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2023 Estate and Gift Tax Conference

Tax Treaties for the Estate Planner

Friday, March 10, 2023
3:45 pm - 5:00 pm

Speakers:

Marsha Dungog

Caroline Ciraolo

Kurt Kawafuchi

Conference Reference Materials

Tax Treaties
For the Estate Planner

2023 Estate and Gift Tax Conference

UC College of Law, San Francisco

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Caroline D. Ciraolo, former Acting Assistant Attorney General of the U.S. Department of Justice's Tax Division, is a partner with Kostelanetz LLP and a founder of its Washington, D.C. office.

Her practice focuses on federal and state civil tax controversies, including representation in sensitive audits, administrative appeals, and litigation, providing related tax advice, conducting internal investigations, and representing individuals and entities in criminal tax investigations and prosecutions. Caroline is President of the American College of Tax Counsel, immediate past Chair of the ABA Tax Section's Civil and Criminal Tax Penalties Committee, and inaugural Vice Chair of Membership, Diversity, and Inclusion of the ABA Tax Section.

She is a recipient of the IRS Chief Counsel Award and the ABA Tax Section's Janet Spragens Pro Bono Award. Caroline serves as an Adjunct Professor at the Georgetown University Law Center (*Criminal Tax Law & Procedure* and *International Tax Controversies*) and University of Baltimore School of Law Graduate Tax Program (*Investigation, Prosecution, and Defense of Tax Crimes* and *Tax Practice & Procedure*). Caroline has been recognized by Chambers, Legal 500, International Tax Review, Best Lawyers in America (Lawyer of the Year, Litigation and Controversy – Tax (Washington, D.C.) (2022)), Super Lawyers, and The Daily Record's Top 100 Women Circle of Excellence.

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- With 30 years of legal experience, Patrick Martin's practice focuses on a wide range of international tax issues. He and his team assists domestic and foreign privately held companies, global investors, funds and other business entities with their international tax treaty planning strategies as well as worldwide investments and financing structures.

- Martin also advises multi-national families on issues related to worldwide income, estate, gift, inheritance, and tax withholding planning, as well as international wealth preservation structures. Martin has a wealth of experience in international tax controversies and routinely defends international taxpayers before the relevant tax authorities, including the IRS.

- Martin obtained his law degree from the University of San Diego School of Law, where he was the Thomas More Scholar. He also studied international law (*Regimen Jurídico de Los Negocios Internacionales en México)* at *La Escuela Libre de Derecho* in Mexico City. He is a prolific writer and speaker, discussing international tax issues. Martin is a Fellow of the American College of Tax Counsel (ACTC) and of the American College of Trust & Estate Counsel (ACTEC). He is also the former chair of the State Bar of California, Taxation Section.

- Martin has been named to Best Lawyers in America since 2015, to Top Lawyers by San Diego Magazine since 2014, and to California Super Lawyers between 2007 and 2019. Other accolades include the Distinguished Alumni Award from the University of San Diego School of Law and the V. Judson Klein Award from the State Bar of California. He really likes under water cave exploration!

- Represented and represents multiple individuals on international tax and Title 31 matters before the U.S. Tax Court, the U.S. Court of Federal Claims, and the Federal District Courts regarding assessed taxes, penalties, and amounts regarding international income, foreign assets, foreign trusts and foreign accounts.

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Prior to opening his own firm, Kurt was a Principal (i.e., Partner) at the Beverly Hills, California law firm of Hochman, Salkin, Rettig, Toscher & Perez, P.C., a Trial Attorney at the U.S. Department of Justice Tax Division, Washington, DC, and a Supervising Attorney, Tax & Charities Division, State of Hawaii Department of Attorney General.

Kurt was also President of the Western States Association of Tax Administrators (WSATA)(2008-2009), Chair of the California Lawyers Association Tax Section DC Delegation, Chair of the Hawaii State Bar Tax Section, and HSCPA Tax Committee. He was voted Outstanding CPA by the AICPA and HSCPA (Government) in 2008, and also received the President's Award by the HSCPA. Kurt has spoken at national taxation conferences including conferences sponsored by NYU, Georgetown, UCLA, California Lawyers Association and the Hawaii Tax Institute, and has taught many taxation, law, business, and estate planning courses at the University of Hawaii School of Law and Graduate School of Accounting and Hawaii Pacific University. He is a co-author of the annual "Taxes of Hawaii: A Comprehensive Guide for Taxpayers and Tax Professionals," (2016-2022 editions), Watermark Publishing. Kurt is a Fellow of the American College of Tax Counsel, a Certified Specialist, Taxation Law, State Bar of California, and earned his LL.M. in Taxation from Georgetown University Law Center.

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Only 3/1 : Key Concepts of Income Tax Treaties

- **There are only 3 substantive concepts in treaties (per PWM)-**
  - Who is subject to a tax treaty (e.g., who is a resident and who is not; the “particular person”)?
  - What is the maximum tax a government can levy on certain income or property under a treaty for particular persons?
  - How are disputes among treaty partners resolved?
- **There is only 1 key procedural concept (per PWM)**
  - What information can be obtained between treaty partner countries?

Tax Treaties for the Estate Planner:

- What are Tax Treaties and tax-related Agreements?
- When does a treaty apply?
- Why is "who can claim treaty benefits" a misnomer-fallacy (PWM)?
- Income Tax Treaties---How they can benefit your clients?
- Estate & Gift Tax Treaties- How they may help clients?
- Rules of Interpretation
- Competent Authority Procedures
- Exchange of Information
- Mutual Collection Assistance
- Recent Enforcement Actions

What are Tax Treaties and Tax-Related Agreements?

What is a Tax Treaty?

- Law like Internal Revenue Code
- "**<u>Supreme Law of the Land</u>**" U.S. Constitution, Article VI cl. 2
- Signed by both countries
- In the United States, treaties require advice and consent of the U.S. Senate
- Can be approved by the U.S. Senate with reservations—from U.S. perspective the provision(s) with reservation(s) are not effective
- Only 1 treaty and 4 protocols approved since 2010

What is a Tax Treaty?

- Treaties
  - "Supreme Law of the Land" U.S. Constitution, Article VI cl. 2

- Where treaty conflicts with IRC, different doctrines
  - IRC 7852(d) – Neither treaty nor IRC has preferential status (codifies case law).
  - *See* IRC 894(a) – Title 26 shall be applied to any taxpayer with due regard to any treaty obligation of the United States
  - Later in time prevails. *Whitney v. Robertson*, 124 U.S. 190 (1888)
  - U.S. still has a treaty obligation. Vienna Convention on the Law of Treaties, Art 27 (but not signed by U.S.)
  - Governments cannot neuter the law of treaties by imposing procedural rules

What is the Purpose of a Tax Treaty?

