

Tax Briefs

Levin & Weiser, LLC
Attorneys and Counselors at Law

950 S. Cherry St., Suite 1000
Denver, Colorado 80246
(303) 504-4242
Fax (303) 691-9719
www.lw-law.com

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In this issue:

- **LEAD STORY: Court of Federal Claims Allows Government to Establish Whether Resident Alien Was A United States Domiciliary**
- **Tax Accounting: Newly Proposed Revenue Procedure Allows for the Deferral of Income**
- **Canada Customs and Revenue Agency Issues Reminder Concerning Gifts to Employees**
- **Streamlined Sales and Use Tax Agreement Update**
- **In Summary . . .**
- **Q & A**

● **LEAD STORY: Court of Federal Claims Allows Government to Establish Whether Resident Alien Was A United States Domiciliary**

In a recently issued opinion, the Court of Federal Claims granted the United States government's partial summary judgment motion that now allows the government the opportunity to show that a resident alien intended to be domiciled in the United States at the time of his death, despite the decedent's status as a nonimmigrant alien in the United States. Should the government prevail in a later proceeding, the decedent's entire estate, wherever situated, is subject to the United States federal estate tax.

Dr. Robert Jack ("Dr. Jack") was born in Canada in 1947, and died in Davis, California in 1996. Until October 1992, Dr. Jack resided and was domiciled in Canada where he practiced veterinary medicine. In October 1992, Dr. Jack was offered a two-year employment contract with the University of California in Davis, California, for the period of January 1993, through December 1994. On November 2, 1992, Dr. Jack applied for admission to the United States as a TC class nonimmigrant and obtained TC Temporary Professional Status that allowed him to be admitted to, and remain in, the United States for a period of one year. Dr. Jack moved to the U.S. and assumed his position with the University of California in January 1993.

During December 1993, Dr. Jack obtained an extension of his TC Temporary Professional Visa through December 31, 1994. In December 1994, Dr. Jack obtained Temporary Professional classification available under the North American Free Trade Agreement ("NAFTA"), enabling him to continue his

employment in the United States. In January 1995, Dr. Jack extended his contract with the University of California through November 1996. Due to the contract extension, Dr. Jack obtained an extension of his visa through November 1996. Dr. Jack died in August 1996.

Following his death, Dr. Jack's estate paid United States estate taxes in the amount of \$15,415, based on the value of his gross estate *located in the United States*. Following an audit of the estate tax return, the Internal Revenue Service (the "IRS") assessed an estate tax deficiency of \$80,443, premised on the IRS's determination that Dr. Jack was domiciled in the United States on the date of his death. Therefore, according to the IRS, Dr. Jack's assets located *outside the United States* at the time of his death were also subject to the federal estate tax.

According to the personal representative of Dr. Jack's estate, while living in California, Dr. Jack maintained bank accounts in Canada, continued his affiliations with Canadian professional associations, maintained his license to practice veterinary medicine in Canada, maintained a Canadian driver's license and voter registration, and also maintained a Canadian mailing address.

Generally, under the Internal Revenue Code, the U.S. federal estate tax is imposed upon the value of all property owned by a decedent at the time of death. However, in the event the decedent is nonresident alien of the United States, the estate tax is only imposed upon that portion of the estate that is situated in the United States at the time of death. Unlike the federal income tax, residency for federal estate tax purposes requires a determination of the decedent's domicile at the time of the decedent's death. Therefore, it is possible that a non-citizen of the United States who maintained (and even resided at) a temporary home in the United States at the time of death, will be treated as a non-resident for federal estate tax purposes, if the decedent's domicile was not in the United States at the time of death.

Generally, domicile is established by physical presence in a place with the *intent to remain there*. Once domicile is established in one place, it is presumed to continue until it can be proved that domicile has changed. Generally, the domicile of an individual is his true, fixed and permanent home and place of habitations. It is the place in which, whenever he is absent, he has the intention of returning. Relevant criteria in resolving the question of domicile include where a year-round residence is maintained, voter registration, place of filing tax returns, property ownership, driver's license and car registration, etc.

The government and personal representative of Dr. Jack's estate both filed motions for summary judgment regarding whether an individual holding a temporary professional visa can legally form the intent to be domiciled in the United States, thus subjecting the individual's non-U.S. situs property to the federal estate tax of the United States.

The personal representative of the estate argued that under the terms of Dr. Jack's temporary professional visa, he was required to retain his Canadian domicile, and that the terms of his visa, therefore, prevented his ability to develop the requisite intent to live permanently in the United States. Under the relevant provisions of NAFTA and the regulations promulgated thereunder, aliens admitted into the United States as temporary professionals were to be treated as if seeking classification as nonimmigrants, and were granted entry to the United States without the intent to establish a permanent residence.

