War Stories From A U.S. International Practitioner – Latest Trends and Events Affecting Foreign Trustees

Steven L. Cantor

Presented Before STEP Bahamas Branch

January 31, 2008

STEP

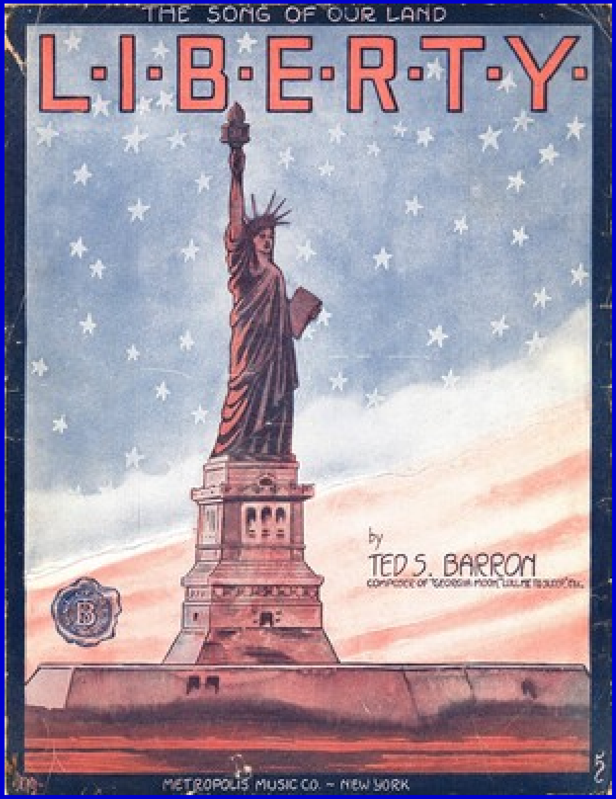
Society of Trust and Estate Practitioners

Current Issues Worth Discussing

- Preresidency Tax and Estate Planning
- Diversity fiscal status family issues
  - Inter Vivos Planning
  - Post Mortem Planning
- "Clean-up" Projects
- Expatriation
- Proposed Legislative Developments

Preresidency Tax and Estate Planning Strategies

REASONS FOR MOBILITY
Political



Resident/Nonresident Domiciliary/Nondomiciliary

- RESIDENT
- DOMICILIARY

Why is he frowning?

- NONRESIDENT
- NONDOMICILIARY

Why is he smiling?

The Preresidency Planning Spectrum
"Are We Coming?"

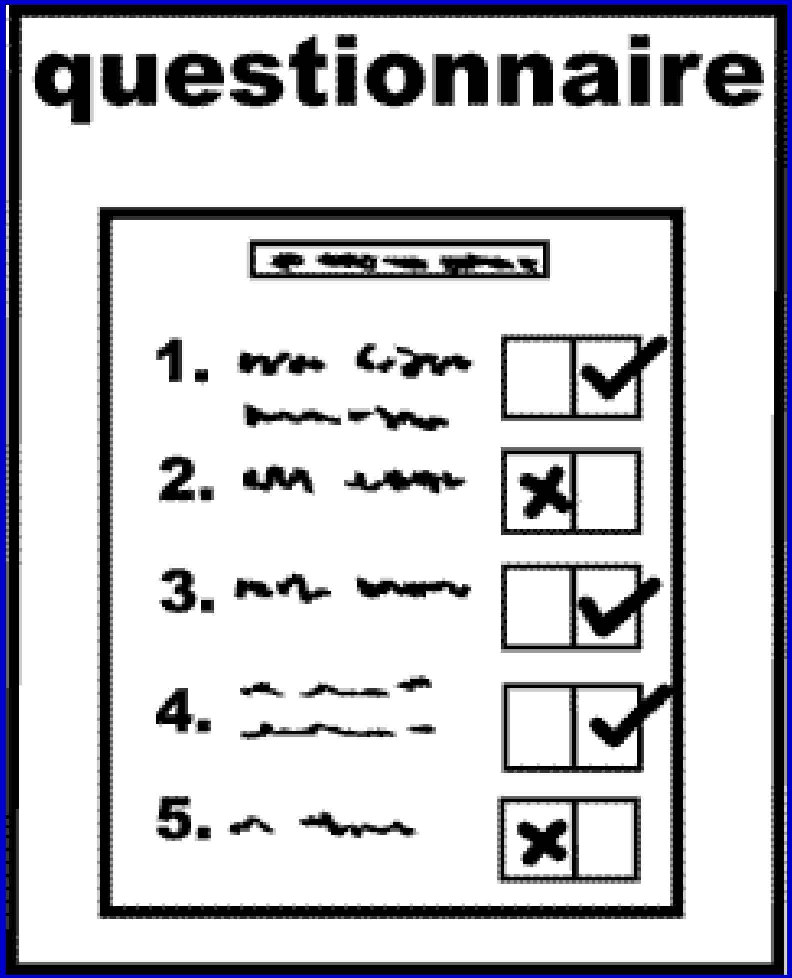
"We might come to the U.S. Give us a plan."