- Facilitate international trade and investment by lowering barriers to the international flow of goods and services including:
  - Lowering withholding rates on interest, dividends, etc. from the IRC 30% withholding rate
  - Generally reducing the U.S. taxes of residents of foreign countries
  - Establishing primary taxing jurisdiction
  - Resolving double taxation issues such as tie breaker rules when an individual may a tax resident of both countries
  - Defining when a country may tax a business from the other country, i.e., requiring and defining a Permanent Establishment (“PE”)
  - Providing reciprocity
  - Preventing tax evasion and avoidance or double non-taxation
  - Exchanging information and mutual assistance

Types of Tax Treaties and Tax-Related Agreements

- Income Tax Treaties
- Estate and Gift Tax Treaties
- Model Treaties
  - U.S. Model Treaty
  - OECD Model Tax Conventions
  - U.N. Model Tax Conventions
  - Each country generally has a standard form which it begins negotiations
- Exchange of information agreements
- FATCA agreements
- Social Security totalization agreements
- Shipping and aircraft agreements
- Bilateral investment treaties
- MLATs, extradition agreements, and other law enforcement agreements
- Other trade, diplomatic, and military agreements that may have tax provisions

Income Tax Treaties

Countries with U.S. Income Tax Treaties

- Australia
- Austria
- Bangladesh
- Barbados
- Belarus
- Belgium
- Bulgaria
- Canada
- China
- Cyprus
- Czech Republic
- Denmark
- Egypt
- Estonia
- Finland
- France
- Germany
- Greece
- Hungary
- Iceland
- India
- Indonesia
- Ireland
- Israel
- Italy
- Jamaica
- Japan
- Kazakhstan
- Korea
- Latvia
- Lithuania
- Luxembourg
- Malta
- Mexico
- Morocco
- Netherlands
- New Zealand
- Norway
- Pakistan
- Philippines
- Poland
- Portugal
- Romania
- Russia
- Slovak Republic
- Slovenia
- South Africa
- Spain
- Sri Lanka
- Sweden
- Switzerland
- Thailand
- Trinidad and Tabago
- Tunisia
- Turkey
- Ukraine
- Union of Soviet Socialist Republics (USSR)*
- United Kingdom
- Venezuela
- Vietnam

*USSR treaty remains in force for former Soviet republics that have not negotiated new treaties: Armenia, Azerbaijan, Belarus, Georgia, Kyrgystan, Modova, Tajikistan, Turkmenistan, and Uzbekistan

Scope of Income Tax Treaties

COVERED

Federal Income Tax

- Interest
- Dividends
- Rents/Royalties
- Business Profits
- Capital Gains
- Services
- Pensions/Social Security
- Withholding
- Other (Guaranty fees)

NOT COVERED

Other Federal taxes

State and Local Taxes

Sales and Use Taxes

U.S. Customs Duties

Key Provisions of Income Tax Treaties

- Reduced Withholding
- Permanent Establishment
- Residency
    - Tie-breaker provisions if taxpayer is a resident of two countries
- Competent Authority
    - Provides relief including double taxation, e.g., dual residents and transfer pricing
- Limitation of Benefits
- Interpretation
- Exchange of Information
- Mutual assistance
- Election of treaty benefits and disclosures on tax returns

When is a Foreign Person subject to tax?

- A U.S. person is subject to tax on worldwide income
- A foreign person - individual or entities - are generally subject to U.S. income tax that is U.S. sourced income that is either
  - Fixed, Determinable, Annual, or Periodic gains, profits, and income (“FDAP”) (IRC 871(a) and 881) e.g., interest, dividends, rents, royals (30% withholding at source (by payor)), or
  - Income that is effectively connected with a U.S. trade or business (“ECI”) (IRC 871(b) and 882) (taxed in same manner as U.S. taxpayers)
    - **Under Treaties, business income is only taxed if the foreign taxpayer has a PE**
    - “Profits of an enterprise of a Contracting State shall be taxable only in the Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.” Article 7, U.S. Model treaty,

Reduced Withholding Rates

	Interest	Dividends (in General)	Dividends Paid by U.S. Subsidiary to a Foreign Parent Corporation
Australia	10%	15%	5%
Canada	0%	15%	5%
Ireland	0%	15%	5%
Japan	10%	10%	5%
Mexico	15%	10%	5%
Philippines	15%	25%	20%
Non-treaty countries	30%	30%	30%

Business Income and Permanent Establishments

Generally, U.S. income tax treaties provide two ways a PE can be established:

Fixed Facility:

- Place of business
- Fixed with a distinct geographical site with certain permanence
- Carrying on a business at that fixed place of business

Dependent Agent:

- Dependent agent has and habitually exercises authority to conclude contacts in agent's country that are binding on enterprise

Permanent Establishments (Facility)

Common Exceptions to Fixed Facility PE

- Facility used solely to purchase goods for a resident of the other contracting state
- Facility used solely for storing, shipping, or displaying merchandise for a resident of a resident of the other contracting state
- Facility maintained solely for collecting or supplying information for a resident of the other contracting state
- Facility used for “preparatory or auxiliary” purposes

Permanent Establishments (Agent)

- To avoid a PE, the independent agent must be: (1) legally and economically independent of business; and (2) acting in ordinary course of *its* business in carrying out business of enterprise
- Foreign head office must be more than a “rubber stamp” and must be real and meaningful
- Apparent authority under common law may cause PE (look to the facts and circumstances). *Taisei Fire & Marine Ins. Co.* (104 T.C. 535, 556) (1995) (U.S.-Japan Convention) (Japanese company “was both legally and economically independent of petitioners, thus satisfying the definition of an agent of an independent status under article 9”)

Residency

“A resident of a Contracting State means any person who, under the laws of that Contracting State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature…”

Savings Clause: Treaty shall not affect taxation of citizens and residents such as long-term permanent residents.

Residency Tie-Breaker Rules

Individuals

Treaties provide for tie-breaker rules when resident of both states (countries)

Corporations

May be resident of neither country but may apply certain provisions to prevent double taxations (e.g., U.S.-Japan Convention)

Competent authority relief in certain treaties (e.g. U.S.-UK Convention)

Other entities

U.S. Model treaty provides for competent authority relief

Residency Tie-Breaker Rules

U.S. Model, Article 4(3) and many treaties:

- Permanent home
- Center of vital interests (closer personal and economic relations)
- Habitual abode
- Country of citizenship
- Competent authority agreement

Residency Tie-Breaker Rules: Title 26 & Title 31

Apply to all non-U.S. citizens, including Lawful Permanent Residents?

Application to Title 31? Yes - per 2023 District Court decision -

- See, Southern District Court of California order issued in the case of ***Aroeste v. United States***. No. 22-cv-682-AJB-KSC, 2023 BL 46094 (S.D. Cal. Feb. 13, 2023).
- *The first issue is purely legal: does Alberto Aroeste's tax residency status under the Treaty have any legal effect on whether he was required to file FBAR forms in 2012 and 2013? . . .*
- [Court's Conclusion] . . . *any person allowed to permanently reside in the United States by virtue of US immigration laws* ***must file an FBAR <u>unless</u> that person is <u>entitled to be treated as a resident of a foreign country under a tax treaty.</u>***

Residency Tie-Breaker Rules: Title 26 & Title 31

Aroeste v. United States. No. 22-cv-682-AJB-KSC, 2023 BL 46094 (S.D. Cal. Feb. 13, 2023).

