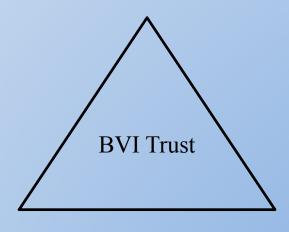
Estate Planning Council of Greater Miami February 19, 2015

U.S. Tax Considerations for Multi-Jurisdictional Family Trust Planning

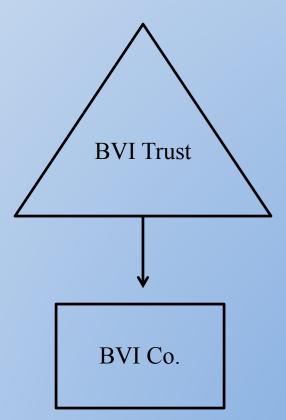
Presented by **Todd N. Rosenberg, Esq.** of Packman, Neuwahl & Rosenberg 1500 San Remo Avenue, Suite 125 Coral Gables, Florida 33146 (305) 665-3311 / tnr@pnrlaw.com

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General Disclaimer: This discussion is not all encompassing as to the various U.S. tax issues associated with foreign trusts and the settlors or beneficiaries thereof. The intention of this discussion is to provide a basic and general discussion as to specific common issues which arise in planning for foreign trusts and multi-jurisdictional family members (including U.S. persons). You should not, and cannot, rely upon this discussion as U.S. tax advice. If there are any U.S. tax concerns in relation to a specific inquiry relating to the U.S. tax treatment of foreign trusts, please contact or engage appropriate U.S. tax counsel to advise accordingly.

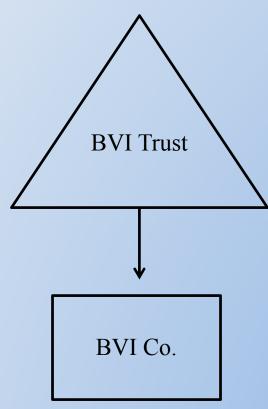


- Revocable trust with a non-U.S. person settlor.
- BVI trust company as trustee.
- The trust is governed by, and administered under, the laws of the BVI.
- The trust is for the primary benefit of the settlor with the settlor having the right to direct income (to the settlor or others).
- There are also U.S. and non-U.S. person remainder beneficiaries upon the settlor's death.



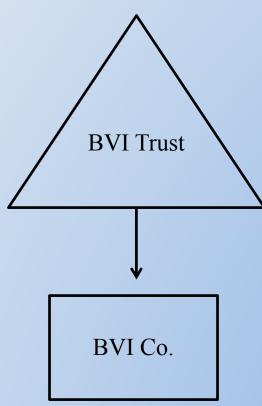
Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments



Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments U.S. Income Tax Considerations



Why is it a "foreign" trust for U.S. tax purposes?

Because it is not a "domestic" trust. To be a "domestic" trust, the trust must satisfy both the "court test" and the "control test."

Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

Court Test

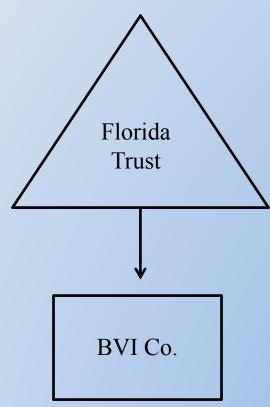
A U.S. court must be able to exercise primary jurisdiction over the trust, i.e., the authority to determine substantially all issues regarding trust administration.

Consider Case Study 1: The trust is subject to, and administered under, the laws of the British Virgin Islands. In Case Study 1, the "court test" is not satisfied.

Control Test

One or more U.S. persons have the power to control <u>all</u> "substantial decisions" of the trust.

Consider Case Study 1: A non-U.S. person settlor has the power to revoke the trust and a non-U.S. person is serving as trustee. In Case Study 1, U.S. persons do not control all "substantial decisions".

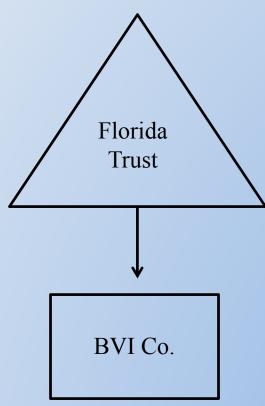


Use the same facts as Case Study 1 except that the trust is a State of Florida revocable trust structure where the trust is governed by, and administered under, the laws of the State of Florida.

Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

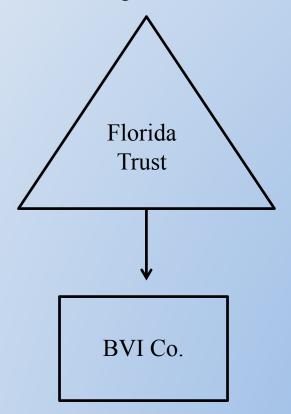
Case Study 1: The Foreign Grantor Trust



Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments The trust is a foreign grantor trust despite the governing law and administration being that of and in the State of Florida.

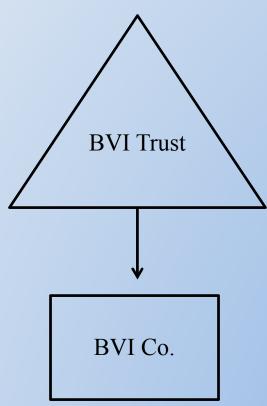
The "control" test is not satisfied as a result of the fact that U.S. persons do not have the power to control all "substantial decisions" of the trust. The trust is subject to a revocation power in the hands of a non-U.S. person.



Account 1: U.S. Portfolio Investments Account 2: Non- U.S. Portfolio Investments Other more common "substantial decisions" to consider:

- Whether and when to distribute income or corpus.
- The amount of any distributions.
- The selection of a beneficiary.
- Whether a receipt is allocable to income or principal.
- Whether to terminate the trust.
- Trustee removal and appointment powers when held by the same party. What if a non-U.S. person holds the power to appoint without the corresponding power to remove and is limited to appointing a U.S. person trustee?
- Investment decisions; however, if a U.S. person hires an investment advisor for the trust, investment decisions made by the investment advisor will be considered substantial decisions controlled by the U.S. person if the U.S. person can terminate the investment advisor's power at will.