The government argued that it is possible that aliens admitted into the United States under valid nonimmigrant visas may develop the subjective intent to remain in the United States indefinitely, even if this is in violation of their visas. Therefore, a domicile in the United States can be established even if that subjective intent violates the terms of a visa. The government cited various Supreme Court cases as proof that temporary visa holders can establish U.S. domiciles in violation of their visas.

The Court of Federal Claims held that although in order to hold a temporary professional visa, Dr. Jack should not have had the intent to establish domicile in the U.S., the government should be allowed

the opportunity to prove that Dr. Jack nevertheless, had the intent to be domiciled in the United States at the time of his death for estate tax purposes.

It should be noted that the United States has treaties in place with many countries concerning the imposition of estate, gift and inheritance taxes on the estates of individuals who at their death may have temporarily resided in one country, but were domiciled in another. These treaties attempt to avoid the double taxation of estates, by defining the appropriate jurisdiction with primary taxing authority. The treaties often define domicile, and in cases in which it can be established that a decedent was domiciled in both treaty countries, there are often “tie-breaking” provisions to establish which country has primary taxing authority.

For example, the estate tax treaty between the United States and Federal Republic of Germany provides that a person is domiciled in the United States if the individual is a citizen or resident thereof, and is domiciled in the Federal Republic of Germany if the person has a “domicile” or “habitual abode” there. If the decedent, under these definitions, is determined to be domiciled in both countries (for example, a citizen of the United States maintained a permanent home in the Federal Republic of Germany) the treaty establishes several “tie-breaking” provisions to narrow domicile down to a single treaty country. These “tie-breaking” provisions focus on the country in which the decedent had permanent homes available, the country with which the decedent’s economic interests were closest, or the location of the decedent’s habitual abode.

The Court of Federal Claims’ decision is not a determination that Dr. Jack was domiciled in the United States, but is merely a decision that the government be allowed to prove its case. Levin and Weiser, LLC will closely follow and report on any future developments in this case.

● **Tax Accounting: Newly Proposed Revenue Procedure Allows for the Deferral of Income**

The IRS has issued a proposed revenue procedure that allows taxpayers to defer from gross income, payments received in one year for services to be performed by the end of the next tax year.

Internal Revenue Code § 451 provides that an item of income should be included in gross income for the taxable year in which it was received by the taxpayer, unless, under the method of accounting used by the taxpayer, the amount is properly included in gross income for a different period. Treasury Regulation § 1.451-1(a) provides that, under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive the income, and the amount can be determined with reasonable accuracy. Events that fix the right to receive income generally occur when (i) the required performance to be provided in exchange for such income has taken place, (ii) payment is due to the taxpayer, or (iii) payment is received by the taxpayer, whichever event occurs first. Under IRC § 446, the Commissioner of Internal Revenue has previously provided that taxpayers using accrual methods of accounting may defer the inclusion of advance payments for services from gross income. The proposed revenue procedure expands the situations in which such a deferral may be made.

The proposed revenue procedure was issued in response to considerable controversy and confusion concerning situations in which it is unclear that advance payments are made in exchange for services, some types of non-service, or some mixture of services and non-services. Advance payments for non-services are not eligible for deferral. In the proposed revenue procedure, the IRS determined that it is appropriate to expand the scope of the deferral rules to include situations in which advance payments are made for certain non-services or mixtures of services and non-services.

The proposed revenue procedure allows taxpayers to defer the inclusion of advance payments in gross income (for tax purposes) to the extent that a deferral is also made for financial reporting purposes.

However, deferral is never allowed beyond the tax year following the year in which such payments are received. In other words, if an advance payment is received in 2002, such payment must be included in gross income by 2003, and cannot be deferred to any tax year beyond 2003.

The proposed revenue procedure defines an advance payment as (i) a payment received in one tax year; (ii) that could be included in gross income for the year of receipt under a permissible method of accounting (without regard to the proposed revenue procedure); (iii) that is included (in whole or in part) in gross income for financial reporting purposes for a subsequent tax year, whether or not the inclusion is contingent upon a future act; and (iv) is solely for specified purposes. Those specified purposes include advance payments received for (a) services; (b) the sale of goods (other than for certain inventoriable goods for which the taxpayer uses a special deferral method of accounting); (c) the use of intellectual property; (d) the occupancy of space if ancillary to the provision of services; (e) guaranty or warranty contracts ancillary to the items in (a) through (d); (f) subscriptions; (g) membership in an organization; and (h) any combination of any of the above. Advance payments eligible for deferral do not include payments for rent, insurance premiums, and payments with respect to financial instruments.

