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Structuring Foreign Investment in U.S. Real Estate: Entity Selection and Transaction Structures
Navigating FIRPTA, Determining Individual vs. Entity Ownership Structures, Achieving Optimal Tax Treatment Through Blocker Corps

WEDNESDAY, JULY 12, 2017
1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today’s faculty features:

Richard S. LeVine, Of Counsel, Withers Bergman, New Haven, Conn.

Lawrence M. Lipoff, CPA, TEP, CEBS, Director, CohnReznick, New York

Brian Oard, Wealth Manager, Northern Trust, Los Angeles

Louis Zuckerbraun, Managing Director, Insurance, GMG Financial Group, Zurich, Switzerland
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Structuring Foreign Investment in US Real Estate

Tax & Legal Considerations for Non-US Investors

Stafford Continuing Education Webinar
July 12, 2017

Panelists:
Lawrence Lipoff - CohnReznick
Richard LeVine – Withers Bergman
Brian Oard – Northern Trust
Louis Zuckerbraun – Geneva Management
Some thoughts on Ownership Structuring

Common objectives include one or more of the following:

• Preserve anonymity (not buy in own name)
• Consider personal use (not pay rent)
• Insulate against US estate tax
• Insulate against US gift tax
• Minimize or eliminate US income tax on rental income
• Minimize or eliminate US income tax on sale of the property
• Minimize US tax filings

These objectives are addressed through ownership structuring…
Preliminary Questions should you want to model estimated after tax economics of one or more holding structures

- What is the use and/or investment strategy?
  - Will you have other partners or co-investors?
  - Will you be a lead or passive investor?
  - What is the time frame for the investment?
  - Will you or your family personally use the property for residence or vacation?
  - Is this in connection with a US business?
  - Do you have an exit strategy?
  - Do you have existing US investments?
  - Do you anticipate future US investments?
- What is the cash flow?
  - Do you have an investment pro forma or projections?
  - Will there be rental or other property related income?
  - Will there be commercial financing?
The Process – Forming and Implementing the Ownership Structure & Acquisition

We try to operate within a predictable three-step process:

• First, agree on a suitable ownership structure (a “design” phase)
  • Analysis of investment strategy
  • Evaluate relevant ownership options
  • Model cash flow and taxation

• Second, choose the structure and engage relevant parties (a “development” phase)
  • Prepare a detailed analysis of chosen ownership structure
  • Prepare an implementation step plan
  • Engage appropriate 3rd party service providers (such as accountants, trustees, directors, and/or property managers)

• Third, implement (a “drafting and building” phase)
  • Prepare legal documents for ownership structure
  • Prepare (or review) legal documents for financing of acquisition
  • Prepare (or review) legal documents for acquisition of the property
  • Payment of registration fees and expenses
  • Execute all relevant documents once finalized
  • Acquire the property
  • Prepare (or review) US tax reporting forms
Ownership Through Single US LLC

- **Advantages**
  - SMLLC provides property liability protection.
  - SMLLC is disregarded for US tax purposes, so you are treated as if property is owned directly.
  - FIRPTA will apply, assuming you are a non-US person at the time of sale.
  - Long-term capital gain tax rate of 20% applies if held for over 12 months.

- **Disadvantages**
  - Privacy concerns since the LLC is disregarded for US tax purposes.
  - All income (annual rental or capital gain at exit) is taxed to the NRA, member.
  - No estate tax protection.
  - No gift tax protection.
  - Annul or periodic US tax filings would be by you, individually.
  - Local law treatment of the LLC should be confirmed (whether characterized as a corporation or a flow-through entity.)
Ownership Through Single Non-US Corporation

- **Advantages**
  - Stock not a USRPI; no FIRPTA issue if stock is sold
  - No US estate tax (foreign corporations are not included in the US taxable estate)
  - No US gift tax on ForCo share transfers. A gift of an intangible asset, such as shares of stock or of a partnership interest, is not subject to gift tax.
  - Expenses related to maintaining the property may be allowed if Form 1120F is filed.

- **Disadvantages**
  - 35% capital gain tax rate (plus state income tax) on property disposition
  - Branch tax risk (30% on 65%) unless cash is re-invested in US trade or business or property
  - Withholding on income at the highest marginal rate if investing via joint venture
  - Interest deductibility limits for related party debt (generally 1.5:1 debt-equity ratio)
  - Filing of Form 1120F requires disclosure of owners and balance sheet
Two-Tier Corporate Structure ("Corporate Sandwich")

- **Advantages**
  - Disposition of ForCo shares not subject to FIRPTA
  - No US gift tax
  - No US estate tax
  - No US branch profits tax.
  - Earning stripping possible with related party loans, but limited

- **Disadvantages**
  - 35% capital gain tax rate (plus state income tax)
  - 30% dividend withholding tax (since Income Tax Treaty benefits are not available)
    - Cannot extract free cash from US Co. without 30% dividend tax until time of liquidation
  - 30% interest withholding tax (unless a reduced tax treaty rate applies)
  - Portfolio debt is often limited
  - 1.5:1 debt-equity limitation
  - Must liquidate to avoid the dividend withholding tax
  - Reduced opportunity to consolidate income and expenses between and among projects
  - Form 1120 US tax compliance requires identity of direct and indirect owners and balance sheet disclosure.
US Irrevocable Trust that Owns Disregarded Entity

- **Advantages**
  - 20% long-term capital gains tax rate on gains from sale (plus state tax)
  - 20% tax on gain from some capital assets (e.g., Section 1231 assets)
  - Related party loans to trust permit 9:1 earnings stripping
  - Can easily consolidate income and expenses from multiple projects for efficient offsetting
  - No withholding required on related party offshore loans, thus can extract free cash without withholding tax.
  - Ability to flip pre-full development property at LTCG rates with installment note
  - No US tax filing requirement for foreign grantor or beneficiaries (except one-time Form 3520)
  - No balance sheet disclosure
  - No US estate tax exposure (settlor will not be a beneficiary)
  - No US gift tax
  - No branch profits tax
  - A single-member domestic LLC would be disregarded as an entity separate from its owner for federal and state income tax purposes but would offer some limited liability protection and a level of privacy.
  - Personal use of property held in trust does not give rise to imputed income to the trust.

