan, Iran, Yemen, Oman, Qatar, certain regions of Indonesia, Nigeria and the United Arab Emirates. Some of the countries fully recognize Shariah as the official law of the land, while others are generally hybrids of Islamic and civil law.

In an Islamic law jurisdiction, the client's discretion and control over the disposition is generally restricted by the default rules (as described below).

3. ***"Forced Heirship" and Other Default Restrictions***.

(i) *"*Forced Heirship*".* Many civil law countries have laws that require that a considerable part of a decedent's estate pass ***outright*** to certain categories of beneficiaries ("reserved heirs"), who are typically the surviving spouse and children ("forced heirship"). Typically, the client cannot alter the "reserved heir" designations and/or the shares to be received by an heir under his or her Will.

Planning Point. The best strategy for a dual resident client whose assets may be exposed to forced heirship rules is either to remove his or her assets from the forced heirship country or take affirmative steps to change his or her domicile. Alternatively, consider interposition of an intermediary entity to own the assets and transfer the interest in such intermediary entity to a U.S. trust. The last strategy may be quite costly and trigger additional reporting requirements, and therefore must be carefully evaluated.

(ii) Other Default Restrictions. Under Shariah law, a Muslim may not dispose of by Will more than 1/3 of his or her property. Shariah law does not consider illegitimate and adopted children as heirs, and non-Muslims cannot benefit from the estate of a Muslim. Shariah law also provides how much the decedent's surviving spouse, children and parents must receive. For example, a surviving wife's share is either 1/8 or 1/4 of property, depending on whether her husband has surviving children or not. As it relates to children, daughters inherit 1/2 the share of a son. Each parent typically inherits 1/6 of the decedent's property.

B. Determination of Governing Law. The next threshold issue for a dual resident client is the determination of the law that will govern the disposition of the client's property.

1. ***Common law jurisdictions***. Generally, in the U.S. and most common law jurisdictions, the following two main choice of law principles govern intestacy and testamentary dispositions, including the testamentary capacity of the testator, and the validity, revocation and construction of the testamentary instrument:

(i) The ***situs*** of ***real property*** determines which law governs *(1)* the distribution of intestate real property; and *(2)* the validity and effect of a testamentary disposition of real property;

(ii) The testator's ***last domicile*** determines which law governs *(1)* the distribution of intestate ***personal*** tangible and intangible property; and *(2)* the validity and effect of a testamentary disposition of ***personal*** tangible and intangible property, irrespective of its location.

2. ***Civil law jurisdictions***

(i) Overview. Historically, civil law jurisdictions based their choice of law rule in succession matters (*i.e.*, intestacy and testamentary dispositions) on the decedent's ***nationality for all property***. However, some of the civil law jurisdictions have departed from the ***nationality-for-all-property*** principle and now provide that succession matters for ***real property*** are governed by the law of the property's ***situs*** and that for all other property such matters are governed by either the decedent's ***nationality*** or the decedent's ***residency*** (*e.g.*, Russia, Costa Rica and Monaco). Further, for the member states of the European Union (the "EU") (excluding the U.K., Denmark and Ireland) the default rule now is that succession matters are to be governed by the law of the country of the decedent's ***habitual residence*** at the time of his or her death (as described immediately below).

(ii) EU Succession Regulation. In an attempt to reconcile and unify succession laws across the EU member states, the EU adopted the EU Succession Regulation (No. 650/2012; also known as "Brussels IV"). The EU Succession Regulation became effective on August 17, 2015 for more than 20 countries that comprise the EU (excluding the U.K., Denmark and Ireland). In the event the EU Succession Regulation applies, the intention is that only ***one succession law*** will govern ***all*** aspects of succession.

(1) *Default Rule*. Absent any legally enforceable choice of law election made by the decedent in a testamentary instrument, the ***default rule*** is that the law applicable to the decedent's estate will be the law of his or her ***habitual residence*** at the ***time***

of death, irrespective of where the property is located and whether the property is movable or immovable.[2]

(a) *"Habitual Residence" Not Defined*. The EU Succession Regulation does not define the term "habitual residence". However, Paragraph 23 of the Preamble to the EU Succession Regulation generally states that such determination will be made based on an overall assessment of ***facts and circumstances*** of the decedent's life during the years preceding his or her death and at the time of his or her death.

