THE AVER ADVISORY

SEPTEMBER 2015

presented by Aver Associates *Estate Planners & Trustees* *contact@averassociates.com*

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IRREVOCABLE TRUSTS

Gains accrued within trusts declared to be beyond spouse's reach

Dmitri Rybolovlev v. Elena Rybolovleva, Court of Appeal of Geneva, June 5, 2015

In 2014, in what had been dubbed the "divorce of the century", Russian divorcee Elena Rybolovleva, was granted the world's largest ever divorce settlement of $4.8 billion.

Her ex-husband Dimitri Rybolovlev is the former owner of fertilizer giant Uralkali, and is one of a small group of Russian oligarchs who became fabulously wealthy during the post-Soviet privatization of the economy.

The couple had been married for 24 years when they started divorce proceedings in 2008. They met as students and she was by his side as he rose from a doctor-turned-entrepreneur into a stockbroker and banker, before becoming chairman and majority shareholder of Uralkali. He sold his stake in Uralkali for $6.5 billion in 2010.

In 2005, Rybolovlev established two irrevocable trusts governed by the law of Cyprus. The value of the marital assets on the date of their settlement into trust was $1.2 billion. At the time of the divorce filing in December 2008, the value of the trust assets had grown to nearly $9 billion.

The court held that gains accrued within the trusts since 2005 must be kept separate from the rest of his billions. The court accordingly reduced the divorce settlement amount to $604 million. ■

ESTATE PLANNING

UK Budget to impact non-domiciled regime of wealthy UK residents

Britain's July 2015 Budget introduced far reaching reforms affecting quite a number of High Net Worth Individuals who have established residence in the UK (for tax reasons). As in other countries (New Zealand, Canada, etc.), new residents get a time frame within which they have to make up their mind on whether they want to stay in the UK or not and be treated as any other taxpayer in the UK.

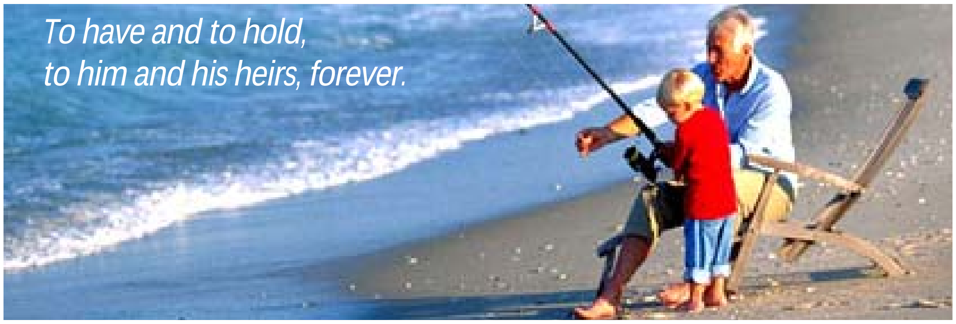
Up to now, UK residents claiming non-domiciled tax status are permitted to pay an annual charge ranging from £30,000 to £90,000, depending on how long they have lived in Britain, thereby avoiding UK tax on income and assets held offshore. Inheritance tax is payable after 17 years of residency in the UK.

The budget reforms will abolish the permanent nature of non-domiciled tax status effective April 2017. The reform will not eliminate the tax status, however:

- Non-domiciled status will be removed from individuals who were born in Britain to British parents and became non-domiciled after moving abroad.
- Individuals who have lived in the UK for 15 of the past 20 years will lose the right to claim non-domiciled status.
- The time required to re-start the domicile clock will increase from four to five years.

The current law also allows non-domiciled UK residents to avoid inheritance tax on their UK residential property by holding it through an offshore company, trust or foundation. Reforms will be enacted to cause such structures to be transparent with regard to the Treasury.

The measures could affect more than 115,000 UK residents currently claiming to be non-domiciled, including politicians, footballers, bankers and businessmen. ■



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TAX RESIDENCY

Economic links trump family connections in determination of tax residency under the centre of vital interests test

In re: Italian Tax Residency, Italian Supreme Court, decision no. 6501, March 31, 2015;
Kfar Saba v. Michael Sapir, Israeli Supreme Court, Civil Appeal no. 4862/13, May 14, 2014

A tax residency change can be a very efficient way forward for tax and estate planning. For some of you, moving to another country is easier than for others. Italian and Israeli residents are among the lucky ones. Luck does not come by its own, but he who changes country, definitely changes luck.

