



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

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### **Seminars/Conferences**

**Chartered Wealth Manager and Certified Trust and Estate Practitioner Course:** Register for the Chartered Wealth Manager (CWM) and Chartered Trust and Estate Planner (CTEP) Designation Courses:

**Course Dates and Locations:**

Annapolis, MD - October

Scottsdale, AZ – November

<http://mfsfinancial.com/bsiexecutiveeducation/>

**Offshore Tax Strategies** by Vernon Jacobs and Richard Duke is an abbreviated primer on the U.S. tax rules for offshore investments, foreign trusts, foreign corporations, foreign partnerships and other foreign entities. And it is written with a minimum of tax jargon. An extensive plain English glossary is included with the book.

*Offshore Tax Strategies* is not a technical reference manual for those who are already experts in the subject. It is written for the layman, the non-lawyer, the non-accountant, and for their various domestic advisors who are not familiar with the often-convoluted tax rules for international transactions.

The book provides a plain English explanation of the complicated U.S. tax laws that apply to U.S. persons with offshore investments, foreign trusts and global business interests.

*Offshore Tax Strategies* is a summary description of all the ba-

sic elements of international taxation. Printed copies are available for \$67. An E-book edition is available for just \$37.

<http://www.offshorepress.com/offshoretax/>

<http://offshorepress.stores.yahoo.net/semreg.html>

### **Structuring in Conjunction with Offshore Life Insurance**

As stated in the July 2006 newsletter, the IRS has now actively begun attacking promoters and their clients who have used and are using mechanisms, in conjunction with offshore life insurance, to provide income tax deferrals or tax benefits. In these transactions, not only is offshore life insurance being purchased, but tax advantages are also taken by U.S. persons outside the normal tax-free build-up of the earnings inside the policy. Some of these structures are extremely complex but, as one noted attorney writes: "By creating so complex a structure, even the parts that might have stood up on their own, fell over from the weight." Or, as Richard Duke stated in the December 2005/January 2006 Comment in *Offshore Investment*: "They may appear to be sophisticated but violate simple tax law principals or specific Internal Revenue Code provisions and make no mention of the required tax compliance and tax reporting requirements. These tax scams or schemes can be compared to a fine architectural building whose foundation is built on quicksand. The difference between the building and tax scams and schemes is that generally they have not only a

faulty foundation but also a faulty structure."

In *Field Attorney Advice, FAA 20062701F*, the IRS stated that a trust was a wholly-owned grantor trust because the trust agreement authorized the use of the entire trust fund to buy insurance on the life of the grantor, even though the trust did not yet own any such insurance. It also denied the tax treatment attempted by the players on the grounds of a lack of economic purpose and substance and imposed penalties.

A grantor trust is a trust in which the grantor is treated as if he owns the trust assets for tax purposes; and he is taxed on all income, gains and losses from that trust are taxable under I.R.C. Section 671, whether the income is distributed or accumulated.

The use of these gimmicks with the attempt to provide tax benefits outside the general tax benefits of variable life insurance tend to give a bad name to "offshore" in general, and specifically to offshore life insurance. This is unfortunate because of the asset protection benefits and economic advantages of variable life insurance policies that are issued by sound offshore carriers that are available where the purpose is the acquisition of life insurance in order to meet the goals of the U.S. insured and his family.

The asset protection benefits of variable life insurance policies issued by foreign carriers, under strong legislation, include: (1) pro-

tection of the separate segregated accounts in the event the insurance carrier becomes insolvent; (2) protection to the policyholder against claims of creditors; (3) a 1% excise tax as opposed to a state premium tax on premiums, which are higher; (4) worldwide investments; and (5) holding in currencies other than just the U.S. dollar.

### **AmSouth Bank Annual Estate Planning Conference**

AmSouth Bank held its annual estate planning conference with its regular speakers, Roy M. Adams, Esq. (New York) and Charles A. Redd, Esq. (St. Louis, MO), both attorneys with Sonnenschein Nath & Rosenthal LLP. The title of the conference was "Unending Changes—Some Good, Some Bad." The following are comments made by Richard Duke that were either directly stated or closely stated by Messieurs Adams and Redd at this conference.

The IRS may not know the law as well as tax practitioners but they do know how to look for facts, and the IRS agents know that they have the full power and economic resources of the U.S. government behind them. The knowledge that the U.S. government is backing the actions of the agents is especially exhibited in matters involving international tax issues where they are classified as "offshore" tax issues.

In the experience of Duke Law Firm, the IRS focuses attention on the fact-gathering process and obtaining information under issued individual document requests (IDRs) and largely ignores the technical aspects of the law. Until the "taxpayer" has produced documents, he cannot, under the law, state a position to an IRS agent.

The IRS is using the power of the federal government to burn private transactions. Because of the shortage in staff at the IRS, the federal government is currently backing efforts of the U.S. Treasury and the IRS through

Circular 230 to place enforcement on third parties (tax professionals). Some at the U.S. Treasury state that changes will be made to Circular 230, but none have been made thus far.

