FRIDAY, MAY 5 **8:00 a.m. – 9:45 p.m.**

INCOME & TRANSFER TAX PLANNING GROUP: ROUNDTABLE

GROUP AND PROGRAM CHAIR:

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RECENT DEVELOPMENTS IN INTERNATIONAL TAX
PRESENTED TO THE AMERICAN BAR ASSOCIATION
REAL PROPERTY, PROBATE AND TAX TRUST SECTION.

Round Table Presentation
Friday, May 5, 2006
8:00 AM
San Diego, California

By Leigh-Alexandra Basha
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Chair, International Tax Committee

I. Introduction

Down to the Banana Republic
Down to the tropical sun
Go the expatriated Americans
Hoping to find some fun

Some of them go for the sailn'
Called by the lure of the sea
Trying to find what is ailing
From living in the land of the free

Some of them are running from lovers
Leaving no forward address
Some of them are running tons of ganga
Some are running from the IRS

Jimmy Buffett
"Banana Republic"

American's may not be flocking to Banana Republics, but if they want to leave the U.S., they should consider doing so quickly in light of recent developments dealing with expatriation and the proposed exit tax. This paper will cover the following recent developments as they relate to international clients: (1) indexed tax changes; (2) expatriation rules; (3) other tax issues; (4) tax fraud; (5) treaty matters; (6) some legislative changes; (7) 2006 changes to the U.K. inheritance tax; and (8) 2006 changes to the French inheritance tax.

II. Indexed Tax Changes

A. Annual Exclusion from Gift Tax IRC § 2503: The annual exclusion for gifts by nonresidents of the U.S. for gift tax is the same as for U.S. citizens and residents and is now

$12,000/per donee/per year effective for gifts made on or after January 1, 2006 . The annual exclusion for gifts to a non-U.S. citizen spouse has increased to $120,000 per year effective January 1, 2006.[1] No gift splitting is permitted if a spouse is a non-resident alien for gift tax purposes. Gift tax payable on amounts in excess of the $12,000 is 20 percent.

B. Estate Tax Exclusion: The applicable exclusion amount applicable to non-residents of the U.S. for estate tax purposes (non domiciliaries of the United States) has remained stagnant at $60,000.[2] The estate tax rate on nonresident alien estates over $60,000 is 26 percent which rises proportionately to 46 percent starting at $2 million.

C. Gifts from Foreign Persons. IRC § 6039F requires the reporting of certain gifts from foreign persons. The new threshold for aggregate gifts is $12,760.[3]

D. Income Tax. Although qualified dividends are currently taxed for U.S. persons as low as at five percent (and dropping to 0% in 2008), they are still subject to a flat 30% (or lower treaty rate) withholding tax under the fixed and determinable annual and periodic ("FDAP") income regime. Many treaties have been negotiated to reduce the dividend rate down to zero. However, not all treaties eliminate this tax. Hence, many non-resident aliens are still subject to a flat 30 percent withholding rate on qualified dividends, although U.S. persons enjoy a much lower percentage tax on those same dividends.

III. Expatriation rules.

There are basically two current sets of rules applicable for expatriating individuals.: 1) those expatriating between 2/6/95 and 6/3/04 and (2) those after 6/4/04. Congress has now also introduced a third set of rules, that of the “exit tax.”

A. Rules 2/6/95 – 6/3/04. Those expatriating between February 6, 1995 and June 3, 2004 which applied a subjective test for determining whether a U.S. citizen renounced his U.S. citizenship or a long term resident terminated his U.S. residency with a "principal purpose of avoiding U.S. taxes." If so, the individual became subject to an alternative of income taxation, rather than that generally applicable to non-resident aliens. The individual was generally made subject to income tax only on U.S. source income at the rate then applicable to U.S. citizens. For determining whether such a renouncing individual had a principal purpose of avoiding U.S. taxes, there was a presumption that he has done so and was subject to the alternate tax regime if:

1. the individual's average annual U.S. federal income tax liability for the five taxable years preceding citizenship relinquishment or residence termination exceeded $100,000; or

2. the individual's net worth on the date of relinquishment/termination equaled or exceeded $500,000.

