



Duke Law Firm, P.C.—in the News

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Conferences/Seminars

J. Richard Duke will be speaking on International Estate Planning at the **Chartered Wealth Manager Course**, Yale Club, New York, NY (date postponed until early 2006):
<http://mfsfinancial.com/bsiexecutiveeducation/id32.html>

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.

Trusts & Estates

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

The November issue of Trusts & Estates magazine will include articles focused on asset protection. The names of the articles and the respective authors are as follows:

- "Nailing the Lawyer For His Debtor-Client's Sins," by Denis A. Kleinfeld and Salvador C. Orofino, Denis A. Kleinfeld is a principal, and Salvador C. Orofino is an associate with The Kleinfeld Law Firm, Miami, FL;
- "Consider the Implications," by Daniel S. Rubin and Karen Goldberg. Daniel S. Rubin is a partner at Moses & Singer LLP, New York, NY. Karen Goldberg is the executive director at Grant Thornton LLP, New York, NY.
- "Florida, the Tax Haven," by Richard S. Franklin and Lester B. Law. Richard S. Franklin is of counsel to Pillsbury Winthrop Shaw Pittman LLP, Washington D.C. Lester B. Law is a shareholder of Grant Fridkin Pearson Athan & Crown, P.A., Naples, FL.
- "Offshore Trusts: Crossing the 'T's,'" by J. Richard Duke of Duke Law Firm, P.C., Birmingham, AL.

Correction Regarding Controlled Foreign Corporations

The August and September 2005 newsletters referred to the four disadvantages of a foreign (per se) corporation and a foreign foun-

ation that is classified as a foreign corporation for U.S. tax purposes. One of those disadvantages no longer applies. Due to the repeal of the foreign personal holding company income provisions under the American Jobs Creation Act, effective January 1, 2005, the basis of shares of stock in a controlled foreign corporation with subpart F income (classified as foreign personal holding company income—passive investment income) steps up to its fair market value at the date of death.

Filing a Gift Tax Return for Funding a Foreign Trust

Treasury Regulation (Treas. Reg.) Sections 25.2511-2(b) and (j) require the grantor to file a Form 709 with the IRS Center where the grantor's Form 1040 is filed and is due on the due date of the Form 1040. Treas. Reg. Section 25.2511-2(j) states that for a gift to be incomplete, the transaction "shall be disclosed in the return and evidence showing all relevant facts, including a copy of the instrument of transfer, should be submitted." Treas. Reg. Section 25.2511-2(b) provides "if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete ... or partially incomplete ... For example, if a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, no portion of the transfer is a completed gift ... if the donor had not retained the

testamentary power of appointment, but instead provided that the remainder should go to X or his heirs, the entire gift would be a completed gift ..." Including a testamentary special power of appointment to the grantor to change the disposition of assets after death causes incomplete gifts upon transfers to the trustee of the offshore trust.

Many foreign trusts do not include a provision providing the settlor with the testamentary special power of appointment to change the disposition of assets after the settlor's death by will or codicil. A completed gift from transfers of assets to the trustee of the foreign trust results if this provision is not included. Upon filing the Form 709, a part or all (depending on the value of the gift or gifts) of the gift tax exemption (total of \$1 million) must be used to avoid gift taxation.

Valuation Discounts for Family Limited Partnerships

*by Melanie P. Hahn, Attorney,
Duke Law Firm, P.C.*

In the *Estate of Webster Kelley, et al. v. Commissioner*, T.C. Memo, 2005-235, the Tax Court considered the appropriate valuation discount for a family limited partnership (FLP) holding cash and cash equivalents. At first glance, this case appears to be a victory for the IRS; however, to some extent it was a taxpayer victory. IRS auditors have often suggested that FLPs receive discounts only in the range of 15-20 percent. However, the Tax Court granted a discount of 32 percent, which is substantially above the expected discount for a cash FLP. This case also reiterates the fact that a properly structured FLP will receive substantial discounts from the Tax Court.

In 1999, the decedent, his daughter and son-in-law, organized a Texas LLC and a Texas FLP. At the time of the decedent's death in December 1999, the decedent owned a 94.83 percent interest of

the FLP that held assets totaling \$1,226,421, consisting of \$807,271 in cash and \$419,150 in CDs, with no liabilities.

After the estate received an appraisal, a Form 706, United States Estate and Generation-Skipping Transfer Tax Return, was filed showing a 53.5 percent valuation discount allowed for the decedent's 94.85 percent interest in the FLP, valuing his interest at \$521,565. The IRS issued a notice of deficiency, determining that the discounts claimed were too high and lower discounts were appropriate. The IRS contended that the estate was entitled to a 25.2 percent discount.

Pursuant to the partnership agreement, a buyer of all or any portion of the transferred interest would have limited control of his investment. The court reasoned that a hypothetical willing buyer would account for this lack of control by demanding a reduced price (a price that is below the net asset value—NAV) of the pro rata share of the interest purchased in the FLP. A minority discount therefore applies in this case because a partner lacks control.