Italian residency. In March 2015, the Italian Supreme Court considered a case where the taxpayer was an Italian citizen who moved to Switzerland. He registered as a Swiss resident and started working for a local employer. His family continued to live in Italy.

The Italian tax administration took the position that the taxpayer should be considered an Italian tax resident based on his personal and family interests located in Italy.

The Italian Supreme Court, however, affirmed the lower court ruling in favor of the taxpayer. The court referred to the centre of vital interests test under the *Italy-Switzerland Tax Treaty*. It held that the taxpayer's tax residency had to be assigned to Switzerland due to the taxpayer's meaningful professional and economic interests located there. These business interests prevailed over the taxpayer's personal interests located in Italy.

Israeli residency. In May 2014, the Israeli Supreme Court considered a case where the taxpayer was an Israeli citizen who had worked and lived with his family in Singapore for several years. The taxpayer then returned to Israel with his family. A few years later, he went back to work in Singapore alone, while his wife and children stayed in Israel.

The court of first instance ruled that, under certain circumstances, the centre of a person's life may be separated from that of his spouse and family due to his occupation and lifestyle. The Israeli Tax Authority Assessing Officer appealed this decision.

On appeal, the Israeli Supreme Court confirmed that the family unit may be split. The court held that a person may be deemed to be a non-Israeli resident, even when his family lives in Israel.

The fact that the taxpayer spent a number of days in Israel that exceeded the number needed to be deemed an Israeli resident was held by the court to be irrelevant in evaluating his centre of vital interests. ■

LIFE INSURANCE TRUSTS

Court reaffirms use of Crummey powers to qualify settlements in trust as tax-free gifts

Mikel v. Commissioner, US Tax Court, Memo 2015-64, April 6, 2015

In April 2015, the US Tax Court held that a family trust's *in terrorem* clause did not nullify the trust's Crummey powers. The decision reaffirms the use of Crummey powers to qualify gifts in trust as tax-free gifts.

Background. A gift in trust generally does not qualify for the annual exclusion from US gift tax. However, if a beneficiary has the right to withdraw such property from the trust, the donor's transfer can qualify as an excluded gift. These withdraw rights are referred to as "Crummey powers," named after a landmark case approving the use of this power.

Annual exclusion gifts can help settlors fund irrevocable life insurance trusts, while preserving their lifetime gift and estate tax exemption amounts. Crummey powers are instrumental in this process. Non-US citizens and non-US domiciliaries are subject to US federal gift tax on transfers of tangible property situated in the US. A donor can exclude up to $14,000 per donee from their taxable gifts for the year, and a married couple may split gifts resulting in a per donee annual exclusion amount of up to $28,000.

Facts. A husband and wife established an irrevocable discretionary trust to which they gifted a personal residence in Brooklyn, two other Brooklyn properties owned through a limited liability company, and a property in Florida. The trust was settled in 2007 when the annual exclusion amount was $12,000.

The trust provided beneficiaries with Crummey powers. The grantors each claimed an annual exclusion of $720,000 based on $12,000 gifts to each of 60 beneficiaries.

The IRS held that the beneficiaries did not have legally enforceable rights to withdraw funds from the trust. The trust included an *in terrorem* clause under which a beneficiary could be excluded from benefitting, if they were to challenge the distribution of the trust fund or initiate certain court proceedings.

The IRS argued that a beneficiary must be able to enforce his right under the trust and that the beneficiaries in this case would be reluctant to do so because of the *in terrorem* clause.

Decision. In granting judgment for the husband and wife, the Tax Court stated that the IRS misconstrued the trust provisions. The court found that the trust's *in terrorem* provision would only become effective where a beneficiary challenged a trustee's exercise of a discretionary distribution power. Accordingly, the *in terrorem* provision would not exclude a beneficiary for merely challenging a trustee's denial of a beneficiary's exercise of the Crummey withdrawal power. The court held in favor of the settlors. ■

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LIFE INSURANCE

Mental capacity required to change beneficiary of life insurance policy

New York Life Insurance Co v. Frieda Bostwick, NO. 3:14-CV-05931-RJB (US Dist. W.D. WA), July 22, 2015

Facts. David Bostwick purchased a life insurance contract on his life from New York Life Insurance. His estranged second wife Nancy visited David on his death bed five days before he died of colon cancer. During her visit, Nancy obtained a change of beneficiary designation in her favor. She then submitted the form to New York Life and made a claim for the death benefit.

