BNY MELLON
WEALTH MANAGEMENT

U.S. Trusts for Global Families: Panacea or Problem?

Introduction

In recent decades, global families have begun to view the United States as a desirable jurisdiction to establish their trusts. States such as Delaware, South Dakota, Nevada, Wyoming and Alaska are viewed as premier trust jurisdictions for foreign nationals due to their international clientele and service providers with cross-border expertise. Before setting up a trust in the U.S., it is important to understand the opportunities and challenges facing foreign nationals. This paper explores the reasons families choose the U.S.; examines the types of U.S. law trusts used and their tax treatment; and evaluates the practical aspects of utilizing U.S. trusts that may often not be fully understood.

Why the U.S.?

The sea change from the use of traditional offshore jurisdictions to onshore jurisdictions such as the U.S. has been driven by various factors.

Advent of "Blacklists"

The late 1990s saw the beginning of restrictions and tax penalties on structures established in countries that are placed on a "blacklist" or meet the definition of a no or low tax jurisdiction.[1] The Financial Action Task Force (FATF), the European Commission (EC), the Organisation for Economic Cooperation and Development (OECD) and other associations have their own blacklists. The European Union (EU), for example, has created the "EU list of non-cooperative tax jurisdictions" to identify those countries it feels create risks for tax abuse and unfair tax competition. This tool forces listed countries to satisfy certain criteria to remove themselves from the list. However, the process can take some time and the taint of having been on a blacklist may linger.

Under most definitions, the U.S. is not considered a low tax jurisdiction. However, non-U.S. persons can achieve minimal to no taxation when structuring trusts under U.S. law. The U.S. tax laws are favorable to trusts established by foreign settlors, which can be classified as foreign trusts for U.S. tax purposes. The rules around when a trust is considered to be foreign or domestic are very clear, creating certainty around tax planning.

Scandals Involving Offshore Planning and Heightened Transparency

Scandals such as the Panama Papers and the Paradise Papers[2] in 2016 and 2017 have shone a harsh light on places like Panama and the British Virgin Islands. While these flushed out many nefarious actors, they also had the effect of painting anyone named in the leaks as someone with something to hide. The fact remains that it is possible to engage in legitimate tax and estate planning utilizing offshore structures, but the perception of doing so—in particular for high-profile families—has been tainted by various scandals.

Since the Panama Papers, laws to fight tax evasion and money laundering have been strengthened around the world. Panama agreed to adopt global tax reporting standards (Common Reporting Standard or CRS) in 2016 and is now exchanging information with 64 countries as of September 2020 for the 2019 tax year.

[1] Countries that have created "blacklists" include Mexico, Argentina, Peru, Uruguay, Brazil, Ecuador, Colombia, France, Belgium, Portugal, Netherlands and Spain.

[2] The "Panama Papers" is the term used to describe the 11.5 million files that were leaked from the offshore law firm of Mossack Fonseca in April 2016. These papers identified 214,000 entities and revealed how 140 politicians, celebrities, drug dealers, alleged arms traffickers, and the global elite obscured their wealth (legally and illegally) through hard-to-trace companies and tax havens. About a year and a half later, the Paradise Papers were leaked from two offshore services firms and 19 corporate registries maintained by governments in offshore jurisdictions. This leak of 13.4 million records exposed ties between Russia and U.S. President Donald Trump's billionaire commerce secretary, the secret dealings of the chief fundraiser for Canadian Prime Minister Justin Trudeau, the offshore interests of Queen Elizabeth II and more than 120 politicians around the world. Source: International Consortium of Investigative Journalists (ICIJ).

Ironically, privacy is highly prized in the U.S. and some have labeled it a "tax haven."[3] The U.S. is powerful enough that it may be able to withstand international pressure to conform to rules and regulations that promote heightened transparency, which some may think rises to unacceptable levels.[4] However, recent initiatives discussed or launched in the U.S. have begun to erode this privacy.

Modern Trust Law

U.S. trust laws now incorporate features often seen in offshore trusts, such as trust protectors and asset protection. As a result, some U.S. states are particularly attractive to global families.

Safety of Assets

The U.S. remains a bastion of safety and security. Given the U.S. rule of law and stable political environment, families are generally comfortable that their assets are protected for future generations while held under U.S. law structures.