Case Study 1: The Foreign Grantor Trust



What is a grantor trust for U.S. income tax purposes?

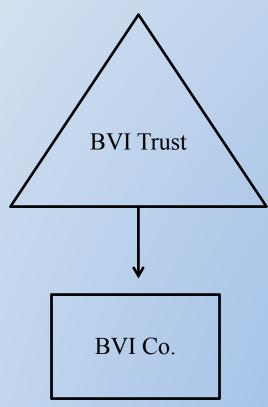
The grantor trust rules are used to determine who is the owner of all or a portion of the trust for U.S. income tax purposes. Generally, the tax attributes (e.g., income, deductions, expenses and credits) are attributable to the "owner."

Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

See Code §§ 671 - 679

Case Study 1: The Foreign Grantor Trust



Why is this trust a grantor trust for U.S. tax purposes?

A foreign grantor will be deemed the owner of property transferred to a trust if: (a) the foreign grantor retains the power to revoke the trust; or (b) the only distributions made from the trust during the grantor's life are to the grantor or the grantor's spouse. Our scenario deals with (a), the power to revoke the trust.

Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

See Code § 672(f)

Drafting tip in relation to the power to revoke...

Most revocable trust documents contain a standard revocation clause that allows the settlor to revoke the trust upon giving a written instruction to the trustee.

What happens to the revocation power in the event the settlor is under a disability or incapacity? Does the revocation power cease temporarily? If the revocation power ceases, does the trust become a foreign nongrantor trust? If the trust becomes a foreign nongrantor trust, the U.S. "tax clock" begins to tick at which time many advantages could be lost in respect of U.S. person beneficiaries and many complications will arise.

Drafting tip in relation to the power to revoke...

Consider drafting for incapacity in order to present stronger arguments that grantor trust status continues during the disability or incapacity of the settlor.

The applicable Regulations indicate that the power to revest (i.e., revoke) can be exercisable solely by the grantor (or, in the event of the grantor's incapacity, by a guardian or other person who has unrestricted authority to exercise such power on the grantor's behalf) without the approval or consent of any other person.

Who can serve as the "other person" for this purpose? How about a trustee, power of attorney or other authorized individual?

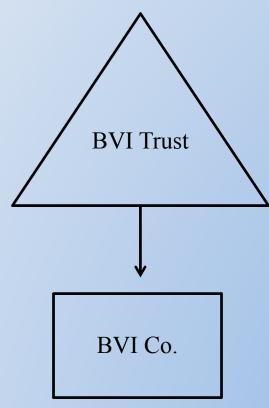
Practical tip in relation to foreign grantor trusts which are jointly settled by husband and wife...

In a jointly settled revocable trust, the revocation power generally remains exercisable by the surviving spouse upon the death of the first settlor.

Due to a technical U.S. tax rule, the trust could arguably be grantor as to one-half (the surviving spouse's half) and nongrantor as to the remaining one-half (the deceased spouse's half).

Practical tip in relation to foreign grantor trusts which are jointly settled by husband and wife...

Consideration should be given to having the surviving spouse settle a new revocable trust upon the death of the first spouse or consideration should be given to distributing the shares of the underlying corporation to the surviving spouse so that the surviving spouse can then recontribute the shares back to the same trust. Actual stock powers, share certificates and updated registries should be used to effectuate the transfers out of and back into the trust.

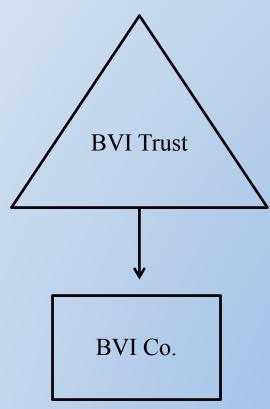


Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments So we know that the settlor is treated as the owner for U.S. tax purposes....

What if distributions are made to U.S. person beneficiaries during the lifetime of the settlor, while the settlor is not disabled (or incapacitated) and the trust still remains revocable?

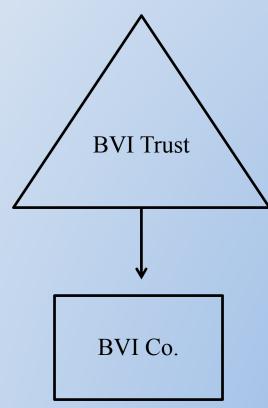
Subject to certain points discussed in the slides that follow, any such distribution should be considered a gift from the settlor and not taxed as a distribution from a foreign trust.



Is there a difference if the physical distribution comes from the foreign grantor trust or the underlying non-U.S. corporation?

Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments



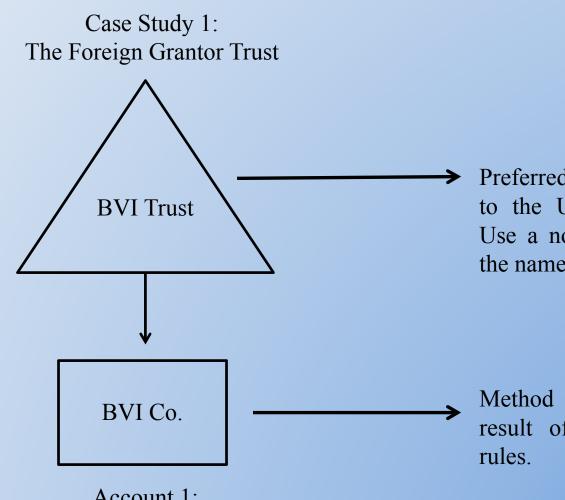
Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

CAUTION as a result of the rules relating to the recharacterization of purported gifts...

- ...if a United States donee directly or indirectly receives a purported gift or bequest from any foreign corporation, the purported gift or bequest must be included in the United States donee's gross income as if it were a distribution from the foreign corporation...
- ...the United States donee is not treated as having basis in the stock of the foreign corporation...