- Partially stayed pending *Bittner* -
  - SCOTUS has spoken in Bittner –
    - Hence, Mr. Aroeste wins the amount of the non-willful FBAR penalties assessed per *Bittner*

    - U.S. Tax Court – pending case –
      - *Res Judicata*
- [Court] *Because the United States and Mexico indisputably have a tax treaty, Mr. Aroeste would **not** be a lawful permanent resident within the meaning of 26 U.S.C. section 7701(b)(6) **if** he commenced to be treated as a resident of Mexico under the Treaty (with the additional caveats enumerated in the statute); which might in turn have ultimately excused him from the requirement to file FBARs as a "United States person." **The Court therefore concludes a determination of Mr. Aroeste's tax residency under the Treaty is directly relevant to—indeed it is outcome determinative of—**the issue of whether he was required to file the FBARs at issue in this lawsuit.*

Treaty Law is ***NOT*** Elective

* U.S. federal tax law is not elective – a U.S. taxpayer cannot elect (or not) to apply, for instance, IRC Section 61

IRS analysis under Rev. Rul. 84-17 is not the law & at its core is a choice of law analysis

Which law applies (which treaty, or which U.S. federal tax law)?

<u>Misnomer of "**electing treaty benefits**" </u>:

Legal conclusions under Treaty: ECI with PE is taxable
ECI with no PE is not taxable
ECI loss with no PE is not deductible

The key question is whether the taxpayer has or not a PE?

<u>If treaty does not apply, Title 26, domestic law applies (Subchapter N)</u>:

ECI with a United States Trade or Business (USTB not same as PE) - then taxable
ECI with no USTB then not taxable
ECI loss with no USTB then not deductible

Tax Treaty Benefits that Reduce Tax

- Must be affirmatively claimed? Not as a matter of law
  - Form W-8BEN (Form W-8BEN-E used by entities and Form W-8IMY used by intermediaries) is generally used by foreign persons to inform withholding agent of entitlement to treaty benefits
    - Signed under penalty of perjury

- Form W-8ECI
- Form 8233

- Why is "**<u>claiming a treaty benefit</u>**" a fallacy a misnomer (PWM)?

Penalties for Not Providing Treaty Disclosures

- Disclosures not made under IRC § 6114 give rise to a statutory penalty under IRC § 6712: World pre- IRC § 6114
  - 6712 - Failure to disclose treaty-based return positions
    - *If a taxpayer fails to meet the requirements of section 6114, there is hereby imposed a penalty equal to $1,000 ($10,000 in the case of a C corporation) on each such failure.*
- *See,* Martin, P. 37 Int'l Tax J. 37 (2011): ***U.S. Tax Treaties and Code Sec. 6114: Why a Taxpayer's Failure to Take a Treaty Position Does Not Deny Treaty Benefits***
- Disclosures should be made to reduce the 30% statutory rate on FDAP to the treaty rate - where payment should be reported on Form 1042-S filed by withholding agent
    - Claims for refund can be made if excess withholding is made under Sections 1441 and 1442

Penalties for Not Providing Treaty Disclosures

- Disclosures not made under IRC § 6114 give rise to a statutory penalty under IRC § 6712: World pre- IRC § 6114
  - 6712 regulations – § 301.7701(b)-7 - Coordination with income tax treaties.
  - *"If the taxpayer fails to file the statement required by paragraph (b) of this section on or before the date prescribed in paragraph (b) of this section, the taxpayer will be subject to the penalties imposed by section 6712. See section 6712 and § 301.6712-1."* The taxpayer does not forfeit the application of the treaty law to her.
- The term "dual resident taxpayer" is not found in Title 26;
  - Rather found in the above regulations.
  - If an individual is NOT a resident under an applicable U.S. tax treaty of the U.S., they simply are not a resident of the U.S.; hence not a "dual resident taxpayer"

Penalties for Not Providing Treaty Disclosures

- Disclosures not made under IRC § 6114 give rise to a statutory penalty under IRC § 6712:

See IRS PMTA 2007-01188 (program manager technical assistance held that treaty benefits cannot be denied if the taxpayer is entitled to them; the examiner was entitled to impose a penalty of $1,000 under section 6712).

3) ***Do we have legal authority to deny a tax tr****eaty because Form 8833 is not attached or the treaty is claimed on the wrong Form (1040EZ or 1040A)?*

No, you cannot deny treaty benefits if the taxpayer is entitled to them. You may impose a penalty of $1,000 under section 6712 of the Code on an individual who is obligated to file and does not. The individual may ask for a waiver of the penalty if there was reasonable cause.

Treaty Disclosures Should be Made

- Form 8833 (attach to U.S. tax return)
- Treaty based return position
  - Difference in tax liability based upon treaty
  - ECI not attributable to PE, reduction of branch profits tax
- $10,000 penalty under IRC 6712 can be imposed for C Corps that fail to properly disclose each treaty based position
- $1,000 penalty under IRC 6712 for others
- Exceptions
  - Disclosure is generally waived for an individual if the aggregate amount for the taxable year does not exceed $10,000 unless reporting is required by instructions to Form 8833

Limitation of Benefits

Article 22 U.S. Model Treaty

- Intended to prevent residents of third country from obtaining benefits under a treaty that were not intended for them, e.g., 0% withholding tax rate

- Entities that are residents of a country with an income tax treaty with U.S. that contains a LOB article are only eligible for benefits if they can satisfy one of the objective tests under the LOB article or can obtain a favorable discretionary determination from U.S. competent authority with respect to specific benefits

Limitation of Benefits

Objective Tests - Article 22(2)(f) of U.S. Model Treaty

- At least 50% of aggregate vote and value of the company's equity is owned by persons qualifying for treaty benefits
  - If there are classes with disproportionate vote or value, the 50% vote or value test is applied separately for each class
  - If there are intermediate owners between the qualifying owner and the tested company, each such owner must itself be a "qualifying intermediate owner" (treaty resident or beneficiary of equivalent treaty)
- Less than 50% of the entity's gross income, and less than 50% of the overall tested group income, is paid or accrued in the form of deductible payments to persons that are not residents of either contracting state
- Other tests include Derivative Benefits, Anti-Triangular provisions, Conduit Finance regulations, and Hybrid entities under IRC 894(c)

Estate and Gift Tax Treaties

International Estate & Gift Tax Treaties (as of July 1, 2022)

