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CROSS-BORDER PLANNING:

Planning for Wealth Succession in the Global Context

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NRAs Have Unique Needs

NRA needs may include:

Stability:	Political uncertainty in the client's home country may be causing currency instability.
Safety:	Institutions in the home country may lack sufficient financial strength.
Privacy:	Home country conditions may increase client desire for privacy.
Diversification:	Home country market may not offer sufficient asset diversification.
Access:	Desire access to U.S. markets directly.

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Food Groups

Foreign Source

- US-Based Children
- Pre-Immigration
- Direct Investments

Influx of Foreign Wealth….

- The double-edged marketing: Tax Haven and Secrecy…
  - Common Reporting Standard and Non-U.S. Resident Preferred Income Tax Regime
- The attorney-client privilege – A Comparison (more than tax laws conflict)
  - What's an attorney to do? Whose rules to we follow.
  - My Conflict when practicing in the U.K.
- Different Due Diligence for Lawyers when onboarding clients
  - UK (Passport, source of wealth, PEP, background check)
  - When referring a client to another jurisdiction, you might expose your client
  - How much do you tell the other attorney

Inbound Wealth Transfers Increasing (cont'd)

- Ex. UK resident has a home in Santa Barbara, CA. They have had the home for many years and it's FMV has increased substantially. A U.S. practitioner thinks he's doing the right thing, if he contributes the house into a California trust (can be a Nevada or Delaware trust, also). Several years later he discovers that he may have triggered a tax implication in the UK. He then decides to call a UK solicitor. What is the result?
  - Should have called at the onset, but now there is an issue…..compare attorney-client obligation…
  - What about our Canadian clients? Do we have issues if they have placed U.S.-situated assets in trust at the onset….later?
  - What is Canadian attorney-client privilege?
  - Do UK banks also have a mandated reporting obligation? These risks may not be limited to the attorneys, but to financial institutions, accounts, and others.
- Think foreign laws don't apply to you in the U.S.? Let's look at some examples.

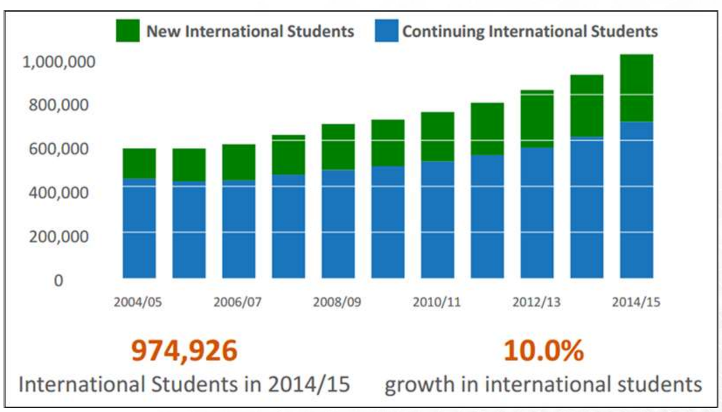
Welcome to America
Inbound Wealth Trends

Our Partnerships….

- The Partnership between attorneys, accountants, and fiduciaries
  - Wearing my fiduciary hat – attorneys can come up with super clever planning, but who's going to administer it?

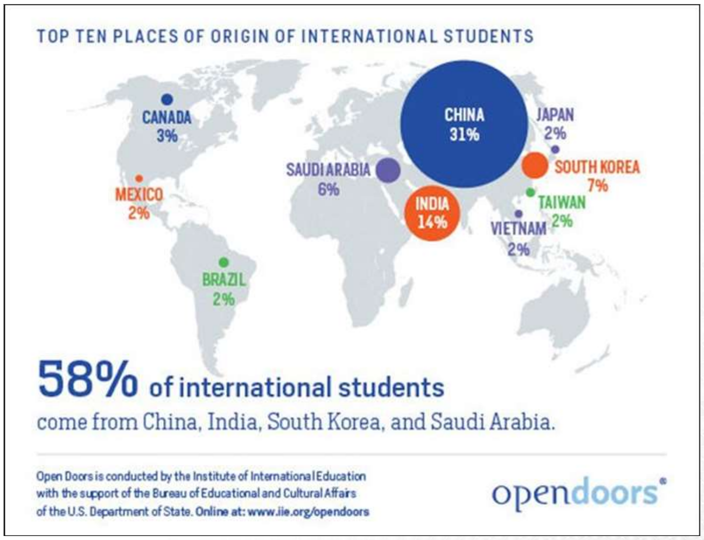
Inbound wealth trends

International student enrollments in the U.S. continue to increase



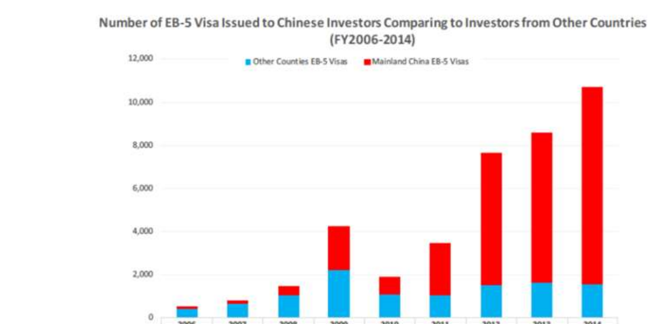
Source: Institute of International Education. (2015). "International Student Enrollment Trends, 1948/49-2014/15." *Open Doors Report on International Educational Exchange.*

Inbound wealth trends (cont'd)



Inbound wealth trends (cont'd)

EB-5 Immigrant Investor Program



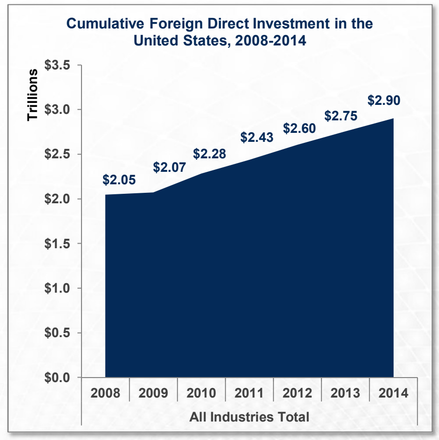
	2006	2007	2008	2009	2010	2011	2012	2013	2014
Mainland China EB-5 Visas	63	110	360	1,979	772	2,408	6,124	6,895	9,128
Other Counties EB-5 Visas	439	683	1,083	2,239	1,113	1,055	1,517	1,669	1,564
Total EB-5 Visas	502	793	1,443	4,218	1,885	3,463	7,641	8,564	10,692
% of Mainland China of Total EB-5 Visas	12.5%	13.9%	24.9%	46.9%	41.0%	69.5%	80.1%	80.5%	85.4%

Data Source: Courtesy of the U.S. Department Of State

Inbound wealth trends (con'td)

Foreign Direct Investment

- Foreign Direct Investment in U.S. businesses, measured on a cumulative stock basis, reached $2.9 trillion at the end of 2014.
- This is equivalent to 16.5% of U.S. GDP.
- European countries lead with a total investment of $1.98 trillion in 2014.



Source: U.S. Bureau of Economic Analysis.

Inbound Wealth Transfers Increasing – WHY?

- Common Reporting Standard
  - Genesis – 2008 FATCA
  - G20 leaders at their meeting in September 2013 fully endorsed the OECD proposal for a truly global model for automatic exchange of tax and financial information. They developed a new single standard for automatic exchange of information.
  - Over 100 Countries are now participants.
  - U.S. has bilateral bespoke agreements
  - The CRS requirements are creeping into the U.S. at a micro and macro level: (Investment products and Industry)
    - Certain hedge funds, private equity funds, product level bank investments…even though contracting with U.S. accounts – must comply with CRS; how does this work technically, for example: Micro level erosion.
    - Real Estate is a prime industry for CRS intrusion at the Macro level.

FinCEN Advisory – Real Estate Industry & CRS

- Fin-2017-A003 – Form 8300 – **Mandatory**
  - FinCEN requires U.S. title insurance companies to identify natural persons behind shell companies used to pay all cash, non-financed for high-end real estate in six major metropolitan areas. FinCEN has found that about 30 percent of the transactions covered by their mandatory Geographic Targeting Orders involve a beneficial owner or purchaser representative that is also the subject of previous suspicious activity reports.
  - The current required mandated reporting locations are all boroughs of NY, Miami-Dade County and the two counties immediately north (Broward and Palm Beach), Los Angeles, San Fran-San Mateo-Santa Clara, San Diego, and San Antonio.

FinCEN Advisory – Real Estate Industry & CRS
(cont'd)

- Persons involved in any real estate transaction are encouraged to report suspicious transactions involving real estate purchases. These persons include real estate brokers, escrow agents, and title insurers. As we know title insurers have to file Form 8300 in the GTO areas. But, others are encouraged to file. Lenders are part of a financial institution mandated to file SARS.
- Certain covered financial institutions are required to file suspicious activity reports if they know, suspect, or have reason to suspect a transaction. (*e.g.*, banks, lenders, financial services)
- What about the Bank Secrecy Act for financial institutions? How is this reconciled.