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[1] Rev. Proc. 2005-70, § 3.28, 2005-47 FRB 979 (Nov. 21, 2005)
[2] (IRC section 2102; all section references are to the Internal Revenue Code of 1986, as amended unless otherwise noted.)
[3] Rev. Proc. 2005-47, § 3.32 2005-47 ARB 979 (No. 21, 2005).

These amounts were adjusted annually for inflation. Certain categories of individuals, such as dual residents, could avoid being deemed to have had a tax avoidance purpose by obtaining a ruling from the IRS under certain circumstances.

B. The Reed Amendment.

In 1996, Congress enacted amendments to the immigration law prohibiting individuals who renounce U.S. citizenship for purposes of avoiding taxation from entering the United States. This is referred to as the Reed Amendment. The Reed Amendment rule however, has never been applied to exclude any individual. The reason being, the Attorney General has never been authorized to obtain the necessary tax returns and other information in order to enforce it. Nevertheless, it was a disincentive for U.S. citizens to expatriate. It was not applicable to long-term resident aliens who relinquished their long-term resident status.

C. 6/4/04 – Present.

1. For expatriation, defined to include both relinquishing citizenship or terminating green card status on or after June 4, 2004, the rules were adjusted to be streamlined and more objective. These are the current rules in effect at this time. No longer is there a subjective determination of tax avoidance as a principal purpose for renunciation or relinquishment. Now a former citizen or former long-term resident will be subject to the 10-year alternative tax regime unless he:

- **a.** establishes that his average annual net income liability for the five preceding years does not exceed $124,000 (adjusted for inflation after 2004),

- **b.** his net worth does not exceed $2 million, and

- **c.** he certifies that he has complied with all U.S. federal tax obligations for the preceding five years and provide such evidence of compliance as may be required.[4]

2. An individual continues to be treated as a U.S. citizen or a long-term resident for U.S. federal tax purposes until he

- **a.** gives notice of an expatriating act or termination of residency (with the requisite intent to relinquish citizenship or terminate residency) to the Secretary of State or the Secretary of Homeland Security, respectively,

- **b.** provides a statement in accordance with the reporting rules in section 6039G, and

[4] IRS Notice 97-19 provides information and examples on point, however, this was issued under a prior set of rules.

c. files Form 8854, Annual Expatriation Information Statement, as revised in May 2005. The existing practice for taking an oath of renunciation is to file one original with the Counselor Officer at the Embassy outside of the United States and the second with the IRS Service Center in Philadelphia.

3. The Thirty-Day Rule.

There is a trap that changes the alternative tax regime for any expatriating individual who is present in the United States for more than 30 days in the calendar year ending in such taxable year during the ten-year period following citizenship relinquishment or residency termination. There are limited circumstances where this 30-day figure can be increased to 60 days. If such individual is present in the United States for more than 30 days in the calendar year, then the individual will be treated as a U.S. citizen or resident for such taxable year and thus taxed on his worldwide income. If any individual initially renounces or relinquishes but does not meet the monetary threshold, then this 30-day rule would not apply to him. If a person flunks in one year and passes in the next, the consequences are unclear. However, there are anti- "in and out" rules in Section 7701(b)(10).

4. Gift Tax Consequences.

Special anti-abuse rules were added to apply the U.S. Gift Tax to certain types of gifts. For instance, normally a non-resident alien can make a gift of U.S. stock without it being subject to gift tax. Now, U.S. gift tax will be imposed on gifts of stock of certain closely held foreign corporations that hold U.S. situated property.