Australia	Estate & Gift
Austria	Estate & Gift
Canada	Estate* *The estate tax provisions are located in Article XXIX B of the United States – Canada Income Tax Treaty.
Denmark	Estate & Gift
Finland	Estate
France	Estate & Gift
Germany	Estate & Gift
Greece	Estate
Ireland	Estate
Italy	Estate
Japan	Estate & Gift
Netherlands	Estate
South Africa	Estate
Switzerland	Estate
United Kingdom	Estate & Gift

Estate and Gift Tax Treaties

- Treaties often cover only U.S. estate tax
- Only 7 of 16 treaties cover gift tax
- Some countries have inheritance taxes and gift taxes that provide the beneficiaries/donees with the obligation to file and pay the taxes
- U.S. allows a credit even in a few circumstances where the country has a deemed sale at death law rather than an estate or inheritance tax
- In addition to foreign countries, approximately 17 U.S. states have an estate or inheritance taxes

Inheritance Taxes and Tax Rates

- Some countries have inheritance taxes and gift taxes that impose the taxes on the beneficiaries and donees, e.g., Japan, South Korea.
- Inheritance taxes generally have different exemptions and tax rates depending upon who is receiving the property from the decedent and donees, e.g., higher exemptions and lower rates for spouses.
- While U.S. top transfer tax rate is 40% (including estate taxes), the U.S.' 40% rate is fourth highest globally and three other countries have higher top rates: Japan (55%), South Korea (50%), and France (45%). U.K.'s top rate is 40%. Other countries with rates of at least 15% or greater include Chile (25%), Greece (20%), Netherlands (20%), Finland (19%), and Denmark (15%).
- Foreign countries don't always allow a step-up in tax basis to date of death value in foreign country. Also, even if tax basis has not changed, the fluctuations in foreign currency may cause a gain or loss.

Tax Regime for a U.S. Person: Worldwide Taxation

- U.S. citizens and domiciliaries are subject to the U.S. gift and estate taxes on transfer of worldwide assets.
    - Tax on worldwide transfers – testamentary and lifetime over a certain exclusion amount
    - Tax return filings are required to report transfers
    - Up to forty percent tax on amounts in excess of exclusion
- **GOTCHA:** An unlimited marital deduction for transfers from decedent spouse estate to surviving spouse is available only if surviving spouse is a U.S. citizen. IRC 2056(d)(1)(A) and 2523(i). Otherwise, the property must be left to a qualified domestic trust (QDOT) in order to be eligible for the unlimited deduction. The 50% inclusion in the gross estate under IRC § 2040(b) also does not apply if the surviving spouse of joint tenancy or tenants by the entirety is not a U.S. citizen. IRC 2056(d)(1)(B).

Domicile for U.S. Estate and Gift Tax Purposes

- “Domicile” for U.S. estate and gift tax purpose is a “fuzzy” concept unlike income tax “bright line” tests.
    - It really is residency, but estate and gift tax residency is referred to as “domicile”. Domicile is strictly determined under the Code, the Treasury Regulations and cases thereunder.
- Even illegal aliens can have domicile in the U.S. for estate tax purposes.
    - See Rev. Rul. 80-209 (illegal alien who lived in United States for 19 years with alien's family, purchased residence, and established strong community ties was domiciled in United States at date of death and taxable estate was subject to tax imposed by section 2001).

Domicile for U.S. Estate and Gift Tax Purposes

- Domicile controls whether a person is a U.S. resident for estate and gift tax purposes.
- An alien individual who resides in the U.S. with no present intention of leaving the U.S. would be treated as domiciled in the United States. *See* Reg. 20.0-1(b).
  - Note the transfer tax provisions (Gift, Estate, & GST) rather than "alien" uses the term "Nonresident Non-Citizens" (NRNC)
  - Visa status (not controlling)
  - Location of principal residence
  - Location of family members
  - Declarations of the individual
  - Testimonies of others well acquainted with the person regarding his or her residence and intentions
  - Place where business and personal affairs are conducted
  - Location of real and tangible personal property
  - Place were person is registered to vote
  - Place where person has a personal bank account
  - Place where person has membership and affiliations with a religious group or social club

Residency for Transfer Tax Purposes

- Residency based on domicile (intent to remain permanently)
  - Green card visa holders
    - Can a U.S. green card holder (permanent resident alien) not be domiciled in U.S.
  - Others
- If a resident then:
  - U.S. gift and estate taxes imposed on worldwide assets
  - May have problems with U.S. marital deduction if spouse is non-U.S. citizen.
- If not resident, then:
  - Only certain assets ("U.S. situs") subject to gift or estate tax
  - Different definition of U.S. situs assets for gift than estate tax
  - Same marital deduction problems if spouse is not a U.S. citizen

Resident for Estate Tax Purposes has Unique Meaning

- Facts
    - Born/lived In Pakistan for 61 years
    - Citizen of Pakistan
    - Obtained investor visa, never worked in the U.S.
    - Resided in U.S. for 10 years
    - Became sick, drafted U.S. will, departed U.S. for Pakistan
    - Died in Pakistan
- U.S. Tax Court Held decedent was a U.S. resident, i.e., domiciled in U.S.
- *Estate of Khan v. Comm., TC Memo 1998-22 at 98-124*

U.S. Estate Tax

Estates of U.S. Citizens and Domiciliaries

- Subject to estate tax at rates of up to 40% of their worldwide assets wherever situated
- US citizens have a lifetime credit against estate, gift and generation skipping transfer ("GST") taxes equivalent to a lifetime exemption of $12,060,001 for 2022 and $12,920,000 for 2023. This amount doubled under the Tax Cuts & Jobs Act from 2016 to 2025 but reverts back to pre-TJCA levels in 2026.
- An unlimited marital deduction is available only if the surviving spouse is a U.S. citizen. Otherwise, the property must be left to a qualified domestic trust (QDOT) in order to be eligible for the unlimited marital deduction.

Estates of Non-U.S. Decedents (i.e., NonCitizen NonDomiciliaries or NCNDs)

- Only $60,000 estate tax exemption/$13,000 credit available unless treaty allows a greater exemption/credit
- Only assets situated in the U.S. ("U.S.-Situs Assets") are subject to estate tax, but may be modified by an applicable treaty.
- TJCA increased the lifetime exemption for U.S. decedents (U.S. citizens or residents) but did not increase estate tax exemption/credit for non-U.S. decedents (noncitizen nonresidents).
- The unlimited marital deduction is not available unless the surviving spouse is a U.S. citizen (or the property is left to a QDOT) or a treaty allows an unlimited or partial deduction/exemption.