Access to U.S. Credit

Having a U.S. situs trust can facilitate access to credit from U.S. financial institutions. With interest rates at attractive and historic lows, trustees may seek to improve returns on trust portfolios through leverage. Options range from the most basic, such as using trust assets as collateral for loans to provide liquidity for distributions or further investments, to more complex options such as financing life insurance policies owned by irrevocable life insurance trusts. However, U.S. lenders are often unfamiliar with non-U.S. entities and view offshore trusts with concern. This can result in a frustrating and protracted process with no guarantee that credit will be obtained.

Who Is Using the U.S.?

While U.S. trusts are common for global families who have U.S. beneficiaries within the family, it has become increasingly popular for families with no U.S. connections as well.

For foreign settlors (or grantors, as is commonly used in the U.S.) with U.S. beneficiaries, it is possible to establish a foreign grantor trust that will not be subject to any taxes in the U.S. during the life of the settlor. (The settlor may be responsible for the taxes on the trust in the home country, if applicable.) Upon the death of the settlor, the trust will automatically become a U.S. nongrantor trust as long as no foreign national retains substantial decision-making power within the trust, and the trust does not contain an automatic migration provision to a jurisdiction outside of the U.S.

For foreign settlors who have no U.S. beneficiaries, the U.S. is a jurisdiction of choice for many of the reasons previously discussed: the U.S. is generally not a blacklisted country; it can be viewed as a high tax jurisdiction and thus not subject to information reporting or controlled foreign company type rules in the home country; it can mitigate unnecessary reporting in the home country where high levels of corruption may exist; and importantly, the U.S. is seen as a safe place to park one's assets for the benefit of the settlor and future generations.

Types of U.S. Law Trusts

What Is a U.S. Trust?

For U.S. tax purposes, the U.S. Internal Revenue Code (IRC) defines a domestic (U.S.) trust based on an objective two-part test.[5] To be a domestic trust, it must satisfy both of the following criteria:

- A court within the U.S. is able to exercise primary supervision over the trust's administration (the "Court Test"); and
- One or more U.S. persons have the authority to control all substantial trust decisions (the "Control Test").

To comply with the Court Test, the trust document cannot direct the trust to be administered outside the U.S., and the trust must actually be administered exclusively in the U.S. In addition, the trust cannot be subject to an automatic migration provision that would remove it from the control of a U.S. court in the event a U.S. court attempted to assert its jurisdiction over the trust. Interestingly, a provision in a trust document providing for the trust to be administered in the U.S. under the law of a foreign country would not preclude its being a U.S. trust for income tax purposes, provided the trust instrument gives a U.S. court primary supervision to enforce the law.

Any one of a number of possible substantial decisions in the hands of a non-U.S. person would cause a trust to fail the Control Test, including the powers to terminate the trust, to make investment decisions and even to replace a trustee.[6]

A trust that does not meet both the Court Test and the Control Test is classified as a foreign trust. Note that the IRS has construed the IRC section 679(d) to mean that a foreign trust established by a U.S. person is also considered a foreign grantor trust if, for any part of the trust, there is at least one U.S. beneficiary or the potential for a U.S. beneficiary in the future. Best drafting practice suggests that the trust document should specifically prohibit having any beneficiaries who are U.S., now or ever.

[3] Ganos, Todd, "World's Best Tax Haven: The United States," Forbes, September 19, 2019.
[4] See discussion of CRS and EU directives later in this paper.
[5] U.S. Treasury Regulation 301.7701-7
[6] U.S Treasury Regulation 301.7701-7(d)(1)(ii)

Note that trusts can be governed by the laws of a U.S. state while still being foreign trusts for U.S. income tax purposes. For instance, a trust established in the state of Delaware that provides for Delaware law to govern the administration could nevertheless be a foreign trust for U.S. income tax purposes if there is a non-U.S. person named as a trustee, co-trustee, trust protector or in another role involving substantial decisions. For some families this presents a planning opportunity, as discussed later in the paper.

What Is a Foreign Grantor Trust and Why Is It so Attractive?

Most U.S. practitioners are familiar with the grantor trust requirements for U.S. trusts. Designed to ensure that grantors who retain a certain level of control over trust assets and/or administration are responsible for paying the income taxes associated with the trust, these are enshrined in IRC sections 673-677. They are extensive, offering many options for U.S. grantors wishing to invoke grantor status in trusts benefiting not only themselves but their families and others.

