

Planning for the U.S. Beneficiary of a Non-U.S. Estate

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1. General Benefits of a Trust;
2. Why foreign nationals should consider setting up trusts in Delaware;
3. When should a foreign trust be domesticated to the United States;
4. Tax considerations in the portfolio management of a trust in the United States;
5. Role of Protectors in United States trusts;
6. Planning for U.S. beneficiaries of Non-U.S. persons;
7. Operational considerations after the establishment of a United States trust.

- Individualized planning
 - Domestic trusts are highly personalized planning vehicles. There is no standard form trust agreement that must be executed.
- Solutions driven
 - Within the confines of governing law, trusts are very flexible devices that can be drafted to meet a variety of different needs of the grantor and his family.
- The design of a trust involves an in-depth consultation process with the grantor's planning attorney, who will draft the trust agreement to meet the client's needs. The end result being a tailored solution to the client.
 - A corporate trustee, with its depth of administrative experience, can also provide valuable guidance during the planning process.

- Jurisdiction Matters
 - Trustee powers
 - Absent clear direction in the trust agreement, state law will govern the duties and powers of the trustee.
 - U.S. taxation
 - A domestic trust is treated as a U.S. person for federal income tax purposes.
 - Generally, grantor trust treatment only applies if the grantor is a U.S. citizen, U.S. resident or a domestic corporation. Thus, the trust (not the grantor) will bear the federal income and capital gains tax burden.
 - Different jurisdictions tax (or do not tax) income and capital gains differently. The situs of the trust and its beneficiaries can have a significant impact on the value of the trust over time. This will be further discussed under Delaware Trusts.
 - Reporting requirements
 - For example, some jurisdictions place duties on the trustee to file an accounting with the court on a regular basis and/or require that all beneficiaries be provided with a minimum amount of information on the trust.
 - Reporting requirements can increase the trust's agency costs in terms of time, money and confidentiality.

- Choice of a Trustee

- Availability

- A trustee must make himself available to the beneficiaries who may have distribution needs, tax questions and other general concerns about the administration of the trust.
 - Many trust agreements are designed to provide for family members over a number of generations. The appointment of a corporate trustee can ensure continuity.

- Experience

- Trustees are tasked with, among other things, tax planning and reporting, record keeping, communications with beneficiaries, interpretation and implementation of trust provisions, and compliance with governing law. Grantors should be mindful of these tasks when nominating a trustee.

- Impartiality

- Many administrative and investment decisions to be made by a trustee have a direct financial impact on beneficiaries. The appointment of a corporate fiduciary can alleviate the pressure on a family member trustee, circumvent intra-family suspicion and prevent perceived or actual impropriety.

- Willingness to accept the responsibility
 - Many individual trustees, particularly family members who may be acting as a favor to the grantor, do not appreciate the full extent of the responsibilities and potential liabilities.
- Tax considerations
 - Beneficiaries also acting as trustee may trigger estate and gift tax liability.
- Key Provisions
 - Income and principal distributions
 - In terrorem/no-contest clauses
 - Incapacitation clause
 - Resignation/removal/replacement of trustee
 - Fiduciary powers
 - Powers of appointment
 - Trustee compensation

Delaware is an Attractive Trust Jurisdiction for Many Reasons:

No rule against perpetuities allows for multigenerational planning

- A Delaware trust which holds intangibles (stocks, bonds, partnership or LLC interests) or tangibles (art, jewelry) may last indefinitely without the further imposition of federal estate or taxes on the trust corpus.
- Trusts holding a direct ownership interest in real estate must terminate within 110 years – however, this limitation can easily be overcome by using an LLC or a partnership to hold the real estate. The trust would then own the LLC or partnership interest.
- By allocating his/her unused GST exemption to the trust, the settlor can ensure that no additional generation-skipping transfer tax will be imposed upon distributions to grandchildren and more remote heirs.

Strong asset protection rules protect trust assets

- Delaware is one of a handful of states that permit a settlor to create an asset protection trust for his/her own benefit.
- A self-settled asset protection trust will protect the settlor's assets from the claims of future creditors, while still allowing for distributions to the settlor in the trustee's discretion.
 - For the grantor: Self-Settled Asset Protection Trusts
 - Delaware permits an individual to create an Asset Protection Trust (“APT”), which has traditionally only been available in offshore jurisdictions.
 - Cash, stocks and bonds are ideal assets for an APT.
 - A Delaware APT should not hold real estate located outside of Delaware; assets of the trust would potentially be under the jurisdiction of courts where the property is located.
 - ❖ Unclear whether placing the real property in an LLC or an FLP and having the interests in the business association owned by the trust may avoid this issue.
 - With the increased scrutiny and reporting requirements, a Delaware APT may be favorable to an offshore trust.
 - For the beneficiary: creditor protection
 - Generally, trust assets are beyond the reach of the beneficiary's creditors.