U.S. Gift Tax

- Noncitizen nondomiciliaries (NCNDs) are subject to gift tax only with respect to gifts of real and tangible personal property situated in the United States.
    - Gifts of intangible property are not subject to gift tax. For example, no gift tax on the gift of stock in a US corporation even through the same stock would be subject to estate tax if held at death.
    - Gifts of cash (possibly including checks) may be subject to gift tax if the cash is in the US at the time of transfer. Any gifts of cash by a non-U.S. person to a U.S. person (including a U.S. trust) should always be made from a non-U.S. account of the donor (ideally to a non-U.S. account of the donee)

- 2022 Exclusion Amounts — 2023 Exclusion Amounts
    - $16,000 USD — $17,000
    - $164,000 for a noncitizen spouse — $175,000
    - Unlimited marital deduction is available for gifts to only a US citizen spouse.
    - No lifetime exemption ($12,060,000) available

U.S. Situs Rules in General

As previously discussed, non-U.S. persons (noncitizen nondomiciliaries or NCND) are subject to estate tax only with respect to that part of the gross estate which, at the time of death, is situated or deemed situated in the United States ("U.S.-situs assets").

Stock in US Companies

- If held by NCND at death would be subject to U.S. estate tax unless taxing rights are assigned under treaty.
- Gifts of stock are not taxable because gifts of intangible property by a NCND are not subject to gift tax.

Tangible Personal Property

- TPP situated in the U.S. is a U.S. situs asset subject to estate tax if held by an NCND at time of death.
- Exception: Artwork on loan to a public gallery
- Gift of TPP in the U.S. is subject to gift tax.

Real Property

- U.S. real property is includible in estate of NCND and is subject to gift tax if the non- U.S. owner makes a gift of the property while still alive.
- Stock in a U.S. real property holding corporation may be gifted by NCND without gift tax,

Life Insurance

- Proceeds paid by a U.S. insurer on life of a NCND is not U.S. situs property.
- However, U.S. -issued policy owned by a non- U.S. person on the life of another person is includable in the decedent's estate at FMV.

U.S. Situs Rules in General

As previously discussed, non-U.S. persons (noncitizen nondomiciliaries or NCND) are subject to estate tax only with respect to that part of the gross estate which, at the time of death, is situated or deemed situated in the United States ("U.S.-situs assets").

Mutual Funds

- Shares in mutual funds held by NCND at death are U.S. situs assets subject to estate tax.
- Real estate mutual funds and publicly-traded REITS subject to estate tax even if exempt from FIRPTA.

Exchange Traded Funds

- Estate taxes on ETFs depend on structure of ETC.
- ETFs structured as exchange-traded grantor trusts may be subject to estate tax depending on trust terms and underlying assets.

Debt Obligations

- May be a U.S. -situs asset but not includible in estate of an NCND who may be eligible for the portfolio interest exemption or bank deposit exception with respect to interest payments.

Cash

- Bank accounts maintained with U.S. banks are not U.S. situs property
- Cash deposits with U.S. brokers, money market accounts with U.S. mutual funds and cash in U.S. safe deposit boxes are considered US situs.
- Cash is considered tangible personal property (TPP).

"Dual" Residents – per Income Tax Treaties

- See, Southern District Court of California order issued in the case of ***Aroeste v. United States***. No. 22-cv-682-AJB-KSC, 2023 BL 46094 (S.D. Cal. Feb. 13, 2023).

- *The United States first suggests application of the Treaty is irrelevant here because the Treaty only concerns income* ***taxes*** *and excises* ***taxes****, and Mr. Aroeste was assessed FBAR* ***penalties*** *under a wholly different body of law. See Doc. No. 36 at 7.* ***But this argument does not refute the plain language of the FBAR regulations****, which explicitly invoke provisions of Title 26, including the provision that requires consideration of an individual's status under an applicable tax treaty for the purpose of determining whether an individual is a "United States person" subject to FBAR filing.*

- *The United States further suggests it "does not matter" how Mr. Aroeste was treated under the Treaty because "[i]t only matters that Mr. Aroeste has lawful permanent residence and has not rescinded that residency." Doc. No. 36 at 8. But,* ***again, the statutory framework explicitly provides that "lawful permanent resident" status can be abrogated***

Dual Residents – Examples of How Treaties May Address?

- Some treaties address dual residency:
  - **U.S.-UK Estate and Gift Tax Treaty** provides a rule that limits each country's taxation of a national of the other country even though domiciled in both countries if the decedent was not domiciled for a significant period of time in the non-citizen country (at least 7 of 10 years).
  - **U.S.-Germany Estate and Gift Tax Treaty**, Article 4(3) provides a tie-breaker if a decent or donor is a citizen of one country and domiciled in both country that country of citizenship controls if the decedent or donor was not domiciled in the noncitizen ship country for not more than 10 years. Otherwise, Article 4(2) provides the traditional income tax tie-breaker tests: (1) permanent home; (2) their center of vital interests; (3) habitual abode; and (4) citizenship.
  - **U.S.-France Estate Treaty** provides that where a decedent or donor is citizen of one country and domiciled in both countries, there are two separate tests that are applied in following order:
    - (1) if person was domiciled in the country of which person was not a citizen for less than 5 of 7 years ending with the year of death or gift and was in that country because of employment, or employment of a spouse or dependent, they will domiciled only in country of citizenship; or
    - (2) decedent or donor is only domiciled in country of citizenship if they had a clear intent to retain their domicile in that country and was domiciled in non-citizenship country for less than 5 of 7 years ending on death or the year that gift was made.
    - If first two tests do not determine domicile, then, domicile is determined by comparable income tax treaty tie-breaker tests: (1) permanent home; (2) his/her personal relations were closest (center of vital interests); (3) habitual abode; and (4) citizenship.

Marital Deductions

- Article XXIX-B of the U.S.-Canada Tax Treaty provides a better outcome for cross-border estates than extending a marital deduction under domestic U.S. tax laws.

- Examples of Countries that Allow Marital Deductions:
    - Denmark and United Kingdom – Allow unlimited marital deductions
    - Germany allows a limited marital deduction at death
    - Netherlands allows a limited marital deduction for certain Netherlands property, i.e., immovable property and business with a permanent establishment, for purposes of the Dutch transfer duty

Credits – Common Treaty Principles

- U.S. – Japan Estate and Gift Tax Treaty allows a proportionate amount of the U.S. $12,060,000 estate and gift tax exemption (2022) or unified tax credit based upon the proportion of U.S. situs assets over worldwide assets. Article IV of U.S. Japan Estate and Gift Tax Treaty; IRC 2102(c)(3); *Revenue Ruling 90-101,* 19902 CB 315; and *Estate of Burghardt v. Commissioner*, 80 T.C. 705 (1983), *aff'd without op.* 734 F.2d 3 (3rd Cir. 1984).
- A credit must be allowed by the country taxing property situated outside its boundaries for the tax imposed by the other country on the basis of situs. The amount of the credit may not exceed the portion of the tax imposed by the crediting country which is attributable to the double-taxed property.
- A credit is also provided where each of the countries imposes tax, by reason of nationality or domicile of the decedent, donor, or beneficiary, on the transfer of property located outside both countries.
- This credit is the lesser of the two taxes imposed with respect to the property and is apportioned between the two countries on the basis of the portion of that tax which the tax of the crediting country (attributable to the property) bears to the sum of the taxes of both countries (attributable to the property).
- Credits under the treaty may generally be granted only if claim therefor is filed within five years from the due date of the tax against which the credit is otherwise allowable. Final allowance of the credit is generally denied until the tax for which the credit is claimed has been paid.