See Reg §1.672(f)-4

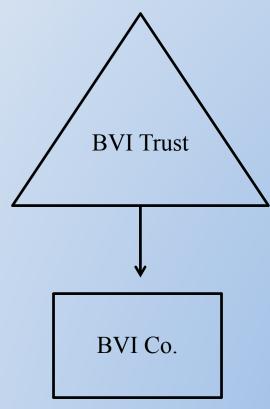


Preferred method for distributionto the U.S. person beneficiary.Use a non-U.S. cash account inthe name of the trust.

Method should be avoided as a result of the recharacterization rules.

Account 1: U.S. Portfolio Investments

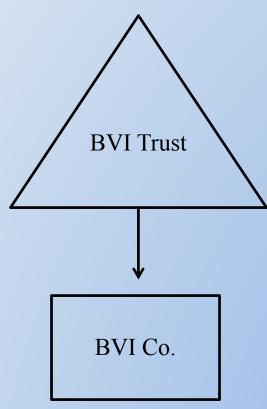
Account 2: Non- U.S. Portfolio Investments



Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments The rules relating to the recharacterzation of purported gifts is a presumption. There are exceptions, and one common exception to note is as follows:

The recharacterization will not occur if, in the non-U.S. person's country of residence and for purposes of that country's tax laws, said person treats and reports the purported gift or bequest as a distribution to himself or herself followed by a subsequent gift or bequest to the U.S. person donee. The burden is on the U.S. person donee to prove that this was done.



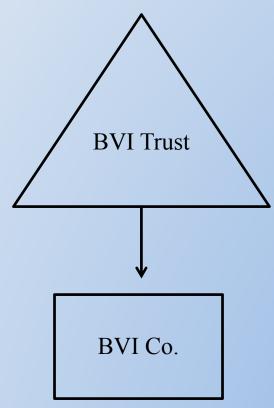
The U.S. person beneficiary will use Form 3520 to report the distribution from the foreign grantor trust.

Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

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Case Study 1: The Foreign Grantor Trust



Account 1: U.S. Portfolio Investments

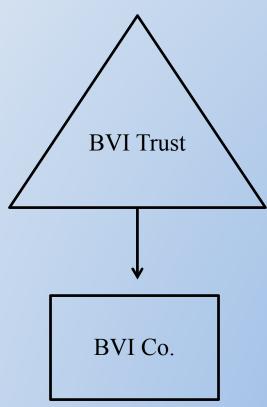
Account 2: Non- U.S. Portfolio Investments Some important notes to consider in relation to Form 3520:

- On the next few slides, notice the difference between the information required in relation to reporting a distribution from a foreign grantor trust versus the information needed to report a gift from a non-U.S. person.
- Notice the line of questioning on Form 3520 in relation to distributions from foreign corporations (and foreign partnerships).

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UPT.	And a second the second s	ovenned	
	Del you receive a Foreign Grantor Trust Beneficiary Statement from the foreign trust eth respect to a	Sector Sectors	171.000
	Seriador?	Yes [.] 100	LI NA
	If "Yes," attach the elotenent and do not complete the remainder of Part II with respect to that doubticitor.		
	If "No," pringletie Schedulo A with respect to that distribution. New complete Schedule C If you writer all		
	answer greater than zero on line 37.		
×.	Dod you receive a Foreign Nongentor Trust Beneficary Elatament fore the Sovign that with respect to a statistication?	No. CLASS	71
	V "Yes," attach the statement and complete sitter Schedule A or Schedule S below (see instructions). New	100 [1] 000	11.000
	to make added the second and complete strate to make an another the schedule in before period to the strategy and the strateg		
	# "No." complete Schedule A with negact to the statistication. Also complete Schedule C if you write an		
	amount grader than zero on the 57.		
-	Schedule A Default Calculation of Trust Distributions (see Instructions)		_
31	Enter amount from the 27	1	
11	Teuritor of years the hust has been a forego trust (see instructions)	1.	_
10	Great total diatrituitures received from the foreign trust during the 2 preceding lies were on storing the number of	1.000	
	yours the third has been a foreign yout. If fever that 2		
24	Multiply Rev 3D by 125		
36	Average dambation: Divide Itim 34 by 3 for the number of years the trust has been a foreign trust, if lewer than 31		
	and over the result		
36	Armaunt treated as ordinary income wanted in the current year. Enter the smaller of line 31 or line 36	-	
37	Amount treated as accumulation distribution. Subtract line 30 horn line (rt. H -0-, do not complete the rest of Part II	-	_
38	Applicable number of years of trust. Divide line \$2 by 3 and enter the result here >		_
211	Schedule 8 – Actual Calculation of Trust Distributions (see instructions)	1.1	
38	Enter emost. Hors live 27	-	
ADA.	Amount treated as undirary moome in the current tax year		
. 6	Quitechilden	And in case of the local division of the loc	
*10	The big strange of sector states and a strange of the sector states of the sector states and t	-	_
. *			
	Ansunt treated as not abort sent capital pain in the current tax year. Ansunt treated as not long-term readiliting on in the current tax year.		
-		-	
45	Arount Invated as distribution from trust corpus	-	
44	Enser any other distributed amount movived from the foreign inust not included on item 40s, 41s, 42s, 42s, and 43	-	
-	latach equipration)		
44	Avecuari of foreign trust's appropriate under brushed net income		
48	Amount of Rangin trust's wolghted underbituted net income		
47	Applicable number of years of trust. Childs line 48 by tine 45 and enter the testal frem IP		
	Behedule C Celculation of Interest Charge (see Instructions)		
48	Enter accumulation distribution from live 37 or 41a, as application	-	
	Grear tax on tatal accumulation diatribution from itre 25 of Form 4870 (attest Form 4870) - see instructions)	-	
50	Enter applicable number of years of fereign trust from time 36 or 47, as applicable interval	100	
	to reasol half year a set of a	-	
新.	Combined Interest rate imposed on the total accumulation distribution (see instructional)		
52	Internet charge. Multiply the amount on line 49 by the combined internet rate on line 51		
58	Tan attributable to annunukation detributions. Alst times 49 and 52, Erbir here and an "attribute" on your		
	Income tax returns		3520