FinCEN Advisory – Real Estate Industry & CRS
(cont'd)

- A safe harbor for liability exists with respect to the filing of suspicious activity reports, including voluntary ones, by persons involved in real estate closings and settlements.
- Real estate transactions have certain characteristics that make them vulnerable to abuse by illicit actors seeking to launder criminal proceeds. Many real estate transactions involve high-value assets, opaque entities, and processes that can limit transparency because of their complexity and diversity.
- If egregious enough, the professional could be deemed complicit.

What is Suspicious Activity?

- Lacks economic sense or has no apparent lawful business purpose. Suspicious activity is a transaction that generates little to no revenue or are conducted with no regard to high fees or monetary penalties;
- Touch and go transaction with no explanation;
- Is used to purchase assets with no regard for the asset's or properties condition, location, assessed value, or sale price;
- Involves funding that far exceeds the purchaser's wealth, comes from an unknown origin, or is from or goes to unrelated individuals or companies; or
- Is deliberately conducted in an irregular manner. Illicit actors may attempt to purchase property under an unrelated individual's or company's name or ask for records (e.g., assessed values) to be altered.

The Success of FinCEN's RE GTO

- In a recent study, over 30 percent of U.S. real estate transactions reported under FINCEN's Geographic Targeting Orders ("GTOs") involved a beneficial owner or purchaser representative that had been the subject of unrelated Suspicious Activity Reports ("SARs") filed by U.S. financial institutions. In other words, the beneficial owners or purchasers representatives in a significant portion of transactions reported under a GTO had been previously connected to a wide array of suspicious activity including:
- A beneficial owner suspected of being connected to over $140 million in suspicious financial activity since 2009 and who sought to disguise true ownership of related accounts;
- Two beneficial owners (husband and wife") involved in a $6 million purchase of two condominiums were named in nine SARs filed from 2013-2016 in connection with allegations of corruption and bribery associated with South American government contracts;
- A beneficial owner suspected of being connected to a network of individuals and shell companies that received over $6 million in wire transfers with no clear business purpose from entities in South America. Much of these funds were used for payments to various real estate related businesses.

AML/KYC – All Financial Institutions/ Possible Attorneys

- In and Out—financial statements
- Politically-exposed Persons – Enhanced Due Diligence by Statute
  - Definition varies between jurisdictions
  - Watch out for directors and other senior employees of state owned companies
  - In response to the FIFA scandal Switzerland has included senior employees of world sport governing bodies
  - Local Mayor in Chinese province: 45K year
  - Bizarrely the UK has only just redefined PEPs as including domestic UK politicians!

AML/KYC – All Financial Institutions (cont'd)

- Source of Funds
- Narrative of Family Wealth – (my story…Cookie Factory)
- Passport
- Family Tree
- Personal Data of officers, directors, and trustees
- Organizational documents
- New regulations to drill down to ultimate beneficial owners, getting all personal documentation for officers and directors of the foreign entities…

Anti-money Laundering and From the Attorney Perspective

- Lack of such requirements for attorneys in the US….
- Different Due Diligence for Lawyers when onboarding clients
  - UK (Passport, source of wealth, PEP, background)
  - When referring a client to another jurisdiction, you might expose your client
  - How much do you tell the other attorney;
- EU 4th Anti-Money Laundering Directive:
  - Application to the "Regulated Sector"
  - Implementation into national laws in the EU – "gold plating" for example in the UK one regulated advisor may not rely on another's due diligence and KYC even if from a FATF "equivalence jurisdiction"
  - The requirements to conduct client due diligence
  - Beneficial ownership registers including trusts

The intimate relationship among attorneys, accountants, and fiduciaries

- AML/KYC should be vetted by ALL ADVISORS – to what extent should an advisor or institution be allowed to rely on another's due diligence and KYC documents?
- Attorneys and Accountants…fiduciaries and financial institutions have to vet the organizational documents, creation of wealth, and paper/money trail, as well as drill down to all beneficial owners
- Fiduciaries may have the last word! (Waste of Super Clever Planning!) – Who's going to administer the plan…
- But, warning to Financial Institutions and U.S. practitioners: Marketing our NRA tax efficient investment platform and Common Reporting Standard status may invite further regulation and scrutiny.
- ABA Guidelines…

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Inbound Wealth Transfers Increasing (cont'd)

- Preferred Income Tax Regime
  - NRAs can avail themselves of a U.S. tax efficient portfolio with certain banks with an NRA investment platform.
  - Legitimate planning for each Food Group:
    - U.S.-based child
    - Pre-immigration
    - Direct Investments
    - Caution: Careful not to set up structures in the U.S. that may violate certain home country laws. What do we do if we know that? How would we know?
    - We may need to get counsel from the client's home jurisdiction in order to structure investments and real estate purchases, etc. in the U.S. (Careful!)

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Application of Foreign Law on U.S. Court

Facts of:

Pasquantino v. United States, 544 U.S. 349 (2005)

Carl J. Pasquantino, David B. Pasquantino, and Arthur Hilts smuggled large quantities of liquor from the United States into Canada to evade CANADA's strict heavy alcohol import taxes. A U.S. federal district court "convicted them for violating the U.S. federal wire fraud statute, which prohibits the use of interstate wires for "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses. The Fourth Circuit affirmed their convictions, rejecting the petitioners' argument that they could not be prosecuted in the U.S. because of the common law revenue, which rule barred courts from enforcing foreign tax laws….

My question to you: Did a plot to defraud a foreign government of tax revenue violate the federal wire fraud statute…wonder what the U.S. Supreme Court said?

The UK Criminal Finances Act 2017

A criminal measure makes companies criminally liable for failing to prevent their employees from engaging in tax evasion.

Relevance: Attorneys, CPAs, financial institutions worldwide who may have the slightest nexus with the UK

We are going to examine other laws like this as we go through our planning review, but suffice to say, since we seems incapable of regulating ourselves, the European Union has decided they will do it for us….with harsh criminal penalties…

Effective September 30, 2017 – Two Corporate Criminal Offenses

- An associated person (employee or agent or referral partner)
- Of a relevant body (a company with even the slightest nexus to the UK)
- Fails to prevent the facilitation of tax evasion.
- Legal Tax avoidance will not trigger liability.
- Affirmative Defense: Adoption of reasonable prevention procedures.
- Definitions are broadly defined.

Disclosure of Aggressive Transactions

The EU's mandated Disclosure of Aggressive Transactions applies to any transaction that seeks to minimize tax.

Compare:

U.S. persons have the absolute right to use any legal structure to minimize tax and have the right to privacy with regard to their structures.

All enterprises and investors with any EU nexus should be aware, that the disclosure requirements will apply to all "intermediaries" and possibly their clients involved in cross border tax arrangements. This could range from third-party service providers, tax advisors, in-house tax counsel, local directors, and other in-house representatives involved in any such arrangement.

Intermediaries (EU and those with an EU nexus…possible includes your client) will have to report any cross-border tax planning arrangement that they design or promote if it bears ***any of the features or hallmarks listed in the Directive.***

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Hallmarks

- Category A
  - Generic tax planning hallmarks: (i) confidentiality agreements imposed on clients; (ii) contingent fee arrangements; (iii) the use of standardized documentation.
- Category B
  - Specific hallmarks related to the nature of the transaction: (i) planning the use of losses; (ii) conversion of income into an item that benefits from more favorable (or no) taxation; and (iii) circular transactions resulting in the round-tripping of funds which yield a net tax benefits…no real purposes other than tax…step transaction.
- Category C
  - Transactions (i) involving payments to stateless entities, to low/no tax jurisdictions, to non-cooperative jurisdictions and to taxpayers benefiting from exemptions or preferential regimes (the U.S.?); and (ii) a wide range of hybrid/dual deduction/double relief transactions.
- Category D
  - Transactions that are by their nature intended to circumvent transparency rules (e.g., frustrating application of CRS rules)
- Category E
  - Transfer pricing/restructuring with 50% decline in revenues. .

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And the Moral of the Story is………………………………………..

Scenarios to demonstrate the difference between Inbound and Outbound Planning and the treatment of trusts in different jurisdictions: The "why" of understanding trusts in the cross-border context.

Outbound

- The California Revocable Trust Migration Story.
- Gifting to UK-based children through U.S. gift trusts.
- Trust planning with California community property.
- Gifting to Israeli-based children through U.S. gift trusts: Example to follow.