Rules of Interpretation

Rules of Interpretation

- Definition article in Treaties (e.g., Article 3 of U.S. Model)
- Plain language of the Treaty
  - Case Law

- Treasury Department's Technical Explanation
- Senate Foreign Relations Committee Report
  - Senate Floor Debate
- Joint Committee on Taxation Report
- President's transmittal letter
- Model Treaties and Commentaries
  - U.S. Model, OECD Model, UN Model
- NOT LAW - IRS Revenue Rulings and other guidance. *But see* Rev. Proc. 2022-7, Section 4.01(9)(IRS will not issue rulings for many treaty issues)
- Some treaties will refer to domestic law, e.g., IRC, case law, regulations, rulings, etc., for interpretation

Competent Authority Procedures

Mutual Agreement Procedures (MAP)

- MAP is a dispute resolution mechanism available to taxpayers facing cross-border disputes.
- U.S. tax treaties generally allow a taxpayer to request a MAP if the taxpayer believes that it will be subject to taxation that is inconsistent with the treaty.
- To request a MAP, the taxpayer will file a MAP request with the U.S. Competent Authority to endeavor to resolve the dispute by mutual agreement between the U.S. and the treaty partner.
- The U.S. Competent Authority is the Commissioner of the Large Business & International Division (Nikole C. Flax)

MAP

- Who can request Competent Authority Assistance?
  - Under most U.S. Income tax treaties, a taxpayer must be a "treaty resident" or a citizen in one of the contracting states to request competent authority assistance under the treaty.
    - (See Article 4 of United States Model Income Tax Convention)
- For what can a taxpayer request competent authority assistance?
  - To relieve double taxation
  - To determine whether a foreign pension plan corresponds to a pension plan recognized for U.S. tax purposes
  - To determine tax residence
  - To determine whether the taxpayer is entitled to treaty benefits under limitations on benefits provisions.

Rev. Proc. 2015-40

- Revenue Procedure 2015-40 sets forth the procedures for requesting competent authority assistance under tax treaties. 2015-35 IRB 236 (superseded in part as to fees by Rev. Proc. 2017-1, 2017-1 IRB 1)
- A taxpayer's formal request for competent authority assistance must include:
  - Identification of specific treaty and provisions pursuant to which request is made;
  - Names, addresses, and U.S. and foreign taxpayer identification numbers of parties subject to the income allocation under IRC 482;
  - Brief description of the issues submitted for competent authority consideration;
  - Brief description of the relevant transactions, activities and circumstances relevant to the issues under consideration;
  - Taxable years and amounts at issue; and
  - Explanation of the specific relief sought by the taxpayer.

Rev. Proc. 2015-40 (Cont.)

- Mandatory Pre-Filing Procedures
  - A taxpayer must submit a mandatory pre-filing memorandum prior to filing a competent authority request if the issue at hand is a transfer-pricing issue.
  - Even if not mandatory, the Revenue Procedure recommends submitting a pre-filing memorandum when the competent authority issues presented by the taxpayer are complex, large in amount, novel, or likely to involve interrelated issues.
  - The pre-filing memorandum must:
    - Identify the taxpayer,
    - Explain the factual and legal basis of the taxpayer-initiated position, and
    - Describe any administrative, legal, or other procedural steps undertaken in the applicable treaty country (including whether the foreign tax authority has accepted an income tax return reflecting the taxpayer-initiated position) and any communications with the foreign competent authority regarding the position.

Rev. Proc. 2015-40 (Cont.)

- Timing to File a Competent Authority Request
  - Generally, taxpayers are urged to file a competent authority request as soon as the relevant issue arises or is likely to arise.
  - However, each individual tax treaty may require that a competent authority request be filed within a certain time limit.

Rev. Proc. 2015-40 (Cont.)

- Accelerated Competent Authority Procedure ("ACAP")
  - Rev. Proc. 2015-40 provides for a streamlined procedure for invoking a process called ACAP. Under ACAP, a taxpayer may request that the terms of a competent authority resolution for a given tax period be extended to cover subsequent tax periods for which it has filed tax returns.
  - The taxpayer may request the procedure at the time of filing, or any time thereafter, but before the conclusion of the mutual agreement process. In filing the request, the taxpayer sends the request in accordance with Rev. Proc. 2015-40 to the Director, International. The request must contain:
    - A written statement that the taxpayer requests ACAP
    - The ACAP years proposed to be covered
    - Whether the taxpayer does not seek to apply the competent authority resolution to one or more ACAP years and its reasons for not requesting ACAP (such as the transactions at issue not having occurred in subsequent taxable years); and
    - The taxpayer agrees that an inspection of books or records under the ACAP will not preclude or impede a later examination of a return or inspection of books and records for any taxable period covered by the ACAP.

Rev. Proc. 2015-40 (Cont.)

- Small Case Competent Authority Requests
  - The Revenue Procedure endeavors to minimize the administrative burden of the competent authority requests by providing an exemption from the usual competent authority administrative requirements to certain taxpayers.
  - A competent authority request will qualify as a small case competent authority request if the sum of the U.S.- and foreign-initiated adjustments does not exceed the following dollar thresholds for all of the competent authority years combined:
    - Corporation/Partnership: $5,000,000
    - Individual: $1,000,000
  - A competent authority request does not qualify as a small case if it arises from a transfer-pricing issue, is a discretionary limitation on benefits request, or is a pension plan request filed by a person other than an individual.

What happens when Competent Authorities agree?

- Typically, when the competent authorities reach an agreement, the contracting parties will memorialize the details in a written memorandum describing the method of relief, and any other details.
- If the U.S. and foreign competent authorities are not able to come to a resolution, the competent authority case may be eligible for arbitration under the tax treaty.
- If there is an agreement, the taxpayer is given the chance to agree or reject the terms of the agreement.
- If the taxpayer decides to reject the competent authority resolution, the case will be considered closed, and the taxpayer is left to exhaust domestic remedies otherwise available.

Exchange of Information

How Does the IRS Obtain Information?