5. Annual Return Filing Requirements.

For those individuals who are subject to the alternative tax regime, in each of the ten years following citizenship relinquishment or residency termination, they must file an annual return even if no federal income tax is due. The return includes certain information on the permanent home of the individual, the individual's country of residence, the number of days the individual was present in the United States for the year and detailed information about the individual's income and asset that are subject to the alternative tax regime. The penalty for failure to file or correctly include all required information is $5,000. It is not clear whether such an individual must also file the non-tax FBAR forms.

6. Published List.

Published in the Federal Register are the names of all former citizens (not former green card holders) who have renounced or otherwise lost U.S. citizenship. In the last quarter of 2005 there were roughly 100 such citizens who lost their citizenship within the meaning of Section 877(a).[5]

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[5] IRS Section 6039G as amended by the Health Insurance Portability and Accounting Act (HIPAA) of 1996 requires its publication.

7. Comment.

These tax rules enacted in 2004 are no longer linked to tax motivation and provide an opportunity for avoiding U.S. tax following the ten-year period of time and even during the ten-year period of time investments can be structured to minimize U.S. tax exposure. With respect to a more unplanned event like death, life insurance for that ten-year period of time may help buffer the impact. Further, if an individual expatriates, he can later make a gift or bequest to a U.S. individual or entity without creating a tax liability for the recipient and without incurring a gift or estate tax if he uses non-U.S. situs assets.

D. The New Proposed Exit Tax.

1. General.

Although the Exit Tax was introduced by Clinton in February, 2000, several other proposals have been offered in Congress. On November 18, 2005, the Senate approved a bill which is buried in a large piece of legislation. The Senate Bill in effect subjects certain U.S. citizens who relinquish their citizenship and certain long-term residents who terminate their residence to tax on the net unrealized gain in their property as if such property were sold for fair market value on the day before the relinquishment/termination. It is also called the "Mark-to-Market" tax which is what Congress and the Treasury Department prefer to call the Exit Tax. Gain from the deemed sale is taken into account at that time without regard to the tax code provisions. Any loss from the deemed sale will be taken into account to the extent otherwise provided in the code. Any net gain on the deemed sale is recognized to the extent it exceeds $600,000 ($1.2 million in the case of married individuals filing a joint return, both of whom relinquish citizenship or terminate residency). The $600,000 amount is increased by a cost-of-living adjustment factor for calendar years after 2005.

As under the existing rules, the Mark-to-Market or Exit Tax applies to U.S. citizens who relinquish citizenship and long-term residents who terminate U.S. residency if they were a lawful permanent resident for at least eight out of the fifteen taxable years ending with the year in which the residency termination occurs.

An individual is permitted to make an irrevocable election to continue to be taxed as a U.S. citizen with respect to all property that otherwise is covered by the expatriation tax. This is an all-or-nothing election and an individual may not pick and choose properties to which it will be applied. Not only would such an individual continue to pay U.S. income taxes at the rates applicable to U.S. citizen following citizenship relinquishment or residency termination, but the property would continue to be subject to U.S. gift, estate and generation-skipping transfer taxes. In order to make this election, the individual is required to waive any treaty rights that would preclude the collection of the tax. The date of citizenship relinquishment is defined as the date the individual swears or affirms his oath of renunciation in front of a counselor officer and witnesses.

The deemed sale rule applies to all property interests held by the individual on the date of citizenship relinquishment or residency termination. Special rules apply in the case of trust interests. U.S. real property interests which remain subject to U.S. tax under the existing Foreign

Investment in Real Property Tax Act (FIRPTA) are generally excepted from the bill. The tax is due on the 90th day after relinquishment/termination. The tax can be deferred at a rate 2 percentage points higher than the rate normally applicable to individual underpayments (currently 5 percent rather than 3 percent). Death of the individual ends the deferral.

2. Trusts.

Interest in trusts are subject to detailed rules. The treatment of trust interests depend on whether the trust is a qualified trust. A qualified trust is similar to a domestic defined in Section 7701(a)(30) and is a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust. If an individual holds an interest in a trust that is not a qualified trust, then a special rule applies for purposes of determining the amount of the Mark-to-Market Tax due with respect to such trust interests. The individual's interest in the trust is treated as a separate trust consisting of the trust assets allocable to such interests. Such separate trust is treated as having sold its net assets as of the date of citizenship relinquishment or residency termination and having distributed the assets to the individual who is then treated as having re-contributed those assets to the non-qualified trust.

