Exemption from US Estate Tax on the proceeds of certain annuity contracts

IRS rules that annuity proceeds, in specific circumstances, are not deemed to be property situated within the United States and are excluded from Decedent’s gross estate for estate tax purposes

Facts. Decedent’s sibling was a citizen and resident of the United States and owned three annuity contracts. The annuity amounts were to be paid to the sibling during his life, while the decedent was designated as a beneficiary of the three annuities after the sibling’s death.

The sibling died. As a designated beneficiary, the decedent became entitled to receive the entire proceeds of two of the annuities and a percentage of the third annuity.

The decedent was a citizen and resident of country A, where she was living at the time of her sibling’s death and all times thereafter.

At the time of the decedent’s death, she had not yet submitted a claim for or been paid any portion of the annuity proceeds or any of the accrued interest, which were being held by the respective issuing companies.

The decedent had not engaged in a trade or business in the United States.

Under the terms of the decedent’s will, her entire estate was bequeathed to A, who is also a citizen and resident of country A.

Prior to filing the decedent’s nonresident US federal estate tax return, the decedent’s personal representative requested a formal ruling that the annuity proceeds and accrued interest were not subject to US estate tax.

Ruling. In a Private Letter Ruling, the US Internal Revenue Service ruled that proceeds of a US citizen’s annuity contracts—to which the decedent, a nonresident alien, became entitled upon the death of the annuitant as the annuitant’s designated beneficiary—are not considered to be assets situated in the US for the purpose of determining the property to be included in the decedent’s gross estate.

The proceeds of the annuity contracts include interest accrued on the annuities through to the date of the decedent’s death, according to the ruling.

Commentary. Section 2105(a) of the Code expressly excludes “proceeds of life insurance” from US situs property. The ruling, however, did not rely on this exclusion, instead treating the annuities similar to bank deposits and other debt obligations.

**Estate Planning**

Effective use of the trust instrument in estate planning for settlers resident within a civil law jurisdiction

*Colussi v. Investec Trust (Guernsey) et al. [2007] GRC 16/2007*

**Facts.** Giacomo Colussi was a successful Italian businessman, who built his fortune producing and selling various bakery, pasta and rice products in Italy.

In 1996, Mr Colussi set up a trust, known as the Colussi Trust, to hold the bulk of his assets, including his company, worth about $35 million. His daughter Maria Cristina (MC) was excluded as a beneficiary of the trust. In subsequent court proceedings, MC testified that she believed she was excluded because her father was a traditionalist who thought the male line should control his company.

Mr Colussi died in Italy in December 1999. During his lifetime, Mr Colussi had a change of heart and expressed the wish that after his death, his daughter would have a one-sixth interest in the company. He died before arrangements were made to give effect to those wishes. All the adult heirs agreed to give effect to his wishes and undertook various steps to do so.

In June 2001, Mr Colussi's son Angelo (A) established the A & MC Trust. Professor Avv Maurizio Lupoi (of Genoa University) was the first trustee. The Deed of Trust was also executed in Genoa, Italy.

Thereafter, the $5 million share of Mr Colussi's estate owned by his second wife, was acquired by the son and daughter and transferred to the A & MC Trust. Unfortunately, the son and daughter disagreed over a number of matters and their disagreement led to litigation in Guernsey and in Italy.

**Analysis.** Article 6 of the A & MC Trust deed declares the governing law to be the law of Guernsey. The Royal Court of Guernsey has exclusive jurisdiction under Article 10A save that certain matters are to be submitted to the Italian Magistracy, Court of Genoa, under Article 10B.

In March 2002, Professor Lupoi was replaced as trustee by Investec Trust (Guernsey Ltd. Article 10B came under scrutiny with regard to the meaning of "directions to the Trustee". All Counsel agreed that the provisions of Article 10B are somewhat unusual.

It was held that the matters concerning the A & M C Trust raised in the Guernsey proceedings do not amount to "directions to the Trustee". They are therefore not to be referred to Genoa and so are justiciable in Guernsey.

The timeframe within which the proceedings are likely to be concluded is also a relevant factor. MC's Italian lawyer submitted that the process could take eight to ten years to resolve in Italy—allowing for an appeal from any decision of the tribunal in Perugia to the Court of Appeal in Perugia and a further appeal to the Court of Cassation in Rome.

