



# Duke Law Firm, P.C.-in the News

400 Vestavia Parkway, Suite 100  
Birmingham, Alabama 35216-3750 USA

Volume 2, Issue 11, November 2005

The following is a publication of Duke Law Firm, P.C. All Rights Reserved © 2005

## IN THIS ISSUE:

Correction to the Trusts & Estates Article .....	1
Foreign Foundations .....	1
Withholding Requirements on Income from Investments by Non-Resident Aliens.....	2
Six Indicted for \$20 Million Conspiracy to Defraud the U.S. Government .....	2
Increased Ownership in International Equities.....	3
IRS, DOJ Say Indictment Reveals New Strategy.....	3
Reform Panel Recommends Territorial System..	3

## Conferences/Seminars

J. Richard Duke will also be speaking on "U.S. Update" at the **12th Annual International Trust Conference**, Jersey (Channel Islands) Society of Trusts & Estates Practitioners (STEP), Friday, November 25, 2005, at the Pomme D'or Hotel, Jersey, Channel Islands.

J. Richard Duke will be speaking on International Estate Planning at the **Chartered Wealth Manager Course** (January 27-29, 2006). The Web site will soon be updated to reflect that the conference is being held at the Ashford Suites, High Point, NC:  
<http://mfsfinancial.com/bsiexecutiveeducation/id32.html>

## Correction to the List of Authors of the Trusts & Estates Magazine

<http://trustsandestates.com/home/>

The October issue of this newsletter included a list of the contributing authors and names of the articles included in the November issue of Trusts & Estates magazine. We apologize to Alexander A. Bove, Jr., of Bove & Langa, Boston, Massachusetts, for failing to list his article:

"Trust Protectors: Are they friends or fiduciaries? And should every trust have one?"

Richard Duke's article titled "Offshore Trusts: Crossing the T's," in the November issue of Trusts & Estates magazine can be accessed through our Web site:  
<http://www.assetlaw.com/news.htm>

## Foreign Foundations

Duke Law Firm continues seeing foreign foundations that are formed or funded by U.S. persons where required tax returns have not been filed. See the discussions of the disadvantages of per se foreign corporations and foreign foundations in the August and September issues of our newsletter, including a correction made in the October issue regarding the step-up in basis for foundations that are classified as foreign corporations for tax purposes.

U.S. persons who have not filed required tax returns must do so. The particular tax returns depend on whether the tax classification of foundation is a foreign trust or a

foreign corporation. Problems result when foundations formed or funded by U.S. persons invest assets with foreign banks or foreign asset management firms (hereinafter referred to as "foreign institutions") outside the U.S.

Foreign institutions that are qualified intermediaries (QIs), or withholding agents if a QI is not involved, must determine beneficial owners in order to receive the appropriate Forms: W-9 or W-8. This is required in order to separate U.S. beneficial owners from non-U.S. beneficial owners. In order to make this determination, the source (party who, directly or indirectly, originated the transfer of funds) must be determined. Thus, if U.S. persons transfer assets to or through other persons, entities, trusts or parties who then form the foundations, and if the originators of those funds are U.S. persons, they are treated as the founders for U.S. tax purposes. Third parties are acting as "accommodation parties" and are disregarded and ignored in determining the founders under U.S. tax laws and the Treasury Regulations.

If U.S. persons form or fund foreign foundations, directly or indirectly, the foundations must be classified for U.S. tax purposes as either foreign trusts or foreign corporations under the Treasury Regulations. Classifications as foreign trusts or foreign corporations depend on the language in the foundation documents pursuant to four tests under the Treasury Regulations. The compliance departments in most foreign institutions are not aware

that foreign foundations must be classified for U.S. tax purposes before the appropriate Forms W-9 or W-8 can be issued to foreign institutions, as QIs, or to the appropriate withholding agents. If foreign foundations are classified as foreign trusts, the founders (as settlors) who transferred assets, directly or indirectly, to the foundations are the beneficial owners and they issue the Form W-9 (Request for Taxpayer Identification Number and Certification) to the foreign institutions as a QI or the appropriate withholding agent. If foreign foundations are classified as foreign corporations for U.S. tax purposes, the beneficial owners are the foundations (as foreign corporations) and the foundations issue the Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding) to the foreign institutions as QIs or the appropriate withholding agent.