Delaware is an Attractive Trust Jurisdiction for Many Reasons:

No state income tax on most Delaware trusts

- Delaware does not impose income tax on accumulated income or capital gains incurred by a Delaware domestic trust if all of the remainder beneficiaries reside outside of Delaware.
- Note that some states, such as California, will impose a separate state income tax on trust income if one or more beneficiaries reside in that state.
- Other tax savings
 - No intangible personal property tax, no state franchise tax, no business license tax

Business-friendly environment and sophisticated court system

- Delaware court system is nationally renowned for its corporate and trust expertise and expeditious handling of trust issues.
- The courts of other jurisdictions do not have the same experience and developed case law for fiduciaries – and beneficiaries – to look to for guidance

More Reasons Why Delaware is an Attractive Trust Jurisdiction:

Confidentiality

- Delaware law gives great protection to ensure confidentiality of trusts.
- Trustees of inter vivos Delaware trusts are not required to file periodic court accountings, register the trust with the court or hold annual meetings of the beneficiaries.

Limited Disclosure to Beneficiaries

- Delaware is one of the few states that allow “quiet trusts”.
- A trustee may withhold information about a trust from the beneficiaries for a “period of time”.
- Under the laws of most states, a trustee must inform a beneficiary of his/her interest in the trust, disclose the terms of the trust, the value and composition of trust assets and generally provide the beneficiary with such information as is necessary to enforce his/her rights.
- States which have adopted the Uniform Trust Code may have more expansive reporting requirements.

Delaware Trusts Benefit From Sophisticated Investment Laws:

Growth Oriented Investing Encouraged

- Delaware was the first state to adopt the Prudent Investor Rule which transformed the investment of trust assets.
- Trustee may invest in almost any type of asset -- investment performance is measured based on the trust portfolio as a whole, not on an asset-by-asset basis.
- Total return unitrust and power to adjust strategies allow a trustee to invest for long-term growth, while still meeting the needs of the current beneficiaries

Prudent Investor Rule May Be Waived

- The trust instrument may also expressly waive compliance with the Prudent Investor Rule, thereby freeing the trustee to hold difficult or concentrated assets such as real estate, art or single stock positions.
- Useful in connection with Irrevocable Life Insurance Trusts, Qualified Personal Residence Trusts, Grantor Retained Annuity Trusts and other sophisticated estate planning strategies.

Directed Investments

- Delaware law allows a settlor to appoint an “investment advisor” whose role is to direct the trustee as to investment strategy by express language in the governing instrument.
- Investment advisor may be the settlor, another individual (professional or non-professional investment manager) or a third-party institution. Investment Advisor may be a Non-U.S. person.
- Trustee may be directed as to a particular investment or class of assets and actively manage the trust’s other assets.
 - Administrative duties are left to the trustee.
 - Attractive when the trust holds a family business and wants to ensure that the business - or control of that business - remains in the family.

Delaware Trusts Also Benefit From Other Administrative Advantages:

Directed Distributions

- In Delaware, a settlor can authorize individual co-trustees, protectors or advisers to direct the trustee to make distributions to beneficiaries.
- Particularly attractive for settlors who wish for distribution decisions to be made by someone other than the corporate trustee and for settlors who are concerned with asset protection planning.

Limited Liability

- Except in cases of willful misconduct, a trustee will not be held liable for any loss resulting from complying with an investment direction or a distribution decision given or made by an authorized person.
- Correspondingly, an investment adviser will not be held liable for any of the trustee's non-investment activities.
- Control over Trust Terms
 - Decanting: the ability to modify the terms of an inefficient trust, without court intervention
 - Useful tool to correct trust provisions or when the trust provisions are no longer suitable to the needs of the beneficiaries.
 - Enforceability of trust terms
 - Delaware recognizes and enforces no-contest clauses: trust clauses that reduce or eliminate a beneficiary's interest in the trust if that beneficiary contests the validity of the trust.

Reduced Fees

- Corporate trustee fees are generally less when administering a trust with a directed investment adviser serving.

