

United States Trusts for Non-US Families

Considerations In Light of Automatic
Exchange of Information Regulatory
Environments

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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
 - ▶ US and UK international reporting regimes
 - “US Reportable Accounts” around globe & “CD/OS Reportable Accounts”
 - ▶ Automatic Exchange of Information
 - ▶ Withholding requirement for “pass-thru” payments considered “stick” to compliance

Common Reporting Standard

- ▶ AEOI sharing treaties applying Common Reporting Standards require exchange of detailed data among more and more jurisdictions
 - ▶ 98 countries (as of April 2016)
 - ▶ But Not United States
 - ▶ First reporting commences 2017
 - ▶ BVI, Cayman, Spain, Mexico
- ▶ 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 withholding requirement - FATCA’s “stick”

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

Trusts/Foundations and FATCA/CRS

- ▶ A non-domestic-law 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 - at least in participating CRS jurisdictions
- ▶ Accounts held by NFFE trusts are reportable where Controlling Person is “specified”

Reporting for FI Trusts & Foundations under FATCA/CRS

- ▶ FATCA requires reporting for “grantors” and beneficiaries and protectors (but only if they control).
 - ▶ Nuance is that while US Regs specify reporting solely for grantors - where trust considered owned by such person under US tax principles -- IGAs expand to refer to “settlor”
- ▶ CRS requires reporting for settlors, beneficiaries and protectors - without regard to level of control - and other controlling persons.
- ▶ Vested beneficiaries - i.e., those entitled to capital or current income - are considered “Account Holders”
- ▶ Purely discretionary beneficiaries are not considered “Account Holders” until such time as they actually receive a distribution

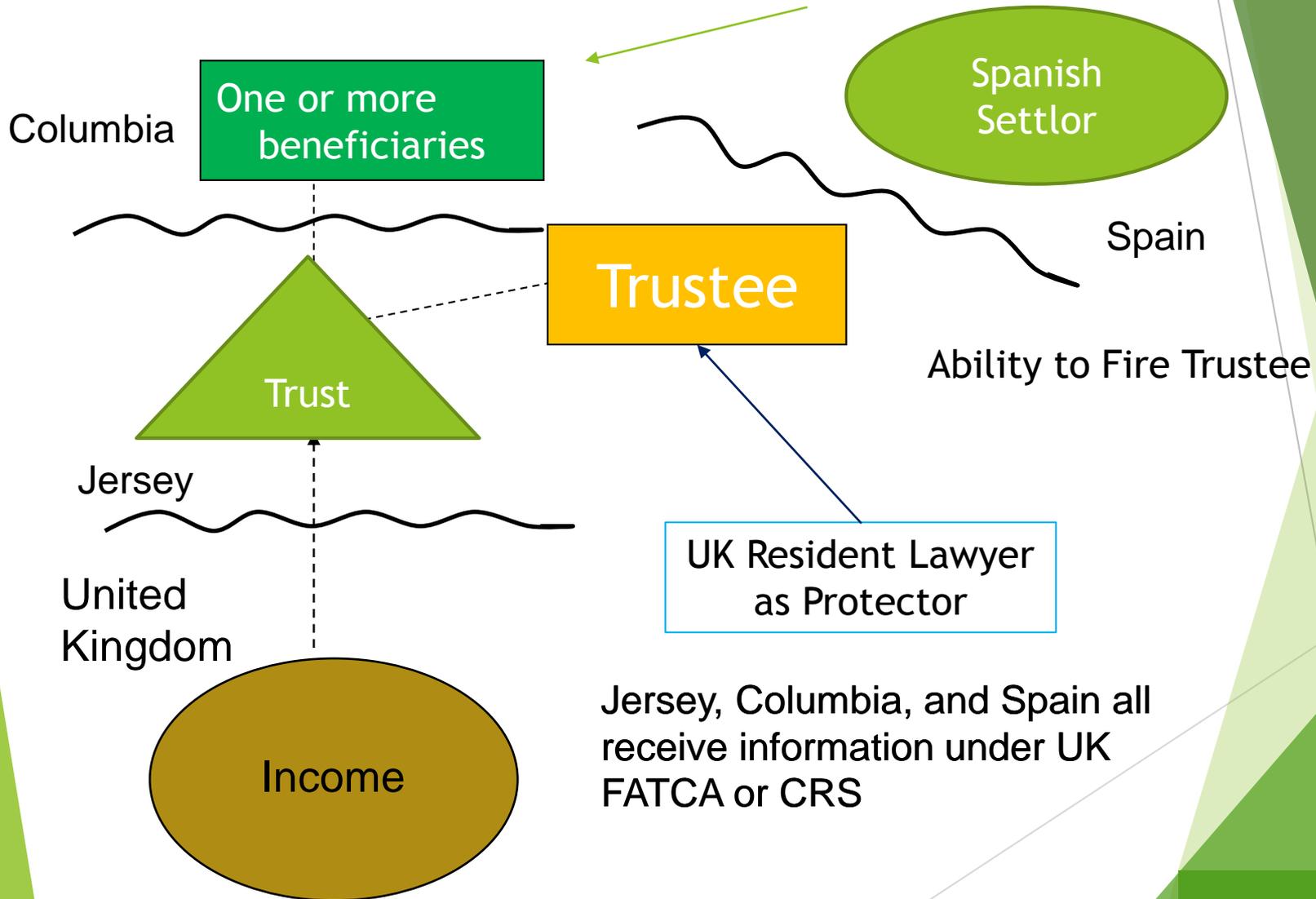
NFE Trusts: “Interest Held by” Controlling Person

