

# United States Trusts for Non-US Families

The United States as a Tax and Regulatory  
Friendly Jurisdiction?  
Not that Hard to Believe

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# Case Study - Representative Family

- ▶ Foreign Family with Substantial Off-Shore Wealth
- ▶ Home Country Safety Concerns Mandate Confidentiality
- ▶ Primary Goal - To find a tax-effective means of transferring wealth to family members w/o exposing family members to risks (tax or otherwise)

# Information Sharing: New Normal

- ▶ FACTA designed to share information regarding ownership of accounts across borders for tax purposes, permitting “home country” to evaluate income and thus tax liability
  - ▶ Currently US and UK international reporting regimes - “US Reportable Accounts” around globe & “CD/OS Reportable Accounts”
  - ▶ Automatic Exchange of Information

# Common Reporting Standard

- ▶ New information sharing treaties applying Common Reporting Standards require exchange of detailed data among more and more jurisdictions
  - ▶ 61 countries (as of June 2015)
  - ▶ But Not United States
  - ▶ Commences 1 January 2016
- ▶ Information Reported = “Consistency” with FATCA information
- ▶ Standards of identification “looser” than FATCA
  - ▶ CRS based on tax residence
  - ▶ Unlike FATCA, does not refer to citizenship
- ▶ Key = “Fully Reciprocal Automatic Exchange System”
  - ▶ No longer requirement of request

# FATCA/CRS Implementation

- ▶ Reportable income:
  - ▶ all types of investment income
  - ▶ account balances and sales proceeds from financial assets that give rise to such income
- ▶ Financial institutions required to report
  - ▶ banks, custodians, brokers, certain collective investment vehicles, trusts and certain insurance companies
- ▶ Reportable accounts include
  - ▶ accounts held by individuals and entities (which includes trusts and foundations), and the requirement to look through passive entities to provide information on reportable

# Multiplicity of CRS Reporting: Same Information/Multiple Countries

- ▶ For account holder/controlling persons that is reportable person with respect to multiple participating countries . . .
  - ▶ The entire account balance or value
  - ▶ the entire amount of income or gross proceeds,
- ▶ “shall” be reported to each participating country.

# Information Sharing By-Product: Safety Exposed

- ▶ CRS data similar in scope to FATCA
  - ▶ Account details
  - ▶ Settlers, beneficiaries personal details
- ▶ Intergovernmental Agreements implementing FATCA or CRS may mean “transparency” but . . .
- ▶ Detailed data may be “lost” or stolen
- ▶ Families exposed to personal safety risks when detailed data of “offshore” financial assets is exchanged

# Usual Planning Solution: Trust or Private Foundation

- ▶ Most foreign families desiring to benefit family members (e.g., children) seek to create structures which make assets available over time.
- ▶ Generally, preferred answer (given numerous issues with various alternatives) is
  - ▶ a trust - a common law entity where trustee manages assets for the benefit of family members; or
  - ▶ A private interest foundation - a civil law entity where the governing body (“council”) manages assets for the benefit of family members.



