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Planning for the Use of the United States as a Financial Haven: Part One

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The United States has not agreed to participate in the Common Reporting Standard[1] (CRS), relying instead on the Foreign Account Tax Compliance Act (FATCA) regime enacted in 2010 and initiated in 2014. United States participation in CRS is highly unlikely.[2] Even with a change in control of Congress, CRS may be viewed as unnecessary because FATCA has been implemented by a series of intergovernmental agreements (''IGAs''), most of which provide for reciprocal exchanges of information.

While reciprocity is a feature in most of the IGAs entered into by the United States with its FATCA partners, the information provided by the United States to a FATCA partner is quite limited.[3] The reciprocal IGAs do not require the United States to give its FATCA partner any information about:

- cash accounts held by entities, even entities resident in the FATCA partner country;
- non-cash accounts, whether held by individuals or entities, even those resident in the FATCA partner country, unless the accounts earn U.S.-source income; or
- the identity of the persons who control entities with U.S. accounts — again, even if the entities or the persons who control them are residents of the FATCA partner country.

The United States has limited reciprocal disclosures to be made to FATCA partners and does not require its financial institutions to gather the same account information which FATCA requires regarding the foreign financial accounts of U.S. citizens. However, non-U.S. owners of U.S. entities are not exempt from other reporting and recordkeeping requirements. In a Notice of Proposed Rulemaking published on May 10, 2016, the IRS proposed amending Reg. §301.7701-2(c) and §1.6038A-1(c) to create a special rule imposing §6038A reporting requirements on U.S. disregarded entities that are wholly owned by a foreign person (individual or entity).[4] When finalized, the regulations will treat foreign-owned single-member LLCs (FSMLLCs) organized in the United

[1] OECD, *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, OECD Publishing (2014) (DOI: http://dx.doi.org/10.1787/9789264216525-en).

[2] A limited sense of the Congressional perspective on information disclosures to other countries may be gleaned from the letter of Republican Representative Bill Posey to Jack Lew, Secretary of the Treasury, dated July 1, 2013, Tax Analyst DOC2013-16408.

[3] A list of countries with which the United States has negotiated and signed or reached an agreement in substance can be found at ''Foreign Account Tax Compliance Act,'' *U.S. Department of the Treasury*, https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx. Only Model I IGAs have reciprocal information exchange provisions. However, a significant minority of Model I IGAs do not.

[4] REG-127199-15, 81 Fed. Reg. 28,784 (May 10, 2016).

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States as corporations.[5] Consequently, FSMLLCs will be required to:

- obtain entity identification numbers from the IRS which will require identification of a natural person related to the LLC;
- annually file Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*;
- identify ''reportable transactions'' between the LLC and any related parties, including the LLC's foreign owner; and
- maintain supporting books and records.[6]

Although financial institutions do not have reciprocal obligations under FATCA to gather information regarding foreign depositors and their U.S. accounts, FinCEN has issued final rules effective July 11, 2016, to strengthen customer due diligence efforts of ''covered financial institutions.''[7] Covered financial institutions for purposes of FinCEN's customer due diligence requirements include banks, federally insured credit unions, broker-dealers, mutual funds, Futures Commission Merchants, and introducing brokers in commodities.[8] The requirements apply to corporations, limited liability companies, general partnerships, and other entities created by filing public documents or formed under laws of a non-U.S. jurisdiction (''Legal Entity Customers''). Covered financial institutions must obtain the identity of an account's ''beneficial owners'' whenever a Legal Entity Customer opens a new account (including new accounts of existing account owners).

Personal identifying information must be obtained by the covered financial institution regarding each beneficial owner, although the covered financial institution is permitted to rely on the Legal Entity Customer's certification regarding its beneficial owners. A beneficial owner is each individual who owns 25% or more of the equity interests in the Legal Entity Customer. Even if no beneficial owner meets the 25% threshold, the covered financial institution must obtain identifying information for at least one individual who exercises significant managerial control over the Legal Entity Customer.[9]

Planning for Financial Privacy

As observed above, the United States is glaringly absent from the list of countries participating in CRS. Similarly, U.S. trusts are glaringly absent from FinCEN's list of Legal Entity Customers, as trusts are not formed by filing public documents. Consequently, non-U.S. persons are enabled to deposit assets with U.S. financial institutions without disclosure of beneficial ownership when the accounts are established by a U.S. resident trustee. How then to structure and draft the trust instrument?