- **Disadvantages**
  - 39.6% income tax on ordinary income (i.e., business and rental income) (plus state tax)
  - 3.8% Medicare tax will apply to ordinary income (rental), but can be avoided with exit strategy planning.
<table>
<thead>
<tr>
<th></th>
<th>Trust with LLC</th>
<th>Dual Corporation</th>
<th>Individual with LLC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gains tax rate on gain</td>
<td>20%</td>
<td>35%</td>
<td>20% (if over $400,000, 15% if less)</td>
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<tr>
<td>Medicare tax at 3.8% rate</td>
<td>Not necessarily</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Files tax returns in personal name</td>
<td>Not necessarily</td>
<td>No but need to disclose foreign shareholders and related party transaction</td>
<td>Always</td>
</tr>
<tr>
<td>Excess interest expense carries forward to offset gain from sale.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes but limited</td>
</tr>
<tr>
<td>30% withholding tax on related party interest payments</td>
<td>No</td>
<td>Yes unless treaty jurisdiction lender</td>
<td>No</td>
</tr>
<tr>
<td>Limits on deductibility of interest expense</td>
<td>Yes (90%)</td>
<td>Yes (60%)</td>
<td>Yes (80%)</td>
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<tr>
<td>Estate tax protection</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Distribution creates additional withholding</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>
Two-Tier Partnership (or LLC) Structure

- Non-U.S. Trust
  - Single level of U.S. tax
  - Credit for Section 1446 tax already paid
  - Preferential capital gains rates
- Non-U.S. check-the-box partnership
  - Estate tax insulator
  - Credit for Section 1446 tax already paid
- U.S. LLC
  - No corporate income tax
  - Section 1446 withholding tax on ECI to foreign partner(s)
Ownership Through Private Placement Variable Insurance Contract Blockers

NRA

Insurance Company
Foreign 953(d) Electing

Life Insurance Contract(s)

Multiple USRPIs

Advantages
- No income tax on gains from property sale
- No income tax on rental income from properties
- No income tax on NRA receipt of insurance proceeds on death of insured
- Tax free access during insured’s lifetime by borrowing
- No US tax filing requirement by foreign grantor or beneficiaries
- No US gift tax
- No US estate tax

Disadvantages
- Must have at least 5 properties in policy
- Cannot control or manage properties—must use independent 3rd party
- Insurance costs (measured by Premium less amount paid for COI and M&E)
- Cannot use property personally
- If complete withdrawal from investment, withholding on CSV minus premiums paid at 30% (can be managed with possible Section 1035 transfer)
Ownership Through Deferred Variable Annuity Contract Blockers

Advantages

- No income tax on gains from property sales
- No income tax on rental income from properties
- No US tax filing requirement by foreign grantor or beneficiaries
- No US gift tax
- No US estate tax

Disadvantages

- Must have at least 5 properties in DVA
- Cannot control or manage properties – must use independent 3rd party
- DVA costs (fairly nominal)
- Cannot use property personally
- Withdrawals by NRA taxed at 30%
- Withdrawals must occur over schedule
- If complete withdrawal from investments withholding on accrued income at 30% (can be managed with possible Section 1035 transfer)
Ownership Through Total Return Equity Swap

Advantages
- No income tax on gains from property sales
- No income tax on rental income from properties
- No income tax on NRA receipt of proceeds on swap expiration
- No US tax filing requirement by NRA
- No US gift tax
- No US estate tax

Disadvantages
- Can only invest in broad based US real estate index
- No control or management of individual properties
- Embedded swap costs (LIBOR based)
- Cannot use any property personally
- Early withdrawal likely difficult
Ownership Through Shared Appreciation Mortgage

NRA

Loan Coupon plus % Appreciation

US Real Estate Holding Venture

USRPI

Advantages
- US payor pays income tax on rental income and sales from properties
- No gift tax
- No estate tax
- NRA recipient at loan maturity may pay no income tax on repayment

Disadvantages
- Cannot control, manage or have greater than 10% ownership interest in holding venture or interest withheld at 30%
- Cannot use property personally
- Cannot receive income/gain from property above shared percentage
- No early cash out without 30% withholding on interest payments (unless treaty jurisdiction lender)
Ownership Through Domestically Controlled REIT

Advantages

• No income tax at REIT level with distributed income
• Dividend tax at 30% (lesser amount if treaty based NRA) on distributions
• Sale of domestically controlled REIT shares is tax free

Disadvantages

• REIT ownership and operations are complicated with multiple shareholders and investment limitations
• Domestically controlled REIT transfers management and control to US person
• US estate taxable asset
• Cash outs with REIT share sale may be limited

NRA
49%
> 100 Preferred Shareholders

USRPI

US Investors
51%

REIT
Foreign Institutional Ownership Through Insurance Blockers

Investing in Insurance Dedicated Fund

- Foreign Institutional Investors
  - Foreign Insurance Company
    - 953(d) Electing
      - Deferred Variable Annuity or Private Placement Variable Life Contracts
        - Fund Manager
          - Insurance Dedicated Fund (Cayman Flow-Through)
            - Multiple USRPIs
Fund Structure (The Basic Elements)

- General Partner (Delaware LLC)
- Management Company (Delaware LLC)
- Blocker (Cayman)
- US Investors
- Non-US Investors
- Non-US Investors and Tax Exempts

Fund (Delaware LP)

US Real Estate Investments
FIRPTA – The General Principles

• Gains from disposition of “US real property interests (USRPIs)” are deemed ECI
  • Section 897 (a) – (j)
  • Causes US source income tax even though capital gain income
    • Source rule does not help avoid taxation
  • Capital gains rate can apply

• Tax collected through withholding (Section 1445).
US Real Property Interest (USRPI)

- **Direct** –
  - US land, buildings and related permanent structures.
  - Unsevered minerals and natural deposits
  - Personal property associated with real property (fixtures)

- **Indirect** –
  - Stock in US Real Property Holding Corporation (USRPHC)
  - Interests in trusts or partnership holding USRPIs
  - Stock in a foreign corporation is not a USRPI unless special Section 897(i) election made
    - Can be USRPI for purposes of test USRPHC status of another corporation
  - Election under Section 882 allows a foreign corporation that receives certain non-ECI income from US real property to elect to treat that income as ECI and allows for a deduction of related expenses use of the graduated tax rates.
    - Section 897(i) “domestic election”
    - Section 882(d) “net election”
What is an “Interest?”

• “Interest” is any interest other than an interest solely as a creditor.

• Interest solely as creditor = “straight debt”
  
  • No right to directly or indirectly share in the appreciation in value of, or the gross/net profits generated by a USRPI
  
  • Mortgage at 8% = interest solely as creditor
  
  • Mortgage at 8% plus 10% of gain from sale of US real estate ≠ interest solely as a creditor.
What is an “Interest?”

“Interest” includes

- co-ownership,
- leaseholds,
- timeshares,
- life estates,
- remainders,
- options to acquire,
- installment sales of USRPI,
- mortgages if rights are not limited to an “interest solely as a creditor,” and
- rights in a USRPHC if rights are not limited to an “interest solely as a creditor”
A US corporation is a USRPHC if it holds USRPIs (including stock of other corporation) having an aggregate FMV that is 50% or more of the FMV of:

- USRPIs;
- Interests in real property outside of the US; and
- Assets used or held for use in a trade or business.

Look through rules apply

A USRPC is any corporation that was a USRPHC in last 5 years unless sold all its USRPIs in a taxable transaction. (the FIRPTA Cleansing Exception)
Noncontrolling Interest

• Stock in corporation is tested for USRPHC status if look through rules do not apply.

• If corporation is USRPHC, then stock is a treated as USRPI.