- ▶ 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

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.

Jersey Reportable Account



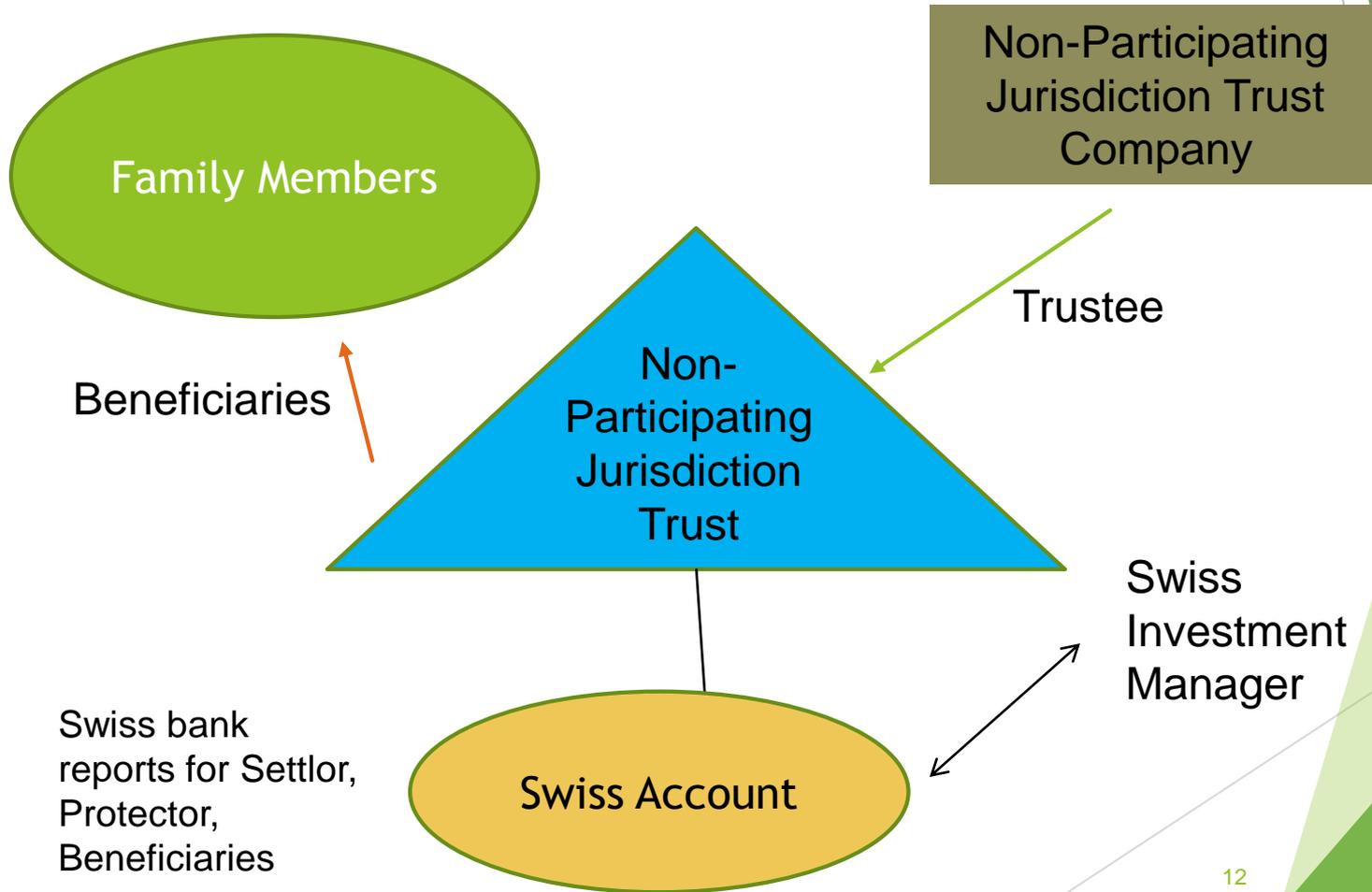
Non-Participating Jurisdictions: Are they Safe havens?