David's mother Frieda also filed a claim for payment as the original beneficiary. New York Life requested that Frieda forward any documents supporting her request that payment to Nancy be withheld. Frieda provided declarations by David's primary physician describing his suffering as "significant cognitive impairment that impaired his ability to reason thoughtfully and to resist influence from others." Other declarations described David as "confused, sleeping for long periods of time, and using indecipherable speech."

Decision. The court noted that just as mental capacity is necessary to execute a valid will, it is also necessary to execute a change of life insurance beneficiary. The court found there was overwhelming evidence that David lacked the capacity to execute a change of beneficiary form and found that Frieda was the rightful beneficiary of the policy ■

PROFESSIONAL INDEMNITY INSURANCE

Victims of holiday home scheme cleared to seek damages from lawyers' insurers

AIG Europe v OC320301 LLP & Ors, England & Wales High Court, 2015 EWHC 2398 Comm, August 14, 2015

In August 2015, the England & Wales High Court held that British residents, who lost money in a failed overseas real estate scheme, may seek to recover their entire losses from their lawyers' insurers.

Facts. With legal assistance from the now defunct International Law Partnership LLP, hundreds of investors purchased holiday homes overseas that turned out to be worthless, either because they were fraudulently marketed or because the developers went bankrupt. Together, the investors lost more than £11 million. Many attempted to recoup their losses by claiming compensation from the lawyers who handled the purchases for them, and failed to safeguard their clients' money.

The professional indemnity insurer AIG Europe argued that its total liability to all clients of the law firm was limited to the standard indemnity coverage of £3 million, because all of the claims arose from similar acts or omissions in a series of related matters or transactions.

Decision. The court rejected AIG's argument and held that, while the underlying claims arose out of similar acts or omissions, they were not in a series of related transactions because the terms of the transactions were not conditional or dependent upon each other. The claims related to several different development projects in different countries - even though they all failed for similar reasons. The investors were therefore permitted to seek damages from AIG. ■

STOLEN DATA

Italian courts offer insight on probative value of stolen account data

Italian Tax Court, Case 5031/16/2015, June 8, 2015

In June 2015, a Milan tax court provided further guidance on the use of stolen account data as evidence in tax evasion prosecutions. The case dealt with the Lagarde list; a list of alleged tax evaders acquired by ex-French Minister of Finance Christine Lagarde. The data was stolen from HSBC Private Bank Suisse SA in 2009 by Herve Falciani, a former IT analyst who was employed by HSBC.

In April 2015, the Italian Supreme Court held that circumstantial evidence within the HSBC files could be used by tax authorities, but not without due process to evaluate its reliability and probative value. The court further stated that tax authorities may ground their tax assessment with "reasonable hints" of alleged tax avoidance and that the Lagarde list might be deemed to be such a hint.

The recent Milan tax court decision further narrows the use of stolen data as evidence in tax matters, adding that such data cannot be used as definitive proof of tax evasion. Tax authorities may employ any circumstantial element of the Lagarde list, but cannot rely on a generic reference as the only reason to ask for the tax payment.

Luxembourg charges French reporter for role in LuxLeaks scandal

In April 2015, French journalist Edouard Perrin was charged in a Luxembourg court for being a "a co-author, if not an accomplice" in the leak of corporate tax returns and advance rulings from the files of global accounting giant PricewaterhouseCoopers. The documents were stolen in 2012 by Antoine Deltour, a junior auditor with PwC in Luxembourg and revealed the preferential tax treatment multinationals received in Luxembourg. The rulings gave approval to complicated accounting and legal structures set up by PwC through which hundreds of multinational companies were able to shift profits to low-tax Luxembourg from the higher-tax countries where they were headquartered or carried on economic activity.

EU Parliament rewards LuxLeaks whistleblower with Citizen's Prize

Charged in 2014 with a series of criminal offenses in Luxembourg, Antoine Deltour was awarded the European Citizen's Prize in June 2015 by the European Parliament in consideration for his "contribution to mutual cultural understanding and promotion of European citizenship." ■