Inbound

- The California Revocable Trust for the Non-Resident, Non-Domiciled individual's inbound activities. (Inbound)
  - United Kingdom individuals, discussed above
  - Canadian residents, similar issues

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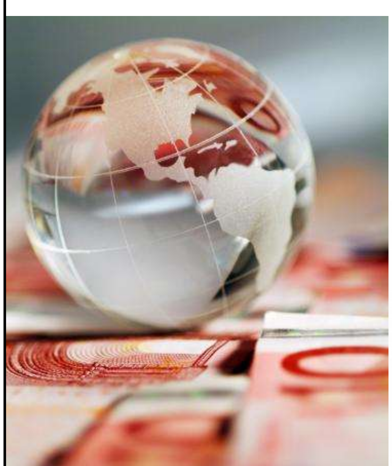
Current Client Issues with trusts…



Mom
U.S. and Israeli Resident

Dad
Israeli

Most desires to set up U.S./DE Gift Trust for her Children (U.S. and Israeli)

What are the issues? Trusts are not always the answer……

- Israel taxes income generated in foreign trusts with an Israeli resident beneficiary
- This income already taxed in the US as a grantor trust;
- What is income?
- Can we get a foreign tax credit?
- Israel, the UK, Canada, France, South Africa – pose particular issues with trusts
  - These require special considerations

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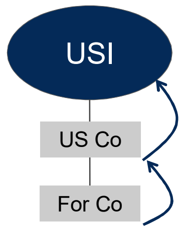
U.S. Income Tax Fundamentals

Key Considerations

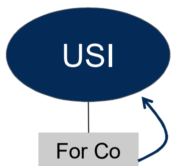
- The U.S. income tax and NRAs.
- The U.S. transfer tax and non-U.S. domiciled individuals.
- Planning to minimize U.S. income and transfer tax for cross border.

GILTI Comparative Examples



Domestic net income	0
Tested income	1,150
Foreign income taxes	0
Adjusted basis of QBAI	1,500

Effective Tax Rate 30.8%



Effective Tax Rate 40.8%

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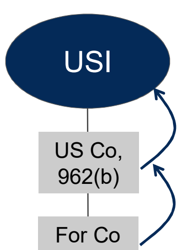
GILTI Comparative Examples:



Domestic net income	0
Tested income	1,150
Foreign income taxes	0
Adjusted basis of QBAI	1,500

Effective Tax Rate - w/ 250 (50) ded 33%

Effective Tax Rate - w/o (50%) 250 ded 39.9%

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Comparative Examples – GILTI – Summary of Results

		Case 1	Case 1A	Case 1B	Case 2	Case 2A	Case 2B
	Combine Effective Tax Rate at various levels	USI USCo ForCo Foreign Tax = 0	USI ForCo Foreign Tax = 0	USI USCo ForCo Foreign Tax = 0	USI USCo ForCo Foreign Tax = 23.9%	USI ForCo Foreign Tax = 23.9%	USI USCo ForCo Foreign Tax = 23.9%
1	ForCo	**0**	**0**	**0**	**23.9%**	**23.9%**	**23.9%**
2 3	Intermediate Shareholder	105/1,150 = **10.5%**	**+ 40.8%**	With W/O $250 $250 **10.5% 21%**	275/1150 = **23.9%**	**+ 55%**	With W/O $250 $250 **23.9% 23.9%**
	Ultimate Shareholder	**+ 30.8%**	**+ 40.8%**	With W/O $250*+ 250*+ **33% 39.9%**	**+ 42%**	**+ 55%**	With W/O $250*+ $250*+ **44.2% 44.2%**

* Assumes qualified dividend rate available for distribution from fictional domestic C corporation
\+ Assumes qualified dividend rate not available for distribution from ForCo.

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Changes To Subpart F

Inclusions by U.S. Shareholder of a CFC under §951(a)(1) require only that the CFC be a CFC at any time (not 30 consecutive days) during the taxable year of the CFC.

PL 115-97, §14215(a) §951(a)(1)

This rule has affected certain tax planning for Inbound transactions where foreign persons have US-based beneficiaries…..GILTI or Subpart F inclusion…need to plan for this…..

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NRA Tax Fundamentals

Benefits to NRA Preferred Tax Regime…

- Taxes are a real and substantial cost of earning income.
- By minimizing or perhaps eliminating U.S. tax, foreign investors will improve their overall after-tax yield of securities, professionally-managed funds, and other investments held in their global portfolios.
- NRAs enjoy a preferred tax regime!

The NRA Preferred Income Tax Regime

Benefits, examples…

- Capital gains, long term and short term, generally escape U.S. income tax under general international tax principles as well as under relevant treaties.
- Capital Gain related to the sale of U.S. real estate does not. U.S. real estate is tax at 10% of the total amount realized under FIRPTA. But, there is a way to mitigate this. New FIRPTA rates became effective February 2017, so different rates apply depending on the value of the real estate.
- Tax treaties often reduce or eliminate U.S. tax on dividend payments, interests payments, and other income for residents in such other contracting jurisdiction. Withholding can be reduced to 5% in some cases.

Tests: "U.S. Person" subject to WW Income

How to determine if a client is a U.S. person for U.S. income tax purposes…

- Client is a U.S. citizen.
- Client has a Green Card.
- Client meets the Substantial Presence Test, and no exceptions apply.
- Client makes an election to be treated as a U.S. person for tax purposes. I'll be discussing a specific example for this point later…..this may be a pre-immigration strategy.
- Eb5 Visas are essentially green card. This may surprise people who wish to come to the US, and those who decide to leave after a certain amount of time. They may have triggered the expatriation rules.

Fundamentals – Tests for U.S. Person Status

- The Green Card Test…

If client awarded U.S. Resident Alien status by the U.S. Citizenship and Immigration Service…

↓

Considered a U.S. resident for income tax purposes…

↓

Therefore, subject to income tax on ***worldwide*** income.

Fundamentals – Tests for U.S. Person Status

The Substantial Presence Test…

- Individuals physically present in the U.S. for at least:

1. 31 days during the current year

AND

2. 183 days during the 3-year period including the current year and the 2-years immediately prior, counting:
   - All days present in current year
   - 1/3 of days present in 1st year prior
   - 1/6 of days present in 2nd year prior

Fundamentals – Tests for U.S. Person Status

The Substantial Presence Test…

- For example, if an individual is present in the U.S. for 300 days in year one, 195 days in year two and only 70 days in year three (the current year), she would still have substantial presence in the U.S. in year three since the weighted average for the three-year period exceeds 183 days.

Year	Days	Applicable Factor	Total
Year 1	300	1/6	50
Year 2	195	1/3	65
Year 3 (Current Year)	70	All days	70
Weighted Average			185 (exceeds 183)

Non-U.S. Resident Example

Exceptions…

- Diplomats, students, teachers, athletes, and employees of international organizations.
- Medical conditions, not a pre-existing illness or injury
- Closer connections.
- Sometimes individuals who have applied for a green card.
- Important to include citizenship on a questionnaire or checklist.
- ****Look to the Treaty for Tie-Breaker options…..with a green card…

U.S. Categories of Income and gains – NRA relevant

Generally, there are four categories of income recognized for U.S. tax purposes. Each category is affected by its own set of rules. There are:

- Foreign-sourced income;
- Effectively Connected Income (ECI): Income effectively connected with a U.S. trade or business, as defined;
- Non-ECI: Income not effectively connected with a U.S. trade or business (FDAP income – interests, dividends, rents, royalties, etc.); with important exceptions (capital gain, bond interest, portfolio debt interest, bank deposit interest)
- Gains from sale and/or income earned from U.S. real estate, or its equivalent.

U.S. Categories of Income

Foreign-Sourced Income – NRAs are not subject to U.S. income taxes on foreign sources of income, including:

- Offshore mutual funds,
- Offshore ETFs,
- ADRs,
- Foreign bonds,
- Other income sources located outside the U.S., and
- Certain income sources located in the U.S., but deemed non-U.S. source by statute or relevant tax treaty.** (Non-ECI assets – again capital gains, bond interest, bank deposit interest, portfolio debt interest.)

U.S. Categories of Income – US-Sourced Income

Effectively Connected Income – NRAs are taxed on income that is Effectively Connected Income, as follows: The Basics –

- NRA engages in a U.S. trade or business.
- You are considered to be engaged in a U.S. trade or business if you perform personal services in the U.S.
- Please see Publication 519, U.S. Tax Guide for Aliens for more discussion on what is a U.S. Trade or Business as defined in the IRC.
- NRAs file U.S. income tax returns and pay the same marginal tax rates as U.S. citizens. (ECI)
- However, in order to get relevant deductions, it is important to file timely U.S. income tax returns. (For example, real estate operating as a business versus passive holding.)
- Election….very helpful in some instances.

U.S. Categories of Income — US-Sourced Income

Not Effectively Connected Income (non-ECI) – NRAs are taxed as follows on non-ECI income:

- Income **not** effectively connected with a US trade or business
- Taxed at 30% tax rate or lower treaty rate (15%, 5%, or 0%).
- Includes other U.S. source income, such as insurance premiums, dividends, rents, annuities, salaries, wages and other compensation, royalties, and certain other returns from intellectual property. (FDAP Income)
- Excludes capital gains (long term and **short term**) and interest from debt instruments satisfying "portfolio interest" definition.