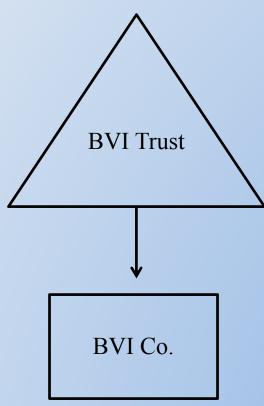
Part IV	U.S. Recipient Instru		or Bequests Rece	lead During the Current Tax Yes	er From Forsign P	Pagel
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Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

U.S. Gift Tax Considerations

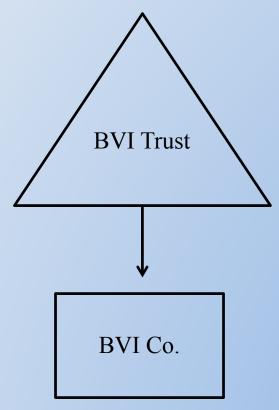


Assuming the distribution is treated as a gift from the non-U.S. person settlor, if the gift is considered a transfer of anything other than U.S. tangible property, the transfer should be free from the U.S. gift tax.

Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

See Code § 2511 and applicable Regs.



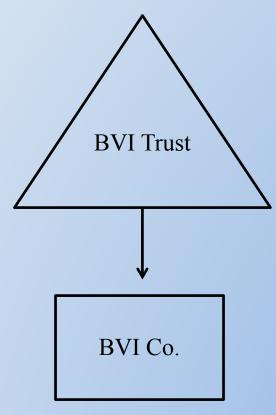
Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments Examples of U.S. tangible property:

- U.S. real estate.
- U.S. situated cars, boats and artwork.
- Cash on deposit at a U.S. bank?

Examples of transfers which should not be subject to the U.S. gift tax:

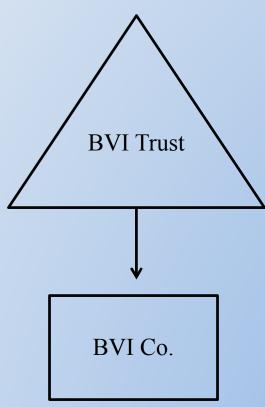
- Non-U.S. real estate.
- Non-U.S. tangible personal property.
- Cash on deposit at a non-U.S. bank.
- Non-U.S. intangible property (e.g., stock of a BVI corporation).
- U.S. intangible property (e.g., stock of a U.S. corporation).



Account 1: U.S. Portfolio Investments

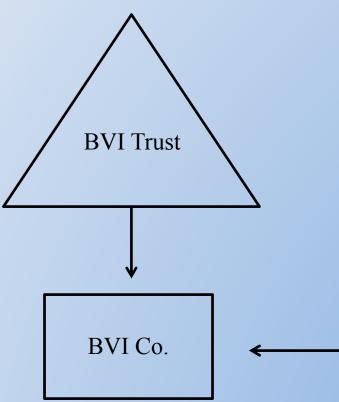
Account 2: Non- U.S. Portfolio Investments Consider the fact that a U.S. person donee is required to file a Form 3520 when the value of the gift from a non-U.S. person is more than \$100,000 (certain related party aggregation rules need to be considered in relation to this amount).

Compare this to the requirement of needing to file Form 3520 in relation to a distribution from a foreign trust regardless of the amount of the distribution (even if \$1). Again, consider the differences in information to be reported on Form 3520 when comparing a gift from a non-U.S. person versus a distribution from a foreign trust.



Account 1: U.S. Portfolio Investments

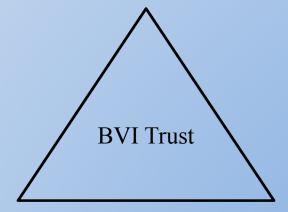
Account 2: Non- U.S. Portfolio Investments U.S. Estate Tax Considerations



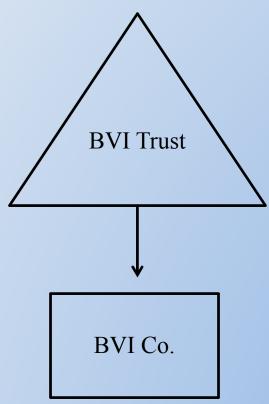
Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments Use of a non-U.S. corporation should shield underlying U.S. situs assets from the U.S. estate tax.

See Code §§ 2103, 2014 and 2015 and the applicable Regs.



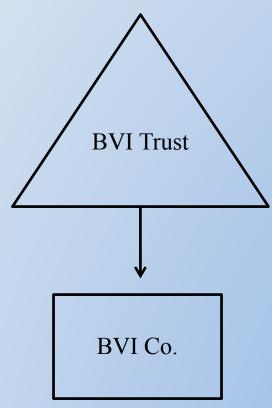
Same trust as Case Study 1, but the settlor has now died, and per the terms of the agreement, the trust is now irrevocable. The trust is now a foreign nongrantor trust for U.S. tax purposes.



Account 1: U.S. Portfolio Investments

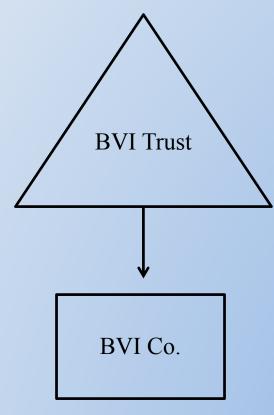
Account 2: Non- U.S. Portfolio Investments U.S. Income Tax Considerations

Upon conversion from foreign grantor trust to foreign nongrantor trust, the U.S. "tax clock" begins to tick....



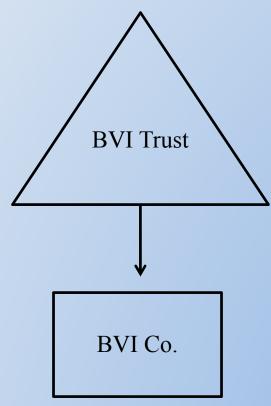
A foreign nongrantor trust may create unfavorable tax results and issues for the U.S. person beneficiary.