  • Note a foreign corporation can be treated as a USRPI if having made a Section 897(i) election. Therefore subject to FIRPTA on its disposition.
Look Through Rules

- Partnerships
  - Assets held by partnership – deemed owned ratably by partners.
Partnerships

- Distributive share of gain – FIRPTA
- Publicly traded partnerships
  - FIRPTA adopted the entity theory of partnerships and treats a partnership as a person pursuant to Temp. Regs. Sec. 1.897-9T(c). A common issue in this context is whether a partnership that sells an interest in a publicly traded domestic corporation is eligible for the publicly traded exception under Sec. 897(c)(3).
  - Pursuant to Sec. 897(c)(3), a USRPI does not include an interest in a publicly traded corporation if such shares are regularly traded on an established security market, provided that the “person” held 5% or less of the shares during the relevant determination period.
  - Partnership or Partner level test? Uncertain.
Partnerships - Interests

• Interests in partnerships technically not a USRPI

• Purchaser of partnership interest must withhold if
  
  • 50% or more of the gross value of partnership consists of USRPIs
  
  • 90% or more of gross value of the partnership’s assets consist of USRPIs, cash and cash equivalents.
Consider withholding certificates

- File Form 8288-B (application, with supporting documents)
- If satisfied, certificate is issued by the IRS
- Allows reduction or elimination of withholding
- Certificate of non-foreign status
- Escrow arrangement?
Section 1445 Withholding

- Transferee must withhold and pay over 15% of the amount realized on the sale of USPRI.
- Agent can be liable
- Partnerships, trusts and estates must withhold 35% of the gain
- Tax must be reported and paid within 20 days of the transfer
Considering a disposition?

Non-recognition provisions

- “Dispositions” – not defined in Section 897
- Broadly defined to include
  - Sales and exchanges
  - Capital contributions
  - Entity distributions
  - Transfers in connection with mergers
  - Gifts .. But only if there is boot or liabilities in excess of basis
Dispositions/non-recognition

• Dispositions generally include non-recognition transactions unless:
  • Non-US person receives USRPI in exchange for USRPI (hot for hot)
  • USRPI received in exchange would be subject to US tax upon disposition \textit{and}
  • Reporting requirements satisfied

• Certain foreign corporations eligible for treaty benefits may elect to be treated as US corporation for these purposes (Section 897(i))
Non-recognition Rules (very, very generally)

- Section 897(d) and (e) restrict a foreign person’s ability to rely on a nonrecognition provision in connection with a transfer of a USRPI.

- Section 897(d) applies to distributions of USRPIs by foreign corporations

- Section 897(e) applies to transactions in which a foreign person exchanges a USRPI for another asset.

- Confusingly, when a foreign corporation that is a party to a reorganization transfers a USRPHC interest to another corporation that is a party to the reorganization, the rules of section 897(e) and temp. reg. section 1.897-6T apply before the rules of section 897(d) and temp. reg. section 1.897-5T.
Nonrecognition Rules (just very generally)

- Applicable regulations (temp. reg. section 1.897-5T and 1.897-6T) have been modified or supplemented by seven different notices (some of which modify other notices in the series):
  1. Notice 2006-46 (providing rules relating to inbound merger transactions, foreign-to-foreign nonrecognition transactions, and the FIRPTA toll charge);
  2. Notice 99-43 (providing rules relating to single-entity reorganization transactions involving a “former” USRPHC);
  3. Notice 89-85 (providing rules relating to certain distributions of USRPHC interests by foreign corporations and section 897(i) elections);
  4. Notice 89-64 (providing rules relating to the application of Article XIII(9) of the Canada-U.S. Income Tax Convention to certain nonrecognition exchanges involving USRPIs);
  5. Notice 89-57 (providing rules relating to the filing requirements that must be satisfied by a foreign person that transfers a USRPI in a nonrecognition transaction);
  6. Notice 88-72 (providing rules applicable to the disposition of interests in partnerships that own USRPIs);
  7. Notice 88-50 (announcing the IRS’s intention to treat a domestication of a foreign corporation as an inbound F reorganization that involves a deemed transfer of assets (including USRPIs) owned by the foreign corporation).
Some parting thoughts on the reorg provisions...

• “Nothing in FIRPTA is clear.”
• “In the end, significant portions of the original regulatory language are no longer applicable, and many of the other rules set forth in the regulations come with exceptions and with exceptions to exceptions that appear only in the notices or notices that modify other notices.”
  • David F. Levy in “Nonrecognition Transactions Involving FIRPTA Companies”

• “more often than not, when the tax advisor consults the regulations and Notices for an answer to a FIRPTA question, she finds no answer, finds a partial answer that cannot be clearly applied to the facts at hand, or finds an answer that is clearly ridiculous under the circumstances.”
  • Kimberly Blanchard in “FIRPTA in the 21st Century — Installment One: A Closer Look at Reg. § 1.897-5T(c),”
What is the Branch Profits Tax

- A dividend equivalent for accumulated earnings. It is an extra income tax on foreign corporations which earn profit from US investments or US business operations.
- Imposed on a non-US corporation’s after-tax net profit. (30% tax is applied on after-tax net income as the branch profits tax). Reported directly on Form 1120F
- Intended to cause non-US corporations (and their shareholders) to be taxed identically to US corporations (and their shareholders).
Impact of the "branch profits tax"

- The overall effective U.S. tax rate on a foreign corporation doing business in a state (such as New York and California) with relatively high corporate income tax can rise to approximately 61% [i.e., 42% + (30% x 58%)] during its operating phase.

- BPT is imposed at the rate of 30% on the after-tax U.S. profits of the foreign corporation from a U.S. trade or business.

- BPT may be eliminated or reduced, though, when the foreign corporation is organized in a favorable U.S. treaty country:
  - treaty overrides or limits the branch profits tax when the treaty-based corporation is more than 50% owned by residents of that treaty country (or USPs).
Branch Profits Tax Can be avoided if:

- Reinvest your profits in the United States;
- Exemption in income tax treaty; or
- Completely terminate all business and investment operations in the United States (i.e., sell assets then liquidate the US sub).
Branch Profits Tax on Real Estate

• The branch profits tax is essentially harmless to nonresident real estate investors if
  • one piece of U.S. real estate
  • that property is not producing income.

• The branch profits tax will apply to nonresident investors in U.S. real estate who have rental income held directly by a non-U.S. corporation. The income collected (after expenses) will be subjected to the BPT.

• This is a problem if a single US corporation holds multiple properties, since sale of one property will generate income, but the US subsidiary cannot be liquidated since it holds multiple properties.
Tax Treaties

- Generally, gain from the disposition of property (whether tangible or intangible) is taxed only in the country of the seller's residence.
  - Dispositions generally not taxed by foreign treaty partners.
  - BUT, exclusion is overridden if the gain is attributable to a permanent establishment in that country, in which case the gain can be taxed there as well (FTC?).

- Treaty questions (similar to the Code/Rev Rul questions):
  1. does the partnership have a permanent establishment in the foreign jurisdiction;
  2. if so, is that establishment imputed to any and all partners regardless of ownership interest and regardless of the extent of the partner's participation in, and management of, the partnership; and
  3. if so, is the gain derived from the disposition of the partnership interest attributable to that permanent establishment?

See: Willis & Postlewaite: Partnership Taxation (WG&L)
Dispositional Issues of International Partnerships
Situs of Partnership Interests

- Treas. Regs. § 20.2104-1(a)(4) addresses situs of corporate stock and bond interests turns on the place of incorporation of the issuer or obligor.

- An entity approach. Analogous rule for a partnership would be:
  - If organized in the United States, its equity and debt interests will have a U.S. situs
  - If organized outside the United States, its equity and debt interests are non-U.S. situs.