The election to defer payment is available for the Mark-to Market Tax attributable to a non-qualified trust interest. Interest is charged for the period the tax is deferred at a rate 2 percentage higher than the rate normally applicable to individual underpayments – currently 9 percent. Note, the individual is allocated the maximum amount that he or she could receive so that all contingencies in discretionary interests are assumed to be resolved in the individual's favor, i.e., that such individual would receive the maximum amount possible. If an individual has an interest in a qualified trust, the individual is subject to the Mark-to-Market Tax upon the receipt of distributions from the trust. These distributions also may be subject to other U.S. income taxes. There are additional very detailed provisions relating to the determination of an individual's interest in the trust and how they will be taxed.

3. Coordination with Present Law Alternative Tax Regime.

The existing expatriation income tax rules in IRC Section 877 and the accompanying expatriation estate and gift tax rules continue to apply to a former citizen or former long-term resident whose citizen relinquishment or residency termination occurs on or after date of enactment of the new provisions.

4. Treatment of Gifts and Inheritances from a Former Citizen or Former Long-Term Resident.

Under IRC Section 102, property received by gift or inheritance generally is excluded from income. However, this is not the case for the recipient of property received from an individual who relinquished U.S. citizenship or terminated U.S. residency, in which case, such property will be income taxable. Thus, a U.S. taxpayer who receives a gift or inheritance from such an individual is required to include the value of such gift or inheritance in gross income and is subject to U.S. tax on such amounts. The recipient of such property would have basis in that property equal to the value. The income tax does not apply to property that is shown on a timely filed gift tax return and that is a taxable gift by the former citizen or former longer-term resident or shown on a timely filed estate tax return and includable in the gross U.S. estate of the former citizen or former long term resident. This is the case even if the tax liability shown on such a return is reduced by credits, deductions or exclusions. For those with wholly discretionary foreign trusts where the class of beneficiaries can change, a beneficiary will need to obtain information, applicable gifts for bequests that are made in trust are treated as made to the beneficiaries of the trust in proportion to their respective interests in the trust.

5. Immigration Rule.

One will lose his ability ever to enter the United States if the taxpayer fails to file proper returns under IRC section 877(a). The immigration rules which deny tax motivated expatriates to re-enter into the United States would be modified by the bill to remove the requirement that the citizenship relinquishment be tax motivated and instead former citizens would be denied reentry if the individual is determined not to be in compliance with his tax obligations. Regardless of the subjective motive for expatriating, former citizens would be denied re-entry if the individual is determined not to be in compliance with his tax obligations.

6. Effective Date.

The Senate Tax Reconciliation Bill (S.2020) is effective for U.S. citizens who relinquish their citizenship or long term residents who terminate their residency on or after the date of enactment which is the date the legislation is signed into law by the President. If this law is enacted, it would probably become law in 30 to 75 days. Consequently, anyone should start the process quickly as it normally takes four to six weeks to renounce citizenship and this assumes that the taxpayer's tax filings are current and up to date. The Senate Bill containing the exit tax provisions was passed by the Senate on November 18, 2005. For this to become law, it would normally have to be approved by a conference committee and such conference committee's report would have to be adopted by both the House and the Senate and the President sign it into law.

Note the provisions of the bill relating to gifts and inheritances are effective for gifts and inheritances received from former citizens and former long-term residents on and after date of enactment with citizenship relinquishment or residency termination occurs on or after such date. Thus, individuals who have renounced prior to the new exit tax and their children will not be affected. Likewise the provisions of the bill relating to former citizens under U.S. immigration laws will be effective on or after the date of enactment.