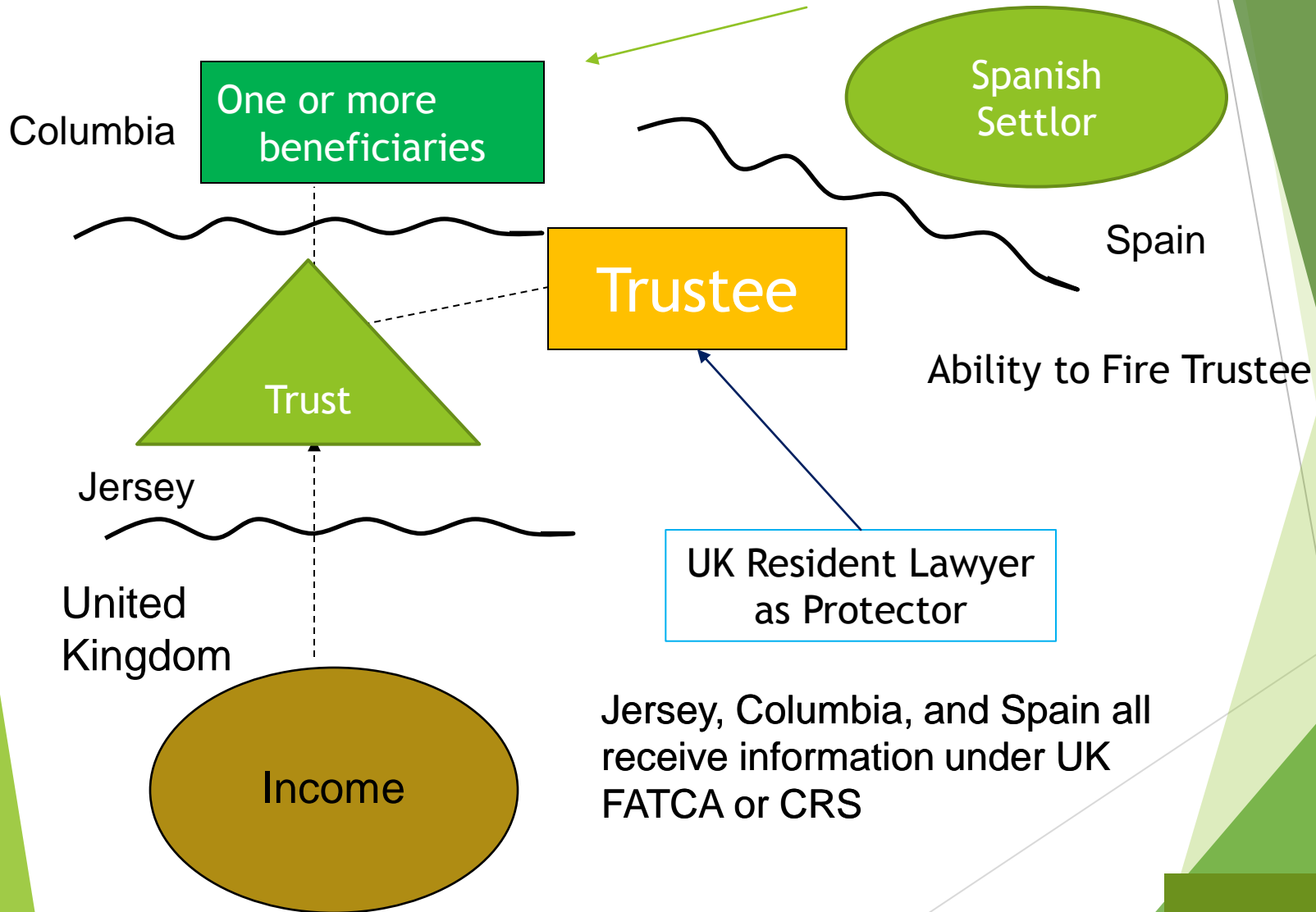
# Trusts/Foundations and FATCA/CRS

- ▶ A non-domestic trust (or more specifically, a “foreign” trust) may be either
  - ▶ a “foreign financial entity” (“FFI”) or
  - ▶ an non-financial foreign entity (“NFFE”)
- ▶ Accounts held by FFIs trusts are non-reportable
- ▶ Accounts held by NFFE trusts are reportable where Controlling Person is “specified”

# “Interest Held by” Controlling Person

- ▶ Natural person exercising “ultimate effective control” - undefined
  - ▶ Controlling Person for NFFE Defined
    - ▶ Natural persons who exercise control
    - ▶ “Means” settlor, trustees, protector, beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control
  - ▶ Expansive Interpretations under CRS
  - ▶ E.g., “Counterparty Country” beneficiaries/ protector causes disclosure of account which may or may not be “tax” relevant

# Jersey Reportable Account



# Where Can We Go?

Back to the Source of Much of  
the Trouble:

The United States

# Why US? High on List of Best Places to Establish Confidential Foothold

- ▶ Strong Attorney-Client Privilege
  - ▶ Lawyers are not permitted to disclose suspicion of crime, unless immediate bodily injury and other very limited circumstances
  - ▶ Contrast UK lawyers: Required to disclose tax fraud that they uncover
- ▶ Limited Know-Your-Customer Rules
  - ▶ Banks only
  - ▶ No lawyers, accountants, private trust companies
- ▶ Tax Reporting for Non-US Persons
  - ▶ Only if have “effectively connected income” or
  - ▶ Insufficient withholding on income taxed on gross basis
    - ▶ I.e., dividends, royalties

# US Automatic Information Sharing

- ▶ US Not a Signatory to Common Reporting Standard
- ▶ Despite Intergovernmental Agreements, FATCA really only one way street
  - ▶ Non-US Financial Institutions report
  - ▶ US Financial Institutions much less so
    - ▶ No reporting for US non-financial “foreign” entities

# FATCA Reporting Limitations

## ▶ Example US-UK IGA

- ▶ “The information to be obtained and exchanged is . . . .

In the case of the United States, with respect to each United Kingdom Reportable Account of each Reporting U.S. Financial Institution:

(1) the name, address, and date of birth of any person that is a resident of the United Kingdom and is an Account Holder of the account;

- ▶ Requires an “Account Holder” that is “resident” of the United Kingdom

# FATCA v. CRS Reporting

- ▶ Thus, no US reporting with respect to UK unless Account Holder is resident in the UK
- ▶ If Domestic Trust considered FFI, its Beneficiaries - Equity Interest Holders -- are Account Holders when Distributed
- ▶ Beneficiaries are not considered “controlling persons” unless exercise ultimate effective control
  - ▶ Contrast CRS where status as beneficiary = status as controlling person
  - ▶ Requirement of ability to control not a factor



# US as a Tax Haven

- ▶ Discriminatory tax system
- ▶ No capital gains tax for NRA's, foreign trusts or entities on U.S. (non-real estate, non-trade or business) investments
- ▶ Relative confidentiality and security of bank & tax information
- ▶ Treaty network; not on any blacklists; badge of legitimacy

# US (Domestic) Trust Law -- Very Sophisticated

- ▶ Each State has its own trust law with nuances among them, leading to state by state competition for most “flexible” solution
  - ▶ Directed trust laws; private trust company laws
  - ▶ Elimination of rule against perpetuities
  - ▶ Short statutes for asset protection trusts
  - ▶ Freedom of testation, no forced heirship
- ▶ Competitive market place for lawyers, accountants, trustees and investment managers
- ▶ Growth of “private trust company” models
- ▶ Flexible U.S. holding structures (particularly LLC’s) and tax election (check- the-box)

# Trust Taxation Principles

- ▶ Trust = partial conduit of income for tax purposes
  - ▶ Either taxed to settlor (grantor) or beneficiaries distributed (or deemed distributed) amounts or
  - ▶ Trust itself (accumulations)
- ▶ Trust may be either “United States person” or “foreign trust”
  - ▶ Any domestic US law Trust without the “right” provisions will be considered a “foreign person” for US income tax purposes
  - ▶ Much more difficult to be “US” trust
  - ▶ Situs of Trustee: US Trustee does not cause trust to be “domestic” for US tax purposes

# When is a Trust a United States Person?

- ▶ Trust must be a Non-Grantor Trust
  - ▶ Otherwise trust is disregarded and income and assets attributed to grantor
- ▶ Court and Control Tests - Must Satisfy Both
- ▶ Court Test: A court within the US must be able to exercise primary jurisdiction over the trust
  - ▶ Safe Harbor - Trust instrument does not direct that administration be offshore, administration conducted in fact onshore, and no automatic migration clause
- ▶ Control Test: US persons must have authority to control all “substantial decisions”