Advantages to Foreign Trusts Under Delaware Law

Advantages over using an “offshore” jurisdiction

- Reputation
- Government stability
- Recognition of fully revocable trusts
- Communication
- Efficiency and service

U.S. Beneficiaries

- U.S. beneficiaries of foreign trusts are subject to U.S. federal tax and information reporting requirements which are not applicable to domestic trusts.
- Foreign trust can easily be domesticated at any time (such as when the trust loses foreign grantor trust status).

Confidentiality

- Option for a “secret trust” for a period of time
 - Uncommon in other U.S. jurisdictions, where state law requires that all persons interested in a trust be notified of the trust’s existence and provided with basic information as to the terms and value of the trust.
- No court accounting required
- No requirement that the trustee file a copy of the trust agreement with a local court

Sophisticated Jurisdiction

- If a court proceeding becomes necessary, the Delaware Court of Chancery, known for its expertise in the corporate law area, also has an excellent reputation in trust law

Delaware is a money-centered jurisdiction, providing ease of transacting business

Domestication of Foreign Trusts

- Foreign Grantor v. Non-Grantor Trusts
 - Distributions to U.S. beneficiaries from foreign grantor trusts are generally non-taxable events. Distributions to U.S. beneficiaries from foreign non-grantor trusts do not enjoy such beneficial treatment.
- Current beneficiary of a foreign non-grantor trust become a U.S. citizen.
 - Throw-back tax and interest charges on accumulated, later distributed income
 - Beneficiary reporting requirements and penalties for inadequate disclosure or failure to disclose
 - Form 3520
 - FBAR
 - FACTA
 - Potential additional tax consequences to U.S. beneficiary
 - CFC, PFIC
- Death of the grantor of a foreign grantor trust with a U.S. beneficiary
 - Same results.

Establishing a Foreign Trust under Delaware Law

“Foreign” Trusts vs. “U.S.” Trusts

- The U.S. tax laws presume that all trusts are foreign trusts unless both of the following tests are met:
 - A U.S. court can exercise primary supervision over the administration of the trust (the “Court Test”); and
 - One or more U.S. fiduciaries have the power to control all substantial decisions of the trust (the “Control Test”).
- Absent either of these factors, a trust is a foreign trust for tax purposes.

Creating a Foreign Trust in Delaware

- A settlor may establish a foreign trust in Delaware by entrusting decision-making power to a non-U.S. person (usually referred to as the “Trust Protector”).
 - This causes the trust to fail the “Control Test”.
- Typically, the trust instrument will provide that the trust will be governed under the laws of Delaware and name a Delaware administrative trustee.
- If the trust is treated as a foreign “grantor” trust for U.S. income tax purposes, income and capital gains earned within the trust will escape U.S. federal income taxation.
 - Note, however, that distributions of accumulated income from a foreign grantor trust to U.S. beneficiaries will be subject to punitive tax rates under the “throwback rules”.
- When the trust loses its status as a foreign grantor trust (i.e., because the grantor has died or has released certain powers), it is relatively easy to bring the trust on-shore for the benefit of the U.S. beneficiaries.