7. Other Resources.

Various articles on the subject include:

- Pending U.S. Anti-Expatriation Legislation: Is an Exit Tax Around the Corner? by Charles M. Bruce, Louis Saret, Stephane Lagonico, and Lauren McKinney, Monday, January 23, 2006, ISSN1522-8800, No. 14, Daily Tax Report of BNA, Inc.

- Anti-Expatriation Legislation aimed at Individuals: Is Congress going to Enact and Exit Tax? by Charles M. Bruce, Esq., Vol. 25, No. 10, Tax Management Weekly Report, March 6, 2006, Vol. 25, No. 10, pp 368-370.

E. How Does One Expatriate?

1. Complete and submit State Department form;

2. Book appointment with counselor office;

3. File Tax Form 8854;

4. Be sure taxpayer has another satisfactory other nationality;

5. Be sure all current tax filings are up to date for the preceding five years.

IV. Other Tax Issues

International tax issues had priorities for IRS Treasury Dept. in 2006 with more guidance and increased focus on complex cross-border transactions and it cracked down on abuses dominating the agenda.[6]

Many issues are being targeted including:

A. Improper use of the foreign tax credit. IRS Acting Associate Chief Counsel Steven Musher, and Treasury International Tax Counsel Hal Hicks were interviewed separately, and outlined what they will be targeting in the upcoming year. They said the foreign tax credit will be under closer scrutiny. At issue is the so-called "technical taxpayer" rule under IRC Section 901. The rule provides that the person considered to pay a foreign tax is the person who is legally liable for the tax under foreign law and thus eligible to claim foreign tax credits.

B. Check the box concerns. Treasury has indicated it will be going after targeted cases where the "check the box" rules are used to produce inappropriate results. Many of this affects the income tax including branch transactions under IRC Section 987. The "check the box" rules have created all kinds of issues with subsidiaries and branches, disregarded entities, hybrid and reverse hybrid structures which are used to evade U.S. tax.

In March, 2006, the IRS lost a case in which a parent company successfully argued that since it was required to collect and remit the tax on income earned by all of its subsidiaries in a foreign hybrid structure, it was entitled to foreign credits for those taxes even though it did not have to take the income into account for tax purposes. (Guardian Industries Corp. v. United States).

[6] BNA Daily Tax Report Supplement Tax Administration, Tuesday, January 17, 2006, ISSN 1522-8800

C. Arbitrage. Hicks said the U.S. will be taking a closer look at situations where taxpayers can take advantage of the fact that transactions are treated differently in two different countries for tax purposes.

D. Other projects. Hicks stated the "stars are aligning" to enable many projects in the international arena to be completed in 2006. Other key projects include: (1) Tax Section 987 to govern the operation of foreign currency by business units; (2) Cross borders restructurings; (3) Transfer pricing; (4) Abuse of corporate inversions; (5) Foreign withholding under Section 1441; and (6) International Agreements.

V. Tax Fraud

A. The Pasquantino Case

In Pasquantino vs. United States (Supreme Court No. 03-725, April 26, 2005), the U.S. Supreme Court held that Federal wire fraud charges can be brought against violators of foreign tax laws. The importance of this case addresses whether U.S. practitioners and others can be held liable for violating foreign tax laws.

B. Current Actions of IRS

There has been a fifty percent increase between 2004 and 2005 in criminal investigations into international tax evasion schemes and tax shelters. Currently the IRS has 1,200 off-shore credit card cases under examination and about one-third of those have been referred for criminal investigation. The IRS is hiring nearly 2,000 new revenue agents this year and currently has approximately 500 international examiners as well as 150 revenue agents and tax compliance officers trained in both domestic and international issues. Agents are now being trained in forensic accounting to ferret out hidden off-shore income. The IRS claims that money that is moved off-shore eventually comes back to the U.S. through brokerage account stock transactions. Most of the criminal investigations begin as a domestic examination and then migrate to foreign tax probe.