Grantor status is an attractive choice for many foreign settlors as they are typically not subject to U.S. tax on income other than that which is U.S. source income (with generous exceptions)[7] or "effectively connected" to a trade or business. Distributions from the trust to U.S. beneficiaries are characterized as gifts, not income. Further, if the trust is a directed trust, the settlor or other parties can potentially hold any type of investment and may control other discretionary decisions. Recognizing these advantages, the IRC now places much tighter restrictions on qualifying as a grantor trust when the trust is a foreign trust. A trust created by a non-U.S. person is a foreign grantor trust only if it meets one of the following conditions:[8]

- The settlor reserves the right to revoke the trust solely or only with the consent of a related or subordinate party; [9] or
- The settlor and spouse (if applicable) are the sole beneficiaries of the trust during the settlor's lifetime.

In addition to appealing to non-U.S. settlors during their lifetimes due to tax efficiency and the ability to retain control and access to trust funds, foreign grantor trusts offer further tax savings at the death of the foreign settlor. If there are no U.S. situs assets held directly by the trust, no U.S. estate tax applies when the grantor dies, and the trust becomes irrevocable. The trust will be a U.S. domestic trust if it meets the Court and Control Tests at that time, which is likely what the planner intended, particularly if there are U.S. beneficiaries.

Once irrevocable, the trust assets will be also be shielded from all U.S. transfer taxes (gift, generation-skipping transfer, and estate taxes) going forward. Asset allocations and types of investments may need to be reviewed in light of the change to U.S. beneficiaries. Furthermore, special attention may be needed to deal with a foreign holding company or foreign partnership owning the trust's U.S. situs investments, particularly since the changes to the check-the-box election under the 2017 Tax Cuts and Jobs Act (TCJA).[10] These notwithstanding, the post-death transition can be generally straightforward and seamless.

Assuming the trust is now a U.S. domestic taxpayer, while the trust was funded without paying U.S. gift or estate tax because the settlor was foreign (and presumably did not use U.S. situs assets to fund the trust), going forward the trust will pay federal income and capital gains on the trust assets as other domestic trusts are required to do. However, the trust may not be subject to state income taxes if it is located in a state that does not tax accumulated income or capital gains in a trust. Further, given the ability to create a dynasty trust in certain U.S. states, the trust may continue for multiple generations and not be subject to future transfer taxes. The benefits provided become especially important when we consider that global transfers are estimated to be $16 trillion in the next three decades.[11]

Choice of U.S. State

The fact that U.S. trusts are controlled by state law, not federal law, allows planners to consider the protections and flexibility offered by individual states. Some of the most frequently leveraged by foreign nationals for their trust laws are Alaska, Delaware, Nevada, New Hampshire, South Dakota and Wyoming. These states, among others, have passed state laws that generally provide benefits for asset protection, and are favorable to dynasty trusts that extend the life of the trust beyond the historic Rule Against Perpetuities that exists in many jurisdictions,

[7] Non-U.S. persons are exempt from capital gains and "portfolio interest," which includes interest on most U.S. government and corporate debt in registered form.

[8] IRC Section 672

[9] For this section, "related or subordinate" is akin to an "adverse party"- i.e., a person with a substantial beneficial interest in the trust who would be adversely affected by this action.

[10] Prior to the TCJA, a simple foreign blocker structure was commonly used to block the application of the U.S. estate tax while allowing for the heirs to avoid paying taxes on embedded gains. However, the elimination of the 30-day window to effectuate a retroactive check-the-box election has made this planning significantly more complex. Foreign settlors with U.S. heirs are encouraged to seek experienced cross-border tax counsel when planning for the disposition of any U.S. situs assets.

[11] Al W. King III, "International Families Increasingly Want U.S. Trusts," Wealth Management.com, June 22, 2018

both of which are often priorities for cross-border families. Their statutes also include modern provisions for directed trusts and so-called silent trusts. Ranking systems are not always in agreement, but generally these states are in the top 10 best states to situs a trust.