A common question is whether estate planning professionals have an obligation to clients to raise asset protection issues and discuss asset protection devices and their advantages and disadvantages (as well as potential problems under the new bankruptcy law with respect to self-settled trusts). Such an obligation depends on the particular client, his assets, and other factors. For example, all estate planning techniques are never discussed with any one particular client but only those that relate to that particular client's fact situation, goals, etc. But certain types of assets must be protected, and certain types of clients who may have a high-medium level of potential risks for lawsuits should also be protected. It was stated at the conference that the first question out of the mouths of executives relate to asset protection.

### **Panamanian Sociedad Anonima**

In previous newsletters, it was pointed out that a foreign corporate statute that is designated as a Sociedad Anonima (S.A.) is a "per se" corporation under Treasury Regulation Section 301.7701-2(b)(8). This means that a Panamanian corporation, for example, is treated for U.S. tax purposes as a foreign corporation and, if that foreign corporation has subpart F income (passive investment income and also business income unless an exception is found), the foreign corporation is subject to adverse tax consequences. The adverse tax consequences include no capital gains, no losses can be taken against the investments until the corporation is liquidated, and a withholding tax is due if investments are made into the U.S. In addition, a Form 926 generally must be filed with respect to the transfer, directly or indirectly, of

assets to the corporation and a Form 5471 must be filed for the operations of the corporation. It is recommended that the Panamanian S.A. not be used because of the foregoing adverse consequences.

It is recommended that U.S. persons use the Sociedad de Responsabilidad Limitada (SRL) instead of the Panamanian S.A., to hold passive investment assets or real estate. An SRL is the equivalent of a limited liability partnership in the U.S. A Form 8832 can be filed electing to treat the SRL as a foreign partnership for tax purposes so that it is not treated as a foreign corporation for tax purposes. The law requires at least two owners, so this cannot include a single owner.

### **I.R.C. § 982—Admissibility of Documentation Maintained in Foreign Countries.**

The Internal Revenue Code provides that during an audit and the issuance of IDRs, if the "taxpayer" is unable to obtain requested documents from the trustee of a foreign trust, foreign service provider or other foreign representative or party, the "taxpayer" will be foreclosed from introducing those documents (that were not provided by the IRS based on its IDR request) in any civil proceeding where the tax treatment of the requested item(s) is an issue. Internal Revenue Code § 982 is a powerful weapon in the hands of the IRS, especially with respect to audits involving transactions including offshore trusts, entities, etc. The following is the provision of the Internal Revenue Code that provides the foregoing:

#### **(a) General Rule.**

If the taxpayer fails to substantially comply with any formal document request arising out of the examination of the tax treatment of any item (hereinafter in this section referred to as the "examined item") before the 90th day after the date of the mailing of such request on motion by the Secretary, any court

having jurisdiction of a civil proceeding in which the tax treatment of the examined item is an issue shall prohibit the introduction by the taxpayer of any foreign-based documentation covered by such request.

## **Second Circuit Reverses Government Loss in Shelter Case**

*Published by Tax AnalystsTM*

The government on August 3 scored another appellate win in its battle against abusive tax shelters, with the Second Circuit's decision in Castle Harbour reversing the lower court's finding that the partnership created was not a sham.

The Second Circuit's ruling follows three other important government wins challenging tax shelters on economic substance grounds, with the Sixth Circuit's reversal in Dow Chemical, the Federal Circuit's reversal in Coltec, and the Sixth Circuit's remand of Black & Decker because of the lower court's faulty economic substance inquiry.

IRS Chief Counsel Donald Korb said in an August 4 written statement that the Castle Harbour opinion is "another example of a court recasting an abusive transaction to reflect the true interests of the parties."

Korb has praised the run of good fortune the IRS is experiencing at the appeals court level as evidence that a recent government loss in the son-of-BOSS case Klamath Strategic Investment Fund LLC v. United States does not foretell how the cases will ultimately be resolved.

While the decision may boost government morale, tax litigators cautioned against reading too much into the decision, which they said was very fact specific.

The fact-specific nature of the Castle Harbour ruling may limit its impact for other shelter cases, some tax litigators said.

"Litigation of factually intensive cases provides resolution of the actual case but not the many other cases that are on the horizon," said Chuck Rettig of Hochman, Salkin, Rettig, Toscher & Perez PC, in Beverly Hills, Calif.

Philip Karter of Miller & Chevalier, Bala Cynwyd, Pa., said a reasonable view of the opinion is that it "merely [reaffirms] the common-sense proposition that economic substance requires real economic risk as well as the possibility of meaningful economic reward."

Matthew Lerner, with Steptoe & Johnson in Washington, said the opinion did not represent a sea change. He warned against reading too much into the opinion or attaching broader significance to the holdings. "[The ruling] appears very fact specific and fact driven," he said.

Government lawyers were more optimistic about the bearing the decision will have on other shelter litigation.

Eileen O'Connor, assistant attorney general for the Tax Division at the Justice Department, in a written statement called the Castle Harbour ruling "another paving stone in the Department's path to stopping abusive tax shelters."

The IRS shares the view that the case will be helpful in its broader war on tax shelters. "In our view, this is a setback for abusive tax shelters of all stripes, not just the brand of lease-strip or income diversion tax shelter in this case," Korb said.

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