Account 1: U.S. Portfolio Investments



Account 1: U.S. Portfolio Investments

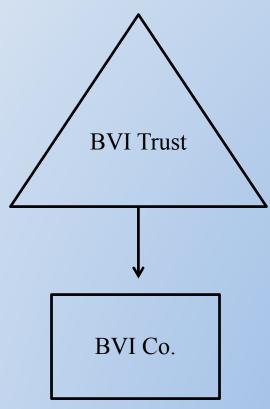
- A foreign nongrantor trust is subject to U.S. income tax in a manner similar to a non-resident individual.
- A foreign nongrantor trust will only be subject to U.S. income tax on its: (1) nonexempt "passive" income from U.S. sources (e.g., dividends from U.S. corporations, interest payments received from certain U.S. persons, rents from U.S. real estate, etc.); and (2) income effectively connected with the conduct of a U.S. trade or business (including U.S. real estate gains).



Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments A U.S. person beneficiary is subject to U.S. income tax on the income of the trust to the extent such beneficiary receives distributions of such trust's current income or gains, or has an unconditional right to receive a distribution of such income or gains, but only to the extent of such trust's worldwide "distributable net income" or "DNI".

The trust gets a corresponding deduction for DNI distributed to avoid potential double taxation.

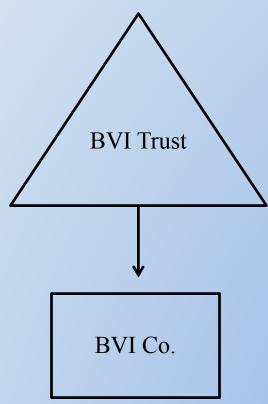


Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments DNI is a concept somewhat similar to taxable income (determined under U.S. income tax accounting principles), with certain adjustments.

See Code § 643 and the applicable Regs.

Case Study 2: The Foreign Nongrantor Trust

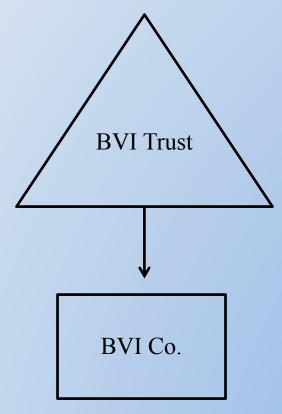


In the case of a foreign nongrantor trust, net capital gains are included in DNI, even if allocable to trust principal under local law or the terms of the trust agreement.

Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

See Code § 643 and the applicable Regs.



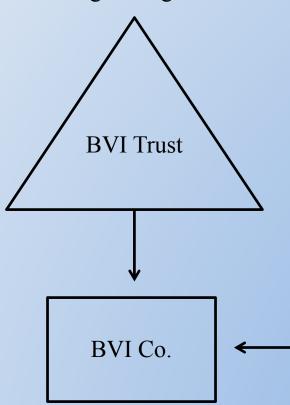
Account 1: U.S. Portfolio Investments Account 2:

Non- U.S. Portfolio Investments

If the trust accumulates any income (including capital gains) instead of distributing them annually (i.e., "undistributed net income" or "UNI"):

- capital gains and other classes of income are reclassified as "ordinary income" (thus losing potential U.S. tax benefits otherwise afforded to such classes, such as the treatment of long-term capital gains).
- When a U.S. person beneficiary receives a distribution of accumulated income or gains from prior years (an "Accumulation Distribution"), such beneficiary is subject to a special tax and to a varying interest charge.

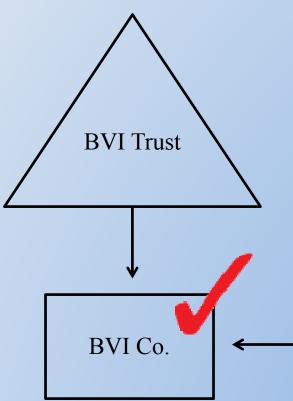
See Code §§ 665, 666, 667 and 668 and the applicable Regs.



Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments Additionally, because of certain attribution rules under the Internal Revenue Code, the shares of the non-U.S. corporation will be attributable to the U.S. person beneficiaries for U.S. tax purposes. In this regard, one has to be cautious of the U.S. anti-deferral tax regimes (the "controlled foreign corporation" or "CFC" regime and the "passive foreign investment company" or "PFIC" regime).

See Code §§ 951-962, 964. See Code §§ 1291, 1293-1298.



Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments A good solution to the anti-deferral regime issue is to get rid of the non-U.S. corporation solely for U.S. tax purposes. How? Form 8832 should be utilized to make the so-called "check-the-box" election.

Slide 45

See Regs.§ 301.7701-3.

	5832 cember 2013)	Entity Classification Election	OMB No. 1545-1	OMB No. 1545-1516			
	ent of the Treasury Revenue Service	► Information about Form 8832 and its instructions is at www.irs.gov/form88					
	Name of eligib	le entity making election	Employer identification number				
Type or	Number, stree	Number, street, and room or suite no. If a P.O. box, see instructions.					
Prin	t City or town, s postal code.	City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country. Follow the country's practice for entering the postal code.					
► Ch	eck if: Add	ress change Late classification relief sought under Revenue Procedure 20 of for a late change of entity classification election sought under Revenue Proce					
Part		Information					
1	Type of electi	on (see instructions):					
a b		☐ Initial classification by a newly-formed entity. Skip lines 2a and 2b and go to line 3. ☐ Change in current classification. Go to line 2a.					
2a	Has the eligible	e entity previously filed an entity election that had an effective date within the la	st 60 months?				
	☐ Yes. Go to ☐ No. Skip lir	line 2b. ne 2b and go to line 3.					
2b	Nas the eligible entity's prior election an initial classification election by a newly formed entity that was effective on the date of formation?						
	☐ Yes. Go to ☐ No. Stop h	line 3. ere. You generally are not currently eligible to make the election (see instruction	ıs).				
3	Does the eligit						
		an elect to be classified as a partnership or an association taxable as a corporation in elect to be classified as an association taxable as a corporation or to be disre					
4	If the eligible e	eligible entity has only one owner, provide the following information:					
а	Name of owne	r ►					
b	Identifying nur	nber of owner ►					
5		he eligible entity is owned by one or more affiliated corporations that file a consolidated return, provide the name and ployer identification number of the parent corporation:					
а		t corporation ►					
b	Employer iden	tification number ►					