VI. Treaty Matters

A. Status

Numerous treaties have been modified or adjusted. The Treasury Department and Congress are working on a new U.S. model tax treaty. A prominent issues is the question of the zero rate on dividends. Patricia Brown, Deputy Treasury International Tax Counsel, Treaty Affairs, said it would be on a case-by-case basis and will not be included in the U.S. model tax treaty.

B. Protocols

Protocols with Sweden, France and Bangladesh all have adjustments. However, only the French accord addresses estate and gift taxes in addition to the income tax. Other countries with income tax treaty amendments include: Bangladesh, Barbados, Japan, the Netherlands, Sri Lanka and Switzerland.

Both the income and the estate tax treaties with France were amended by two protocols. On December 8, 2004, the U.S. and France signed a protocol amending the existing U.S.-France Estate and Gift Tax Treaty which the U.S. Senate just approved this year. The protocol replaces the articles dealing with real property and exemptions and credits. Under the protocol, real property includes shares, participation and other rights in a company or legal person, the assets of which consist, directly or indirectly, through one or more companies or legal entitles of at least 50 percent of real property situated in one of the contracting states or rights pertaining to such property. The estate tax treaty allows the U.S. to tax the estate of a decedent or the gift of a donor who is either a U.S. citizen living in the U.S. or a former citizen or long-term resident who left the U.S. for the principal purpose of tax avoidance. The protocol also addresses a range of definitions of real property taxable by the U.S. or France if it is located in those countries including such property held through various entities including a *"société civile immobilière"* (SCI).

VII. Legislative Changes

Legislative changes include the following:

A. Under the American Jobs Creation Act of 2004, HUB.L.NO.108-357,118 STAT 1418 (AJCA) added or amended the following provisions of the code applicable to the U.S. activity of foreign taxpayers: Section 72(u) and Section 83(4) provided that certain contributions and earnings on contributions do not form part of a non-resident alien basis in certain contracts for purposes of determining the portion of a distribution from such a contract which is includable in gross income of the non-resident alien.

B. Section 332(d) provides that the rules of Section 331 and 332(a) generally do not apply to distribution of earnings by an applicable U.S. holding company in a complete liquidation.

C. Section 334(b)(1) and Section 362(e) are intended to prevent the importation or transfer of built in losses to the U.S. tax system by transferors that are not subject to U.S. tax.

D. Section 861(a)(1) provides that interest paid by a foreign partnership predominately engaged in the active conduct of a trade or business outside of the U.S. will be considered U.S. source only if the interest is paid by a U.S. trade or business of the partnership.

E. Section 864(c)(4)(b) expands the definition of income that is effectively connected to a U.S. trade or business to include foreign source income that is the economic equivalent of foreign source rents or royalties, dividends, or interest derived from the active conduct of financial business, and income from the disposition of inventory, to the extent that such items would be treated as effectively connected income.

F. Section 937, 932, 934(b)(4), 935 and 957, collectively codify income sourcing rules and bona fide residence rules for U.S. possessions including American Somali, Guam, the Northern Marianne Islands, Puerto Rico and the Virgin Islands. In general, the same rules used to determine whether income is from U.S. sources or is effective connected with a U.S. trade or business will apply to determining whether income is from sources within a U.S. possession or is effectively connected with the conduct of a trade or business within the U.S. possession.

G. New Section 2105(d) excludes a portion of a non-resident alien stockholding from an RIC from the non-resident alien's estate for federal estate purposes. The exempt portion will be treated as property without the U.S.

VIII. Changes to U.K. Inheritance Tax Regime.

A. The U.K. budget announced on March 22, 2005 had unexpected and extensive changes to the inheritance tax ("IHT") treatment of trusts. Those affected are individuals who have set up interest in possession trusts ("IIP"s) and accumulation and maintenance trusts ("A&M"s).

B. Operative Date:

These measures apply on and after March 22, 2006 to new trusts, additions of new assets to existing trusts and to other IHT-relevant events in relation to existing trusts. Certain transition rules apply to certain existing trusts up to April 6, 2008.