Taxpayers wishing to change to the new accounting method must follow the automatic change in method of accounting provisions established by the IRS.

● **Canada Customs and Revenue Agency Issues Reminder Concerning Gifts to Employees**

The Canada Customs and Revenue Agency has reminded employers about the way in which gifts and awards given to employees are taxed.

To mark special occasions such as Christmas, Hanukkah, birthdays, or a marriage, employers can give employees two non-cash gifts each year on a tax-free basis. Additionally, achievements such as years of services or meeting safety standards, may be rewarded with two non-cash gifts each year on a tax free basis. The total cost of all gifts and awards including any sales or goods and services taxes, may not exceed CA \$500 per year. This policy does not apply to cash or near-cash gifts such as gift certificates or other items that are readily convertible to cash, as such gifts are treated as taxable employee benefits.

Under the United States' Internal Revenue Code, employee gifts are generally subject to taxation, however, nominal gifts that are not readily convertible to cash (i.e., a Thanksgiving turkey) are not reported as income by the employee even though the employer is entitled to deduct the cost as a business expense. Deductions for business gifts are limited to \$25 per recipient per year.

● **Streamlined Sales and Use Tax Agreement Update**

On November 12, 2002, the Streamlined Sales Tax Implementing States ratified their model legislation. State delegates to the streamlining effort will now push the individual states to pass the model legislation. This process actually began on December 11, 2002, during a meeting of the National Conference of State Legislatures' Executive Committee Task Force on State and Local Taxation of Telecommunications and Electronic Commerce (the "Task Force").

The Task Force endorsed the Streamlined Sales and Use Tax Agreement, without objection from any members. A letter will now be sent from the Task Force to the presiding officers of the participating state legislatures asking them to take up the agreement. A goal of ten enacting states of the model legislation has been set. At a January 2001 meeting, the task force had rejected various streamlined sales tax proposals, so the endorsement by the Task Force is seen as significant progress on this matter. Most of the remaining division over the streamlining effort lies within the Republican Party, and centers on a desire not to pay taxes on remote transactions, a belief that the government should not get involved with

the Internet, and the fear that requiring remote vendors to collect taxes will result in more companies moving offshore.

In a related matter, the Multistate Tax Commission responded to paper presented by the Business Roundtable concerning state sales tax nexus. The response discussed the need to update the state sales tax systems to reflect the modern economy and achieve greater clarity, certainty, and equity in state taxation. The response pointed out that nexus is currently defined in terms of physical activity, and looks backward in time towards the industrial age, whereas the modern information age economy is characterized by services, digital products and technology and is not easily defined in terms of physical activities or presence. The Multistate Tax Commission went on the state that physical activity standards discriminate against businesses that are fixed and capital intensive in favor of more mobile businesses. It noted that physical activity standards are also subject to manipulation as currently demonstrated by off-shore holding companies and off-shore reincorporations (*see* Tax Briefs, December 2, 2002).

Tax Briefs and Levin & Weiser, LLC will continue to keep our readers up to date concerning the streamlined sales tax initiative.

● In Summary . . .

Several Bush administration tax and economic policy officials are hinting that a major reform of the corporate income tax code is in the works. This will include a repeal of the FSC Repeal and Extraterritorial Income Exclusion Act. . . . Treasury Assistant Secretary for Tax Policy Pamela F. Olson has acknowledged that the White House may include international tax reforms in its fiscal 2003 budget. Ms. Olson noted that the United States' international tax rules appear outmoded in our ever increasingly global marketplace, and may even be punitive towards United States economic interests. One of the primary villains is the 40 year old subpart F rules, originally designed to tax passive investment income earned by foreign subsidiaries of U.S. companies. Ms. Olson was also critical of the current foreign tax credit regime. (For a review of how some U.S. companies are combating these issues *see* Tax Briefs, December 2, 2002). . . . The Treasury Inspector General for Tax Administration in an October audit of the IRS's Electronic Tax Law Assistance program (the "ETLA Program"), found that the IRS met its goal of providing responses to questions within two business days, in 89% of questions anonymously submitted for consideration. Furthermore, the accuracy rate of those responses was higher than those received via the IRS's walk-in Taxpayer Assistance Center offices. The ETLA Program was created in 1995 to answer taxpayer questions submitted through the IRS's internet site.

Q&A

If you have any questions on any tax matter feel free to write us at info@lw-law.com. We can't answer every question we receive, but if you ask a short question that can be answered concisely, we'll consider it for publication. Remember, questions answered are only intended to provide general information. Consult with your attorney before acting on information you see here.

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