- Planning point: ensure that the foreign partnership is regarded (under local, foreign law) as an entity separate from its partners and that the death of the partner in question does not terminate the partnership.
Situs of partnership interests

• Problem with Treas. Regs. § 20.2104-1(a)(4) is that the situs rules do NOT mention partnership interests, nor does any case law specifically apply the relevant provisions to partnership interests (some older cases may be helpful).

• Classic entity versus aggregate theory

• Case law and commentary seem to support entity over aggregate theory. But there are still two possible outcomes:
  
  • Situs is determined based on the location where the partnership conducts its business, following Rev. Rul. 55-701 (1955)
  
  • Situs is determined based on the residency of the partnership for income tax purposes (i.e., its place of organization) following Reg. 301.7701-5, which is consistent with the rules applied to corporations under Section 2104(a) and Reg. 20.2104-1(a)(5).

At this point, there is no clear rule.
SALT: conveyance, transfer tax or stamp duty (synonymous)

- Grant of a lease of less that 50 (in practice 48.5) years in NY is not subject to the NYS transfer tax
- Surrender of a lease (of any length) is subject to the NYS transfer tax
- Leases with purchase options in NY are deemed to be sales and subject to the full tax, even if the option is never exercised.
SALT ... matters

• New York state individual/trust tax rate: 8.82%
• New York City individual/trust tax rate: 3.88%
• New York State + City combined: 12.7%

• New York State + City corporate income tax (whether US or non-US) levied one of four ways. One is a minimum tax. Two are based on income. The fourth is based on a “capital base” based on net asset value so that a corporation could be stuck with an annual income tax based on the value of its assets.

• California individual/trust tax rate: 13.3%
• California corporate income tax rate: 8.84%
GMG Insurance

PRIVATE PLACEMENT LIFE INSURANCE
US investments for non-US persons using PPLI
1) Investment Options

2) Private Placement Life Insurance

3) Market & Legal Issues
   - Asset Protection
   - Compliance & reporting
     - 953d vs non-953d

1) Contacts

US investments for non-US persons using PPLI

GMG Insurance
Investment Options

Why PPLI?

- Non US Persons face a variety of solutions regarding US investments
- US Real Estate is especially complicated

⚠️ Non US persons investing into the USA want to have a simple and efficient structure

⚠️ Non US persons investing into the USA want a compliant means to limit costs including income tax, capital gains, estate tax and in certain cases withholding taxes
Investment Options

Options for NRA Investors

• Foreign Corporation holding US assets (Typically BVI Hold Co.)

• Two-Tier Corporate Structure

• Non-US Irrevocable Trusts

• Other vehicles including Equity SWAPs

• Private Placement Life Insurance or Annuities
Insurance and BVI Corporation Comparison

Insurance

- Contractually based and used by millions
- Tax deferral
- Insurance company is beneficial owner
- Simplified or limited reporting
- Potentially tax free
- No capital gains taxes
- No trustee
- Asset protection

Non-USA Corp ("BVI")

- 35% capital gain tax on property sale
- Branch tax risk (30% on 65%) unless cash is re-invested in US trade or business or property
- Withholding tax
- No Estate or Gift taxes
- No FIRPTA
- Filing of Form 1120F (which requires disclosure of owners and balance sheet)
Investment Options

Trust and Insurance Comparison

Insurance
- Contractually based and used by millions
- Tax deferral
- Insurance company is beneficial owner
- Simplified or limited reporting
- Potentially tax free
- No capital gains taxes
- No trustee
- Asset protection

Trusts
- Provides some asset protection
- Sometimes seen as tool for the rich
- Requires “trustee” with full control
- More stringent reporting requirements
- Tax filings for trust and possibly beneficiaries required by some jurisdictions
- Limited or not direct tax deferral on payouts
### Investment Options

#### Comparison of Investment Vehicles

<table>
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<td>Files tax returns in personal name</td>
<td>Not necessarily</td>
<td>No, but need to disclose foreign shareholders and related party transaction</td>
<td>Always</td>
<td>No</td>
</tr>
<tr>
<td>Excess interest expense carries forward to offset gain from sale</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes but limited</td>
<td>No</td>
</tr>
<tr>
<td>30% withholding tax on related party interest payments</td>
<td>No</td>
<td>Yes unless treaty jurisdiction lender</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Limits on deductibility of interest expense</td>
<td>Yes (90%)</td>
<td>Yes (60%)</td>
<td>Yes (80%)</td>
<td>No</td>
</tr>
<tr>
<td>Estate tax protection</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Distribution creates additional withholding</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>
Private Placement Life Insurance

US investments for non-US persons using PPLI

• An insurance solution using a specific life or annuity product can greatly simplify or eliminate many of these issues and make long term investing even more appealing

• Life insurance, and specifically Private Placement Life Insurance ("PPLI"), is a well-established tax and estate planning tool that many qualified investors utilize to mitigate and manage these exposures

• It is more likely than not that Foreigners will continue to be exposed to a US Estate Tax even if proposed changes to the Code are passed by Congress
Private Placement Life Insurance

US investments for non-US persons using PPLI

• PPLI provides the same tax advantages of commercial life insurance
  • Tax free or tax deferred growth of internal cash value
  • Tax free or tax deferred payment of death benefit
  • No capital gains taxes
  • No income taxes
  • Ability to access Cash Value through tax free loans
  • Ability to manage or mitigate estate taxes (if applicable)
  • Asset Protection

• PPLI is a justifiable purchase (structure)
Private Placement Life Insurance

US investments for non-US persons using PPLI

• PPLI combines the well documented and compliant attributes of a standard life and annuity insurance product with a flexible investment platform

• The flexibility includes a broad range of asset classes and employs qualifying Separately Managed Accounts (“SMAs”) or Insurance Dedicated Funds (“IDFs”).

• Most current structures can remain intact with the simple addition of a compliant life or annuity policy

• The Insurance Company can work with most custodians, managers or funds, making the transaction as simple to set up as a trust or other less effective structures
Private Placement Life Insurance

Real Estate Structure Components

ABC Trust

Investment Fund

Various LLC’s

US Real Estate

Simple Trust/LLC Is exposed to US tax

K-1 Filed

Files K-1 Limits on Deductions
Private Placement Life Insurance

Basic Components

A. Insured Life – the person(s) who are insured and if they die trigger payment

B. Policyholder – The person, trust or entity that owns the contract

C. Beneficiary – The person(s) or entity(ies) that receive the proceeds of the life insurance contract

D. Asset Management/Custodian. The actual entity that manages the funds in the contract and where the assets are custodied.