Foreign Trusts Under Delaware Law

Role of the Protector

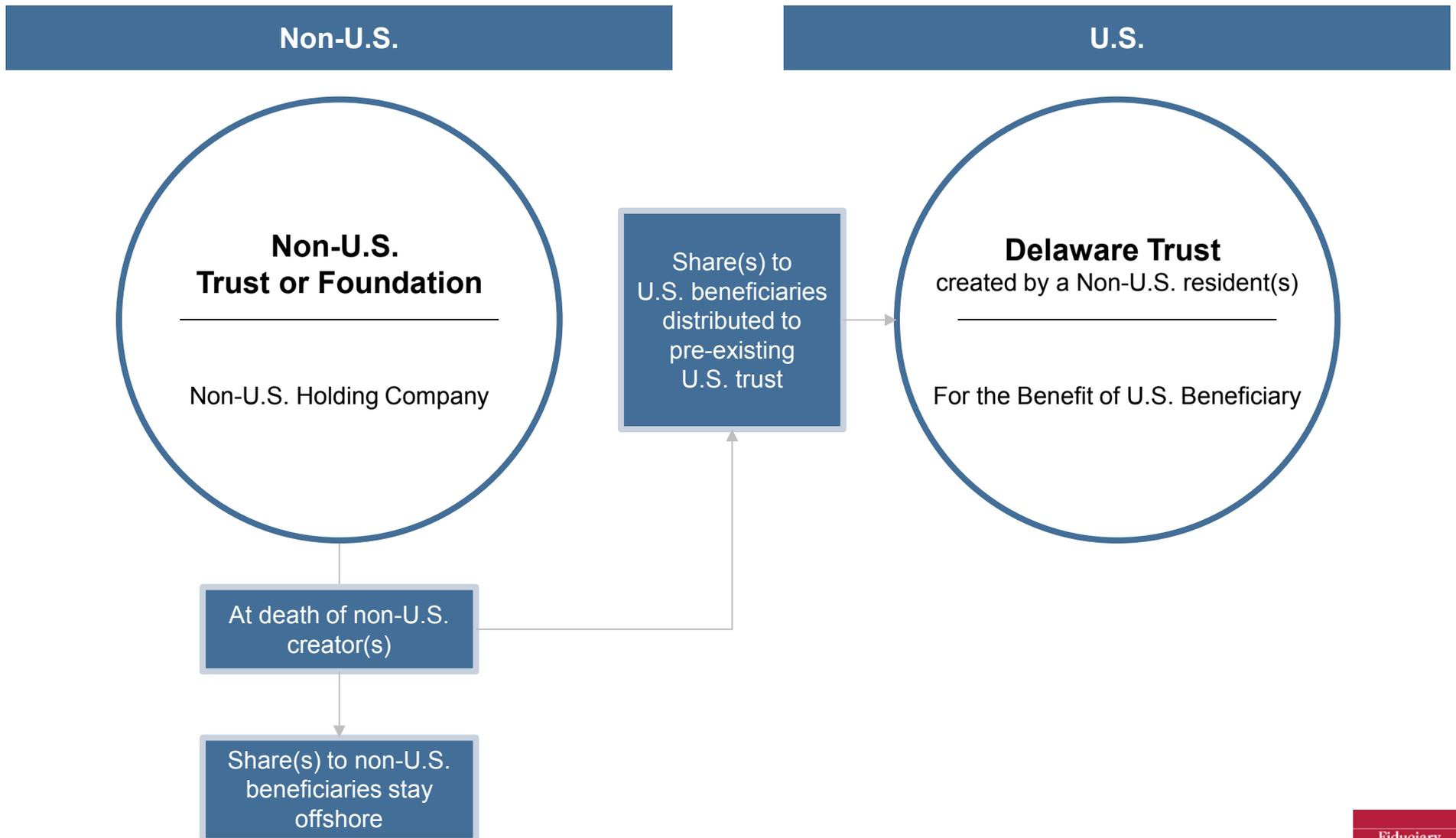
- Although the statute refers to “fiduciaries”, if a person has the power to control substantial decisions, that person (the Protector) will be treated as a “fiduciary” for the purposes of the statute.
- Substantial decisions include:
 - Whether and when to distribute income or principal
 - The amount of any distribution
 - The selection of a beneficiary
 - The power to make investment decisions
 - Allocation of receipts 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 defend a suit
 - Whether to add, remove or replace a trustee
- By naming a corporate trustee of a trust created by a non-resident alien, and selecting a non-U.S. Protector who has the power to control substantial decisions, the trust will be considered a foreign trust for U.S. tax purposes.

Using a Delaware Trust Structure

The share of a non-US estate that is for a US beneficiary should be distributed to a Delaware Trust

- The trust can be created during non-U.S. grantor's lifetime
- The trust can be nominally or significantly funded at the option of the non-U.S. grantor
- The trust is irrevocable, but can be changed during the non-U.S. grantor's lifetime by distributing the corpus to a new trust
- The trust may have one or more of the following flexibility provisions:
 - The beneficiary can be a co-Trustee
 - The beneficiary may have power to invade the trust in his or her own favor limited by an ascertainable standard
 - The beneficiary can direct investments
 - The beneficiary can have lifetime and/or testamentary power to appoint to anyone other than beneficiary, the beneficiary's estate, the beneficiary's creditors and the creditors of beneficiary's estate.
 - A distribution committee or advisor can be created to direct the trustee regarding distributions, as long as the committee or advisor is a US person.
 - The independent trustee should have broad, liberal powers to invade and terminate the trust.
 - The beneficiary may have a power to fire the trustee and appoint a new trustee who is not related or subordinate to the beneficiary.

Distribute U.S. Beneficiary's Inheritance Into a Fiduciary Trust Delaware Trust



Establishing a Delaware Trust

Goals Achieved

Protect assets from U.S. estate, gift & generation skipping taxes for every generation (currently 40% of fair market value of assets)

Protect assets from claims of divorcing spouses

Protect assets from claims of creditors - i.e., professional malpractice claims, negligence, shareholder claims, etc.