U.S. Categories of Income – U.S.-Sourced Income

Specific rules for U.S. Real Property, U.S. Real Estate Gains and Income…

Interest/Dividend from ownership:

- Rental income, mineral, oil and gas rights. (FDAP Income)
- Subject to 30% withholding or lower treaty rate if applicable, unless election made.

Gains from sale of U.S. real estate: Estate Tax Issues…

- NRAs taxed under FIRPTA. (New FIRPTA Effective 2-17-2016)
  - REITS – More attractive now for foreign investors…foreign individuals can hold more stock in their REIT and foreign pension funds can now invest.
  - 15%, more than $1 million on amount realized.
  - 0%, less than $300,000
  - 10%, $300k and $1 million, on amount realized

The Foreign Investor in U.S. Real Estate – no U.S. Beneficiaries

A foreign investor could receive a 40% reduction in the U.S. income and gains from U.S. Real Property.

Taxes on U.S. real estate will now be lowered to tax rates of 21% for corporations, both foreign and domestic. Plus:

- Accelerated depreciation
- Carry forward of business interest expenses
- A foreign holding company will establish several U.S. corporations as 100% owned subsidiaries. FHC has to be careful.
- If the foreign company holds the U.S. real estate directly, then there is a second layer of tax. But,
- The sale of real estate is reduced to 21%, unless the branch profits tax is applicable.
- The ultimate liquidation and distribution to the foreign person is tax free.
- Investing through a pass-thru is still good because of the 20% deduction, but no blocker.

Definition of a Trust – in the world of global relationships

Modern Cross-Border Mobility Scenarios

It is increasingly common for families to have cross-border circumstances that give rise to a multitude of U.S. income, gift, estate and generation-skipping transfer tax consequences, particularly when trusts are involved.

Incoming Trusts and Distributions into the U.S.

- Parents are citizens and residents of Mexico. They would like to make a substantial gift in trust for the benefit of their daughter, a Mexican citizen residing in the United States.
- **If parents establish an irrevocable gift trust in the United States, will U.S. gift taxes apply and will the trust be subject to future estate or generation-skipping transfer taxes? How will the trust be taxed for U.S. income tax purposes?**

- Many years ago, grandparents in Europe established overseas trusts for the benefit of their grandchildren with a foreign trustee.
- Grandchildren are U.S. citizens and residents. Now that the oldest grandchild is 21 he will receive a distribution from the trust.
- **How will a distribution from a foreign trust to a U.S. beneficiary be taxed?**
  - Would this be different if the trust were originally set up for the grandparents' children?

Resident's Trusts and Transfers

- Husband is a U.S. citizen and resident and wife is a citizen of the United Kingdom who is resident in the United States (wife moved to the United States when the couple married a few years ago).
- They intend to retire in the United Kingdom and have assets in both the United States and the United Kingdom.
- **Will there be any U.S. gift taxes if they transfer property between themselves? What about transfers in trust during life or at death?**

Concepts To Keep In Mind Regarding Inbound Planning

- **For this presentation we will use the following terminology.**
  - A person who creates a trust is the "settlor".
  - The settlor of a trust who is treated as the owner of the trust under the *U.S. income tax rules* is the "grantor".
  - A person is "foreign" if they are neither a citizen nor a resident of the United States (although the determination of whether a person is a resident differs depending on the type of tax in question – which is beyond the scope of this presentation).

Initial Classifications

What is a Trust for U.S. tax purposes?

Lichtenstein Foundation
Stiftung
Usufruct
Treuhand
Establishment
Investment Trust
Business Trust

Are these all Trusts?

Initial Classifications

Ordinary Trusts – 301.7701-4(a)

In general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually the beneficiaries of such a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under the Internal Revenue Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Initial Classifications

Business Trusts – 301.7701-4(b)

There are other arrangements which are known as trusts because the legal title to property is conveyed to trustees for the benefit of beneficiaries, but which are not classified as trusts for purposes of the Internal Revenue Code because they are not simply arrangements to protect or conserve the property for the beneficiaries. These trusts, which are often known as business or commercial trusts, generally are created by the beneficiaries simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships under the Internal Revenue Code. However, the fact that the corpus of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association or partnership. The fact that any organization is technically cast in the trust form, by conveying title to property to trustees for the benefit of persons designated as beneficiaries, will not change the real character of the organization if the organization is more properly classified as a business entity under Section 301.7701-2.

Initial Classifications

Investment Trusts – 301.7701-4(c)(1)

An "investment" trust will not be classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders. See Commissioner v. North American Bond Trust, 122 F. 2d 545 (2d Cir. 1941), cert. denied, 314 U.S. 701 (1942). An investment trust with a single class of ownership interests, representing undivided beneficial interests in the assets of the trust, will be classified as a trust if there is no power under the trust agreement to vary the investment of the certificate holders. An investment trust with multiple classes of ownership interests ordinarily will be classified as a business entity under Section 301.7701-2; however, an investment trust with multiple classes of ownership interests, in which there is no power under the trust agreement to vary the investment of the certificate holders, will be classified as a trust if the trust is formed to facilitate direct investment in the assets of the trust and the existence of multiple classes of ownership interests is incidental to that purpose.

Initial Classifications

301.7701-4(c)(2), Example 4. Business Interest versus Trust Classification.

Corporation N purchases a portfolio of bonds and transfers the bonds to a bank under a trust agreement. At the same time, the trustee delivers to N certificates evidencing interests in the bonds. These certificates are sold to public investors. Each certificate represents the right to receive a particular payment with respect to a specific bond. Under section 1286, stripped coupons and stripped bonds are treated as separate bonds for federal income tax purposes. Although the interest of each certificate holder is different from that of each other certificate holder, and the trust thus has multiple classes of ownership, the multiple classes simply provide each certificate holder with a direct interest in what is treated under section 1286 as a separate bond. Given the similarity of the interests acquired by the certificate holders to the interests that could be acquired by direct investment, the multiple classes of trust interests merely facilitate direct investment in the assets held by the trust. Accordingly, the trust is classified as a trust.

Why is Trust Classification Important?

Usufruct –

In Public Letter Ruling – 9121035 (91 TNT 116-47 (February 25, 1991), the IRS characterized a *usufruct* under German law (a Civil Law country) as a foreign non-grantor trust.

Stiftung – Great Analysis of trust factors…

In Estate of O.T. Swan, 24 T.C. 803 (1981, acq. 1981-2 C.B. 1., the Tax Court determined that *stiftungs* should be treated as trusts for U.S. tax purposes.

The family wanted the stiftung to be treated as a trust because U.S. children were inheriting German assets.

Liechtenstein Anstalt

A trust analysis provided that the anstalt was a trust. (AM 2009-012).

Trust uses for exotic purposes

- In certain Muslim countries, the forced heirship rules may be applicable. Sharia Law may apply which means that the inheritance rules under that country's specific interpretation of Sharia Law will apply to inheritance. The application of Sharia Law may differ from country to country.
- The benefit of a trust: In some Sharia Law countries, lifetime transfers into trust may assist to bypass the strict forced inheritance laws of the specific country.

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Long arm of Foreign Laws that Affect U.S. Practitioners

- UK Criminal Finances Act 2017
- EU Succession Regulation, *two-tiered layers*
- EU Aggressive Transaction Disclosure
- EU Trust Registration Requirements

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Conflicting Agreements – Reconciled

Example, Germany-Turkey

The EU Succession Regulation does not affect the provisions of international conventions that were valid before the EU Succession Regulation was adopted.

- The "German-Turkish Succession Agreement," for example is of major practical significance.
- It differs from the EU Succession Regulation in that the single scheme principle does not apply.
- Rather:
- For immovable assets and, thus for real estate, the jurisdiction lies with the courts in the country where the estate's immovable assets are situated.
- For movables, the succession law to be applied is determined by the deceased's nationality. Jurisdiction lies with the courts in the country of decedent's nationality.

Example, California

- If the decedent's assets are to be governed by the law of California, then special care needs to be taken to make sure competing jurisdictions do not cause an unintended tax consequence.
- For example, if property is located in the UK which has certain harsh tax triggers for contributions to trusts, then a conflict may arise if the California resident has a California trust that disposes of his or her assets.
- In general, a Heggstad Petition is used to pour over into the trust assets titled outside the trust. However, under Heggstad, the language suggests that the intent was that the property was deemed transferred into the trust at the time of the trust.
- Therefore, careful drafting should be in place in the Will to ensure disposition under California law at date of death.

U.S. Transfer Tax Fundamentals

Test for U.S. Domicile

Who is a U.S. domiciled individual? The test is different from income tax test!!

U.S. domiciled individual is subject to estate tax and gift tax on his or worldwide assets.

Test for Domicile – The test for domicile is a subjective test focused on the intentions of the individual. As such, the test relies on an evaluation of the facts and circumstances of an individual's intentions. No intention of remaining in the U.S. indefinitely.

Example – Consider the circumstances of a husband and wife, where the husband is a U.S. citizen, but the wife is a UK resident. If the wife is living in the U.S. at present, but intends to return to the UK, she is a resident for purposes of U.S. income tax, but may still be a UK "resident" or domicile for U.S. transfer tax purposes.

