U.S. Gains Favor as Trust Jurisdiction for Nonresidents

Recent developments reduce the allure of off-shore "tax havens," increasing the comparative advantage of forming trusts in the U.S.

This article was originally published in the September 2016 edition of *Estate Planning* magazine.

by Michael Kosnitzky

Recent developments reduce the allure of off-shore "tax havens," increasing the comparative advantage of forming trusts in the U.S.

Two recent international developments have raised concerns among professionals in the international tax and estate planning communities about the continued viability of using many of the traditional off-shore "tax haven" or structured product jurisdictions such as the British Virgin Islands, the Cayman Islands, Ireland, the Isle of Man, Jersey, Liechtenstein, Luxembourg, the Netherlands, and Panama for trusts and family or private-interest foundations. These concerns have caused international practitioners and their clients to consider moving trust assets to the U.S. and the use of trusts formed in the U.S. that are governed by protective state laws with U.S. resident trustees.

New transparency

The Panama Papers disclosures (i.e., leaked documents associated with the Panamanian law firm of Mossack Fonseca containing detailed information about hundreds of thousands of offshore entities) have created great concern in the ultra-wealthy foreign community that its long-treasured confidentiality will be compromised. Furthermore, many jurisdictions, including the tax havens listed above, have adopted or are on the verge of adopting an international system that will provide for the automatic sharing between participating jurisdictions of the identity and residence of the financial account holder, account detail, and reporting entity, as well as the account's balance and value and its income, sale, and redemption proceeds. The exchange of information will begin for many jurisdictions next year, although the information that is required to be reported in 2017 is from 2016 so the jurisdictions in the earliest phase should have already started to gather the required information.1 This global cooperation and sharing of information system is known as the Common Reporting Standard (CRS), and it creates an information standard for the automatic information exchange (or AIE) between jurisdictions that are participating members in the program. In March 2014, the "Early Adopter Group" issued a statement declaring their support for the adoption of the CRS in their respective jurisdictions. Then in May 2014, a declaration on AIE in tax matters was first approved at the meeting of the Organization for Economic Co-operation and Development (OECD) Council at the Ministerial Level, making the CRS the first ever world-wide system of automatic information exchange.

Michael Kosnitzky
Tax
+1.786.913.4884
michael.kosnitzky@pillsburylaw.com

Michael Kosnitzky is a partner in Pillsbury's Tax practice, resident in the law firm's New York and Miami offices. His practice includes representation of both domestic and foreign high-net-worth individuals and corporations, partnerships, limited liability companies, S corporations, and real estate investment trusts.

Even with its many flaws, the CRS significantly enhances transparency in multinational business and investment reporting among the participating jurisdictions' respective tax authorities. The legal basis for exchange of data comes from the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (CRS MCAA), the Convention on Mutual Administrative Assistance in Tax Matters, and the respective participating countries' enabling legislations. The concept is based upon the United States' Foreign Account Tax Compliance Act (FATCA) whereby over 100 countries signed intergovernmental agreements and have either enacted, or will enact local information exchange legislation.

Both FATCA and the CRS require that financial institutions residing in a participating jurisdiction implement due diligence procedures, document and identify reportable accounts, and establish an extensive reporting process. Under both FATCA and the CRS, the burden of reporting is generally placed on financial institutions. The typical financial institutions that are required to report include custodial institutions, depository institutions, investment entities, and certain insurance companies.

A custodial institution for CRS purposes is defined as "any Entity that holds, as a substantial portion of its business, Financial Assets for the account of others. An Entity holds Financial Assets for the account of others as a substantial portion of its business if the Entity's gross income attributable to the holding of Financial Assets and related financial services equals or exceeds 20 percent of the Entity's gross income during the shorter of: (i) the three-year period that ends on 31 December (or the final day of a non-calendar year accounting period) prior to the year in which the determination is being made; or (ii) the period during which the Entity has been in existence." Thus, a custodial institution would include most corporate trustees as we understand them to be that are acting as professional fiduciaries over assets held in trust for others. In addition, the trusts themselves could be reporting financial institutions depending on the circumstances.

The U.S. has said that it is committed to sharing FATCA-related information under its IGAs, but the scope of this information and the number of foreign recipient countries is limited.

Participating jurisdictions

More than 100 jurisdictions, including all 34 member countries of the OECD and G20 members, have committed to implement the CRS. Emulating the model created by FATCA, the CRS created a global standard for the annual automatic exchange of financial account information between the tax authorities of participating members. Starting in 2017, 55 jurisdictions will begin reporting, including:

- Argentina.
- Bermuda.
- The British Virgin Islands.
- The Cayman Islands.
- Colombia.
- France.
- Germany.
- Gibraltar.
- Guernsey.
- Hungary.
- India.
- Ireland.
- The Isle of Man.
- Italy.
- Jersey.
- Liechtenstein.
- Luxemburg.
- Malta.
- Mexico.
- Netherlands.
- Spain.
- The United Kingdom.