In addition to the states mentioned above, Florida is a popular choice, particularly for families from Latin America. With family members and second homes in Florida, settlors are naturally drawn to Florida, and the legal profession there has responded with a growing level of expertise and advisors who can converse with such families in Spanish or Portuguese. While lacking the option to create a Self-Settled Asset Protection Trust, Florida has most of the attractions of the other states. Florida also rates highly in its modern trust laws, with an updated directed trust statute, an extended Rule Against Perpetuities (360 years) and provisions for Designated Representatives to address the goal of Silent Trusts. With no state income tax on trusts, Florida is often chosen by settlors seeking to act as the trustee of their own trusts. While Florida does not mandate a trustee be resident in the state, it will be important to establish some sort of nexus with the state in order to have a trust that is valid under Florida law.

Caveats and Practical Aspects of U.S. Trusts for Global Families

Investment Considerations

While establishing U.S. law trusts can be desirable for tax purposes, the choice of law may result in an increase in investment restrictions. The U.S. tax law and the U.S. securities laws define a U.S. person differently. While a U.S. law trust can be foreign and not a "U.S. person" for tax purposes by failing the Court and Control Tests, it may very well be a "U.S. person" for investment purposes under the U.S. securities laws, in particular where there is only one U.S. trustee serving and the trust has U.S. beneficiaries.[12]

As a result, investment vehicles often utilized by foreign investors—in particular those that are not required to be registered with the U.S. Securities and Exchange Commission such as offshore mutual funds — will not be available to many U.S. law trusts. Furthermore, where the same trust is foreign for U.S. tax purposes it will provide the financial institution where it holds accounts with a Form W-8BEN for foreign account holders, which will then restrict it from investing in funds that are typically only available to U.S. investors, such as U.S. mutual funds.

The rules around Regulation S and its applicability to the U.S. structures of foreign investors are complex and not always interpreted in a consistent manner across financial institutions. As such, professional advice is recommended.

Privacy vs. Transparency: A Dynamic Process

Governments around the world are increasingly focused on combatting money laundering as a means of curbing terrorism. At the same time, they recognize that cracking down on tax evasion is a potentially effective and politically acceptable way to satisfy their urgent need for additional revenue. These dual motivations have led to the enactment and extension of heightened reporting requirements for individuals and families with assets and entities outside their home countries. As this trend toward global transparency continues, global families, many of whom had previously kept a low profile, face the strong probability that their personal information and financial affairs will be shared among various agencies of different countries, and even be made available to the broad public.

This poses significant concerns, particularly for wealthy families. Greater sharing outside and within national borders heightens the risk of security leaks, both intentional and accidental. One has only to look at the debacles over the Panama Papers and Paradise Papers for examples of the erosion of privacy and subsequent reputational and potentially financial risks for law-abiding citizens as well as criminals.

Enhanced disclosure heightens the risk that the information will be accessed by hackers and criminals, leading to fears of extortion and even kidnapping. In some countries, information about owners of private companies is available to the general public. Other countries limit access to government agencies such as law enforcement and those "with a legitimate interest," a vague phrase easily interpreted to include those with bad intentions.[13]

Finally, legal experts have already noted the potential conflict between the General Data Protection Regulation (GDPR), which became effective in the EU on May 25, 2018, and the EU's own disclosure directives.[14] Others are considering challenging the broad information sharing as a violation of Articles 7 and 8 of the EU Charter of Fundamental Rights. Even the FATF, an international organization charged with combatting money laundering has emphasized that each country's anti-money laundering (AML) regulations be compatible with data protection and privacy rules. However, the FATF has provided scant specifics on how to reconcile the different mandates.

[12] Rule 902 of Regulation S promulgated under the U.S. Securities Act of 1933, as amended, provides that "any trust of which any trustee is a U.S. person" shall be a U.S. person unless the U.S. person trustee serves along with a non-U.S. person co-trustee "who has sole or shared investment discretion with respect to the trust assets, and no beneficiary of the trust (and no settlor if the trust is revocable) is a U.S. person."

Reporting Requirements Outside the U.S.: Transparency Reigns

To effectuate their anti-tax evasion and anti-money laundering efforts, most developed countries are moving forward with the implementation of a number of initiatives.

In 2010, the U.S. was a pioneer in establishing a framework that compelled financial institutions in other countries to report information to the U.S. Department of Treasury on financial accounts held by their U.S. customers. This body of law is known as the Foreign Account Tax Compliance Act, or "FATCA." FATCA laid the groundwork and was the basis for the establishment of the Common Reporting Standard (CRS) in 2014 by the OECD. CRS requires all participating jurisdictions to collect information from their financial institutions that will be automatically exchanged with other member jurisdictions on an annual basis. In 2020, 140 jurisdictions were committed to automatic exchange of information, with 102 of those already exchanging information and the rest committed to do so over the next couple of years.[15] Ironically, the U.S. has opted not to participate in CRS.