- ▶ Only 98 signatories (thus far) and that is only ½ of 196 countries worldwide
- ▶ So, let's not set up our structures in “participating jurisdictions”?
- ▶ Problem is that, under CRS, an FI in a non-participating jurisdiction (e.g., US) is viewed as a “passive NFE” for which reporting will be required
- ▶ Thus, cannot hide (generally speaking) in non-participating jurisdiction when there is a “jurisdictional nexus” with a participating jurisdiction

CRS Look-Through Rule: Interposed Legal Entities/Arrangements

- ▶ Meanwhile . . .
- ▶ Definition of “Reportable Account” includes accounts held by individuals and entities (which includes trusts and foundations), looking through “passive entities” to provide information on reportable controlling persons
- ▶ Requires financial institutions to look through shell companies, trusts or similar arrangements, including taxable entities to cover situations where a taxpayer seeks to hide the principal but is willing to pay tax on the income.
- ▶ No similar rule under FATCA or any IGA

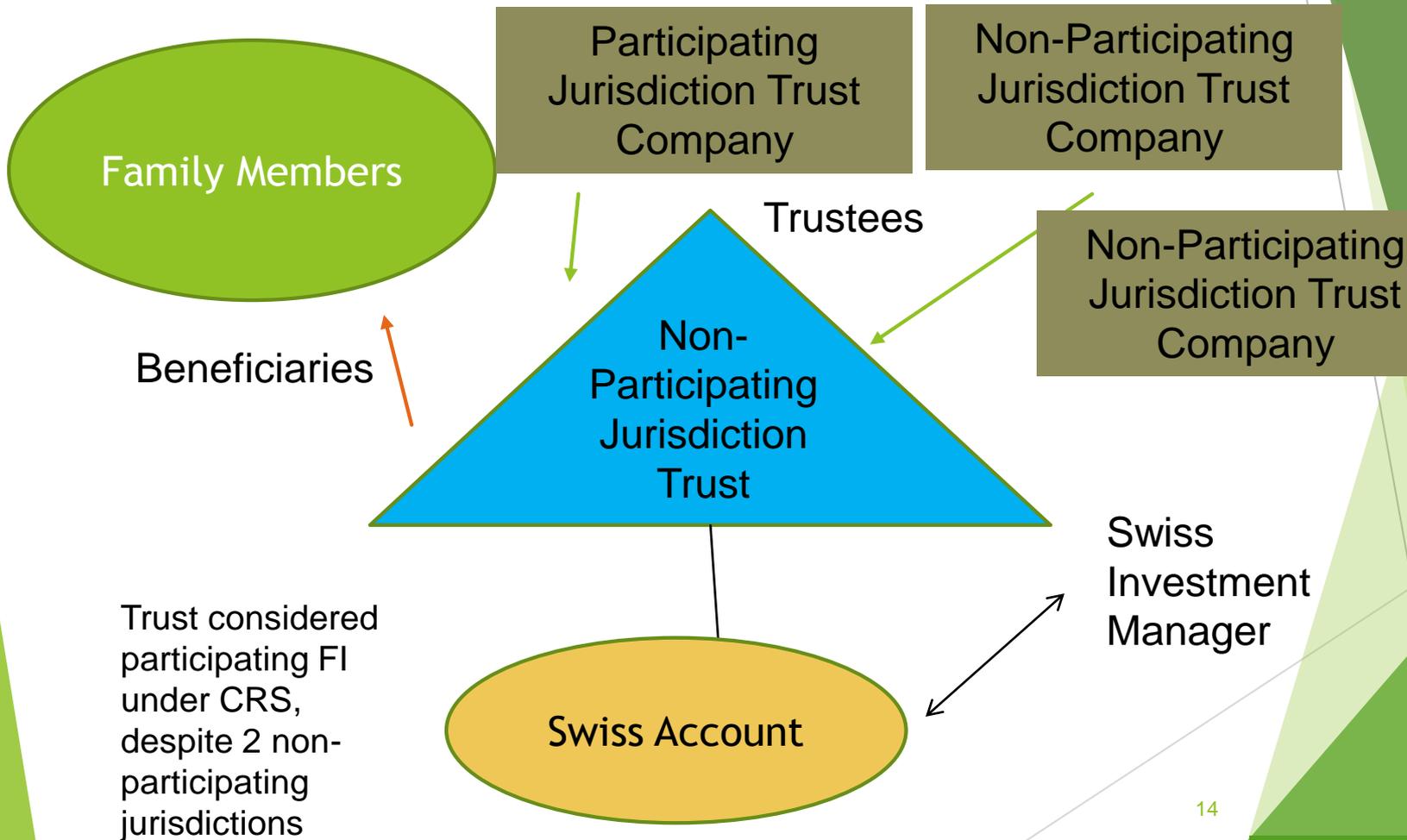
Look-Thru Rule



CRS Expansion of “Participation”

- ▶ Meanwhile . . .
- ▶ If any FI in a participating jurisdiction “manages” an investment entity (e.g., a trust) administered under non-participating jurisdiction, CRS treats FI as “participating”
- ▶ In other words, the “participating FI” manager would be required to report with respect to trust accounts as if trust were resident in its jurisdiction and, then, as an FI.

Participating & Non-Participating FI Trustees



Information Sharing By-Product: Safety Exposed

- ▶ Lots of personal financial data “sloshing around”
 - ▶ 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

Safety Considerations Leading to Search for Alternatives

- ▶ Unfortunate jurisdictions experiencing high rate of kidnapping and extortion
- ▶ Expectation is that bureaucratic regimes in place are insufficient to stop data breaches, including sale of account details and controlling person names to highest bidder
- ▶ Families are seeking solutions - Venezuela, Mexico, Peru, Columbia and elsewhere.

Where Can We Go?

The United States

Why US? High on List of Best Places for Confidentiality

- ▶ 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

FATCA One Way Street: Inbound

- ▶ Despite Intergovernmental Agreements, limited reporting
 - ▶ Non-US Financial Institutions report
 - ▶ US Financial Institutions much less so
 - ▶ Reporting for Account Holders who are resident in Counterparty Country
 - ▶ No reporting for US non-financial “foreign” entities

FATCA v. CRS Reporting

- ▶ No US reporting under FATCA with respect to counterparty country unless Account Holder is “resident” in that counterparty country
- ▶ If US Trust is 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

FATCA Reporting Very Limited For Structures (e.g., Trusts)

- ▶ 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

US Participation in CRS?