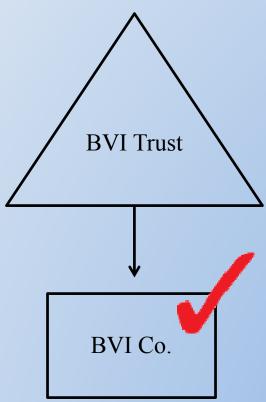
art	Election Information (Continued)			
6	Type of entity (see instructions):			
а	A domestic eligible entity electing to be classified as an association taxable as a corporation.			
b	A domestic eligible entity electing to be classified as a partnership.			
с	A domestic eligible entity with a single owner electing to be disregarded as a separate entity.			
d	A foreign eligible entity electing to be classified as an association taxable as a corporation.			
е	A foreign eligible entity electing to be classified as a partnership.			
f	A foreign eligible entity with a single owner electing to be disregarded as a separate entity.			
7	If the eligible entity is created or organized in a foreign jurisdiction, provide the foreign country of organization			
B	Election is to be effective beginning (month, day, year) (see instructions)			
9	Name and title of contact person whom the IRS may call for more information 10 Contact person's telephone number			

Consent Statement and Signature(s) (see instructions)

Under penalties of perjury, I (we) declare that I (we) consent to the election of the above-named entity to be classified as indicated above, and that I (we) have examined this election and consent statement, and to the best of my (our) knowledge and belief, this election and consent statement are true, correct, and complete. If I am an officer, manager, or member signing for the entity, I further declare under penalties of perjury that I am authorized to make the election on its behalf.

Signature(s)	Date	Title
		Form 8832 (Rev. 12-20

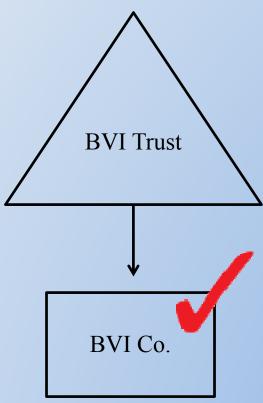
Case Study 2: The Foreign Nongrantor Trust



The consequences of making the "check-thebox" election is a deemed liquidation of the non-U.S. corporation for U.S. tax purposes.

The liquidation is deemed to occur at the end of the day of the date immediately prior to the "effective date" of the check-the-box election.

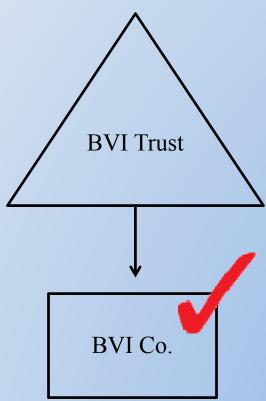
Account 1: U.S. Portfolio Investments



What happens if the effective date of the checkthe-box election is the actual date of death? What about the date after the date of death? What about two days after?

CAUTION as to causing U.S. situs assets to be included in the U.S. gross estate, and, thus, subject to the U.S. estate tax.

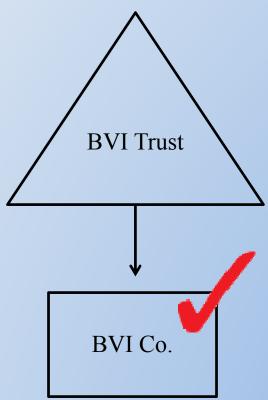
Account 1: U.S. Portfolio Investments



How soon do we have to file the Form 8832 to make the check-the-box election?

Account 1: U.S. Portfolio Investments

Case Study 2: The Foreign Nongrantor Trust

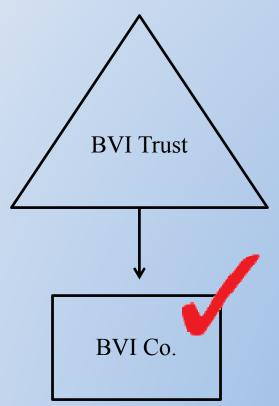


Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments As noted, the effect of making the check-the-box election is a deemed liquidation.

If the trust agreement is not properly worded, a capital gain could be triggered when making the check-the-box election, and such capital gain will be considered DNI.

Consider the following example....

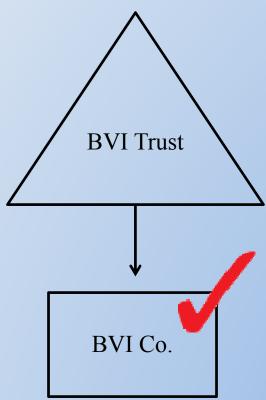


Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments Settlor initially funds non-U.S. corporation with \$1 Million, and said cash is used to purchase the initial assets held in the portfolios. At the date of the Settlor's death, the fair market value of the portfolios, and, thus, the fair market value of the non-U.S. corporation is \$1.5 Million.

If the trust does not receive a "step-up" in basis as to the trust's ownership of the shares of stock in the non-U.S. corporation, then, upon making the check-the-box election (a deemed liquidation in which there is a deemed sale or exchange), the transaction will generate a \$500,000 capital gain.

Said capital gain will be included in DNI. If the trust received a "step-up" in basis, there would be no gain to the trust upon making the check-the-box election.



Remember, if any such gain was accumulated and not paid out in the year earned, said gain would be taxed as ordinary income when it did come out and would otherwise be considered an Accumulation Distribution subject to the throwback tax and related interest charge.

Account 1: U.S. Portfolio Investments

Generally, the tax basis or tax cost of property in the hands of a person acquiring property from a decedent will be the fair market value of the property at the date of the decedent's death. This "stepup" in basis can be quite beneficial as it basically nullifies the appreciation that remains unrealized at the time of the decedent's death without a corresponding income tax consequence.