Duke Law Firm has spoken with other international tax practitioners who are experiencing the same problems with U.S. persons forming and funding foreign foundations, directly or indirectly.

It appears that many U.S. persons are not receiving proper advice with respect to the tax complexities and tax implications of forming and funding foreign foundations, directly or indirectly.

### **Withholding Requirements on Income from Investments by Non-Resident Aliens**

Income from investments in the U.S. by foreigners may be subject to a withholding tax, generally 30% on the gross income. U.S. professionals, such as lawyers, accountants, real estate agents and others, may be classified as a "withholding agent" under the Internal Revenue Code and the withholding agent is responsible for withholding 30% (unless reduced by a tax treaty with the U.S.) of certain types of income, such as rental income. Some U.S. professionals are unaware of this

withholding requirement and are sending gross income, such as rental payments, to foreign persons who own assets in the U.S. without withholding and filing the required IRS withholding forms—1042 and 1042-S. For those who are classified as withholding agents and who have failed to withhold, a voluntary compliance program is available through March 31, 2006. See the following article from Tax Analysts:

### **IRS Extends Compliance Initiative for Withholding Agents of Foreign Payments**

*Published by Tax AnalystsTM*

The IRS has extended (Rev. Proc. 2005-71) until March 31, 2006, its voluntary compliance program on the tax, withholding, and reporting obligations of withholding agents on payments to foreigners.

The program, which began as a temporary initiative on September 29, 2004, allows eligible withholding agents to disclose compliance problems to the IRS without incurring related underpayment penalties, provided the agents also pay all applicable taxes, interest, and penalties and develop appropriate remedial procedures. The program applies only to tax and reporting obligations related to Forms 1042 and 1042-S.

Because the volume of program submissions has increased steadily since inception, the IRS said that many withholding agents would be excluded from participation unless they received an extension. Accordingly, the IRS has extended the sunset date of the program by three months and has allowed taxpayers to request extensions to complete program submissions under certain circumstances. The revenue procedure, however, provides that for program submissions made after December 31, 2005, no extensions will be granted beyond June 30, 2006.

*Document: (Doc 2005-22303)  
Electronic Citation: See 2005 TNT 213-9*

### **Six Indicted for \$20 Million Conspiracy to Defraud the U.S. Government**

*Thursday, November 3, 2005*

<http://WWW.USDOJ.GOV>

*Tax (202) 514-2007 TDD (202) 514-1888*

WASHINGTON, D.C.-A federal grand jury in Salt Lake City indicted six individuals for promoting a tax fraud scheme that cost the federal treasury over \$20 million in taxes, the Department of Justice and Internal Revenue Service (IRS) announced today. The indictment includes charges of conspiracy to defraud the United States and conspiracy to commit mail and wire fraud against all six defendants, as well as tax evasion and aiding and assisting the filing of false tax returns against five of the defendants. The defendants are attorney Dennis B. Evanson of Sandy, Utah; Certified Public Accountant (CPA) Steven F. Petersen, of Coalville, Utah; accountant Brent H. Metcalf, of Cottonwood, Utah; CPA Reed H. Barker of Littleton, Colorado; investment broker Wayne F. DeMeester of Sammamish, Washington; and attorney Graham R. Taylor of Tiburon, California.

The indictment alleges that the fraud scheme took multiple forms, but chiefly involved providing documentation for fictitious currency transaction losses, false insurance expense deductions and bogus capital losses to the defendants and approximately 75 of their clients for the purpose of offsetting taxable income. The defendants' scheme utilized, among other things, offshore companies, offshore bank accounts, the services of offshore nominees, and opinion letters which purported to give legal authority to the fraudulent transactions.

"Tax cheats defraud all honest taxpayers," said Eileen J. O'Connor, Assistant Attorney General for the Department of Justice's Tax Division. "The Justice Department and the IRS are using

all available tools to investigate and prosecute tax fraud."