- ▶ Treasury and the IRS believe they don't have the regulatory authority to require U.S. financial institutions to collect all the information required under both FATCA and the CRS.
- ▶ Persuading Congress to make the necessary changes to U.S. law doesn't seem like a viable solution in the current political environment
 - ▶ Banking lobby seemingly opposed
 - ▶ No benefit for US banks
- ▶ Election may change landscape but may require Congress controlled by Democratic Party - an unlikely event in the near term

US as Tax “Neutral”

- ▶ 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

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 purpose

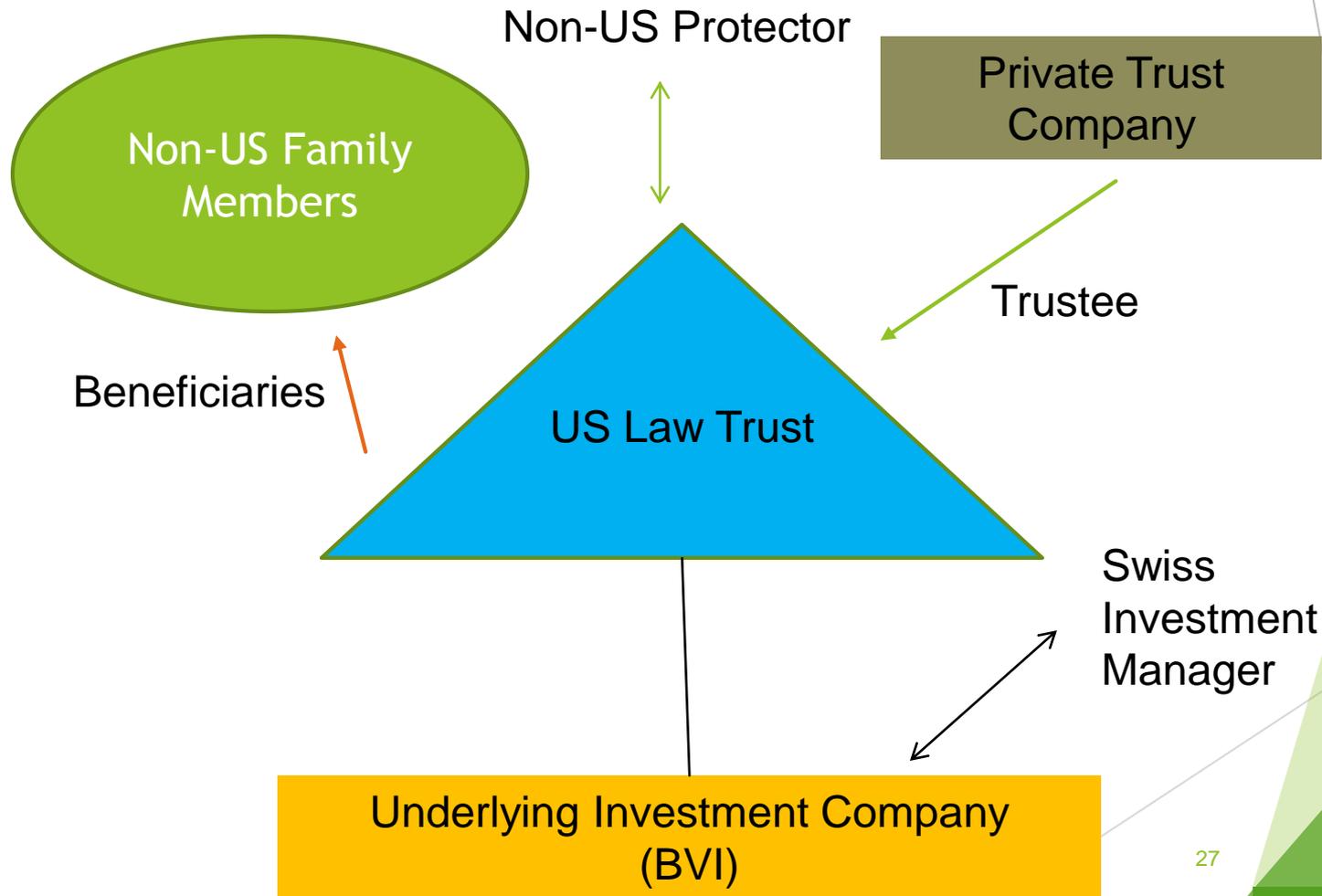
Choices for Trust: US Trust or Foreign Trust?