E. Life Insurance Policy – the actual contract

Premium = Consideration for the contract to perform (payment of death benefit at some point in the future)
Public Placement Life Insurance

Real Estate Structure Components

A. Insured Life
   Mr. X (Non-US)

B. Policyholder
   ABC Trust

C. 953d
   US Compliant
   Life Insurance

D. Life Insurance Policy
   - US IDF
   - Various LLC’s
   - US Real Estate

E. Policy Eliminates or Mitigates:
   - US Estate taxes
   - US Withholding taxes
   - Capital Gains

K-1 Filed = 0 Income
Market and Legal Issues

Asset Protection

• Institutional partner
  ▪ Insurance company is beneficial owner of assets held in the policy
  ▪ Insurance company is listed as beneficial owner on bank accounts
  ▪ Transactions are done in the name of the insurance company
  ▪ No look through to policyholders (certain structures)

• All policy assets are separate from the general account of the insurance company

• Transfer of Ownership
  • Insurance company is Beneficial Owner of assets held in specific policy separate account
Market and Legal Issues

Asset Protection

• Many Jurisdictions provide protection against bankruptcy and third party creditors
  ▪ Legally protected by law

• Additionally many US States protect the Cash Surrender Value and Death benefits
  • Varies by State
  • Varies by Structure (Irrevocable vs. Revocable)
Market and Legal Issues

Compliance and Reporting

• PPLI provides simplified reporting and confidentiality. Policy is reported not underlying investments

• Life insurance can also mitigate reporting issues associated with multi-jurisdictional families and investment strategies
  • Pre-immigration planning and US exposure
  • Controlled Foreign Corporation ("CFC") holdings
  • FATCA*
  • CRS*
  • General accounting

• The policy is reported once, and not the assets held or underlying investments
PPLI Structure

Compliance and Reporting

- Transactions are done in the name of the insurance company
- No reporting of investment in the policy
- Only report “Cash Value” from a FATCA perspective
- All bank accounts to be opened in the name of the Insurance Company as a Separate Account
Market and Legal Issues

IRC Sec 953d vs Non-953d

953(d)

- No federal excise tax (FET) for US insured lives
- No requirement to file and maintain form 720
- No withholding tax on US dividend income
- No Income tax related to K-1 filings
- “DAC” tax
- W-9 entity

Non-953(d)

- 1% FET requirement for all US insured lives
- Insurance company is beneficial owner of assets held in the policy
- Withholding tax on US dividend income
- No “DAC” tax
- W-8 BEN-E, Non-USA status
Market and Legal Issues

What do you really achieve?

“Insurance” your structure will be stable:

• PPLI provides a stable, globally recognized platform that is tax efficient, simple and a long term solution

• Contractually based and statutorily defined

• Something every one either has or can provide needs justification

• Value for money
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Unique Private Banking & Trust Needs and Concerns for the Non-Resident Alien Client

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Senior Wealth Strategist
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NRAS HAVE UNIQUE NEEDS

NRA needs may include:

- **Stability:**
  - Political uncertainty in the client’s home country may be causing currency instability.

- **Safety:**
  - Institutions in the home country may lack sufficient financial strength.

- **Privacy:**
  - Home country conditions may increase client desire for privacy.

- **Diversification:**
  - Home country market may not offer sufficient asset diversification.

- **Access:**
  - Desire access to U.S. markets directly.
NON RESIDENT ALIENS HAVE UNIQUE NEEDS AND CONCERNS
NRA PREFERENCES

✓ Asset Classes/Concepts – More familiar and comfortable
  ✓ Control
  ✓ Operating Companies
  ✓ Real Estate
  ✓ Cash
  ✓ Corporate Structures

✓ Asset Classes/Concepts  - Less familiar and less comfortable
  ✓ Equities
  ✓ Bonds
  ✓ Hedge Funds
  ✓ Lending
  ✓ U.S. World Taxation on Estate, Gift and Income Taxes
  ✓ Trust Structures
Key Considerations In The Selection of a Trust Jurisdiction & Structure
Should The U.S. Adopt The Oecd's Common Reporting Standard? (Forbes)

The World’s Favorite New Tax Haven Is the United States

Moving money out of the usual offshore secrecy havens and into the U.S. is a brisk new business.

Forget Panama: Why Corporations And The Rich Love US Tax Havens

Both Panama and the U.S. have refused to sign a treaty that requires the sharing of financial information with other countries, making both nations attractive to wealthy people and businesses eager to hide their earnings.

The U.S. “is effectively the biggest tax haven in the world” —Andrew Penney, Rothschild & Co.
WHAT SHOULD YOU LOOK FOR IN A JURISDICTION?

*It is the combination of the following items that are often discussed*

- Favorable tax treatment
- The ability to have perpetual or long term trusts
- Trust instrument flexibility
- Directed Trusts
- Protection from creditors
- A developed body of law regarding flexible trust provisions
- Significant history and robust trust industry
Delaware and Nevada’s jurisdictions offer unique advantages:

Both Delaware and Nevada are trust-friendly jurisdictions that promote innovative trust laws and attractive income tax advantages.

Important Delaware and Nevada Advantages:
DELAWARE DYNASTY TRUSTS

- Increased exemption amounts, coupled with the longer, or even unlimited, periods that property can remain in trust in Delaware compared to most states, provides strong incentive for families to set up Delaware Dynasty Trusts.

- The ability to contribute assets to a trust that will continue for generations without the imposition of any transfer tax is an extraordinary opportunity compared to the alternative of passing assets outright subject to a federal transfer tax at each generation.

A Delaware Dynasty Trust may afford you the opportunity to transfer your assets undiminished by future transfer tax, without limitation, potentially forever.
## CONFIDENTIALITY

<table>
<thead>
<tr>
<th>Withholding of Information</th>
<th>• Allows trustees to withhold information about trusts from beneficiaries for a <strong>designated period of time</strong> as long as your trust specifies non-disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Avoidance of public filings</td>
<td>• Does not require a trustee to file trust agreements in court or to register trusts with a public agency, nor does it mandate court accountings for living trusts or testamentary trusts unless the instrument so directs</td>
</tr>
<tr>
<td>Limited court supervision</td>
<td>• The Delaware Court of Chancery does not exercise continuing jurisdiction over trusts, acting only in response to petitions brought by interested parties</td>
</tr>
<tr>
<td>Ability to appoint a Designated Representative</td>
<td>• Allows the appointment of a “Designated Representative” to protect the interests of beneficiaries during the period of nondisclosure</td>
</tr>
</tbody>
</table>

Delaware law also provides you a high level of confidentiality regarding your wealth transfer plans.
INVESTMENT FLEXIBILITY WITH DIRECTED TRUSTS

Delaware law permits trustees to take direction from authorized “investment advisers.” Delaware law gives you the freedom to appoint investment advisers to manage trust assets and to limit the trustee’s liability for the management of those assets.

The benefits of the bifurcation of investment responsibility between the trustee and the authorized adviser include:

• The ability to hold interests in closely-held investment entities or operating businesses where you may not want the trustee to be involved with the management of those assets

• The freedom from trustee involvement in the investment and business management decisions made by you or someone else acting as the investment advisor for some or all assets

• The power of the investment advisor to direct the trustee to retain a concentrated holding in the trust portfolio

• The ability to direct investments that you view as socially responsible
DISTRIBUTION FLEXIBILITY

Unlike some other states, Delaware law affords you the opportunity to name advisers to direct distributions to your beneficiaries. In addition to affording greater investment flexibility, Delaware law also provides you the option of appointing an adviser who determines if and when your beneficiaries receive distributions.