The Justice Department and the IRS, noting an increase in the sophistication and brazenness of tax scam promotions across the country, have initiated a new approach to dealing with these types of schemes. Specifically, prosecutors now target the proceeds of the crime. Toward this end, the indictment also includes a notice to seek forfeiture of the proceeds of the crimes alleged in the indictment—including money, real property and vehicles—that defendants Evanson and Petersen received from the scheme. The indictment alleges that Evanson and Petersen together collected over \$4 million in fees related to the scheme.

"Those who participate in or encourage taxpayers to structure transactions for the purpose of evading taxes are engaging in criminal activity," said Nancy J. Jardini, IRS Chief, Criminal Investigation. "Today's indictment reaffirms IRS's commitment to investigate and recommend prosecution against professional accountants and attorneys who manipulate the law to create fictitious financial transactions."

"Individuals who seek to defraud the United States government of tax revenue should not be permitted to retain the proceeds of their illegal efforts," U.S. Attorney Paul M. Warner said.

If convicted, the defendants face maximum potential sentences of five years imprisonment and a fine of the greater of \$250,000 or twice the amount of the tax loss for the conspiracy and each income tax evasion charge.

The charges contained in the indictment are only allegations. A defendant is entitled to a fair trial in which it will be the government's burden to prove guilt beyond a reasonable doubt.

Assistant Attorney General O'Connor and U.S. Attorney Paul Warner thanked Assistant U.S. Attorney Loren Washburn and Tax Division Attorney Caryn D. Mark, who are handling this case. They also thanked the special agents of the IRS whose assistance was essential to the successful investigation of this case.

<http://www.usdoj.gov/tax/txdv05589.htm>

### **Increased Ownership in International Equities**

The Wall Street Journal reports that many strategists on Wall Street and financial planners are advising clients to increase their ownership of international equities. It is expected that continued investments overseas will occur because of fear of general price rises in the U.S. that may have a negative impact on prices of U.S. stocks. Standard and Poors recommends international stock allocation of 20% and JP Morgan Chase & Co. increased its holdings of international equities to 33%.

*See: Foreign Stocks Get New Push, Wall Street Firms Lift Allocation Levels As High as 33%, Despite Rebound of Dollar*

*By Eleanor Laise staff reporter of The Wall Street Journal, November 8, 2005; Page D1*

### **IRS, DOJ Say Indictment Reveals New Strategy**

*Published by Tax AnalystsTM*

An indictment announced November 3 reflects a new way of combating tax schemes that involves going after promoters' profits from scams, government officials said.

A federal grand jury in Salt Lake City, Utah, indicted six individuals on November 3 for allegedly promoting a fraudulent scam that cost the government over \$20 million in taxes. The indictment seeks to seize more than \$4 million in fees that two defendants--attorney Dennis B. Evanson of Sandy, Utah, and accountant Steven F. Petersen of Coalville, Utah--allegedly collected for their efforts.

"Individuals who seek to defraud the United States government of tax revenue should not be permitted to retain the proceeds of their illegal efforts," said U.S. Attorney Paul M. Warner.

IRS and the Department of Justice said they were spurred toward the new approach by "an increase in the sophistication and brazenness of tax scam promotions across the country."

The indictment charges all six individuals with conspiracy to defraud the United States and conspiracy to commit mail and wire fraud. It also charges five of the defendants with tax evasion and aiding and assisting the filing of false tax returns.

*Document: (Doc 2005-22540)*

*Electronic Citation: See 2005 TNT 213-6*

### **Reform Panel Recommends Territorial System**

*Published by Tax AnalystsTM*

The November 1 report by the President's Advisory Panel on Federal Tax Reform recommends significant reforms to U.S. international tax rules, primarily targeting the current system's extraterritorial regime.

The extraterritorial system seeks to tax U.S. taxpayers on their worldwide income on a current basis, regardless of where the income is earned. Foreign-source earnings of foreign subsidiaries are not taxed until those profits are repatriated to U.S. parent companies in the form of inbound dividends. Because repatriation is elective, taxation is rendered elective, leading to a system in which massive amounts of profits are held offshore for as long as possible. According to the panel, that causes U.S. multinationals to forgo attractive investment opportunities, because their funds are tied up overseas, and it creates a disincentive to reinvest those funds domestically.