- ▶ 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

Private Trust Companies Abound

- ▶ Expansion of Private Trust Company (PTC) legislation throughout US States
- ▶ Family may participate and even “control” most/all PTC decisions
 - ▶ Only caveat relates to US tax considerations where US situs assets (estate tax) or US beneficiaries (income tax) involved
- ▶ Fortunately, CRS speaks to PTCs:
 - ▶ PTCs performing administrative (non-financial) functions are not “managing” trusts
 - ▶ Moreover, use of PTC “investment committee” bolsters conclusion
 - ▶ Staff committee with family members or non-professionals

Structure Options: Mixed US/Non-US



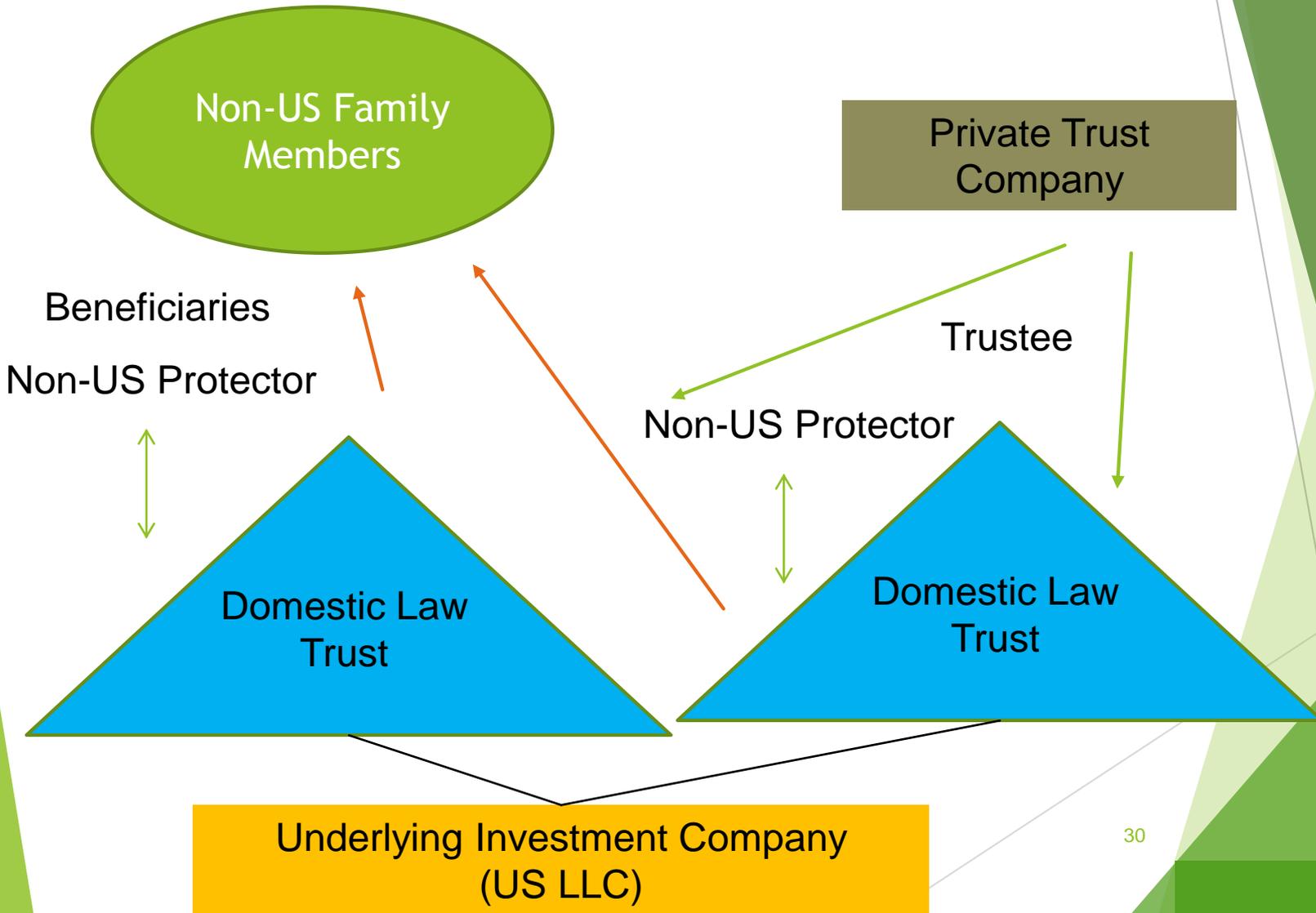
All Clear Here Under FATCA

- ▶ 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

Not So Fast Under CRS

- ▶ Underlying company considered resident in its place of organization - i.e., BVI, a signatory to CRS
- ▶ FIs in Non-Participating Jurisdictions (e.g., US) are treated as participating FIs when they are “managed by” FIs in Participating Jurisdictions - relationship of Swiss adviser important to “managed” question
- ▶ Even if . . . entities (FI or NFE) in non-participating jurisdiction (e.g., US) are automatically viewed as Passive NFE for which reporting is to occur
- ▶ BVI thus reports to the home country of the trust’s controlling persons (assuming that Swiss adviser does not have “discretionary” account control)
- ▶ So, watch out where (a) companies are organized and (b) location of bank accounts
 - ▶ JURISDICTIONS MATTER!

Better Structure: All US



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”³¹ (e.g., real estate income)

CRS Applied?

- ▶ Even though trusts would be considered passive NFEs under CRS for which reporting of Controlling Persons required, there is simply no jurisdictional nexus to CRS.
- ▶ Put differently, US-compliant structure avoids reporting under FATCA and CRS
- ▶ To report would be bad for US banks and business

Additional Concerns with CRS Planning in the United States

Estate Tax Considerations

- ▶ Asset Protection Trusts enable grantor to retain interest without income, estate or inheritance taxation: Must be certain that trust “outside” settlor’s estate, requiring irrevocability.