To determine the minority interest discount, expert witnesses both for the estate and for the IRS referenced general equity closed-end funds. In a closed-end fund, the assets are brought together for professional management, and the shareholders have no control over the underlying assets. The owner of an interest does not have the ability to sell the underlying assets.

Both experts determined a minority interest discount or a discount for lack of control by reference to general equity closed-end funds. Each divided the comparable closed-end funds into quartiles by price to NAV ratios. The expert then determined that a 25 percent minority discount would be used for valuing the interests in the FLP. The expert for the IRS calculated a minority discount of 12 percent by

calculating the entire data set for closed-end funds, not only the fourth quartile. The court applied a 12 percent discount because the estate failed to prove that a figure greater than 12 percent would be appropriate.

A discount for lack of marketability is also appropriate in valuing the interests in the FLP as there is not a ready market for partnership interests in closely held partnerships. Both experts agree that a lack-of-marketability discount should be applied to the partnership NAV after applying the minority interest discount. However, each expert used a different approach when determining that discount. The valuation discount suggested by the estate's expert concluded that a 38 percent marketability discount is appropriate when using a restricted stock approach. The expert for the IRS compared the FLP to a private placement of unregistered shares, which receive an average discount of 14.09 percent, and he suggested a 15 percent discount for the minority interest discount.

The Tax Court concluded that a 12 percent minority discount and a 23 percent marketability discount were appropriate in valuing the interests in the FLP, making the combined discount 32 percent for the cash FLP.

Change of Trust Situs

As states in the U.S. adopt the Uniform Trust Code and clients are advised of the negative provisions relating primarily to loss of asset protection benefits, more individuals will create trusts under laws in states that have not adopted the Uniform Trust Code. Roy Adams, a well-known estate planner in New York and speaker for Cannon Financial Institute and numerous conferences, stated to Richard Duke that settlors who are not advised that the Uniform Trust Code allows beneficiaries to get together after the settlor's death to change the testamentary provisions, may "come out of the grave" to get at

the lawyer who failed to advise of these rights to beneficiaries. For existing trusts, a change of trust situs (also referred to as redomiciliation) may be recommended or required. A trust may change its situs from foreign to domestic, domestic to foreign, from one foreign jurisdiction to another, or from one U.S. state to another state.

Three basic methods of changing the situs are available. The first is through modifying the factors that caused the trust to be established in the initial jurisdiction. An example of this method is a foreign trust governed by the laws of a foreign jurisdiction for legal purposes but that is domesticated for U.S. tax purposes. Thus, the legal situs and the tax situs are different. For a foreign trust to be classified for tax purposes as a domestic trust, the foreign trust instrument must provide that a court in the U.S. has primary supervision over the administration of the trust, and a U.S. person is authorized to make all substantial decisions with respect to the trust. By changing one or both of these requirements, the trust becomes a foreign trust for tax purposes and thereby changes its situs for tax purposes.

A second method involves termination of the trust, resulting in distribution of the assets to the beneficiaries who then create and fund a separate and distinct trust in another jurisdiction having terms identical to those in the initial jurisdiction.

The third method of changing situs is referred to as "decanting." The initial trust makes either a total or partial transfer of trust assets to another trust formed in a different jurisdiction. If all property is transferred to the newly formed trust, the initial trust terminates. If a partial transfer of assets occurs, both trusts continue to exist.

A good discussion with respect to the foregoing methods of changing trust situs is provided in International Income Tax and Estate Plan-

ning, Second Edition, William H. Newton III, paragraphs 6.62-6.68.
<http://www.law.upenn.edu/bl/ulc/uta/2005final.htm>

United States and Sweden Sign Protocol to Income Tax Treaty

This Department of Treasury press release may be viewed at:
<http://www.treas.gov/press/releases/is2959.htm>

WASHINGTON, DC—The Treasury Department announced that Assistant Secretary of State for Economic and Business Affairs E. Anthony Wayne and Swedish Ambassador Gunnar Lund signed a new Protocol to amend the existing bilateral income tax treaty, concluded in 1994, between the two countries. The Protocol was signed Friday afternoon [October 7, 2005].

The agreement significantly reduces tax-related barriers to trade and investment flows between the United States and Sweden. It also modernizes the treaty to take account of changes in the laws and policies of both countries since the current treaty was signed. The Protocol brings the tax treaty relationship with Sweden into closer conformity with U.S. treaty policy.

The most important aspect of the Protocol deals with the taxation of cross-border dividend payments. The Protocol is one of a few recent U.S. tax agreements to provide an elimination of the withholding tax on dividends arising from certain direct investments.

The Protocol also strengthens the treaty's provisions preventing so-called treaty shopping, which is the inappropriate use of a tax treaty by third-country residents.

U.S. Judge Denies Preliminary Approval of KPMG Settlement with Shelter Investors

Published by Tax AnalystsTM

A U.S. federal judge has refused to grant preliminary approval of KPMG's proposed US \$225 million settlement with shelter investors after objectors alleged the settlement negotiations were marred by

collusion and conflict of interest, the Associated Press reported October 7.

The settlement would pay US \$195 million plus US \$30 million in legal fees to 280 investors in tax shelters sold by KPMG through the law firm Brown & Wood (now Sidley Austin Brown & Wood) and disallowed by the U.S. Internal Revenue Service.