The panel's Simplified Income Tax Plan recommends that Congress jettison the worldwide system in favor of a territorial tax system. The proposed system would look at all foreign-source income of foreign affiliates--without distinguishing between controlled foreign corporations and branches -- and would separate earnings into two broad categories: income derived from an active trade or business (foreign business income) and passive or portfolio income (mobile income). The former would be exempt from U.S. taxation; the latter would be taxed in a manner closer to the current system.

Other governments would continue to claim taxing jurisdiction over foreign business income. Double taxation could be avoided without the need for complex foreign tax credit rules under the full exemption. As a result, U.S. investments in overseas markets would face the same tax burden as foreign competitors in those same markets, therefore achieving capital import neutrality.

Also, the repatriation of those foreign earnings from subsidiaries (as dividends) or branches (as remittances) would not trigger U.S. taxation, because the benefit of the exemption would flow through to the U.S. parent. That would eliminate incentives for corporate multinationals to hoard profits offshore. A small but important carveout from the exemption would apply for inbound transfers other than dividends (such as interest payments and royalty fees), which are typically deductible in foreign jurisdictions. Those payments would be taxable in the United States, despite having a foreign source, to prevent the escape from taxation at both levels. Otherwise, foreign branches and subsidiaries would have an incentive to channel their earnings into the United States and avoid taxation at both ends.

The second category of foreign-source income--mobile income--

would not be affected by the shift to territoriality for active business earnings. Mobile income would include foreign personal holding company income (rents, interest, royalties, or dividends from passive assets). For simplicity, a de minimis rule would exclude relatively small amounts of foreign portfolio income. The panel's report recommends that the de minimis rule be set as a percentage of gross income or total assets rather than as a fixed dollar amount.

Foreign tax credits would continue to be relevant for mobile income and would be necessary to avoid double taxation. The panel recommends that a U.S. credit be allowed for all foreign taxes paid on mobile income, including withholding taxes, subject only to a single limitation and doing away with the complex system of multiple baskets and related limitations. Special rules would be required to clarify that the foreign-source income of banks, securities dealers, insurance companies, and financial service firms would be categorized as active business income rather than mobile income.

*Document: (Doc 2005-22211)*

*Electronic Citation: See 2005 TNT 211-4*

**THIS NEWSLETTER WAS NOT INTENDED OR WRITTEN BY DUKE LAW FIRM TO BE USED, AND CANNOT BE USED, BY A READER FOR THE PURPOSE OF AVOIDING PENALTIES. IRS CIRCULAR 230, SECTION 10.35(b)(4)(ii).**

This newsletter is purely a public resource of general information that is intended, but not promised or guaranteed, to be correct, complete and up-to-date. This newsletter is not a source of advertising, solicitation or legal advice, and thus the material provided in this newsletter is not intended to create, and the receipt of it does not constitute, an attorney-client relationship. Do not rely on information provided herein, and always seek the advice of competent counsel in the reader's state or country outside the United States. The publisher of this newsletter is a law firm that includes attorneys licensed in the States of Alabama and Florida, and Duke Law Firm and its attorneys do not desire to represent anyone who views this newsletter in a state or country outside the

United States where this newsletter fails to comply with all laws and ethical rules of that state or foreign country. Please speak with one of our lawyers before sending information to the publisher of this newsletter, Duke Law Firm, or anyone listed herein.

No comparison is made for the services of Duke Law Firm and its lawyers, and the services of other law firms and their lawyers. Alabama State Bar Rules of Professional Conduct, Rule 7.1(c) and The Florida Bar Rules of Professional Conduct, Rule 4-7.2(b)(1)(D).

**Duke Law Firm, P.C.  
(205) 823-3900**

**Facsimile: (205) 823-2630  
400 Vestavia Parkway, Suite 100  
Birmingham, AL 35216 USA  
<http://www.assetlaw.com>**