Examples of situations where distribution advisers can be useful:

- If you wish to impose subjective criteria for a beneficiary’s eligibility for distributions, such as “lifestyle” or “productivity” standards
- If you wish to impose mandatory testing for substance abuse prior to a beneficiary receiving a distribution
- Where you prefer family members and/or friends with greater knowledge of your beneficiaries’ needs to assume responsibility for those decisions
- For Supplemental Needs Trusts, family members can make determinations on eligibility for governmental programs and direct the trustee to make supplemental distributions
- The authority to decant assets into a new trust can be held by a distribution advisor
ADMINISTRATIVE FLEXIBILITY

The availability of total return unitrusts and equitable adjustments in Delaware confers greater flexibility to treat different classes of beneficiaries fairly. Consistent with Delaware’s long history of innovative trust laws, your trustee(s) can leverage various techniques to address your beneficiaries’ needs today and in the future.

- **Total Return Trusts**: To help meet the investment needs of current and future beneficiaries, Delaware law permits your trustee to convert an income only trust into a trust that pays your beneficiaries a percentage of the total value of the trust, including a portion of the capital appreciation.

- **Power to Adjust**: Delaware law allows your trustee the ability to make equitable transfers between income and principal without a formal conversion to a total return trust to satisfy their duty of impartiality to all beneficiaries.

- **Decanting**: Delaware law offers your trustee the ability to modify the terms of your irrevocable trust by granting discretion to distribute trust principal to another trust, whose terms may vary within certain parameters.
PRE-MORTEM VALIDATION

How It Works:

• The trustee gives written notice to “a person” of the existence of the trust, starting a 120-day period for the person to challenge the trust
• The dissenting person must file a challenge during this period while you are still living and able to provide testimony negating the lack of capacity or undue influence
• After this 120-day period, the person is precluded from challenging the trust after your death, offering finality and certainty that your wishes will be honored

In the event you are not comfortable with this approach, Delaware law also recognizes the validity of no-contest clauses in trusts, with certain exceptions.

Delaware law additionally allows for challenges to the validity of trusts before your death, compelling dissenting parties to raise any objections while you are still living.
Directed Trusts
DIRECTED TRUSTS

One of the most frequent reasons clients seek a specialized jurisdiction for their trusts is the ability to access its directed trustee statute.

Delaware
• Delaware’s directed trust statute provides that the trustee is not liable for any loss to the trust which results from the trustee following the direction of an adviser named in the trust instrument unless the trustee acts with “willful misconduct”, 12 Del. C. §3313.
• Also specifically recognizes the role of trust protector.

Nevada
• Nevada’s directed trust statute provides that an adviser can direct the trustee and the trustee is not liable for any loss to the trust which results from the trustee following the direction of an adviser, NRS 163.553.
• Specifically defines adviser to include an investment adviser and a distribution adviser.
• Specifically defines trust protector as an adviser with the power to direct the trustee.

Uniform Trust Code
• The Uniform Trust Code §808(b) provides that the trustee is not liable for any loss to the trust which results from the trustee following the direction of an adviser named in the trust instrument, unless the direction is “manifestly contrary to terms of the trust or if the trustee knows the direction is a serious breach of fiduciary duty of the directing person” – thus putting an obligation on the trustee to review the direction, UTC §808(b).

California
• Does not have a directed trust statute.
DIRECTED TRUSTS, CONTINUED

The Nevada statute

NRS 163.5549 provides for limitations on liability of an excluded fiduciary

An excluded fiduciary is not liable, individually or as a fiduciary for any loss which results from:

(a) Complying with a direction of a trust adviser, custodial account owner or authorized designee of a custodial account owner;

(b) A failure to take any action proposed by an excluded fiduciary which requires prior authorization of the trust adviser if the excluded fiduciary timely sought but failed to obtain such authorization; or

(c) Any action taken at the direction of a trust protector.

2. An excluded fiduciary is not liable for any obligation to perform an investment or suitability review, inquiry or investigation or to make any recommendation or evaluation with respect to any investment, to the extent that the trust adviser, custodial account owner or authorized designee of a custodial account owner had authority to direct the acquisition, disposition or retention of such investment.

3. The provisions of this section do not impose an obligation or liability on a custodian of a custodial account for providing any authorization.
DIRECTED TRUSTS, CONTINUED

The Nevada statute

NRS 163.5553 provides for the powers of a trust protector

1. A trust protector may exercise the powers provided to the trust protector in the instrument in the best interests of the trust. The powers exercised by a trust protector are at the sole discretion of the trust protector and are binding on all other persons. The powers granted to a trust protector may include, without limitation, the power to:

(a) Modify or amend the instrument to achieve a more favorable tax status or to respond to changes in federal or state law.

(b) Modify or amend the instrument to take advantage of changes in the rule against perpetuities, restraints on alienation or other state laws restricting the terms of a trust, the distribution of trust property or the administration of the trust.

(c) Increase or decrease the interests of any beneficiary under the trust.

(d) Modify the terms of any power of appointment granted by the trust. A modification or amendment may not grant a beneficial interest to a person which was not specifically provided for under the trust instrument.

(e) Remove and appoint a trustee, trust adviser, investment committee member or distribution committee member.

(f) Terminate the trust.

(g) Direct or veto trust distributions.

(h) Change the location or governing law of the trust.

(i) Appoint a successor trust protector or trust adviser.

(j) Interpret terms of the instrument at the request of the trustee.

(k) Advise the trustee on matters concerning a beneficiary.

(l) Review and approve a trustee’s reports or accounting.

2. The powers provided pursuant to subsection 1 may be incorporated by reference to this section at the time a testator executes a will or a settlor signs a trust instrument. The powers provided pursuant to subsection 1 may be incorporated in whole or in part.
DIRECTED TRUSTS, CONTINUED

The Nevada statute

NRS 163.5557 provides for the powers of an investment trust adviser and a distribution trust adviser

1. An instrument may provide for the appointment of a person to act as an investment trust adviser or a distribution trust adviser with regard to investment decisions or discretionary distributions.

2. An investment trust adviser may exercise the powers provided to the investment trust adviser in the instrument in the best interests of the trust. The powers exercised by an investment trust adviser are at the sole discretion of the investment trust adviser and are binding on all other persons. The powers granted to an investment trust adviser may include, without limitation, the power to:

   (a) Direct the trustee with respect to the retention, purchase, sale or encumbrance of trust property and the investment and reinvestment of principal and income of the trust.

   (b) Vote proxies for securities held in trust.

   (c) Select one or more investment advisers, managers or counselors, including the trustee, and delegate to such persons any of the powers of the investment trust adviser.

3. A distribution trust adviser may exercise the powers provided to the distribution trust adviser in the instrument in the best interests of the trust. The powers exercised by a distribution trust adviser are at the sole discretion of the distribution trust adviser and are binding on all other persons. Except as otherwise provided in the instrument, the distribution trust adviser shall direct the trustee with regard to all discretionary distributions to a beneficiary.
DIRECTED TRUSTS, CONTINUED

The Delaware statute

3313. Advisers

- (a) Where 1 or more persons are given authority by the terms of a governing instrument to direct, consent to or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decision of the fiduciary, such persons shall be considered to be advisers and fiduciaries when exercising such authority unless the governing instrument otherwise provides.