The EU is arguably the leader in the march to full transparency. The Fourth and Fifth Anti-Money Laundering Directives (AMLDs), released in 2015 and 2018 respectively, require member states to create and keep current registers of the beneficial owners[16] (RBOs) of companies and trusts, to exchange such information among each other and, in the case of companies, to make that information available to the public.[17]

These lists are to be held centrally in electronic national registers. The list of required information is extensive, including personal details such as identification number, current address, nationality, and date and place of birth. Given the sensitive nature of these items, some countries have limited public access. There is also a provision for the entity or beneficial owner to request restriction in exceptional circumstances; however, this has yet to prove sufficient to limit the risks.

The United Kingdom led the way on April 6, 2016, with public registers of "Persons with Significant Control" (PSCs) over companies. More recently, they also implemented a trust registry that is currently accessible only by government authorities. The U.K. government has also put pressure on the British Overseas Territories and Crown Dependencies, which are following suit, albeit with some reluctance and restrictions.[18]

However, despite the January 20, 2020 deadline for fully functional public registers, overall progress among the 27 EU member states has not been promising. By March 2020, only five countries satisfied the AMLD criteria, with the rest in varying stages of implementation, interpretation and, in some cases, resisting some of the requirements.[19]

In a parallel mode with the EU, the OECD, an international group primarily of leading developed countries, is aggressively reviewing schemes to avoid CRS and other reporting requirements. In addition to looking to financial institutions to report suspicious activity and cross-border holdings, a recent initiative targets professional advisors who assist clients in what appear to be structures and activities to avoid taxes or launder funds. Effective July 1, 2020, the U.K.'s Criminal Finances Act of 2017[20] is an example of a leading effort in this regard and includes the possibility of criminal prosecution.

Reporting Requirements Within the U.S.: A Lighter Touch?

Given what global families perceive as a minefield of potential security risks inherent in the explosion of detailed reporting among most developed and desirable nations, and the self- imposed exclusion by the U.S. from many of the key mandates, the U.S. has recently been viewed as a beacon for privacy. Wealthy families around the world have increasingly considered a U.S. situs when establishing entities to hold significant portions of their wealth.

Despite praise from the FATF for aggressive enforcement of anti-tax evasion and AML laws,[21] the U.S. has been widely criticized for a lack of reciprocity in information sharing[22] and providing the legal loopholes for those seeking to hide their financial activities. Even if U.S. federal law permitted disclosure, in many cases there has been little information to share. U.S. companies

[13] A later section of this paper discusses Registries of Beneficial Owners and related access in greater detail.

[14] Article 5(1)(b) of the GDPR limits access to personal data only to be used for "specified, explicit and legitimate purposes" and provides that the controller of the data must inform the "data subjects" of requests for access.

[15] See https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/crs-by-jurisdiction/ for a list of the CRS participating jurisdictions.

[16] A Beneficial Owner is a natural person who ultimately owns or controls an entity. For example, in the case of a corporation this would be a person who directly or indirectly owns at least 25% of the shares or voting rights.

[17] The Fifth AMLD mandates public access to all registries except those of trusts, which are restricted to those "with a legitimate interest."

[18] For example, in July 2017 the Cayman Islands government approved new legislation providing for RBOs of companies. Beginning in 2021, the Crown Dependencies (Jersey, Guernsey and the Isle of Man) will interconnect corporate beneficial ownership registers with similar databases in the EU, thereby allowing law enforcement officials and financial intelligence units to access the information. Public access is planned for future years.

[19] "Patchy Progress in Setting Up Beneficial Owner Registries in the EU," Global Witness, March 20, 2020. The five EU countries with fully accessible registries are Bulgaria, Denmark, Latvia, Luxembourg and Slovenia.

[20] The Criminal Finances Act 2017 received Royal Assent on April 27, 2017. Successful prosecution can result in unlimited financial penalties, ancillary orders such as confiscation and even criminal charges. It has a wide territorial scope and applies globally to advisors working with clients or assets with a U.K. nexus.