- ▶ 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

Holistic Estate/Income Tax Planning Alternatives to Irrevocable Trusts

- ▶ Asset protection structure requires that settlor have no retained powers to revest assets
- ▶ Income tax considerations (e.g., 645 election) show ability to revest assets is highly desirable when US beneficiaries involved.
- ▶ Depending on client, more sophisticated planning thus required (e.g., bond portfolio not issue)
- ▶ Forces structure to consider other mechanisms by which “block” for estate tax (or minimize).

Securities Regulation

- ▶ Ability of non-US investment advisers to provide advice - whether discretionary (“managed-by-advice”) or non-discretionary (“NFE-advice”) - may be limited
- ▶ US Securities law (Regulation S) views any US trustee of any trust to be a “US Person”, requiring regulation
- ▶ Definition of “investment advice” very broad
- ▶ Thus, companies “advising” trusts or their beneficiaries must usually register as an “investment adviser” before the US Securities & Exchange Commission

Exemption from Securities Regulation

- ▶ Exemptions exist for banks, state-chartered trust companies and “family offices”
 - ▶ PTC should qualify as a “family office” if acts for trusts within 10 lineal generations of ancestor
 - ▶ Classic “purpose” trust likely not workable. PTC must be owned by family (or trust for benefit of family)
- ▶ Preferred approach for “foreign” advisers is to cooperate with US banks to split fees; back to back arrangements possible

Ethical Considerations: Practitioners Beware!

- ▶ Planners must be especially vigilant -- particularly where secrecy is client goal
- ▶ Must avoid assisting in tax evasion, drug trafficking, terrorism, or use of international asset transfers to launder funds traced to illegal sources
- ▶ Engage in due diligence before accepting clients -- screening so as to avoid participation in activities that may violate planner's ethical or legal obligations.
- ▶ Get home country legal/tax support from jurisdiction in which trust settlor and beneficiaries reside
- ▶ Have clients certify that are tax compliant in home jurisdictions and planning engaged will not change that compliance