# Control Test - Substantial Decisions

- ▶ US Persons must have authority to “control” all substantial decisions
  - ▶ Power to vote or otherwise make
  - ▶ No non-US person with power to veto
- ▶ All “Substantial Decisions”
  - ▶ Power to determine timing or amount of distribution
  - ▶ Determine beneficiary to whom distributed
  - ▶ Allocation of receipts to capital or income
  - ▶ Power to remove or replace trustee

# When is a Trust a Foreign Person?

- ▶ Whenever it is not a United States person
  - ▶ In other words, if it fails either the court or control test
- ▶ Location of Trustee Does Not Matter
- ▶ Choice of Law Does Not Matter
- ▶ Administration Being Entirely in the United States Does Not Matter
- ▶ Thus . . .
  - ▶ A domestic law US trust with something as simple as a Non-US Protector will be “Foreign”

# Choices for Domestic Law Trust: US Trust or Foreign Trust?

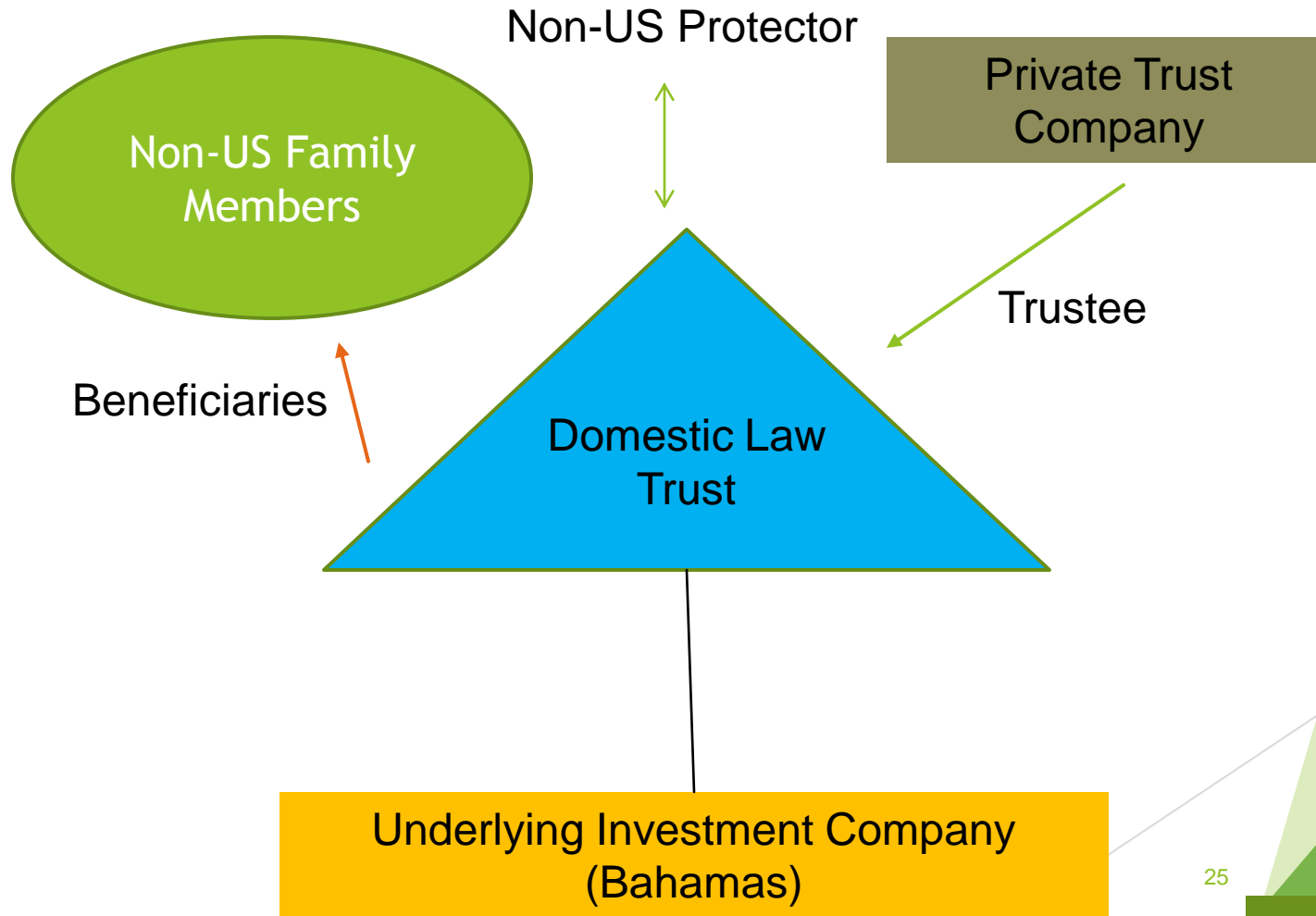
- ▶ US Trust is taxable in its own right on income, unless it distributes that income to beneficiaries.
- ▶ Foreign Trusts taxed similar to Non-resident Aliens
  - ▶ Generally taxable in the US only on US source dividend income. Most other income (capital gains, interest) is exempt
- ▶ Foreign trust thus not cause non-US beneficiaries/settlor to pay US tax on capital gains or most interest payments even though earned or distributed