Practice TIP: U.S. ancillary documents should be drafted carefully. (Wills, should not include "resident in State of X" or state in Health Care Directives that the person's primary document is Dr. Y. Make sure to state both Country X and Country Y doctors.

U.S. Estate Tax on U.S. Situs Assets of Non-U.S. Domicile

Non-U.S. domicile: Taxed on U.S. Assets

- Applicable exclusion amount shields only $60,000 from tax, a unified credit amount of only $13,000
- An applicable treaty may increase that amount if it includes a pro rata formula which we will see shortly.
  - The United States has estate and gift tax treaties with a number of countries including Australia, Austria, Canada (*note – this is an income tax Treaty but addresses some estate/gifting issues*), Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, South Africa, Sweden, Switzerland, United Kingdom.

Tangible Versus Intangible Assets

The U.S. Transfer Tax System Applies to All U.S. Situated Assets: Gift, Estate, GST…however, but…

The definition of a U.S. assets for U.S. gift tax is different than the definition of a U.S. assets for U.S. estate tax.

Gift Tax = Only Tangible Assets subject to tax; intangibles when transferred are not.

Estate Tax = Tangible and intangible assets are subject to tax.

The Basic Gift Tax Rule – Tangible Versus Intangible Assets

Gifting strategies…

- Gifts of intangible property, *i.e.*, stock, bonds, T-bills, mutual fund shares and partnership interest) are not subject to U.S. gift tax upon transfer.
- This creates a great planning opportunity:
  - A NRNC may gift stock prior to death without incurring gift tax. The U.S. stock is out of the decedent's U.S. taxable estate. The same may also apply to U.S. partnership interest – subject to § 2035 through § 2038.

Cash is highly controversial. (T-Bill solution) Otherwise, cumbersome.

- U.S. real property is tangible property. Intangible conversion. P/S versus Corporation
- Note: Gifts to non-U.S. citizen spouse. Use an increased annual exclusion amount at $152,000, adjusted for inflation.
- But, consider intra-spousal loans.
- A married foreign donor may not take advantage of gift-splitting elections.

The Non-U.S. Domiciled Individual's U.S. Taxable Estate

A Non-U.S. Domiciled Individual's U.S. Taxable Estate:

- The value of the gross estate of every decedent NRNC (non-domiciled):
  - The part of decedent's gross estate which, at the time of death, is **situated** in the U.S., and which shall include U.S. real property, U.S. tangible personal property, and U.S. intangible property.
  - **Examples:**
    - – Domestic company stock
    - – Jewelry, art
    - – U.S. real property

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The Non-U.S. Domiciled Individual's U.S. Taxable Estate (cont'd)

- The value of the gross estate shall not include certain property, even though physically in the U.S.
  - **Examples:**
    - – U.S. bank accounts, as defined
    - – Works of art on loan in the U.S.
    - – Life insurance
    - – Qualified debt obligations
    - – By treaty, sometimes shares of domestic companies

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The Non-U.S. Domiciled Individual's U.S. Taxable Estate

A Non-U.S. Domiciled Individual's U.S. Taxable Estate, continued:

- **Deductions:** The value of the gross estate may be reduced by applicable deductions; however, the use of such deductions is subject to a formula which requires disclosure of the NRNC's worldwide assets. This may not be something the NRA family wishes to do.
- **Tainted Property:** The value of the gross estate shall also include property deemed situated in the U.S. if it was situated in the U.S. either at the time of the gift or at the time of the death of the donor/decedent. Section 2104(b). **The sequence of purchase and subsequent planning makes a difference.**
- Additionally, the United States has estate and gift tax treaties with various countries.

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Planning Considerations

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UK Considerations…

- UK citizens have the UK as their domicile of origin.
- Sticky…six years.
- It revives anytime the individual does not have a domicile of choice.
- From the UK perspective, a domicile of choice will be acquired in a particular state in the U.S. when the individual is resident in that state for a period of six years and intends to remain there permanently or indefinitely.

UK Considerations… (cont'd)

- It is also worth noting that, a person who was born in the UK with a UK domicile of origin, but who acquires a domicile of choice outside the UK will nevertheless be deemed domiciled in the UK for all tax purposes during any future tax year in which they return as UK resident. During this time, they will be treated as if they had never acquired a non-UK domicile in the first place.
- It is not yet clear what this will mean in practice, but it is suggested that any trusts settled by the individual while they were non-UK domiciled using non-UK assets will lose their 'excluded property trust' status and will be exposed to IHT.
- A U.S. born citizen, can avail herself of the excluded property trust regime…perhaps consider gifting to U.S. spouse …for UK IHT purposes if you are moving back….

Treaty Domicile – possible corrective planning

- Based on the time period required to lose *deemed domiciled* or UK *domicile of origin* status, even after a person becomes a U.S. income tax resident and domiciliary, he or she may also remain domiciled in the UK for a period.
- Depending on the circumstances, the Treaty might consider the person to be domiciled in the UK (and not the U.S.), allowing him or her to make transfers of non-U.S. property without exposure to U.S. gift tax.
- This could present an attractive planning opportunity from the U.S. perspective, but the UK tax consequences would need to be considered carefully.

Leaving the UK -- Issues to Consider

- **Existing trusts:**

  It will be important to give some consideration to any UK resident trusts of which the person leaving the UK is a trustee. If the individual becoming non-UK resident will cause the trust to become nonresident, then this will trigger a deemed disposal and reacquisition of all the trust assets at market value, and therefore a 28% CGT charge on the "exit" from the UK The emigrating trustee(s) might, therefore, consider retiring in favor of UK resident trustees before they cease UK residence. Any existing trusts (whether UK resident or not) should be reviewed to determine how they will be treated for U.S. income, gift and estate tax purposes.

- **Restarting the Clock: Non-UK domiciled Individuals**

  Remittance Basis Taxpayer: Under the current law, once the individual has been non-UK resident for six complete tax years, they will have "restarted the clock" for the purposes of the remittance basis. Importantly, this means that upon their return to the UK, they can claim the remittance basis free of charge for another seven tax years.

  Non-domiciled status: Under the current law, six tax years of non-UK residence is sufficient to "restart the clock" for the purposes of the '17 out of 20 year' deemed domicile rule for IHT.

- **Be careful of interim planning**

  Ex. UK resident buys a home in U.S. A U.S. practitioner thinks he's doing the right thing to contribute the home to a revocable trust. What is the result?

Foreign Trusts – Defined

When is a Trust a Foreign Trust?

- A Trust is deemed to be foreign unless both of the following are satisfied:*
  - Court Test
  - Control Test
  - You can toggle!!
- Curing an inadvertent change

*Definitions found in IRC §7701(a)(30)(E), (a)(31)

Domestic or foreign trusts: the control test

A trust satisfies the control test if only U.S. persons have the authority to control all substantial (non-ministerial) decisions regarding the trust

- **Substantial decisions include (but are not limited to) decisions concerning –**
  - Whether and when to distribute income or corpus
  - The amount of distributions
  - The selection of a beneficiary
  - Whether a receipt is allocable to income or principal
  - Whether to terminate the trust
  - Whether to compromise, arbitrate or abandon claims of the trust
  - Whether to sue on behalf of the trust or to defend suits against the trust
  - Whether to remove, add or replace a trustee
  - Whether to appoint a successor trustee to succeed a trustee who has died, resigned or otherwise ceased to act as a trustee (regardless of whether there is an unrestricted power to remove a trustee, unless the power is limited to removal/appointment of a U.S. person)
  - Investment decisions
- **Practice Pointer**
  - If a foreign trust is not desired, consider limiting the holders of decision-making authority to U.S. persons

Domestic or foreign trusts: grantor trust rules for foreigners

The grantor trust rules have special application to foreign grantors, beneficiaries and trusts

- **Foreign Grantors – Code § 672(f)**
  - Default to foreign non-grantor trust status
  - Exception: A trust having a foreign grantor is considered a grantor trust only if –
    - The foreign grantor has the power to revoke the trust; or
    - The only amounts distributable (whether income or corpus) during the grantor's lifetime are distributable to the grantor or the grantor's spouse

Domestic or foreign trusts: grantor trust rules for foreigners (cont'd)

- **U.S. Grantor Foreign Trusts with U.S. Beneficiaries – Code § 679**
  - A U.S. person who transfers property to a foreign trust is deemed the owner of the trust for U.S. income tax purposes if the trust has a U.S. beneficiary
  - A foreign trust is deemed to have a U.S. beneficiary unless certain limited exceptions apply
- **U.S. Beneficiary Treated as Owner – Code § 678**
  - A U.S. beneficiary (and not a foreign beneficiary) is treated as the owner of a trust if the beneficiary has the power, exercisable alone, to vest any part or all of the trust corpus of income in himself or herself, provided the grantor is not otherwise treated as the owner of the trust

QDOT Requirements – Generally

A QDOT document must provide for the following:

- If a U.S. spouse has a non-U.S. citizen spouse and an estate subject to U.S. estate tax, normal planning such as the QTIP or use of the unlimited marital deduction is not available.
- To defer tax on the first death, a QDOT must be in place.
  - At least one of the trustees must be an individual citizen of the U.S. or a domestic corporation (U.S. Trustee).
  - No distribution (other than an income distribution) may be made from the trust unless a U.S. Trustee has the right to withhold the QDOT tax from the distribution, subject only to limited exceptions.
  - The trust must be maintained and administered under the laws of a state of the U.S. or the District of Columbia.