[21] Anti-Money Laundering and Counter-terrorist Financing Measures, FATF Mutual Evaluation Report, December 2016.

are registered at the state level and many states don't require data collection for entities. Similarly, trust deeds are not subject to public record. Trusts are governed by state statutes, and, unless part of an estate settlement, are typically not required to register or submit any sort of accountings or other reports to courts or other government agencies.

So there would seem to be opportunities for people from all around the world to set up structures in the U.S. and thereby avoid most of the intrusion on privacy that they would face were they to establish their entities in another country. This has been true, but in recent years there have been an increasing number of caveats.

Applicability of Common Reporting Standard to U.S. Trusts

While it is the case that the U.S. is not a participant in the automatic exchange of information under CRS, foreign investors may still become subject to reporting even if they set up U.S. trust structures.

As discussed earlier, it is common planning for a foreign settlor to establish a foreign grantor trust under U.S. law (by, for example, retaining the power to revoke or revest assets in personal name). Since this type of trust will be transparent for tax purposes, a foreign blocker company such as a private investment company (PIC) will be required to avoid application of the U.S. estate tax on U.S. situs assets.[23] All of the reputable countries in which one would choose to establish a PIC are participants in CRS, which means there would be an exchange of information between the country of incorporation of the company and the home country of the settlor, and potentially of the beneficiaries as well.

The only ways that a trust would not require the use of a PIC for U.S. estate tax purposes would be if the trust were drafted in a way that the trust itself would act as a U.S. estate tax blocker (such as a U.S. nongrantor trust or an irrevocable U.S. foreign grantor trust) or the trust did not invest in U.S. assets. There are some unique considerations with each of these alternatives, which are exacerbated by changes in the TCJA.

Leaving aside the fact that one must give up control over the trust assets, which is often a difficult mental hurdle to overcome, a foreign settlor may choose to create a nongrantor trust in the U.S. Nongrantor trusts in the U.S. can either be considered foreign or U.S. for U.S. tax purposes depending on how they are drafted and/or who controls the substantial decisions within the trust agreement. Typically, a foreign settlor would prefer the trust to be foreign for U.S. tax purposes for maximum tax efficiency. Either way, the trust itself can block the application of the U.S. estate tax so a PIC is not necessary. That being said, difficulties may arise on the investment side as a result of the mismatch of the U.S. securities and tax laws.

From a CRS point of view, investing in offshore funds would also subject the beneficial owner to reporting in the jurisdiction where the fund is located.

In summary, a grantor trust will only be able to make limited investments without a PIC (i.e., only non-U.S. situs assets such as bonds, foreign stocks or offshore funds) and a nongrantor trust might be limited to individual stocks and bonds or other U.S.-registered investments. It is also important to note that setting up U.S. structures solely to evade reporting under CRS is not encouraged, and professional advisors may be subject to civil and criminal penalties in aiding clients in this regard.[24]

Protection From Prying Eyes: U.S. vs. Offshore

So-called "offshore tax havens" have long marketed their superior legal protection from foreign (to them) creditors and judgments. To varying degrees, many have legislation ensuring that a foreign court cannot force a trustee to disclose information, and that foreign judgments that may alter the terms of a trust or affect the beneficial interests cannot be enforced. For instance, neither the Cook Islands nor Nevis will recognize foreign judgments against a trust, forcing potential creditors to file claims in their local courts.

However, many other countries where wealthy families are domiciled view these firewalls with suspicion and place such jurisdictions on their blacklists, as discussed earlier in this paper. This can lead to additional surveillance and "enhanced customer due diligence" requirements on the part of financial institutions when doing transactions involving blacklisted countries. In turn, this results in delays and extra costs passed on to the settlors, trustees and/or beneficiaries of trusts with a situs there.[25]

Without going to the extent of countries such as the Cook Islands, states in the U.S. have varying degrees of protection from foreign legislation and judgments. Provisions against forced heirship[26] laws of other countries is one area that has found its way into the statutes of many states. While not all states explicitly refuse to recognize forced heirship claims, some have express provisions against these laws.[27]

[22] While the United States' predecessor to CRS, the Foreign Account Tax Compliance Act (FATCA), requires other countries to provide the U.S. with extensive details on the financial accounts and activities of U.S. taxpayers, the information that the U.S. must provide in return is fragmented and in most cases much more limited.