The 2017 reporting jurisdictions are known as the Early Adopter Group. Then in 2018, 46 jurisdictions will start reporting including:

- The Bahamas.
- Brazil.
- Canada.
- Costa Rica.
- Hong Kong.
- Israel.
- Macao.
- Monaco.
- New Zealand.
- Saint Kitts.
- Nevis.
- Singapore.
- Switzerland.
- Uruguay.

In April, shortly after the release of the Panama Papers, Panama also agreed to become a participating member and will undertake its first exchange by 2018. So, for example, starting in 2018, if a Colombian resident is a beneficiary of a New Zealand trust or Panamanian

foundation, the trustee or foundation council will be required to provide financial information of the trust or foundation to the New Zealand Department of Inland Revenue, which in turn will exchange it with the Colombian taxing authority.

The dates of disclosure are misleading because the information to be exchanged by 9/30/2017 is for 2016 tax information. Thus, the Early Adopters should already be gathering the information that is required to be exchanged. The information that is required to be exchanged by 9/30/2018 will start to be captured on 1/1/2017.

Other jurisdictions are close to implementation including Peru and Guatemala. Peru and Guatemala are members of the OECD's Global Forum on Transparency and Exchange of Information, so they presumably have committed to implementing AIE. Moreover, Guatemala has actually signed the Convention on Mutual Administrative Assistance in Tax Matters (the Convention is an information exchange agreement similar to CRS MCAA).

The Early Adopters Group committed to the implementation of the CRS in 2015 and, as noted above, the first exchanges of information start next year. All EU members, with the exception of Austria, are also members of the Early Adopters Group. The OECD released the full version of the CRS in July 2014. The full version includes:

- Commentaries and guidance for implementation by governments and financial institutions.
- A model Competent Authority Agreement.
- Standards for harmonized technical and information technology modalities (including a standard reporting format).
- Requirements for secure transmission of data.

Each participating jurisdiction will be required to enact domestic legislation or rules to provide for the implementation of the CRS.

There is one very notable exception from the list of countries that have joined CRS. The U.S. has, so far, not joined the initiative because of its own extensive network of intergovernmental agreements it has already implemented under FATCA. The prevailing view is that the U.S. does not need to be a party to the CRS because it already receives information with respect to U.S. taxpayers through FATCA.

Comparison of CRS and FATCA

Supporters of the CRS argue that bilateral FATCA agreements are not as comprehensive as the CRS. FATCA is a reporting standard that emphasizes the reporting of U.S. persons' foreign accounts. While the FATCA 1A intergovernmental agreements (1A IGAs) provide for reciprocal reporting of information on non-U.S. persons' accounts in the U.S., the information is limited. For example, these FATCA bilateral agreements fail to include information on accounts that are indirectly owned (i.e., FATCA does not look through corporate structures that own numerous bank accounts to determine the true beneficial owner of the account). Furthermore, the automatic exchange of information for non-U.S. residents under FATCA does not provide account balances, and information is shared with only a limited number of jurisdictions that meet stringent privacy standards which therefore excludes many non-European jurisdictions.

It seems that these differences will not be ironed out anytime soon. Any attempt to better align FATCA with CRS would require congressional approval, and our elected officials are in no hurry to enact changes because of the strength of the U.S. banking lobbying and the desire to give U.S. financial institutions a marketing advantage over their foreign counterparts. Furthermore, the Treasury and the IRS believe they do not have the regulatory authority to require U.S. financial institutions to collect all the information required under both FATCA and the CRS in the absence of congressional approval.

One of the big differences in the two disclosure regimes is that under FACTA, if a financial institution fails to comply, the U.S. imposes a punitive withholding tax against the institution. While the domestic laws of other jurisdictions may someday impose penalties for noncompliance, CRS does not impose a withholding tax regime for noncompliance. The point is that the U.S. has the leverage to demand significant amounts of financial information from foreign financial institutions about U.S. citizens but the foreign jurisdictions participating in the CRS and FATCA cannot impose reciprocal treatment on the U.S. with respect to their residents. The U.S. has said that it is committed to sharing FATCA-related information under its IGAs, but as discussed above, the scope of this information and the number of foreign recipient countries is limited.

Conclusion

Because the U.S. has thus far refused to participate in the CRS, trustees of trusts that have direct or indirect beneficiaries who are residents of CRS-participating jurisdictions should consider moving their trusts and their trust assets to the U.S. for legitimate non-tax evasion reasons, such as asset protection and or privacy. Alaska, Delaware, Nevada, and South Dakota are examples of jurisdictions with favorable asset protection and privacy regimes for trusts. Such trustees should also consider, however, retaining competent U.S. counsel to advise them on, among other issues, the implication of U.S. reporting such as FBARs, Form 8938, and U.S. income tax considerations.

Endnotes

1 Several countries—including Brazil, Chile, and Argentina—anticipating the concern of their residents, have implemented or are considering implementing amnesty programs allowing for the repatriation of off-shore money provided that taxes are paid.

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | +1.877.323.4171