# Estate Tax Considerations

- ▶ Asset Protection Trusts enable grantor to retain interest without income, estate or inheritance taxation
- ▶ Income-stripping or “domestic-foreign” grantor trusts can thus benefit US as well as foreign persons without exposing settlors or beneficiaries to estate tax
- ▶ Retained powers to manage investments and hire/fire trustee don’t undermine



# Structure Options: Mixed US/Non-US



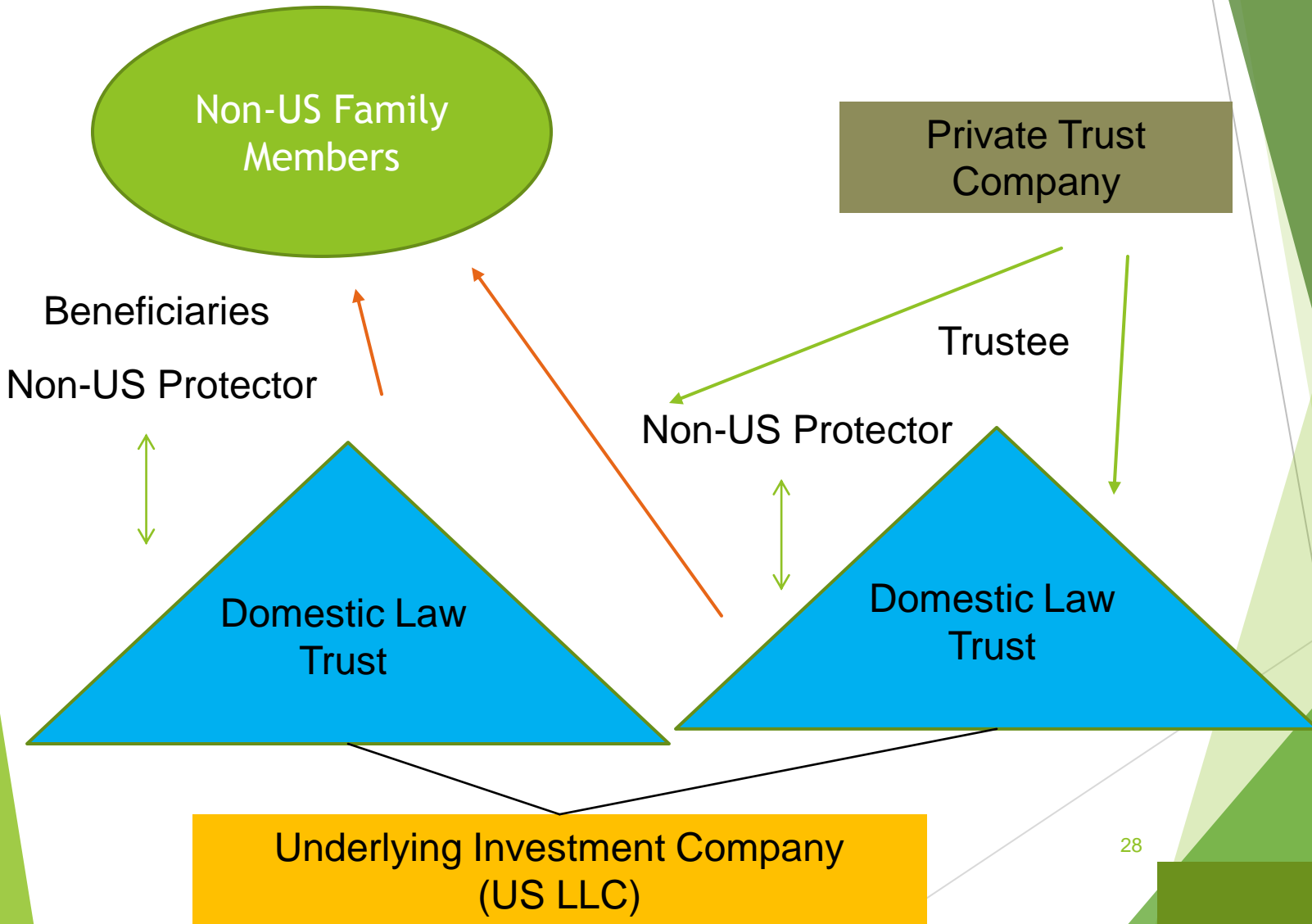
# FATCA Reporting

- ▶ Underlying Company may be FFI or NFFE
  - ▶ If FFI, reports only when distributes to US Specified Person
  - ▶ If NFFE, reports only if US Specified Person is a Controlling Member
- ▶ Domestic Law Trust is not a Specified US Person
  - ▶ Non-US Protector makes it a “Foreign” Trust despite US trustee and administration before US courts
  - ▶ No FFI or NFFE reporting
- ▶ Underlying Company delivers W-8EN-E to non-US financial institutions
  - ▶ Claiming beneficial ownership as non-US person
- ▶ If NFFE, Company delivers W-8BEN-E for Trust as a non-US person
  - ▶ Presumes that trust is a non-grantor complex trust
  - ▶ If trust is a grantor trust, would deliver W-8BEN for grantor (i.e., possibly less desirable than non-grantor trust)
- ▶ If Underlying Company an FFI, no requirement to report its Trust Members under FATCA