[23] U.S. situs assets for purposes of the U.S. estate tax include things such as the stock of U.S. companies, U.S. real estate and U.S. tangible property

[24] See FL professional responsibility conduct rule 4-1.2(d) and NY Bar rules of Professional Conduct rule 1.2. Also U.K. "Criminal Finances Act 2017

[25] https://www.washingtonpost.com/politics/2019/03/14/eu-tried-blacklist-countries-high-risk-money-laundering-it-backfired-heres-why/

[26] Forced heirship limits the disposition of some or all of a deceased individual's assets to "entitled heirs" as determined by the statutes of the governing jurisdiction. Individuals are not free to leave their inheritances to whomever they want.

[27] See DE (12Del laws, c.35, ss3536 and 3573); and SD (SDCL) 55-3-46)

In addition, while the U.S. may enforce some foreign judgments, it generally will not enforce the tax judgments of other countries[28] except for certain countries with which the U.S. has a tax treaty.[29]

Note that the U.S., like many offshore jurisdictions, may honor Letters of Request pursuant to the Hague Evidence Convention of 1970, of which the U.S. is a signatory. However, information would only be shared if it would still be kept confidential, and privilege in the context of U.S. domestic law would be protected.

U.S. Actions to Heighten Transparency

Despite its nonparticipation in CRS reporting, the U.S. has in recent years enacted regulations and legislation that provide the government with information regarding ownership and financial activities of foreigners as well as U.S. citizens and residents.

Geographic Targeting Orders

In January 2016 the Financial Crimes Enforcement Network (FinCEN) expanded its sources of information by requiring title companies to report beneficial owners of entities (other than trusts) used to make cash purchases[30] of residential real estate worth more than various thresholds in key markets such as New York and Miami. These Geographic Targeting Orders (GTOs) have been repeatedly reissued and extended to cover more cities and more types of transactions, including wire transfers.

Expanded Form 5472 Requirements

In December 2016 the U.S. Treasury made major changes to requirements for filing IRC Form 5472. Domestic disregarded entities such as LLCs are now required to file this form if they are owned directly or indirectly by a non-U.S. person and have a "reportable transaction" between the entity and the foreign owner or related parties. The definition of "reportable transaction" has been greatly expanded to now include the mere funding of an LLC by a foreign owner, even if the LLC does not own any U.S. assets or have any U.S. income. This in turn requires the entity, and oftentimes the foreign owner, to obtain U.S. tax identification numbers. Although currently purely a reporting issue that doesn't involve any tax liability, this puts the foreign entity and owner(s) on the IRS' radar screen, easily identifiable for future anti-privacy and potential tax initiatives.

Customer Due Diligence Rules for Financial Institutions and Advisors

In May 2016 the U.S. Treasury adopted stronger Customer Due Diligence (CDD) requirements for financial institutions and advisors. Effective May 11, 2018, banks, trust companies, brokers and other financial institutions were required to adopt written procedures to obtain information about beneficial owners, develop customer risk profiles and monitor customer accounts for suspicious activity. Discussions continue regarding expanding these obligations to involve other institutions and individuals typically dealing with wealthy clients, as well as having this information reporting centrally.

The Future for Trusts in the U.S.: Privacy vs. Transparency?

Although affected by politics and despite past opposition from some protectors of privacy, there are clear indications that the U.S. may continue in the direction of increased transparency.

In November 2018 and again in May 2019, representatives from the Office of the Controller of the Currency (OCC), FinCEN and the Federal Bureau of Investigation (FBI) testified before the Senate Committee on Banking, Housing and Urban Affairs regarding the need for a central register of the true owners of entities. U.S. Senator Mike Crapo (R-Idaho) noted FATF's criticizing the U.S. for its "anonymous corporate vehicles" with "high potential for abuse."

The Corporate Transparency Act of 2019 proposed by the Finance Committee of the House of Representatives aimed to make data available online by requiring federal financial regulatory agencies to adopt specific data standards regarding the format, searchability and transparency. This required companies, including LLCs, to disclose the identities of their beneficial owners to the U.S. Treasury. While this was not enacted immediately, it had bipartisan support, leading to the passing of the Corporate Transparency Act of 2021 (CTA).