QDOT Requirements – Generally (cont'd)

- The trust must be an "ordinary" trust (as distinguished from a business trust taxable as an associate) as defined under Reg. §301.7701-4(a).
- There are other requirements if the trust is a large trust, meaning having a fair market value in excess of two million dollars.
- The executor of the estate must make a timely election to have the trust qualify as a QDOT.

Planning for the Food Groups…

Irrevocable U.S. Domestic non-grantor trust – putting it all together

With proper gift and trust design, it is possible for a foreign person to achieve a number of wealth-planning goals with an irrevocable U.S. domestic non-grantor trust.

- Unlimited lifetime transfers of foreign assets and intangible U.S. assets for the benefit of U.S. beneficiaries may be made free of U.S. gift and GST taxes.
- Assets for the ultimate benefit of U.S. beneficiaries may be removed from the foreign person's U.S. estate and from the reach of U.S. estate and GST taxes going forward.
- The trust may be a dynasty trust which avoids U.S. transfer taxes for future generations.
- While the trust will be subject to U.S. Federal income tax, it may be established in a state free of state income tax.

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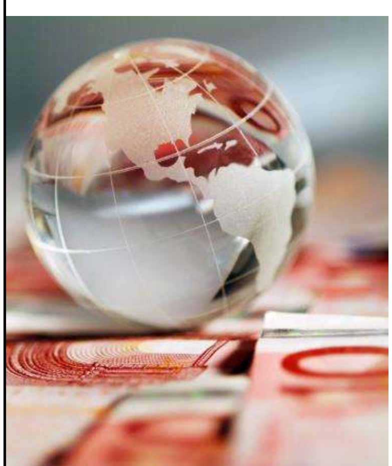
Gift to U.S.-based Child from NRA Parent – Domestic Solution



Mom and Dad
(In China)

↓

Child
(In United States)

1. Mom and Dad do not want U.S. estate tax on what they give to child when they pass away.
2. Mom and Dad do not want U.S. gift tax on what they give to child.
3. Mom and Dad do not ever want to trigger U.S. estate tax.
4. Technique: Mom and Dad set up a domestic dynasty trust. Parents transfer funds as their practitioner directs into the domestic trust. (Further issue related to foreign denominated currency)
5. This technique should shield future generations from U.S. estate tax and avoid U.S. gift tax currently.

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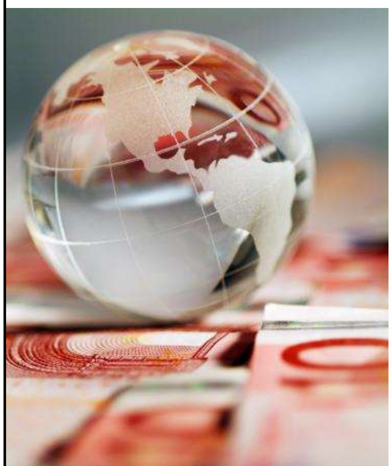
Foreign Grantor Trust – Income and Transfer Tax Minimization – Different when US beneficiaries



Mom and Dad
(In China)

Foreign Grantor Trust:
Irrevocable – Lifetime to Parents; or
Revocable – Children can be beneficiaries

ForeignCo US Assets | ForeignCo For Assets → Check the box Eligible, watch if US beneficiaries.

1. Mom and Dad do not want U.S. estate tax on what they give to child.
2. Mom and Dad do not want U.S. gift tax on what they give to child.
3. Mom and Dad do not ever want to trigger U.S. estate tax.
4. **Mom and Dad would like to minimize U.S. income tax during their lifetimes, if they can.**

So, Mom and Dad set up a foreign grantor trust. There are a number of scenarios, but child is usually named as one of the beneficiaries along with the parents.

International Trust Structures – Case Study

Step-Up In Basis for Assets in Trust: Impact and Goals

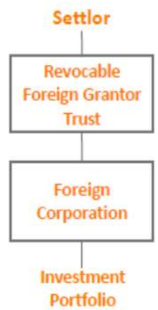
- Impact: Step-up in basis is in the shares of the company, not underlying assets

- Goals: End up with a step-up in basis in the underlying assets, no income tax (e.g., no retained earnings as of the date of death) and no estate tax

Step-Up in Basis for Assets in Trust: Planning

- Periodic recognition of gain during lifetime of settlor
- CTB election can be made effective prior to settlor's death
  - If company owns U.S. situs assets, then may have estate tax exposure if CTB election is made effective prior to settlor's death
  - Should planning be done in advance, and if so, what?
    - Separate US situs assets from foreign situs property
    - Confirm trust is a grantor trust and settlor is the owner
    - Make check-the-box election for company holding only foreign situs property?
  - Should advice be provided to the settlor about what types of investments to hold (or not hold) through the trust during settlor's lifetime?
  - What can/should be done after the death of the settlor?
- CTB election can be made effective two days or more after settlor's death if not made while the settlor is alive
  - Income tax treatment
  - PFIC and CFC issues
  - Repeal of 30-day rule

Typical (Pre-Repeal) Structure #1



- Upon death of Settlor, trust automatically receives step-up in basis in shares of FC (if trust structured properly)
- No automatic step-up of FC's basis in IP
- FC can elect to change its classification if eligible entity (treated as liquidation of FC)
- Check-the-box election made by FC effective prior to death, except if IP includes U.S. situs assets
- If IP includes U.S. situs assets, check-the-box election made effective post-death
  - Typically effective between 2 days and 29 days after death to avoid CFC rules; otherwise potential Subpart F inclusion if gain is realized
  - If IP includes PFICs, indirect disposition of PFICs
  - Usually nominal amount of gain or loss in shares of FC
  - Potential tax position risk

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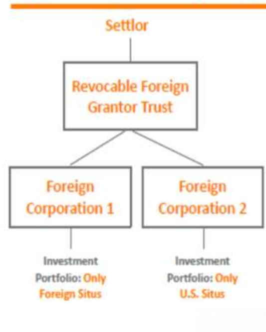
Typical (Pre-Repeal) Structure #2



- Same as previous slide, except:
  - Check-the-box election made by FC1 effective prior to death
  - Check-the-box election made by FC2 effective post-death
  - Separates foreign situs assets from U.S. situs assets so foreign situs assets are not subject to some federal tax issues applicable to U.S. situs assets
  - May not need FC1/portfolio could be owned by trust

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Planning Option #1: No U.S. Situs Assets

Settlor → Revocable Foreign Grantor Trust → Foreign Corporation → Investment Portfolio: Only Foreign Situs

- Upon death of Settlor, trust automatically receives step-up in basis in shares of FC (if trust structured properly)
- No automatic step-up of FC's basis in IP
- Check-the-box election made by FC effective prior to death
- FC can invest in U.S. equity markets via foreign funds
- May not need FC/portfolio could be owned by trust

Cross Border Scenario — Mom is U.S. and Dad is NRA/Non-Domiciled – Current Situation…what can we do??

The Mother's SP Trust

Allocate GST

$5,430,000	$23,570,000	$12,800,000	$31,800,000
Family Trust – Unified Credit Amount Outright to children in stages	**QDOT--** Outright to children in stages.	**Mom's Gift Trust –** From her parents. To GC in stages.	**Mom's Gift Trust –** From her parents. To GC in stages.
This value passes free of estate tax and GST Tax. We presume $67,000,000 at death of Surviving spouse. $67,000,000 estate tax free to children.	This value at SS death is $213MM. Subject to U.S. Estate Tax=$85,200,000	At Mom's passing, this amount can be double. Taxed in children's estates	At Mom's passing, this amount can be double. Taxed in children's estates.
(40,45,50	(40,45,50	(35,40,45,50)	(25,30,35)

All become subject to U.S. Estate Tax at Child's Level

Recommendation – **GST Planning** and **Loan to NRA Spouse under § 7672**.

Cross Border Recommendations (continued)

The Mother's SP Trust

$10mm Intra-spousal loan

Family Trust – GST-Exempt (**Delaware Dynasty Recommended**)

1. GST from Parents to children -- $67,000,000
2. GST from Children to grandchildren -- $318,363,602;
3. GST from Grandchildren to GGC -- $1,918,571,243
4. GGC pass away -- $23,716,699,973 – planning dynastically

These amounts stay in trust. Wealth transfer grows estate tax free; Ultimate distribution to great-grandchildren estate tax free.