- (b) If a governing instrument provides that a fiduciary is to follow the direction of an adviser, and the fiduciary acts in accordance with such a direction, then except in cases of willful misconduct on the part of the fiduciary so directed, the fiduciary shall not be liable for any loss resulting directly or indirectly from any such act.

- (c) If a governing instrument provides that a fiduciary is to make decisions with the consent of an adviser, then except in cases of willful misconduct or gross negligence on the part of the fiduciary, the fiduciary shall not be liable for any loss resulting directly or indirectly from any act taken or omitted as a result of such adviser's failure to provide such consent after having been requested to do so by the fiduciary.

- (d) For purposes of this section, "investment decision" means with respect to any investment, the retention, purchase, sale, exchange, tender or other transaction affecting the ownership thereof or rights therein, and an adviser with authority with respect to such decisions is an investment adviser.
DIRECTED TRUSTS, CONTINUED

The Delaware statute

3313. Advisers

(e) Whenever a governing instrument provides that a fiduciary is to follow the direction of an adviser with respect to investment decisions, distribution decisions, or other decisions of the fiduciary, then, except to the extent that the governing instrument provides otherwise, the fiduciary shall have no duty to:

1. Monitor the conduct of the adviser;
2. Provide advice to the adviser or consult with the adviser; or
3. Communicate with or warn or apprise any beneficiary or third party concerning instances in which the fiduciary would or might have exercised the fiduciary’s own discretion in a manner different from the manner directed by the adviser.

Absent clear and convincing evidence to the contrary, the actions of the fiduciary pertaining to matters within the scope of the adviser’s authority (such as confirming that the adviser’s directions have been carried out and recording and reporting actions taken at the adviser’s direction), shall be presumed to be administrative actions taken by the fiduciary solely to allow the fiduciary to perform those duties assigned to the fiduciary under the governing instrument and such administrative actions shall not be deemed to constitute an undertaking by the fiduciary to monitor the adviser or otherwise participate in actions within the scope of the adviser’s authority.

- Willful misconduct is defined as “intentional wrong doing, not mere negligence, gross negligence, or recklessness”, 12 Del. C. §§3301(a) and 3301(h)(4).
- The 2011 revision to the statute defines wrong doing as “intentionally malicious conduct or conduct intended to defraud or seen an unconscionable advantage”.

Case law on directed trusts


• Paradee v. Paradee, C.A. No. 4988-VCL, October 5, 2010 (memorandum opinion), which cited the standard of §3313 even though there was not a trust adviser.

• Kathryn Mennen v. Wilmington Trust Company, a Delaware corporation, C.A. No. 8432-ML (January 17, 2014), in which a beneficiary brought suit against the corporate trustee as well as the individual trustee who is a family member. The case against the corporate trustee was settled and the case against the individual trustee is ongoing, although a draft Chancery Court opinion was published on December 8, 2014. The draft opinion recommended damages against the individual trustee in the amount of $72,448,299.93 plus interest at the rate of 7.75%.

• Rollins v. Branch Banking, Trust Company of Virginia, 2001 Va.Cir.Lexis 146 (Va. Cir. Ct. 2001), which upheld the statute but held that the trustee was liable and could not “rid himself of this duty to warn”.

DIRECTED TRUSTS, CONTINUED
ADMINISTRATION OF DIRECTED TRUSTS

What are the duties of a directed trustee? Outlined below are the various duties performed as Administrative Trustee of a Directed Trust.

Services performed by Directed Trustees

- **Custody of Assets** – safekeeping of assets and maintenance of trust records
- **Trust Operations** – administration of the trust account via our various systems, fiduciary oversight, periodic administrative reviews
- **Fiduciary Accounting** – electronic imaging, account for receipts/disseminations and proper reporting of asset values, production of statements reflecting current trust activity and assets, online account access, on-going communication with all powerholders and beneficiaries
- **Distributions to Beneficiaries** – facilitate distributions upon receipt of directions
- **Expenses** – processing of all expenses incurred at the trust level
- **Tax Matters** – prepare/monitor preparation and filing of fiduciary income tax returns for trust and coordinate collection and dissemination of information to proper parties
- **Investments** – implement all transactions, execute operating agreements and other documents, manage proxy and corporate action notifications, update market values and execute subscription agreements when directed to do so.
International Trust Structures – Case Study
FOREIGN REVOCABLE GRANTOR TRUST: REVOCABLE DURING GRANTOR’S LIFETIME

- Non-U.S. grantor establishes a revocable trust governed by Delaware or Nevada law
- Considered non-U.S. for U.S. income tax purposes – because foreign person (grantor) has power over the trust. Also, perhaps a non-U.S. Trust Protector
- Gifts of intangible U.S. assets by non-U.S. grantor - not subject to U.S. gift or GST taxation

Corporate Trustee is either a Delaware or Nevada Trustee

- Delaware or Nevada trustee - trust governed by Delaware or Nevada law, but non-U.S. for income tax purposes because foreign person has control over the trust

Non-U.S. Private Investment Company

- Distributions made from the trust for the benefit of settlor / spouse or other beneficiaries – “foreign revocable trust” – all income and capital gains in the trust are attributable to the foreign grantor – not subject to U.S. fiduciary income tax

Delaware or Nevada Revocable Trust

- Delaware and Nevada “directed trust” statutes allow trustee to be directed on investments or other matters – grantor or other party directs trustee to hold a non-U.S. investment company

Assets

- Assets held in non-U.S. entity (the Private Investment Company) are not subject to U.S. estate taxes in grantor’s estate
FOREIGN REVOCABLE GRANTOR TRUST: IRREVOCABLE AFTER GRANTOR’S DEATH

- After grantor’s death – trust becomes irrevocable; beneficiaries are U.S. persons
- Trust is subject to U.S. income taxation – no longer have a non-U.S. Trust Protector

Corporate Trustee is either a Delaware or Nevada Trustee

- Delaware or Nevada trustee - trust governed by Delaware or Nevada law, trust now subject to U.S. income taxation; possibly no state level income taxation

Delaware or Nevada Revocable Trust

- Distributions made from the trust to or for the benefit of U.S. beneficiaries – all accumulated income and capital gains in the trust are subject to U.S. income tax payable by the trust – or income taxable to beneficiaries when they receive distributions of income

Assets

- Assets no longer held in offshore investment company – trustee can still be directed on investments, or trustee can have investment responsibility
IRREVOCABLE TRUST CREATED BY NON-U.S. GRANTOR: A COMPLETED GIFT

- Grantor creates an irrevocable trust for the benefit of U.S. persons
- If structured correctly, the gift is not subject to U.S. gift or GST taxes
- Trust is subject to U.S. income taxation, but possibly not state level income taxes

Corporate Trustee is either a Delaware or Nevada Trustee

- A completed gift, but non-U.S. grantor not subject to U.S. gift or GST tax – not limited to the $5,450,000 exemption amount

Delaware or Nevada Irrevocable Trust

- Distributions made from the trust to or for the benefit of U.S. beneficiaries – all accumulated income and capital gains in the trust are subject to U.S. income tax payable by the trust – or income taxable to beneficiaries when they receive distributions of income

Assets

- Assets can be held directly in the trust. No need to have an offshore holding company. There is no issue of estate tax going forward for Dynasty Trusts
CASH MOVEMENT ON SHORE

✓ Potential Gift Tax Issue
  ✓ US beneficiaries of gift from a Non-Resident Alien Client could trigger U.S. gift tax.
  ✓ Gift to trust ideally should take place off shore.