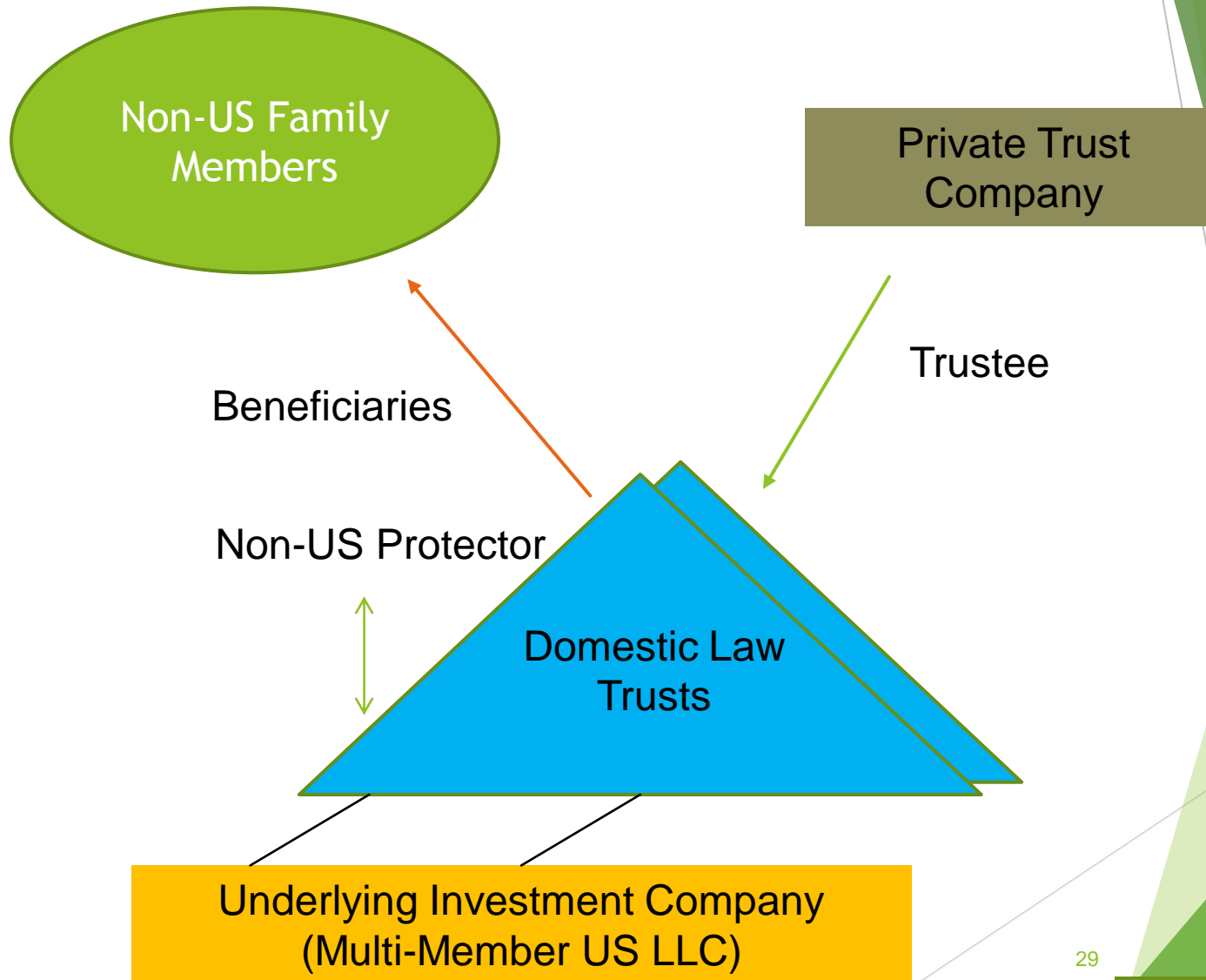
# CRS Reporting: Details Matter

- ▶ Underlying company considered resident in its place of organization
- ▶ Bahamas not a (current) signatory to the CRS
- ▶ No reporting as to the “controlling persons” to their respective home countries
- ▶ However, if underlying company were in BVI, BVI may report to the home country of the trust’s controlling persons since BVI is CRS signatory
- ▶ So, watch out where (a) companies are organized and (b) location of bank accounts

# Structure Options: All US



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# Reporting and Tax Liability Treatment

- ▶ Multi-Member LLC is a partnership for US tax purposes
- ▶ As a partnership, LLC delivers Form W-9 to its financial institutions
  - ▶ No US financial institution will withhold on income of LLC
  - ▶ LLC is responsible for reporting and paying tax on behalf of its Trust members - i.e., LLC becomes “withholding agent”
  - ▶ Since members are non-US trusts for US tax purposes, tax is withheld on gross basis (subject to treaty reduction) of 30% of dividends and royalties. Most interest exempt from withholding (unless related party)
  - ▶ US LLC files partnership tax return in US
- ▶ Trusts file as Non-resident Aliens of the US if insufficient tax withheld at source or income is “effectively connected”<sup>30</sup> (e.g., real estate income)

# FATCA/CRS Reporting

- ▶ No reporting under CRS as US is not a signatory
  - ▶ Banking lobby in US recognizes costs of implementation as well as competitive advantage to being non-signatory.
- ▶ Under FATCA, reporting only for “US financial institutions” (“USFIs”) when all three conditions exists
  - ▶ IGA
  - ▶ Managed by professional trust company and
  - ▶ Holds predominantly financial assets
- ▶ Trusts are non-financial entities when not USFIs
- ▶ Thus easy to avoid reporting as USFI