$23,570,000

QDOT – Outright to children in stages, or in trust for asset protection

$179MM outright.
(Only $13,570,000 invested with $10MM note freeze)
U.S. Est. Tax = $71,600,000
Versus
$23,570,000—invested
U.S. Est. Tax= $85,200,000
Keep in Trust for asset protection.

The real savings shows in the FGT planning.

$12,800,000

Mom's Gift Trust - To children in stages.

After Mom's passing, this amount can more than double.
Taxed in children's estate.

$31,800,000

1980 Children's Trust To children in stages

After Mom's passing, this amount can more than double.
Taxed in children's estate

Foreign Grantor Trust – This is GST Exempt. Use with estate freeze. Dad should also consider

Separate children's Trusts GST Exempt (**Delaware Dynasty Trust**)

$10mm invested U.S. estate tax free. During Dad's life, U.S. income tax free. Provides greater investment yield, except to extent taxed in Israel.

- GST from Parents to Children -- $124MM
- GST from Children to grandchildren - $7,270,000,000.
- Options with drop-off trust and foreign grantor trust. Two strategies in tandem.

But, recall the foreign intermediary rules…

U.S. Estate Tax with Pro Rata – Canadian Treaty

- While the U.S. has a policy-driven, NRA favorable income tax regime, the estate tax on non-domiciliaries can be onerous. To illustrate the severity of the tax, property valued at $500,000 would be subject to U.S. estate tax in the amount of $142,800. This is payable to the IRS no later than 9 months after date of death and, if not paid timely, is subject to penalties and interest, which would be added to the estate tax.
- Canadian residents have significant advantages over residents of certain other countries due to the favorable provisions contained in the U.S.-Canadian income tax treaty. Canadians are allowed a pro-rata portion of the credit afforded to U.S. citizens and domiciliaries based upon the value of the U.S. assets to their worldwide assets.
- The following example shows how the U.S. estate tax is calculated on the estate of a Canadian resident. All values are stated in terms of U.S. dollars.

U.S. Estate Tax with Pro Rata Canadian Treaty

A Canadian resident dies in 2014 owning U.S. real estate valued at $500,000 and a worldwide estate valued at $5,000,000. No estate tax is due, calculated as follows:

Value of U.S. Estate	$1,500,000
Value of Worldwide Estate	$15,000,000
Percentage of U.S. to Worldwide:	10%
U. S. Estate Tax on $15,000,000 (Unified Credit)	$4,425,800
U.S. Estate Tax on $1,500,000	$545,800

<u>CALCULATION OF U.S. ESTATE TAX</u>

U.S. Estate Tax on U.S. Assets Valued at $1,500,000:	$545.800
Maximum Unified Credit ($4,425,800 x 10% = $442,580, limited to the actual amount of estate tax of $)	-$442,480
U.S. Estate Tax Payable	$ 103,220

It is important to note there is additional benefit built in for non-U.S. Canadian spouses. Though unlimited marital deductions are available for U.S. spouses, in general.

Pre-Immigration

Pre-immigration planning can present a variety of opportunities to improve an individual's U.S. tax position.

Integrated planning will be essential to ensure optimum structuring and avoid potential pitfalls.

From the U.S. perspective, the immigrant might be advised to engage in the following types of planning (among others):

a) To realize income and gains before becoming U.S. resident for income tax purposes;

b) To make pre-immigration gifts (either outright or in trust); or

c) To fund a "drop-off" trust. In doing so, there will be a number of important points to bear in mind from the UK perspective. A dangerous option for UK domiciles and Canadian domiciles…

Pre-Immigration

Another way of overcoming certain home country tax issues may be for the individual to arrange his or her affairs in such a way as to cease home country residence for a period to shed home country taxation (e.g., six years for the UK) prior to becoming U.S. income tax resident, and to trigger income and gains during this period.

"Tropical Island here we come!"

Pre-Immigration – UK IHT …

Use of Trusts

Particular care should be taken in respect of trusts. An IHT event will be triggered where:

- Any assets are transferred into trust by a UK domiciliary (or deemed domiciliary); or
- UK assets are transferred into trust by a non-UK domiciliary. This is because gifts into trust are immediately chargeable transfers for IHT purposes. They will give rise to an immediate IHT charge of 20% (increasing to 40% if the donor dies within seven years of the transfer) on the value in excess of the available NRB. Furthermore, the trust will be subject to the relevant property regime. Broadly, this means that the assets will be subject to IHT charges of 6% every ten years and a charge of up to 6% on distributions of capital between ten year anniversaries.
- The take away point here is that pre-U.S. residence drop-off trusts may be a "no-go area" for UK domiciliaries (or deemed domiciliaries).

Pre-Immigration – Gifting prior to become U.S. Resident

Outright Gifts

- The UK rules permit various opportunities to make outright gifts without triggering IHT. In particular:
  - Unlimited outright gifts can be made between spouses (provided both spouses are non-UK domiciled or the recipient is UK domiciled;
  - Outright gifts to other beneficiaries (such as children) will be PETs (potential excluded transfers) and will pass free of IHT if the donor survives the gift transfer by seven years. No matter what the amount …

Pre-Immigration Planning

Income Tax

- Consider accelerating (realize and recognize) any and all income earned by the immigrating taxpayer prior to becoming a U.S. resident.
- Possible income to accelerate includes compensation, pension plans, stock options, prepaid rents, royalties, dividends, interest, annuities and capital gains.
- Elect out of installment sales treatment; defer recognizing losses; review for PFIC or CFC status; explore strategies to step up tax basis in assets

Transfer Tax

- Consider transferring assets to an NCND spouse before establishing a U.S. domicile.
- Determine if accelerating gift planning would be appropriate.
- Gifts of tangible personal property located within the U.S. will be subject to U.S. gift tax.
- The immigrating NCND can gift any intangible assets either inside or outside the U.S.

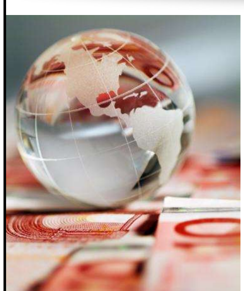
Trusts

- Consider a foreign or U.S. trust for estate planning prior to moving to the U.S.
- For the NCND who is not immigrating, but who has immigrating children, foreign grantor trusts may be a viable planning strategy.
- The NCND parents remain the deemed owners of the underlying trust assets for U.S. income tax purposes.
- When the NCND parents pass away, the trust assets remain available for the benefit of the U.S.-based children but will forever escape US estate tax net.

Pre-Immigration – Stock Basis Step Up

- Check-the-box election
- This can be helpful to check the box prior to immigrating. However, this is not available in all circumstances.
- Family Corporation
- Per Se Corporation
- Boot in § 351
- Receipt of non-qualified preferred stock is treated as boot for Sec. 351 purposes. (§ 351(g)(1))
- This will increase basis and the NRA is not subject to U.S. tax

How can Mom and Dad fund a trust that is U.S. transfer tax efficient when they, too, want to come to the U.S.?



1. **Establish a Drop Off trust – Purpose: Income/Transfer Tax efficiency**
   - A trust for incoming nonresident aliens
2. Should the trust be foreign or domestic?
   - If the settlor is a beneficiary, the trust will be classified as a grantor trust so it doesn't matter.
   - If the settlor is not a beneficiary and the trust is foreign, and the settlor moved to the U.S. within five years of formation, the trust is a grantor trust (§ 679), unless the trust prohibits any U.S. person from receiving any Income or corpus, during life of trust or at its termination.
     – This will need to be a non-grantor trust.
   - If the settlor is moving permanently to the U.S., and the trust will benefit family already in the U.S., and the trust is domestic, and the settlor is not a beneficiary, then §§ 671-678 apply.
     – Might as well make it a U.S. Trust
3. IRS reporting rules
   - More stringent reporting for foreign § 679 trusts.
   - Potentially file forms 3520-A, 3520, 8938, and 114
4. Mark to market may apply if the settlor moves from the U.S. after living for a period of time in the U.S., expat rules.
5. If a foreign trust – possible § 684 at settlor's date of death, there is no tax on a domestic trust at settlor's death, though no step up.
6. No U.S. estate tax: Be sure to create the drop off trust well in advance of moving to the U.S. Don't stop off in a tax haven en route…

(BNA: 42 Tax Mgmt. Int'l – Should a 'Drop-off trust' for an incoming Alien Be Domestic or Foreign?/Premier Tax Library, Thomas S. Bissell, CPA)

Should there be more than one will?

Multiple Wills:

- LOCAL COUNSEL from each jurisdiction should draft the respective Will and coordinate; otherwise, one last Will may revoke the other. If possible, one Will can reduce confusion.
- Address the foreign property in the Will. If property is later purchased with no Will update, then intestacy rules may apply.
- Be careful when declaring residence in a Will. Same for stating your 'primary' physician.