Minimize income taxes

Provide maximum control to beneficiary

Provide safety of assets in the U.S.

Better than the Alternatives

If the offshore foundation or trust continues for the benefit of the U.S. person:

- The offshore foundation or trust must comply with U.S. reporting requirements
- The U.S. beneficiary may be subject to significant U.S. income tax disadvantages, especially if the offshore foundation or trust is not properly administered to minimize those disadvantages

If offshore foundation or trust migrates onshore, significant accounting and legal delays may result

If non-U.S. estate is paid outright to the U.S. beneficiary, there are no protections for the beneficiary such as transfer tax protection and protection against claims

Tailored Family Wealth Solutions for Discerning Clients with Complex Needs

- Fiduciary Trust was founded in 1931 as a trust company to serve as a multi-family office for wealthy families.
- Fiduciary Trust is responsible for \$46.4 billion in client assets.*
- Fiduciary Trust's structure as a trust company, along with our approach, delivers clients a safe haven.
- Dependent on client needs and circumstances, Fiduciary Trust consults with the client in designing and implementing tailored family solutions.
- Custom investment portfolios for preserving the family legacy and transferring wealth in a prudent manner to the next generation.
- As a wealth management firm, Fiduciary Trust integrates strategic planning, strategic and tactical asset allocation, investment consultant advice, investment management, trustee services, master custody, reporting, tax services and account administration.
- Franklin Templeton, founded in 1947, is our parent and an established global leader in investments with \$879.1 billion in client assets invested in 85 countries.*
- Franklin Templeton is a publicly traded company that is 35% owned by the firm's founding family and employees.

* Information as of December 31, 2013.

Teresa V-F Weintraub, *President & CEO, Fiduciary Trust International of the South* (305.349.2367 - tweintraub@ftci.com.) She serves on the parent company's Operating Committee and is a member of the board of its Delaware trust company. Prior to joining Fiduciary Trust in 1998, Mrs. Weintraub was vice president and trust officer at Northern Trust Bank of Florida. From 1986-1996, she was employed by the University of Miami in positions of increasing responsibility, her last position was as executive director of development. Mrs. Weintraub began her career in 1979 as a tax attorney with Exxon Corporation in New York City. She graduated from Newton College of the Sacred Heart, now Boston College, with a B.A., *cum laude*, and from Boston College Law School. She is currently a member of the Florida Bar, Boston College Council for Women, Boston College Law School Board of Overseers and serves on the Boards of the Miami-Dade County Leave A Legacy Program and International Women's Forum. She has lectured extensively in the fields of leadership, philanthropy and estate planning as well as having served on numerous not for profit boards.

Gloria Fieldcamp, *Managing Director* (212.632.3225 - gfieldcamp@ftci.com.) is responsible for building investment and trust relationships with individuals, families and foundations. With more than 20 years of wealth management experience, Ms. Fieldcamp has held senior positions with leading financial institutions. Prior to joining the firm, Ms. Fieldcamp served as first vice president within Merrill Lynch's Private Banking and Investment Group, a division dedicated to ultra-high net worth clients. Most of Ms. Fieldcamp's previous career was spent at JPMorgan Chase & Company, where she also focused on ultra-high net worth individuals and families. Ms. Fieldcamp earned her B.A. in economics and B.A. in romance languages from New York University. She is fluent in Spanish, French, Italian and Portuguese. Ms. Fieldcamp is actively involved in 100 Women in the Hedge Funds organization and the Woman's Committee of the City Museum of New York. Ms. Fieldcamp is on the advisory board of Tata Harper Skincare as well as Chair of the Audubon's Women in Conservation.

Xavier Martinez, CFA, *Managing Director* (305.349.2374 – xcmartin@ftci.com.) joined Fiduciary Trust in 2006. Prior to joining Fiduciary Trust, Mr. Martinez practiced law for over eight years with Podhurst Orseck P.A., litigating plaintiff's tort cases in the field of aviation and products liability law, as well as representing corporate clients in complex commercial disputes. Mr. Martinez is a Chartered Financial Analyst (CFA) charterholder. He received his J.D. from Duke University School of Law in 1995 and his undergraduate degree in civil engineering from Tulane University in 1992. He is a member of the Florida Bar and has served on the Board of the Dade County Trial Lawyers Association. He presently serves as president on the Board of Directors of the College Assistance Program (CAP), Inc. and on the Board of Advisors of Belen Jesuit Preparatory School.