- Recordkeeping Requirements – IRC 6001, etc.
- Information Documents Requests (IDRs) (Form 4564)
- Taxpayer Interviews
- Formal Document Requests (FDRs) – IRC 982
- Summons and Enforcement – IRC 7601 and 7602
- Exchange of Information (EOI)

International Exchange of Information by Request

- Tax Treaties – Bilateral Agreements, Income Tax Conventions, Double Taxation Conventions
  - Convention on Mutual Administrative Assistance in Tax Matters (US ratified convention in 1991, entered into force 1995, has not ratified amending protocol) (protocol in force in 96 jurisdictions)
- Tax Information Exchange Agreements (TIEAs) (criminal and civil)
- Mutual Legal Assistance Treaties (MLATs) (criminal)
- Financial Intelligence Units (i.e., FinCEN) and Egmont Requests
- The Hague Convention on the Taking of Evidence (Letters Rogatory - 28 USC 1781)

International Exchange of Information Administrative and Statutory Authorities

- Authority for the exchange of information with foreign partners is founded primarily on:
  - IRS Delegation Order 4-12
  - IRC 6103
  - IRC 6105
  - disclosure or secrecy provisions of relevant international treaty or agreement
- Improper disclosure of returns and return information under IRC 6103(b) may result in civil or criminal penalties under IRC 7431 and 7213
- No IRS employee may contact, provide any information to, request any information from, or receive any information from a foreign tax official, other than employees in the Commissioner, LB&I (U.S. Competent Authority)

International Exchange of Information Standard EOI Provisions in Agreements

1. General obligation to exchange information as is foreseeably relevant
2. Procedures regarding the use and disclosure of the exchanged information
3. Language which prohibits imposing the following obligations on the countries party to the agreement:
   i) carrying out administrative measures at variance with the laws and administrative practice
   ii) supplying information which is not obtainable
   iii) supplying information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or would disclose any other information the disclosure of which would be contrary to public policy

International Audit Procedures Using EOI

- **Spontaneous Exchange of Information Program**
  - operates through the EOI provisions of international exchange agreements
  - transmission of information not specifically requested by a Competent Authority
  - in the judgment of providing authority may be of interest to a foreign partner for tax purposes
  - information discovered during a tax exam, investigation, or other administrative procedure
- **Simultaneous Examination Program**
  - involve U.S. and foreign partner(s) conducting separate, independent examinations of selected taxpayer(s) in respective jurisdictions where partners have common or related interest
  - assigned EOI analyst, representatives of IRS and foreign partner(s) meet to coordinate strategies and discuss technical issues developed during the examinations.
- **Joint Audits**
  - involves two or more jurisdictions joining together to form a single audit team
  - examine transaction(s) of related taxpayers with cross-border activities
  - Joint audit parties attempt to reach a joint resolution regarding the joint audit issues

Treasury Inspector General's Report

- On September 11, 2017, TIGTA (Treasury Inspector General for Tax Administration) issued a report concluding generally that "*Exchange of Information Capabilities Are Underutilized by the Internal Revenue Service*"

- The focus was on automatically exchanged data:
    - Agents do not use it enough
    - Records of how it is used are inadequate

Automatic Exchange of Information

- Foreign partners agree to exchange certain tax or financial account-related information on a regular and systematic basis, without the need for a specific request pursuant to a tax treaty or tax information exchange agreement.
- AEOI Program administers and coordinates all automatic exchanges of information between U.S. and host country tax authorities (HCTA)
- AEOI Program exchanges the following information on an automatic basis:
  - Information on certain U.S.-sourced FDAP payments to foreign persons and foreign-sourced FDAP payments to U.S. persons (traditional automatic exchange)
  - FATCA
  - OECD BEPS project (Country-by-Country Reporting).
- AEOI Program also coordinates activities with internal business units and HCTAs with respect to FATCA intergovernmental agreements, confidentiality and data safeguards, and CA Arrangements.

Foreign Account Tax Compliance Act

- FATCA – Intergovernmental Agreements (IGAs) (over 100 jurisdictions and over 300,000 foreign financial institutions registered)
  - Reporting for Individuals (Form 8938) – 2012 (2011 tax reporting) – disclosure of foreign financial accounts and assets
  - Entity registration for Financial Institutions – May 2014
  - Reporting – FFI's in non-IGA countries – March 2015 (Account Balance)
  - Reporting – FFI in IGA countries – Sept 2015 (Account Balance)
  - Reporting expanded in 2017 – includes "foreign proceeds"

OECD and EC

- OECD Standard for Automatic Exchange of Financial Account Information in Tax Matters (**Common Reporting Standards**) (over 100 jurisdictions committed to exchanging information beginning in 2017 and 2018)
- OECD Global Forum on Transparency and Exchange of Information for Tax Purposes (154 countries): International body that ensures implementation of agreed standards of transparency and exchange of information in the tax area
- OECD - **Country by Country** reporting by multi-national enterprises and exchanged pursuant to bilateral Competent Authority Arrangement (Rev Proc 2017-23) (from June 2018)
- European Commission transparency rules for EU intermediaries (accountants, banks, lawyers and tax advisors) for mandatory reporting to EU tax authorities and AEOI (July 1, 2020)

Mutual Collection Assistance

The Revenue Rule

The U.S. and most foreign jurisdictions recognize the "revenue rule," which states that jurisdictions have no obligation to assist in collecting taxes assessed by a foreign government. *See, e.g.*, *Attorney Gen. of Canada v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 109 (2d Cir. 2001).

International Tax Collections

- Exhaust all domestic sources of information – IRM 5.21.2.3.2 (04-06-2018)
- Types of Information
  - Tax Returns and Return Information
  - Third party information return filings
  - Bank records
  - Business records
  - Public records
  - Witness interviews
- International Field Calls – IRM 5.21.5 (04-02-2018)

Bilateral Tax Treaties

- Bilateral tax treaties can provide an exception to the Revenue Rule. Some U.S. tax treaties authorize the Service to request assistance from foreign governments in collecting U.S. taxes.
- Of the over 60 ratified bilateral tax treaties, 24 provide for <u>limited</u> collection assistance.
- This narrow assistance is limited to collecting taxes that will prevent abuse of treaty benefits. *See* Article 26 of the U.S.-Belgium Income Tax Treaty ("Each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such taxes imposed by that other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by that other Contracting State shall not be enjoyed by persons not entitled to such benefits.").

Mutual Collection Assistance Requests

- 6 bilateral U.S. tax treaties provide for broad collection assistance, by which the IRS can request collection of liability owed by a U.S. taxpayer (Canada, Denmark, France, Japan, Netherlands, and Sweden).
- When a treaty authorizes a MCAR, then the foreign country "can take whatever actions it would take to collect its own taxes" in carrying out the U.S. MCAR. IRM 5.21.7.4(2) (Nov. 13, 2015).
- The MCAR-authorizing treaties generally do not allow for collection activity against persons who are citizens of the requested foreign state.
  - In Canada and Denmark, MCAR collection is still allowed if the taxpayer only obtained Canadian or Danish citizenship in a tax year subsequent to the years at issue.
  - In Japan, MCAR collection on a Japanese citizen may be allowed if there is evidence of tax fraud or evasion, or the taxpayer has transferred assets into the requested State to avoid collection. IRM 5.21.7.4.8 (June 3, 2020); U.S.-Japan Income Tax Treaty, 2013 Protocol, Article XIII, amending Article 27.
- Once the foreign country agrees to cooperate with a MCAR, the procedures taken are subject to foreign law.