(2) Choice-of-law. The default rule can be overridden by an individual's choice of law. An individual can elect in his or her testamentary instrument (*e.g.*, a Will) that the law of his or her ***nationality*** apply (instead of his or her ***habitual residence***).[3] In making the election, the testator may choose between the nationality that he or she possesses at the time of ***making the choice*** or the nationality at the time of ***death***. An individual possessing ***multiple*** nationalities may choose the law of any of the countries whose nationality he or she possesses.[4] It should be noted though that the testamentary instruments that are recognized by the EU Succession Regulation include a Will, a joint Will, or a succession agreement, but ***not*** a ***trust instrument***.[5]

(3) Importantly, the law of the decedent's habitual residence and the elected law of his or her nationality does ***not*** have to be the law of the state that adopted the EU Succession Regulation. In other words, if a U.S. citizen has property located in France and heirs residing in France (a forced heirship jurisdiction), the U.S. citizen can make an election in his Will to have U.S. law apply[6] to the disposition of that property and thus ensure that the property will pass under the applicable U.S. state's law, not under French succession law. In light of this, advisors may utilize the EU Succession Regulation to avoid forced heirship rules by making the necessary elections when applicable. When planning around the forced heirship rules, advisors should consider conflicts of law (as described immediately below).

3. ***Conflicts of Law***. Occasionally, the application of the choice of law rules may result in a ***conflict*** between jurisdictions as to which laws apply.

(i) Fact Pattern. Assume a U.S. citizen died owning real estate in Taiwan, a civil law country that determines succession matters based on the decedent's ***nationality*** at his or her death. Given that the decedent was a ***U.S. citizen*** at death, the law of Taiwan refers to U.S. law to govern succession matters. However, the U.S. choice of law rule is that the law of the ***situs*** of ***real property*** governs its disposition. Thus, the U.S. choice of law rule ***refers back*** to Taiwan law as the law of the country in which the real property is located.

(ii) Renvoi. The above-described referral mechanism is called ***renvoi*** (from the French meaning "***send back***"). ***Renvoi*** means a remission back to the original forum through the application by the forum of the foreign jurisdiction's whole law (*i.e.*, its substantive law

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2 Article 21 of the EU Succession Regulation.
3 Article 22 of the EU Succession Regulation.
4 *Id.*
5 Article 3 of the EU Succession Regulation.
6 More specifically, the state law of the U.S. jurisdiction to which he has the closest connection.

and the choice of law rules, rather than its substantive law). The original purpose of this mechanism was to prevent "forum shopping" and the ***same law*** is applied to achieve the same outcome regardless of where the case is actually decided. In the example above, Taiwan will accept *renvoi*, and therefore a Taiwan court will accept the reference and apply Taiwan law with respect to the real property.

(1) *No Renvoi in the U.S.* As a general rule, the U.S. does ***not*** follow the doctrine of ***renvoi*** because it can lead to the problem of circularity.

(2) *Exception to "No Renvoi" in the U.S.* When a succession law matter related to foreign property owned by a U.S. decedent is litigated in a U.S. court, the court may decide the case in the same manner as a court of the foreign country in which the property is located applying both the substantive law and the choice of law rules of that ***foreign*** country. This mechanism is known as "*double renvoi*".

(iii) EU Succession Regulation & Renvoi. When attempting to plan around forced heirship rules under the EU Succession Regulation, advisors should consider that *renvoi* applies to the default rule (*i.e.*, when no election is made by the testator) and therefore the forced heirship rules can govern. In contrast, if the testator makes an election, no *renvoi* applies.

C. Will Options

1. ***Recognition of U.S. Wills***. Another essential issue to consider for a dual resident client is whether a Will drafted in the U.S. will be recognized by a foreign jurisdiction as validly executed.

(i) Validity in General. In general terms, a U.S. Will must be formally valid under the laws of a foreign jurisdiction to be recognized by that jurisdiction. Advisors should be aware that some foreign jurisdictions will ***not*** recognize a U.S. Will under any circumstances, while others may afford recognition only under certain circumstance. Thus, a general rule of thumb is that an advisor should consult with an attorney of the foreign jurisdiction in which the client's assets are located to determine: *(i)* which law governs the Will; *(ii)* the requirements for a validly executed Will; and *(iii)* possible tax ramifications of the Will.

(ii) International Conventions. Advisors should also keep in mind that the validity of a Will often can be resolved by the following ***two*** conventions:

(1) *The Washington Convention*. In 1973, the International Institute for the Unification of Private Law (UNIDROIT) completed the Convention Providing a Uniform Law on the Form of an International Will (the "Washington Convention"). Briefly, the Washington Convention allows a testator who owns property in various foreign jurisdictions to execute an ***International Will***. Provided that the International Will meets a number of formalities set forth by the Washington Convention, it will be valid in any jurisdiction that either signed or adopted the Washington Convention.[7] In order to be valid, an International Will must meet the following requirements:

[7] The countries who either signed or enacted the Washington Convention include, but are not limited to: Belgium, Bosnia-Herzegovina, Canada, Cyprus, Ecuador, France, the Holy See, Italy, Iran, Laos, Libya, Niger, Portugal, the Russian Federation, Sierra Leone, Slovenia, the U.K., and the U.S. Regarding the U.S., each state also had to enact the Washington Convention (currently, approximately 24 U.S. states [including D.C.] have enacted the Washington Convention).