Said "step-up" in basis is only beneficial to the extent there was appreciation at the date of death. Consideration should be given as to what can occur if the value of the assets at the date of death are less than the tax basis or tax cost.

In a situation such as Case Study 1 (now Case Study 2), the basis adjustment would only be available if one of the following is satisfied:

- The property is transferred by the decedent during lifetime in trust to pay the income for life, to, or, on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to revoke the trust.
- The property is transferred by the decedent during lifetime in trust to pay the income for life, to, or, on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust.

In a situation such as Case Study 1 (now Case Study 2), the settlor will have either the right to revoke or the right to alter, amend, (i.e., modify) or terminate (and possibly will have the right to exercise all such powers).

What about the "income interest"? The applicable Internal Revenue Code Section says the trust must "pay the income for life, to, or, on the order or direction of the decedent."

Try to draft so that the settlor has the right to direct the payment of income to the settlor or others until the date of death.

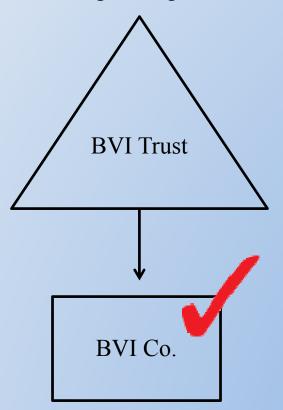
What happens in the event of the settlor's incapacity or disability when the settlor can no longer direct the payment of income?

Consider a clause that requires the trustee to distribute income to or for the benefit of the settlor in the event of incapacity or disability.

The "magic" wording will be there for U.S. tax purposes but for practical purposes does it really matter?

What is "income" to the trust? Dividends from the underlying non-U.S. corporation that would not be declared unless the funds were needed.

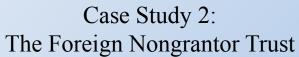
Everybody wins....

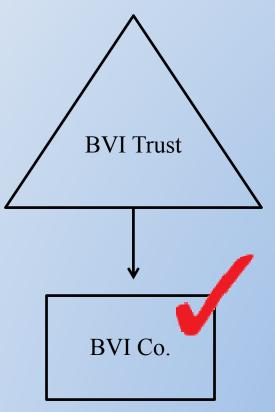


Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments Recap of where we are:

- The settlor has died and trust is a foreign nongrantor trust.
- A Form 8832 has been filed so as to liquidate the non-U.S. corporation (i.e., BVI Co.) for U.S. tax purposes.
- Going forward, there is no need to worry about anti-deferral regimes in relation to BVI Co. It will still exist for all purposes other than U.S. tax purposes. What about non-U.S. portfolio investments such as foreign hedge funds or foreign mutual funds? Are there PFIC issues?
- Upon the deemed liquidation, we want to draft the trust so that no capital gain is included in DNI when the check-the-box election is made.

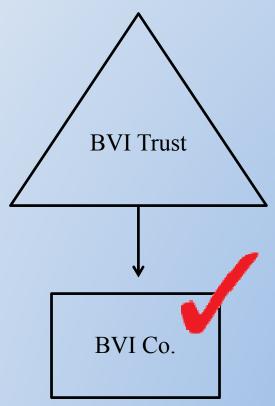




Interest income, dividends, gains, etc. generated in the portfolios will now be considered as earned directly by the trust and will be included in DNI.

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Case Study 2: The Foreign Nongrantor Trust

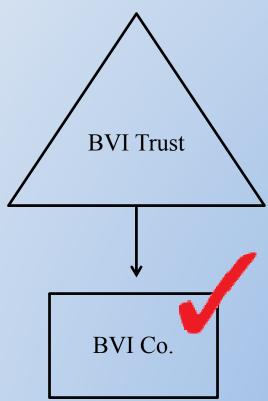


Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments Some common ways to deal with the DNI generated on annual basis:

- Distribute current year income and gains on an annual basis (to the U.S. person beneficiary or to a domestic sub-trust benefiting the beneficiary).
- Use the "FAI limitation" rule.
- Consider non-income generating products such as special life insurance products.
- Consider tax-exempt income.
- Consider an actual trust domestication.
- Use a charitable remainder trust.
- Planning for Internal Revenue Code Section 645.

Case Study 2: The Foreign Nongrantor Trust



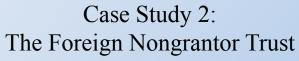
It is virtually impossible to know the DNI of any given year by December 31st of that year. So how to we know the exact amount of DNI to deal with by year-end?

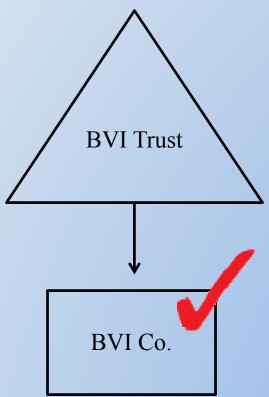
The solution lies in the so-called "65-day rule."

Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

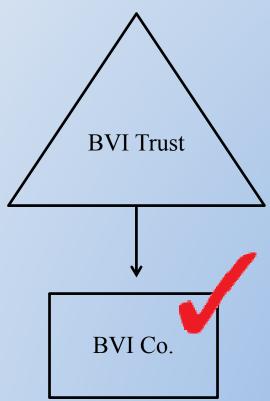
See Code § 663(b).





If within the first 65 days of any taxable year of an estate or a trust, an amount is properly paid or credited, such amount shall be considered paid or credited on the last day of the preceding taxable year. This rule only applies if the fiduciary makes the proper election.

Account 1: U.S. Portfolio Investments

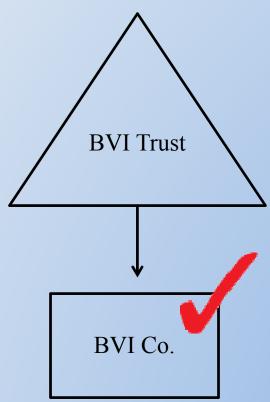


Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments Another option in planning for DNI is to consider drafting for specific gifts in no more than three installments.