C. Prior to the Budget:

The inheritance tax treatment for discretionary trusts was such that gifts to "interest in possession trusts" (i.e., trusts under which a person is entitled to the income as of right, "life interest trusts"), or to accumulation and maintenance trusts (trusts under which the beneficiaries become entitled to trust property or its income on or before their 25^{th} birthday) were potentially exempt transfers with no IHT if the settlor survived the gift by seven (7) years.

D. The New Budget Rules:

1. "Entry Charge". An immediate charge to inheritance tax will now be payable on all lifetime gifts into trusts at a rate of twenty percent (20%) to the extent they exceed the transfers available nil rate band (currently £285,000) with additional tax payable if the transferor dies within seven years of the transfer.

2. "Periodic Charge". All trusts other than a limited category of trusts established on death will now be subject to inheritance tax charge every ten (10) years at a rate of six percent (6%) to the extent that the value of the trust property exceeds the inheritance tax threshold.

3. "Exit Charge". Such trusts will also be subject to an exit charge when property leaves the trust.

4. There are transitional rules relating to existing IIPs and A&Ms: if the provisions of the trust allow it, it may be necessary to alter the terms of affected trusts prior to April 6, 2008.[7] One can still create accumulation and maintenance or interest in possession trusts on death to which the old rules apply provided that trusts comply with stringent requirements.

5. Trusts within wills do not have effect until the date of death. Therefore, the transitional provisions in the budget notice which permits some flexibility for trusts implemented before March 22, 2006 will not apply to wills where the date of death is on or after March 22, 2006. Trusts within wills where the testator does not change them following this law are given harsher treatment. Certain gifts will still be relevant. The nil rate band is currently £285,000 Sterling beginning April 6, 2006

a. Discretionary trust contained within a will still works.

b. A fully discretionary trust within a will over the residuary estate is unaffected.

c. An outright gift to a surviving spouse is unaffected and the spouse co-exemption will still apply. However, a life interest in favor of a surviving spouse in a trust could be effected

6. Trusts established in lifetimes.

Gifts into new trusts that are accumulation and maintenance trusts will attract an upfront 20 percent charge above the nil rate band, a ten year anniversary charge, and exit charges of up to six percent.

E. Non-U.K. domiciliaries.

Life interest trusts set up by non-U.K. domiciliaries and non-U.K. deemed domiciliaries which contain non-U.K. situs assets will continue to be excluded property and the new rules are not expected to affect this treatment. However, the creation or addition to lifetime trusts should not be taken until the details of the new rules are known.

IX. Changes under French Law.

A. Abatements applicable every 6 years instead of every 10 years. Prior to January 2006, gift tax abatements were only applicable every 10 years. As of January 2006, gift tax

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[7] Macfarlanes Newsletter, March, 2006 and Inland Revenue. For more information and to follow this legislation see Macfarlanes website at http://www.macfalanes.com/pdf/Major-changes.pdf and at Inland Revenue at http://www.hmrc.gov.uk/budget2006/bn25.

abatements can be used every 6 years. These new rules apply to inheritance and gifts granted as from January 1, 2006. As of January 2006, the main inheritance and gift tax abatements are as follows: 50,000 euros for children, 76,000 euros for spouses, 5,000 euros for brothers and sisters, and 1,500 for other beneficiaries.

B. New abatements of 5,000 euros. A 5,000 euros abatement in favor of brothers and sisters, nieces and nephews and great-grandchildren has been created in 2006.

C. Lifetime gift rebate. As of 2006, lifetime gifts benefit from new tax rebates as follows: if the donor is aged less than 70 years old (65 years old prior to 2006), the rebate is 50% if it is a gift in full ownership or *usufruit* and 35% if it is a gift in *nue-propriété*. If the donor is aged between 70 and 80 (75 years old prior to 2006), the rebate is 30% if it is a gift in full ownership or *usufruit* and 10% if it is a gift in *nue-propriété*.

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