On the evidence, the Court found that the issue is likely to be resolved more quickly in Guernsey than in Perugia.

"The Trustee is a Guernsey company, administering a Guernsey law trust and it is entitled to seek directions from the Guernsey court. It has asked to have the Construction Dispute resolved as soon as possible and that is an important factor in my considerations. Having weighed in the balance all the factors I have been asked to consider, I conclude that the forum in which the Trust Claims can be tried most suitably for the interests of all the parties and the ends of justice is Guernsey."

**Commentary.** This case illustrates to what extent in certain civil law jurisdictions local family advisors and local civil law courts in the client's country may be given an active role in the context of foreign trusts (since the 1985 Hague Convention of the Law Applicable to Trusts and on their Recognition came into force).
WEALTH PRESERVATION

Divorcing spouse unsuccessful in enforcing onshore court order against assets held in offshore trust

*Mubarak v. Mubarak [2008] JRC 136*

**Facts.** Mr Mubarak and his wife are Indian citizens who had been in London for only a few months when Mrs Mubarak issued divorce proceedings. Described as "titanic," this dispute has become the longest running and most bitterly fought divorce case in England.

Mr Mubarak is an international jeweller who had, for tax purposes, transferred various companies that own his jewellery business into a trust established in Jersey.

During a 1999 proceeding, the English divorce court ordered Mr Mubarak to pay his wife over GBP 4 million. Further, the court ordered that if the money was not received within three hours, then jewellery held in a store owned by the Jersey trust would be delivered to Mr Mubarak’s wife.

Mr Mubarak successfully appealed against the delivery of the jewellery, but not against the monetary award. Since the appeal, Mrs Mubarak has sought to enforce the order, at great cost and without success.

**Analysis.** In 2006, Mrs Mubarak, an excluded beneficiary, obtained an order from the English court to alter the terms of the Jersey trust, so as to reinstate her as a beneficiary to the extent of sums owing to her by her husband. She then tried to enforce the order in Jersey.

The Jersey court opposed, concluding that it did not have the jurisdiction to enforce the order, as the Jersey trusts law did not provide any power for the court to alter the terms of the trust.

**Commentary.** This decision reinforced the independence of the Jersey Royal Court, which confirmed that it cannot enforce a decision of a foreign court which purports to alter a trust in terms inconsistent with the trust deed. Mrs. Mubarak ultimately managed to alter the terms of the trust because Mr Mubarak had undertaken, as a precondition to being heard in England, to adhere to whatever order the English court may make.

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CHANGING TRUSTEES

Duties of retiring trustee in relation to transfer of trust administration and assets to incoming trustee

*Re: Caversham Trustees Limited [2008] JRC 65*

**Facts.** Mr Van Dalfsen had established a trust under which he was the principal beneficiary and Caversham Trustees Limited was the trustee. The relationship between Mr Van Dalfsen and Caversham broke down and became unworkable. It was agreed that the trust assets and the administration of the trust would be transferred to a new trustee.

A dispute then arose regarding the fees due to Caversham and the terms of indemnification to which it was entitled. Consequently, the transfer of trusteeship, which would normally take six months, took four years. Legal proceedings were launched and the court was asked to rule on the obligations and duties of the outgoing trustee.

**Ruling.** The court held that, subject only to retaining reasonable security in relation to its fees, an outgoing trustee has a duty to cooperate fully and actively in the transfer of the trusteeship and the transfer of the assets of a trust, and to give effect to the transfer as soon as is reasonably possible. In this case, Caversham acted improperly by trying to exert pressure through the slow pace of the transfer.

In regard to the outgoing trustee’s right to retain reasonable security in relation to its fees, the court found that Caversham exerted improper pressure by retaining control over the whole of the trust assets. Security over the entirety of the trust fund was unreasonable in the circumstances.

**Commentary.** This decision reconfirmed that the trustee’s right to security is a right to “reasonable” security only. The trustee may not take security on the entire trust fund.

When administration of the trust by the trustee is no longer possible, the trustee must—to protect both its own interests and those of the beneficiaries—act diligently to appoint a new trustee or apply to the court for directions.