Special rules exist which are designed to allow U.S. income tax-free distributions even in the case where the trust has DNI or UNI which if distributed would be taxable to the U.S. person beneficiaries.

Case Study 2: The Foreign Nongrantor Trust

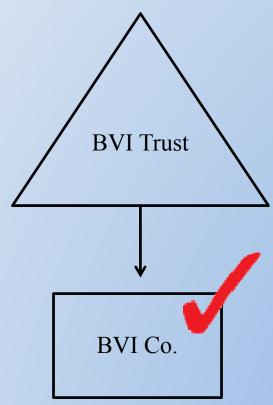


Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments Three payment rule...

This rule applies to "[a]ny amount which, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than 3 installments." Distributions that meet these conditions are tax-free to the U.S. person beneficiary.

See Code§ 663(a)(1).



Account 1: U.S. Portfolio Investments

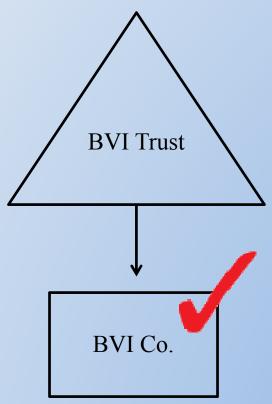
Account 2: Non- U.S. Portfolio Investments It is important to note that DNI is distributable "net" income, and, thus, expenses can be utilized.

Expenses can be "direct" and "indirect" and the fiduciary has certain discretion to allocate indirect expenses to various classes of income.

In this regard, consideration should be given to allocating indirect expenses to classes of income which carry a higher rate of U.S. income tax.

Tax exempt income requires a prorata allocation of expenses.

See Regs.§ 1.652(b)-3.

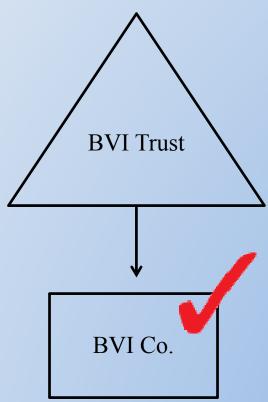


Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments It is very common to see a discretionary trust drafted in a manner that allows the trustee to distribute to any one or more of the beneficiaries in the trustee's discretion.

How does such a discretionary pool of beneficiaries impact the computation of DNI? If there are U.S. and non-U.S. person beneficiaries, complications could arise. Consider utilizing separate shares created for the benefit of each such beneficiary.

Case Study 2: The Foreign Nongrantor Trust

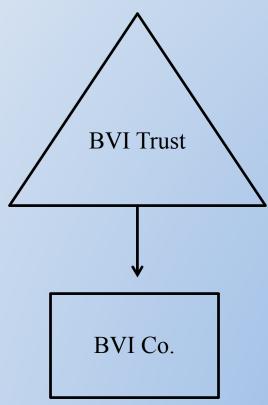


For the sole purpose of determining the amount of DNI, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts.

Account 1: U.S. Portfolio Investments

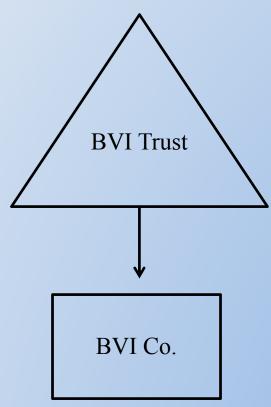
Account 2: Non- U.S. Portfolio Investments

See Code§ 663(c).



Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments U.S. Estate Tax Considerations



Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments U.S. Estate Tax Considerations

- A properly drafted discretionary trust should keep the assets out of the U.S. person beneficiary's U.S. gross estate for U.S. estate tax purposes.
- A properly drafted discretionary trust should also afford general creditor protection.
- Avoid giving a general powers of appointment ("GPOA") wherein the U.S. person beneficiary can appoint to anyone including himself, herself or his or her estate or creditors.

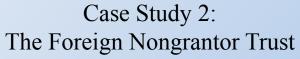
Drafting tip in relation to avoiding general powers of appointment...

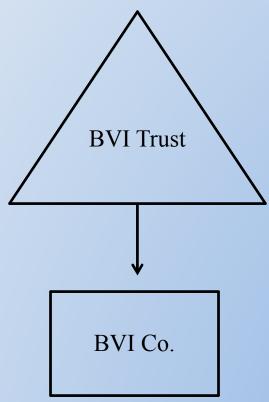
Many trust documents contain a standard power allowing one or more parties to remove and appoint trustees. Many times this power is given to beneficiaries. What if there is no limitation on who the beneficiary can appoint? What if the beneficiary could appoint himself or herself?

If a U.S. person beneficiary has the power to remove and appoint trustees, the trust document should provide that any such trustee shall be a trustee that is not "related or subordinate" to the beneficiary within the meaning of Code § 672(c).

Drafting tip in relation to avoiding general powers of appointment...

If a beneficiary is able to serve as trustee, make sure there is a clause therein prohibiting the beneficiary from exercising certain powers that would be considered a GPOA (e.g., prohibit the beneficiary from being able to make discretionary distributions to himself or herself).

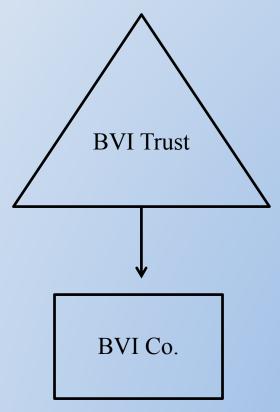




Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments

U.S. Gift Tax Considerations



Account 1: U.S. Portfolio Investments

Account 2: Non- U.S. Portfolio Investments U.S. Gift Tax Considerations

- The U.S. gift tax is generally not an issue for the U.S. person beneficiary in relation to his or her beneficial interest in the trust.
- The trust should contain clauses which prohibit the U.S. person beneficiary from assigning, pledging or otherwise encumbering his or her beneficial interest in the trust.
- The use of a special power of appointment may allow a beneficiary to have control over beneficial enjoyment during life or at death without causing a taxable transfer for U.S. gift tax purposes.