Foreign Recognition of Wills:

- SOME foreign jurisdictions will recognize a Will drafted in the U.S.
- California will recognize a foreign Will , if the Will complies with the law at the time of execution of the place where the Will is executed; the Will complies with the law of the place where at the time of execution or at the time of death the testator is domiciled, or is a national. (Cal. Prob. Code § 6113)

Uniform International Wills Act

- One of the best ways to prepare for death while owning property in a foreign country is to execute an international will. California has adopted the Uniform International Wills Act.
- Just because a Will provides for contribution to a trust or a person, if the property is going to be sold imminently, consider selling it first to avoid stamp duty or transfer/notary tax which can be onerous on transfer.

Uniform International Wills Act

- In 1973 in Washington, D.C., the International Institute for the Unification of Private Law (UNIDROIT) held the Convention Providing a Uniform Law on the Form of an International Will. The Washington Convention was held in hopes of creating an international will that would make estate planning with international ramifications more straightforward and uncomplicated. The Convention did not and has not attempted to revoke or override the laws of signatory nations. It merely seeks to create a system of estate planning for those individuals who hold property and assets in a nation or nations other than their domiciliary country. There is a list of requirements that must be met in order for the will to be considered an international will: As set forth in Cal. Prob. Code § 6380.
- The greatest benefit to an international will is the knowledge that, when drafted to meet the requirements set forth, the will is valid in any jurisdiction that has signed or enacted the Washington Convention, also known as the Uniform International Wills Act. Belgium, Bosnia-Herzegovina, Canada, Cyprus, Ecuador, France, Italy, Libya, Niger, Portugal, and Slovenia have enacted the Uniform International Wills Act; the Holy See, Iran, Laos, the Russian Federation, Sierra Leone, the United Kingdom, and the United States are all signatories of the treaty. Because of the federal nature of the United States, individual states also had to enact the Washington Convention; 23 states and the District of Columbia have done so.

U.S. Compliance Considerations

Below is a summary of some of the significant reporting forms. This is an ever-changing area of the law that requires diligent attention to ongoing developments.

- Reporting and Withholding on Distributions from U.S. Trusts to Non-resident Alien Beneficiaries
- Report of Foreign Bank and Financial Accounts (FBAR). There is a new Form for FBAR reporting. Form 114.
- Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts (Form 3520)
- Annual Information Return of Foreign Trust with a U.S. Owner (Form 3520-A)
- Foreign Account Tax Compliance Act (FATCA) and Statement of Specified Foreign Financial Assets (Form 8938)

Cultural Dynamics in Setting Up a Family Business Board.

The Mexican Family Business

- Mexico relies heavily upon family businesses to produce jobs and invigorate the domestic economy, but the current environment creates significant challenges for smaller family business start-ups.
- Family businesses are hugely vital all across Latin America: They constitute 60% of Latin America's GDP growth.
- Smaller Mexican family businesses face significant challenges:
  - Harder to secure capital or debt financing…
  - Competition is usually against a larger family that has locked in the market…business is relationship based.
  - Hiring practices favor nepotism or insiders.
  - Nepotism is unlikely to depart the scene any time soon.
- The good news is that younger entrepreneurs are starting to form businesses more than ever before.
- But true financing and legitimate access to capital is necessary to stimulate further growth.

The Family Board

- Because of the fear of corruption and risks involved with securing outside debt, family businesses value privacy and family.
- Working in the business is expected and generally the family sees themselves and their business as one.
- There is generally not the same desire to separate out the family branches as in the U.S. For example, we often hear in our client meetings, we will just sell everything so the kids can be separate. It is just too much of a headache. They want to divide everything.
- Often U.S. children do not wish to continue the family business.
- The Family may be offended by the inclusion of rules of communication.
- The Family may not need the same education as who may be the deemed successor to lead the company.
- New ideas and innovations is not the challenge; capital support is a serious problem.

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The Chinese Family Business

- Same in China, where Chinese family businesses control an extremely large percentage of Asia's economic wealth.
- Initiatives by Deng Xiaoping encouraged the formation of rural enterprise and private businesses, liberalized foreign trade and investment, relaxed state control over some pricing.
- Since 1978, thousands of Chinese mainland private enterprises ("CMPEs") have been established and prosperously developed.
- Chinese family businesses are mainly family possessions with the managerial ideology primarily derived from Chinese traditional values of Confucianism which advocates clear hierarchy and vertical obligations.
- Confucian ideology relates to family, education, work, social ethics, group conformity and centralized authoritarian values, where the collective good of the group and society subsumes the needs of the individuals.
- This ideology is antithetical to competitiveness so prized in American culture.
- The family is the unit and the division between work, leisure, and homelife are blurred or non-existent.
- Paternalism and nepotism are known as significant characteristics. While many family members may own top management position, a head of the family leads all members and owns final right of decision making. (HK example) Tail Male
- This tight family structure in some ways can limit company growth.
- It is hard for tight companies to get new ideas and innovate.

The Family Board

- Example: LKK Co.
- The famous flavoring manufacturing company in Hong Kong has successfully expanded their family business through four generations without outside capital support while maintaining family control.
- Family succession provides for closed property rights. The family keeps control.
- Reliance on outside managers is minimized. Important issues and resource allocation decisions are rarely delegated to professional managers.
- The head of the family leads the business.
- It will be unusual for family members to do anything that will facilitate the success or the achievement of an individual, to disturb the harmonious settings within the family, the collectivism culture. Roles are well established even as new generations rise.
- Anglo-American is of a typical individualism orientation.
- However, the 30% rule is true for Chinese family businesses just as for U.S. Family businesses.
- The Chinese board needs to introduce ways to bring in new ideas and innovations.

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Same Succession Failure Rate in U.S., China, and Mexico

30%

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Planning for Privacy and Continuity … A possible option for certain High Net Worth Global Families…Private Trust Companies…

- **Cultural Closeness of the Family Business**
- **Country Risks**
- **Overwhelming Due Diligence and Disclosure for Trustees**
- **Lack of Continuity of Advisors at Certain Institutions**
- **Movement of Information**
- **What is an alternative…..An Excellent Option for Some Families…the Private Trust Company**

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Private Trust Compliance …
Family Board Managed

- A trustee designed expressly to exercise discretion according to Strategic Family values and in pursuit of a strategic plan.
- A perpetual entity – a corporation or LLC – that is:
  - Legally qualified to act as trustee of family trusts
  - Owned and controlled by, and serving a single family and the family's related entities.
  - Structured to provide ultimate privacy. (Regulated and unregulated options)
  - A U.S. PTC can serve as trustee for domestic and foreign trusts.
- A PTC is empowered to:
  - Act as trustee with full control as a fiduciary over trust assets
  - Exercise comprehensive financial services powers to provide a full range of family
  - Investment and other financial service.
- A PTC Board can provide continuity and retain historic memory for the family.
- Family members work together on the Board, along with other trusted advisor board members.
- A PTC keeps a family sharing and working together…they can groom younger generations.
- A PTC can pursue charitable objectives…(Discuss: Trojan House charity method)
- The PTC does not pay tax at this level.
- The PTC can agree to hold a concentrated position in a family company. (Directed trust, option)

Directed Trusts

Directed Trusts

One of the most frequent reasons clients seek a specialized jurisdiction for their trusts is the ability to access its directed trustee statute.

- **Delaware**
  - Delaware's directed trust statute provides that the trustee is not liable for any loss to the trust which results from the trustee following the direction of an adviser named in the trust instrument unless the trustee acts with "**willful misconduct**", 12 Del. C. §3313.
  - Also specifically recognizes the role of **trust protector**.
  - Trust Act 2017 added the role of administrative trustee without directed trust structure, 12 Del. C. §3313A
- **Nevada**
  - Nevada's directed trust statute provides that an adviser can direct the trustee and the trustee is not liable for any loss to the trust which results from the trustee following the direction of an adviser, NRS 163.553.
  - Specifically defines adviser to include an **investment adviser** and a **distribution adviser**.
  - Specifically defines **trust protector** as an adviser with the power to direct the trustee.
- **Uniform Trust Code**
  - The Uniform Trust Code §808(b) provides that the trustee is not liable for any loss to the trust which results from the trustee following the direction of an adviser named in the trust instrument, unless the direction is "**manifestly contrary to terms of the trust or if the trustee knows the direction is a serious breach of fiduciary duty of the directing person**" – thus putting an obligation on the trustee to review the direction, UTC §808(b).
- **California**
  - Does not have a directed trust statute.

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Long Term Trusts

Delaware and Nevada have similar perpetuities provisions

- **Delaware**
  - Delaware abolished its Rule Against Perpetuities for intangible assets, 25 Del. C.§503.
  - The 110-year limit on real estate still applies in Delaware, 25 Del. C.§503 (b).
  - However, entities such as corporations, LLC's, and LLP's owning real property may be held in a Delaware trust in perpetuity, 25 Del. C. §503(e).

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Long Term Trusts (cont'd)

- **Nevada**
  - Nevada has extended its perpetuities period to 365 years for all property held in trust, NRS 111.1031.
- **California**
  - California has enacted the Uniform Statutory Rule Against Perpetuities, which creates a perpetuities period of lives in being plus 21 years, or 90 years after creation of the property interest, Cal. Prob. Code §§21200 – 21231.

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