Suspension of Statute of Limitations

- Suspension of SOL on criminal charges - Government seeking foreign evidence. 18 USC 3292

- Suspension of SOL on civil assessment and collection **or** on criminal charges - Third party summons enforcement proceedings or the absence of the resolution of the summoned party's response to the summons starting 6 months after issuance until final resolution. IRC 7609(e)(1) and (2)

- Suspension of SOL on civil collection under IRC 6502 - The time during which the taxpayer is outside the United States for a continuous period of at least six (6) months, and for six (6) months after his/her return. IRC 6503(c)

- Suspension of SOL on criminal charges - Defendant outside U.S. or a fugitive. IRC 6531

Recent Enforcement Actions

U.S. EOI Summons Enforcement

- A summons is an information gathering tool that the IRS can issue for various tax administration purposes including "ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person," etc. IRC 7602(a).
- While IRC 7602 makes no mention of the issuance of a summons to obtain information for a treaty partner, courts have held that issuance for such a purpose is proper. *See Lidas v. United States*, 238 F.3d 1076, 1081 (9th Cir. 2001).
- A summons is not a self-enforcing tool. If a party fails to comply, the government must bring an action in federal district court pursuant to IRC 7604 for an enforcement order. If a party is summonsed for records pertaining to a third party (*e.g.*, if the IRS issues a summons to a bank for specific customer account-related information), the third party can petition a federal district court for an order quashing the summons pursuant to IRC 7609.
- In this sense, the federal court system acts as a gatekeeper to the IRS's otherwise broad administrative ability to gather information. *United States v. Clarke*, 573 U.S. 248, 253 (2014) ("Congress made enforcement of an IRS summons contingent on a court's approval.").

U.S. EOI Summons Enforcement

- Under *United States v. Powell*, 379 U.S. 48 (1964), the government must make a *prima facie* showing that its summons was issued in good faith by establishing (typically through the declarations of government officials) that "the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the [Internal Revenue] Code have been followed." *Powell*, 379 U.S. at 57-58.
- If the government fails to make such a *prima facie* showing, the court should quash the summons (or enter a corollary order denying enforcement).
- If the government makes this *prima facie* showing, the burden shifts to the taxpayer who may "challenge the summons on any appropriate ground." *Id.* at 58 (citing *Reisman v. Caplin*, 375 U.S. 440, 449 (1964)).
- The *Powell* court explained that "it is the court's process which is invoked to enforce the administrative summons and a court may not permit its process to be abused." *Id.*
- Accordingly, if a taxpayer can establish that the summons was "issued for an improper purpose, such as to harass the taxpayer or to put pressure on him to settle a collateral dispute, or *for any other purpose reflecting on the good faith of the investigation*," the summons should be quashed. *Id.* (emphasis added). "[A]lthough bare assertion or conjecture" by the taxpayer of an abuse of process will not suffice to warrant an evidentiary hearing under *Powell*'s second step, "neither is a fleshed out case demanded: The taxpayer need only make a showing of facts that give rise to a plausible inference of improper motive." *United States v. Clarke*, 573 U.S. 248, 254 (2014).

Puri v. United States, No. 21-55132 *(9th Circuit 2022)*

- Petitioner challenged IRS third party summons to Citibank pursuant to EOI request from India regarding Petitioner, who was under audit by Indian tax authorities. Petitioner filed a motion to quash in district court.
- Under *Powell*, Petitioner argued that the request was not legitimate because she was not a resident of India for tax purposes. The district court rejected the residency argument, finding that the evidence indicated otherwise and, moreover, the EOI requests were not limited only to tax residents of India.
- Petitioner also argued the request was overbroad. The district court found the request was tailored to the years under audit and sought the same types of records the IRS would request if it were conducting the examination.
- With the *Powell* factors satisfied, Petitioner argued improper purpose and focused on the bad faith of the Indian tax authorities: (a) misrepresenting that they had exhausted the means reasonably available to them to obtain the information requested; and (b) seeking 16 years of bank account information.
- The district court rejected all arguments, finding that "the IRS need not establish the good faith of the requesting nation." *Lidas, Inc. v. United States*, 238 F.3d 1076, 1082 (9th Cir. 2001). "So long as the IRS itself acts in good faith, as that term was explicated in [*Powell*], and complies with applicable statutes, it is entitled to enforcement of its summons." *Stuart*, 489 U.S. at 370 (rejecting argument that IRS was required to attest to whether CA tax authorities' investigation had progressed to stage analogous to Justice Department referral in United States); *Mazurek v. United States*, 271 F.3d 226, 230, 231 (5th Cir. 2001) ("It does not follow, simply because Mazurek challenges the FTA's residency determination, that the FTA's investigation is being conducted for an improper purpose."); *United States v. Hiley*, 2007 U.S. Dist. LEXIS 73542, *10 (S.D. Cal. Oct. 2, 2007) (same).
- The Ninth Circuit affirmed.

Zhang v. United States, No. 21-17093 (9th Circuit 2022)

- Petitioners argued that Canada had not secured necessary judicial warrants before making the EOI Request, and that "under Canadian law, when an investigation is of a criminal matter, investigators are not permitted to use administrative 'requirement letters'" (Canadian equivalents of an IRS summons) to collect information in furtherance of such an investigation.
- Petitioners asserted that any resulting enforcement of the summons requested by Canada would be an abuse of the district court's process by essentially turning the court into a conduit for Canada's violation of its own citizens' Charter (*i.e.*, constitutional) rights.
- Petitioners requested that the district court allow limited discovery and hold an evidentiary hearing on these lack of judicial warrant allegations.
- The district court rejected the request, ruling that "it is not the IRS's job to establish Canada's good faith," and it was not the job of the district court "to interpret Canadian law," citing *United States v. Stuart*, 489 U.S. 353 (1989) (the IRS need not inquire into whether a "Canadian tax investigation has not reached a stage analogous to a domestic tax investigation's referral to the Justice Department [for] criminal prosecution" before issuing a summons pursuant to a treaty request). Effectively, the district court held that a requesting foreign government's motives, good faith, and adherence to its own laws are irrelevant to the summons enforcement inquiry, and that Petitioners failed to sufficiently demonstrate a plausible inference of an abuse of process or "improper purpose."
- The district court noted that its focus was on "whether the IRS is acting in good faith," not the motives of the requesting foreign government.
- The Ninth Circuit affirmed, citing its recent decision in *Puri v. United States,* [cite].

Pandora Papers – What's Next?

. . .

U.S. has powerful information collection tools – before ever getting to the treaties

John Doe summonses - See generally 26 U.S.C. § 7609(c)(1), (f)

Taylor Lohmeyer Law Firm P.L.L.C. v. United States, No. 19-50506, 2020 WL 1966844 (5th Cir. Apr. 24, 2020)

Grand jury subpoenas to law firms for their records - ***IN RE GRAND JURY***, No. 21-55085 (9th Cir. 2022)

Thank you!!

Questions?