(a) *No Joint Wills*. The Will may not be a disposition of more than one person's property (Article 2).

(b) *Made in Writing.* The Will must be made in writing by hand or by other means (Article 3).

(c) *Can Be Written by Third Person*. The Will does not need to be written by the testator himself (Article 3).

(d) *Any Language Permitted.* The Will can be made in any language (Article 3).

(e) *Two Witnesses & One Authorized Person Required.* The Will must be signed in the presence of and signed by two witnesses and an authorized person (an authorized person can only be an attorney, and therefore a notary is not sufficient) (Article 5).

(f) *If Not Signed, Reason Must Be Stated.* In the event the testator cannot sign the Will, the reason must be stated in the Will (Article 5).

(g) *Signatures & Pages.* All signatures must be placed at the end of the Will. If the Will has more than one page, each page must be numbered and the testator must sign each page (Article 6).

(h) *Certificate.* The authorized person must attach a certificate in the form provided in Article 10 of the Washington Convention (Article 9).

(2) *The Hague Convention of the Conflicts of Laws Relating to the Form of Testamentary Dispositions (the "Hague Convention on Testamentary Dispositions").* The Hague Convention on Testamentary Dispositions was enacted on October 5, 1961. The purpose of this Convention is to unify the provisions on the conflicts on laws relating to the form of testamentary dispositions. Currently, there are over 40 Contracting States/signatories to this Convention.[8]

The U.S. has not adopted the Hague Convention on Testamentary Dispositions. However, as long as relevant property is located in a Contracting State, a U.S. advisor may take advantage of this Convention. Specifically, Article 6 of the Hague Convention on Testamentary Dispositions provides that it applies "even if the nationality of the person involved or the law to be applied … is not that of a Contracting State." Under Article 1 of the Hague Convention on Testamentary Dispositions, a Will is recognized as valid, with respect to its ***form***, if its form complies with the ***internal*** law of any of the following:

(a) the ***place*** in which the testator ***made*** the Will;
(b) the testator's ***nationality*** either at the time the Will is made or at the testator's death;
(c) the testator's ***domicile*** either at the time the Will is made or at the testator's death;

[8] The following are Contracting States/signatories to The Hague Convention on Testamentary Dispositions: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Israel, Japan, Luxemburg, the Netherlands, Norway, Spain, Sweden, Switzerland, Turkey, and the U.K.

(d) the testator's ***habitual residence*** either at the time the Will is made or at the testator's death; ***or***

(e) as it relates to real property, the ***situs*** of the real property.

2. ***U.S. Will.*** Provided that the foreign jurisdictions in which the dual resident client's assets are located recognize his or her U.S. Will as valid (either by virtue of their domestic laws or because they are members of the Washington Convention or the Hague Convention on Testamentary Dispositions), the client can dispose of his or her property under a single U.S. Will.

(i) Advantages

(1) A single Will provides simplicity for the client;

(2) There is no need to apportion tax liabilities among various beneficiaries of multiple Wills;

(3) Upfront legal fees regarding the Will are less than executing multiple Wills.

(ii) Disadvantages

(1) There is a risk that the Will may not be recognized by the foreign jurisdiction;

(2) U.S. legal terminology may be difficult to comprehend and may result in ambiguities;

(3) The U.S. Will may require translation;

(4) Each foreign jurisdiction in which the decedent's assets are located may require the submission of the original Will;

(5) The foreign jurisdiction may require that only a national of that jurisdiction administer the estate;

(6) Additional unexpected costs during probate.

3. ***Situs Will.*** A situs Will is a type of Will that governs the disposition of ***only*** property located in a certain country. Although drafting multiple Wills may be more expensive, having situs Wills may be more advisable for certain dual resident clients, provided that all of the Wills: *(i)* are carefully coordinated to avoid inadvertent revocation of one Will by another; *(ii)* cover all of the client's assets; *(iii)* contain complementary language referencing all of the Wills to avoid confusion; and *(iv)* properly apportion tax liabilities among various beneficiaries.