The AP reported that the judge instead scheduled a hearing for October 28 to allow opponents of the settlement to present evidence that the negotiations were flawed by ethical violations by some lawyers for the clients.

Document: (Doc 2005-20598)

Electronic Citation: See 2005 WTD 196-5

U.S. Law Firms Make a Play for Europe

The National Law Journal

Responding to heightened client demands and changes in the trans-Atlantic legal market, U.S. law firms are opening new European offices, or adding muscle to their existing practices in London, Paris, Brussels and elsewhere. Part of the growth is due to the pending dissolution of Coudert Brothers, which once boasted 20 foreign offices. Many U.S.-based firms have also lured lawyers away from European practices to increase their strength in foreign legal markets.

<http://www.law.com/jsp/article.jsp?id=1129552516493>

Law as a Tin of Beans

Douglas McCollam, The Deal Law.com 10-25-2005

British government proposes alternative business structures for law firms to make legal system more consumer-friendly.

For years now, whenever American lawyers have caught the slightest whiff of government trespassers encroaching on their turf, they've begun baying like a pack of bloodhounds hot on the trail of an escaped convict. A proposal float-

ed by the Securities and Exchange Committee requiring lawyers to "report out" misconduct by clients who refuse to take their counsel's advice was denounced as an Orwellian plot to transform lawyers into government snitches. Efforts to open up the profession to outside competition by allowing nonlawyers to perform certain tasks was viewed as apostasy and beaten back. The profession's open hostility to outside oversight and competition led one commentator to label it the last of the medieval guilds.

But a series of sweeping reforms the British government announced recently may point the way to a radically different future for the legal profession. In an extensive white paper, the government proposes doing away with several centuries-old prerogatives of British lawyers. The proposed reforms would allow the government to license "alternative business structures" for law firms, including outside ownership by private investors and stock exchange listings. The proposed changes would also allow firms to appoint non-lawyers as full partners. The government also plans to strip the profession of the ability to police misconduct, setting up an Office of Legal Complaints which nonlawyers could staff.

The reforms are the result of an ongoing effort to make the British legal system more consumer-friendly. In announcing the reforms, Lord Falconer, Britain's lord chancellor and secretary of state for constitutional affairs, said that he hoped the changes would "change the ethos" of how British lawyers practiced, giving them flexible access to new sources of capital that would allow them to cope with rapidly changing market forces. A central aim of the reforms is also to make legal services, long-governed by the arcane traditions of the British bar, more commoditized and thus accessible to average citizens.

Bridget Prentice, a minister at the Department of Constitutional Affairs, said she envisioned a legal system where someone could pick a lawyer "as easily as they can buy a tin of beans." Indeed, wags have dubbed the reforms the "Tesco Law" after the well-known British supermarket chain. The label is only partly in jest. Lord Falconer told reporters he saw no problem with supermarkets, banks or other businesses selling legal services out of their stores right alongside other products. They could partner with law firms to do so, or buy the firms outright.

As you can imagine, the reaction to the proposed changes among U.K. lawyers has been mixed. London's Magic Circle firms have taken a cautiously positive tack, saying they welcome the increased financing options the revised ownership rules will offer U.K. law firms. However, implementing those changes could be problematic for the firms, as they operate in widely less liberal jurisdictions, including, notably, the U.S. Other lawyers worry that the new Legal Services Board, which will oversee all aspects of the profession, be sufficiently independent of the government. The solicitors' Law Society, the target of a lot of consumer ire for its slow handling of client complaints, tepidly endorsed the new oversight, but suggested the board should operate with a "light touch." One initiative in the plan that drew almost universal acclaim was Falconer's proposal to crack down on ambulance chasing, "claim farming," contingency compensation and other American imports that have sprung up like weeds in an English garden in recent years.

The British reforms are taken from a report undertaken by David Clementi, who was appointed by Lord Falconer in July 2003 to study changes to the profession. Clementi's suggestions, which included abolishing the British tradition of prohibiting solicitors and barristers from practicing together, were based on putting the needs

of clients ahead of the wants of lawyers. "The current regulatory system is focused on those who provide legal services," Clementi wrote. "The new framework will place the interests of consumers at its centre."

Could such a radical notion take hold on this side of the Atlantic?

If anything, the American legal system is less consumer-friendly than that of the Brits. With professional oversight left mainly to individual states, and a powerful bar eternally vigilant in guarding its rice bowl against interlopers, the prospect of any meaningful changes to the American legal industry seem remote. But one reform that could easily be implemented at the state level would be to set up independent complaint boards comprised of nonlawyers to police abuses. It would contribute to a feeling of greater accountability to the public and diminish the profession's well-earned reputation for insularity. It might cut down on those lawyer jokes as well. Other kinds of regulation, however, seem less adaptable.

From colonial days, the American lawyer has occupied a different place in society than his British counterpart. I'll refrain from the obligatory de Tocqueville quote, but suffice to say that most Americans don't want to shop for their legal representation next to the produce aisle.

Of course, is that really all that different than getting it out of a phone book?

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