Embedded as Provision F of the National Defense Authorization Act of 2021 (NDAA), the CTA of 2021 mandates the disclosure of beneficial owners of entities formed or registered to do business in the U.S. This information must be reported to FinCEN. It is not available to the general public, and is intended primarily for use by law enforcement and federal agencies. There are restrictions on access by state and local governments.

The CTA will be effective upon the issuance of final regulations by the U.S. Treasury, which could happen any time up to a year after the enactment.

In January 2020 the U.S. Treasury issued a National Strategy for Combatting Terrorist and Other Illicit Financing. This outlines the top priorities of the U.S. government for enforcing the Bank Secrecy Act, as well as other AML and ATE initiatives. The focus is on increasing

[28] The common law revenue rule generally allows courts to decline entertaining suits or enforcing foreign tax judgments or foreign revenue laws, but the scope of the rule is uncertain, as evidenced in the case Pasquantino v. United States - 544 U.S. 349, 125 S. Ct. 1766 (2005).

[29] These countries include Canada, Denmark, France, Switzerland and Netherlands.

[30] "Cash" includes cashier's checks, and excludes funds obtained through a bank loan.

transparency and closing gaps that open up the greatest vulnerabilities.

Furthermore, FinCEN has set about closing another potential loophole for money launderers. For the purposes of AML, banks not supervised by a federal regulator have now been brought under FinCEN's oversight and must now satisfy FinCEN's minimum standards for AML programs.

Various U.S. states are also cooperating with federal agencies by sharing information that previously was available only within the states' own government departments. For instance, in the fall of 2020, the Delaware state government agreed to disclose "protected information" to the U.S. Department of Treasury for the purpose of enforcing financial sanctions against individuals and companies. This agreement includes materials covered by attorney-client privilege as well as confidential business information.

Choosing a Trustee in the U.S.: Corporate vs. Individual?

Selecting a trustee is a critical decision that unfortunately is often not given appropriate thought. The appointment of a dependable trustee ensures that family wealth is managed and distributed according to the settlor's wishes. For non-U.S. settlors establishing a U.S. trust the choice is especially important since U.S. trust laws, taxes and reporting are particularly complex and unfamiliar. The settlor as well as the family entrust considerable authority to their trustee(s).

Despite the plethora of corporate trustees, trust settlors often think first of naming a family member or close friend as their trustee. At first blush this may appear to be the most cost-effective choice. However, given the myriad legal and tax-related duties, not to mention the increasingly complex array of investment options and the potentially delicate distribution decisions, family members typically find it necessary to engage outside advisors to guide them and even take over some of these tasks. In the end, the advisors' fees far outstrip those that would have been charged by a professional trustee.

Further, settlors from abroad often choose U.S. situs trusts for long-term wealth preservation. They take advantage of the long or nonexistent rule against perpetuities available in some U.S. states to establish dynasty trusts. To assure continuity and seamless service for future generations of beneficiaries, these long-term trusts require a corporate trustee. Individuals die, become incapacitated and may be preoccupied with their own busy lives, whereas strong trust companies live on for generations.

Appointing a corporate trustee provides a team of dedicated, full-time trust professionals working to administer trust assets. Trust officers serving at corporate trust companies are typically highly trained, experienced professionals who understand their fiduciary duties and are able to navigate the complex legal and tax issues that inevitably arise over the years while coordinating with their investment colleagues to manage the trust assets to best serve the family.

Trust companies in the U.S. are highly regulated at the national and/or state level. Regular external as well as internal audits support consistency and adherence to proper procedures, ensuring that the trust assets are safe.

But possibly the most important and rarely fully understood benefit of a corporate trustee is the value of their objectivity when administering the trust. Unlike many family members, a corporate trustee is not beholden to the special interests of beneficiaries, but acts impartially in the best interests of the trust. The trustee can also serve as a neutral intermediary to resolve any conflicts that arise among beneficiaries.

In summary, a corporate trustee adds a depth of resources, objectivity and continuity that an individual is rarely able to provide.

Conclusion

Establishing a trust in the U.S. holds many advantages for non-U.S. persons wishing to pass significant wealth to their children. At the same time, there are myriad complications and it is best to be aware of the pitfalls as well as the opportunities. Engaging a team of experienced professionals who specialize in cross-border planning is a critical first step.

@BNYMellonWealth | bnymellonwealth.com

BNY MELLON | WEALTH MANAGEMENT