(i) Advantages

(1) A foreign situs Will removes concerns that it would not be recognized by the foreign jurisdiction;

(2) It may be more efficient to administer assets confined to a single jurisdiction;

(3) There is no need for translation;

(4) Given that the Will is drafted using the law of the foreign jurisdiction and the appropriate legal terminology, there is less risk of ambiguity and confusion;

(5) There will be no issue with the submission of original Wills in each jurisdiction;

(6) The disclosure of the assets is limited only to the jurisdiction of the situs Will.

(ii) Disadvantages

(1) One Will can inadvertently revoke another Will;

(2) Multiple Wills may leave some assets out and therefore invite intestacy (*e.g.*, a dual status resident purchases property in a different jurisdiction, but forgets to execute an additional situs Will);

(3) Improper apportionment of tax liabilities may result in disputes among beneficiaries and protract administration;

(4) Multiple Wills may result in conflict issues during administration.

4. ***International Will***. In the event all of the assets of a dual resident client are located in member states of the Washington Convention, an estate planning advisor may consider execution of one International Will (as discussed in Section III.C.1(ii)(*1*), *supra*). The obvious advantage of having an International Will is that it ensures the validity in a foreign jurisdiction. However, the estate planner should carefully evaluate if the client may benefit more from the execution of situs Wills.

D. Recognition of U.S. Trusts[9]

1. ***Overview***. As described above, a trust can be an extremely useful tool to achieve the client's various estate planning goals in the U.S. A trust, however, is a creation of common law, and civil law jurisdictions generally do ***not recognize*** the concept of a trust. In view of this, before including a trust (either a domestic trust or a foreign trust for U.S. tax purposes) in a client's estate plan, an estate planning advisor should consider that it may not travel well across the border.

2. ***Hague Convention on Trusts***. On July 1, 1985, the Hague Conference on Private International Law adopted the Hague Convention on the Law Applicable to Trusts and on Their Recognition (the "Hague Convention on Trusts"). The Hague Convention on Trusts has been adopted by several civil law jurisdictions, including Italy, Luxemburg, the Netherlands and Switzerland. The Convention sets forth the procedures under which the member states, irrespective of their own legislation, will recognize trusts established in other jurisdictions. However, Article 15 of the Hague Convention on Trusts expressly provides that the Convention does not prevent the application of mandatory domestic law governing succession matters, marital rights and creditors' rights. Consequently, even if the client's trust is recognized under the Hague Convention on Trusts, the forced heirship and other mandatory rules will still apply to the trust's distributions, thereby rendering the trust instrument totally ineffective in a foreign jurisdiction.

3. ***Potential Issues with Trust Structures***. Using a trust structure for a dual resident may result in the following issues:

(i) Transfers to and from trust structures may cause titling issues;

(ii) Forced heirship rules and other default rules of a foreign jurisdiction may cause the provisions of the trust instrument to become totally ineffective;

(iii) Foreign jurisdictions may impose higher transfer taxes on distributions from trusts;

Example: German inheritance tax law favorably taxes inheritances passing from relatives. For instance, an inheritance passing from a parent receives a ***€400,000*** exemption and is subject to the most favorable inheritance tax rates ranging from ***7%*** to ***30%***. In contrast, an inheritance passing from a non-relative or a ***legal entity*** receives only a ***€20,000*** exemption and is subject to the least favorable inheritance tax rates ranging from ***30%*** to ***50%***. To this effect, German inheritance tax law treats some trusts (so-called "non-transparent" trusts) as ***legal entities***. Although the U.S. – German Estate and Gift Tax Treaty may provide some relief, such relief may not necessarily be available to German resident beneficiaries. Thus, passing an inheritance via a ***non-transparent trust*** may

[9] For purposes of this section a "U.S. trust" means an instrument drafted in the U.S. Consequently, it can be either a foreign or a domestic trust for U.S. tax purposes.

result in a substantial inheritance tax bill that could have been avoided by passing such inheritance ***outright***.

(iv) Expatriation of certain U.S. citizens or long-term "green card" holders ("covered expatriates") who previously established a ***domestic grantor*** trust may cause the trust to become a ***foreign nongrantor*** trust as to the covered expatriate and trigger gain recognition under I.R.C. § 684 (which applies before the "exit tax" under I.R.C. § 877A and therefore renders an exclusion available under this section unavailable).[10]

(v) If a dual resident client moves to a foreign jurisdiction (*e.g.*, the U.K.) having an existing U.S. trust, the foreign jurisdiction may deem the U.S. trust a resident trust and subject the unrealized appreciation of trust assets to income taxation.

[10] IRS Notice 2009-85, 2009-45 I.R.B. 598 § 4.