✓ Practical Problems
  ✓ Opening a bank account for a series of small transactions.
  ✓ Almost impossible to find an institution to open an account for this purpose.
  ✓ Concerns about KYC/AML issues.

✓ Potential Solution
  ✓ Trust opens an account through a Sub-Custodian – Correspondent Bank in a jurisdiction outside of the United States.
Income Taxation And Its Applicability To Dynasty Trusts
Benefits to NRA Preferred Tax Regime...

- Taxes are a real and substantial cost of earning income. By minimizing or perhaps eliminating it, the U.S. tax cost of investing in U.S. stocks and securities, foreign investors will improve their overall after-tax yield of securities, professionally-managed funds, and other investments held in their global portfolios.

- Although many types of investment income from U.S. sources are subject to tax, opportunities are available to perhaps eliminate this tax. Essentially, foreign investors are subject to preferential tax rates to encourage their participation in U.S. markets.
LONG TERM TRUSTS

Delaware and Nevada have similar perpetuities provisions

Delaware

- Delaware abolished its Rule Against Perpetuities for intangible assets, 25 Del. C.§503.

- The 110-year limit on real estate still applies in Delaware, 25 Del. C.§503 (b).

- However, entities such as corporations, LLC’s, and LLP’s owning real property may be held in a Delaware trust in perpetuity, 25 Del. C. §503(e).

Nevada

- Nevada has extended its perpetuities period to 365 years for all property held in trust, NRS 111.1031.

California

- California has enacted the Uniform Statutory Rule Against Perpetuities, which creates a perpetuities period of lives in being plus 21 years, or 90 years after creation of the property interest, Cal. Prob. Code §§21200 – 21231.
COMBINE LONG TERM TRUSTS WITH FAVORABLE TAX TREATMENT

Delaware

• In general Delaware treats a trust as a resident trust if there is at least one Delaware trustee, 30 Del. C. § 1601(8).

• Delaware resident trusts may take an income tax deduction for both federal DNI that is actually distributed and for the amount of their federal taxable income that is set aside for future distribution to nonresident beneficiaries, 30 Del. C. §§ 1635 and 1636.

• Therefore as long as there are no Delaware beneficiaries, there will be no Delaware fiduciary income tax on accumulated income and realized capital gains in the trust.

Nevada

• Nevada has no individual or corporate income tax – no income taxation on trusts.
Impact of Other States

- But the Delaware or Nevada trust may be subject to income tax of other states. The following are bases for states imposing taxation on an out of state trust:
  - A fiduciary, including a Trust Adviser, lives in that state, or the trust is administered in that state.
  - The trust has property located in that state or source income from that state.
  - One or more beneficiaries live in that state.
  - The grantor was a resident of that state when the trust became irrevocable.

California

- A non-grantor trust can be subject to California fiduciary income taxation in any of the three following ways: (this applies to accumulated income)
  - One or more of the fiduciaries is a California resident, Cal. Rev. & Tax Code §§17742 and 17743, Cal. Code Regs. titl. 18, §17743;
  - One or more of the “non-contingent beneficiaries” is a California resident, Cal. Rev. & Tax Code §§17742 and 17744, Cal. Code Regs. titl. 18 §17744; or
  - The trust has California source income, see e.g., Cal. Code Regs. titl. 18, §§17951-3, 17951-4, and 17952.
  - Note that a California resident beneficiary whose interest in a trust is subject to the sole and absolute discretion of the trustee holds a contingent interest in the trust.
Considerations In The Purchase and Management of Real Estate
CONSIDERATIONS IN THE PURCHASE & MANAGEMENT OF REAL ESTATE

- Understanding what the financial performance of the proposed purchase will be or determining whether market conditions have changed and they should sell

- Conducting periodic inspections of the property and communicating with tenants or third party managers to help assure that properties are appropriately maintained

- Determining capital improvement expenditures

- Assessing value of the property through periodic appraisals and alternative methods

- Dealing with Environmental reviews and remediation

- Annual budgets

- Dealing with real estate tax assessment notices and engaging counsel to file appeals where appropriate

- Reviewing and maintaining proper insurance coverage on the property

- Assessing cash reserve needs for building repairs and capital improvements

- Negotiating leases

- Negotiating contracts with outside vendors for capital improvements and property maintenance

- Managing tenant relationships and disputes

- Collecting rents and managing rental delinquencies and vacancies

- Paying all property related expenses

- Compiling performance reports
Considerations For The Non-Resident Alien (NRA) Borrower
LENDING CONSIDERATIONS FOR THE NRA CLIENT

Underwriting Guidelines

✓ Most banks will only do recourse lending

✓ Loan to Value – Maximum of 60%

✓ One domestic and two International References

✓ 3 months worth of bank statements to verify liquidity

✓ Establish an investment management or depository relationship

✓ No income verification
  ✓ Pledged account with 6 months of Principal, Interest, Tax and Insurance payments
  ✓ Must be different from the account to pay mortgage.

✓ Use of lines of credit secured by Investment Management Accounts
  ✓ Attractive rates
  ✓ Flexibility to move fast to pay cash for properties

✓ Insurance Companies and hard money lenders will consider non-recourse lending
Know Your Customer (KYC) and Anti-Money Laundering (AML)
ENHANCED DUE DILIGENCE

**HIGH RISK**

Institutions

- Insurance Companies, Gambling, Commodities (And Others)

People

- Drug cartels, Terrorists, PEP’s (And Others)

Countries

- Iran, Iraq, North Korea, Cuba, Venezuela (And Others)

**HIGH COSTS**

- Increased Regulations and Compliance Needs
- Fines,
- Personnel needed to monitor
NRA RISKS

❖ Regulatory Risks:
   Annual periodic reviews require annual re-onboarding of clients.
   Relationship Managers need to know their NRA clients. They have to be very careful about anything that might be construed as “willful blindness”.

❖ Reporting Risks:
   FACTA reporting – the bank needs to report the presence of “U.S. persons” in any offshore structure. All U.S. indicia needs to be cured. RMs need to certify to the best of their knowledge, the reporting is true and correct.
    ➢ Note – someone who has surrendered U.S. citizenship needs to have a “certificate of loss” issued by the U.S. State Department. Nothing else can be accepted if the client wants to sign a W-8.
   CRS Reporting – similar to FATCA.
NRA RISKS TO SERVICE PROFESSIONALS

❖ Primary Risk:
    Reputational risk or headline risk consists of opening an account for a UBO or powerholder with whom we do not want to be associated.

❖ Mitigants:
    Verification of source of wealth - This goes beyond simple identification of source of funds. It includes an understanding of client’s business with special care taken for those that are in high cash businesses.
    Understanding transaction flow - Who is sending money into accounts and where money is being sent?
    Have established AML procedures including background checks and review of all corporate documentation.

❖ Operational Risks:
    Failure to maintain a valid W-8.
    Investing in the wrong products.
DISCLOSURES

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Thank you

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