Settling a Trust in the United States: Generally, the presence of a trustee in a particular U.S. jurisdiction (one of the 50 states or District of Columbia) and the trust instrument's invocation of the law of the jurisdiction in which the trustee resides is sufficient to cause the trust to be viewed as established in a particular U.S. jurisdiction for state law purposes. In order to avoid CRS reporting, the trust must minimize its contacts with those jurisdictions participating in CRS disclosure. The presence of trustees in CRS jurisdictions is to be avoided. In order to avoid CRS disclosure, the trust established in the United States can only custody its assets with U.S. financial institutions (or financial institutions in another non-reporting jurisdiction). Otherwise, if the financial institution is in a CRS jurisdiction, the financial institution will be obligated to disclose not only the owner of the account (that is, the U.S. trust) but also ''controlling persons.'' For CRS purposes, the controlling persons of a trust include the settlors, trustees, trust protectors, beneficiaries, and any other natural person exercising ultimate effective control over the trust.[10]

U.S. Tax Laws

While the United States is desirable as a financial haven, its comprehensive tax system must be reckoned with. The United States taxes residents (including trusts deemed resident in the United States) on worldwide income including interest, dividends, rents, annuities, and other types of investment income as well as gains realized on the sale of foreign and do-

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[5] Prop. Reg. §301.7701-2(c)(2)(vi).

[6] 81 Fed. Reg. 28,786 (May 10, 2016) (Preamble: Explanation of Provisions).

[7] *See* RIN 1506-AB25, 81 Fed. Reg. 29,398–29,458 (May 11, 2016).

[8] 31 C.F.R. §1010.605(e)(1).

[9] *See* 31 C.F.R. §1010.230(d)(2).

[10] ''The term Controlling Person corresponds to the term 'beneficial owner' as described in the Financial Action Task Force (FATF) Recommendations. For an Entity that is a legal person, the term Controlling Person means the natural person(s) who exercises control over the Entity, generally natural person(s) with a controlling ownership interest in the Entity.'' *The CRS Implementation Handbook*, p. 47, ¶106. ''Countries should require trustees of any express trust governed under their law to obtain and hold adequate, accurate, and current beneficial ownership information regarding the trust. This should include information on the identity of the settlor, the trustee(s), the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust.'' *Financial Action Task Force:* the FATF Recommendations for International Standards on Combatting Money Laundering and the Financing of Terrorism & Proliferation, February 2012 (updated June 2016) p. 91.

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mestic assets.[11] The United States also has a comprehensive estate tax system which taxes individuals domiciled in the United States on the fair market value of worldwide assets. The estate tax exemption for nonresidents is limited to $60,000.[12] Assets in excess of the exemption are subject to estate tax rates of 18–40%.[13] The U.S. estate tax is imposed on the entire fair market value of the assets included in the decedent's gross estate (less debt and other liabilities to which the assets are subject).[14]

Designing the trust to make it nonresident for U.S. income tax purposes, as well as further planning to minimize U.S. income taxes and avoid U.S. estate taxation, will be discussed in a subsequent commentary.

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[11] *See generally* §871(a)(1)(A). In contrast to the income itself, gains from assets that produce U.S.-source income are generally not subject to U.S. income taxation when realized by a non-U.S. person (including a nonresident trust). The notable exception, however, are gains derived from sales of U.S. real property interests. *See generally* §897.

[12] *See* §2102(b). The tax credit of $13,000 yields an exempt amount under the rate schedule of §2001(c) of $60,000.

[13] §2001(c).

[14] §2031, §2051.

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