We're here now and we're not leaving. Go figure out how we can save on taxes."

The Preresidency Planning Spectrum
"What Do I Need?"

Fancy Techniques $$$	———	Control and Possession of Everything

Preresidency Planning Questionnaire



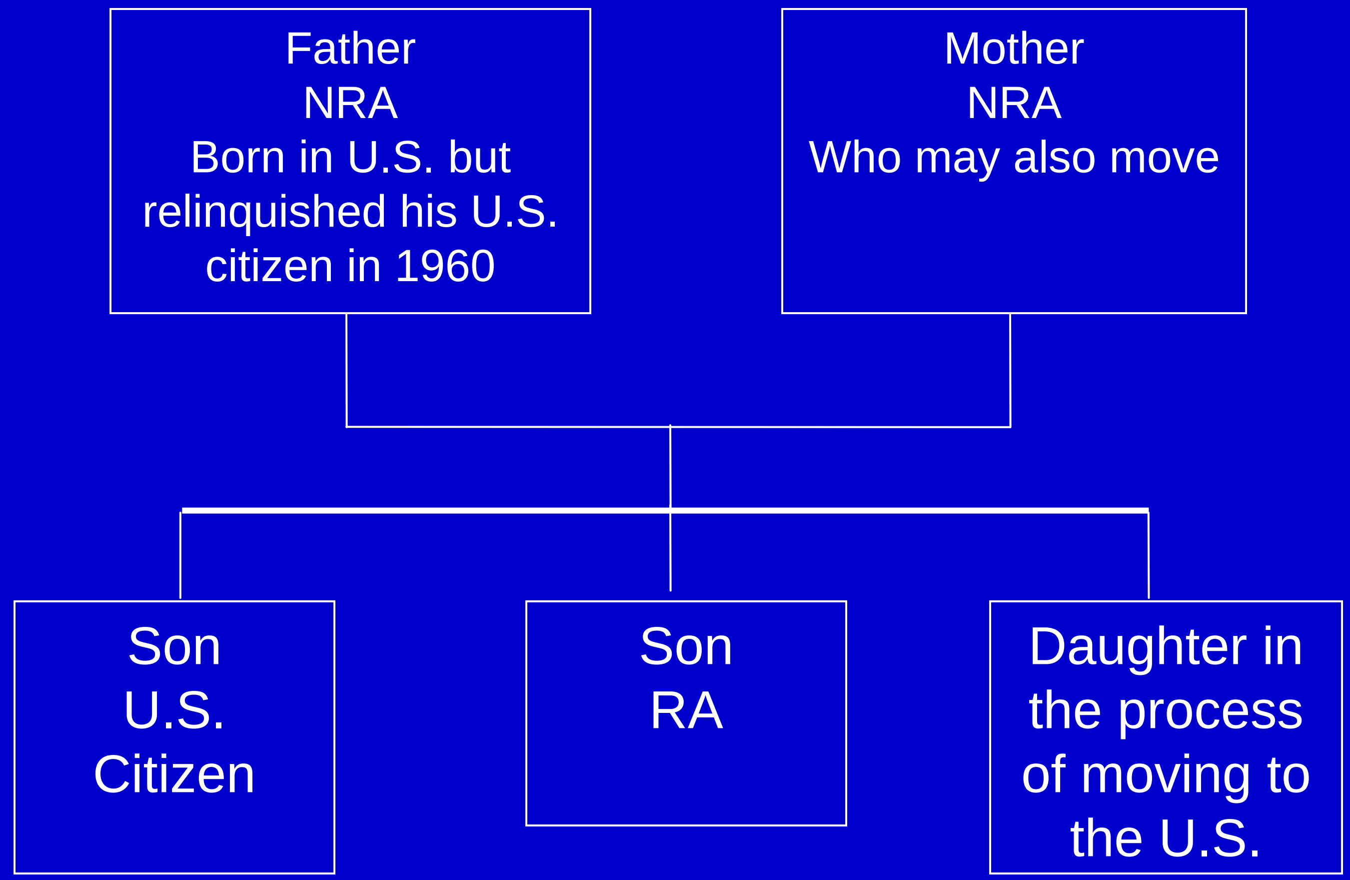
Preresidency Tax Planning

- Know your client
  - Family
  - Assets and Business
  - Citizenship(s), Residence and Domicile
  - Date of Change in Residence

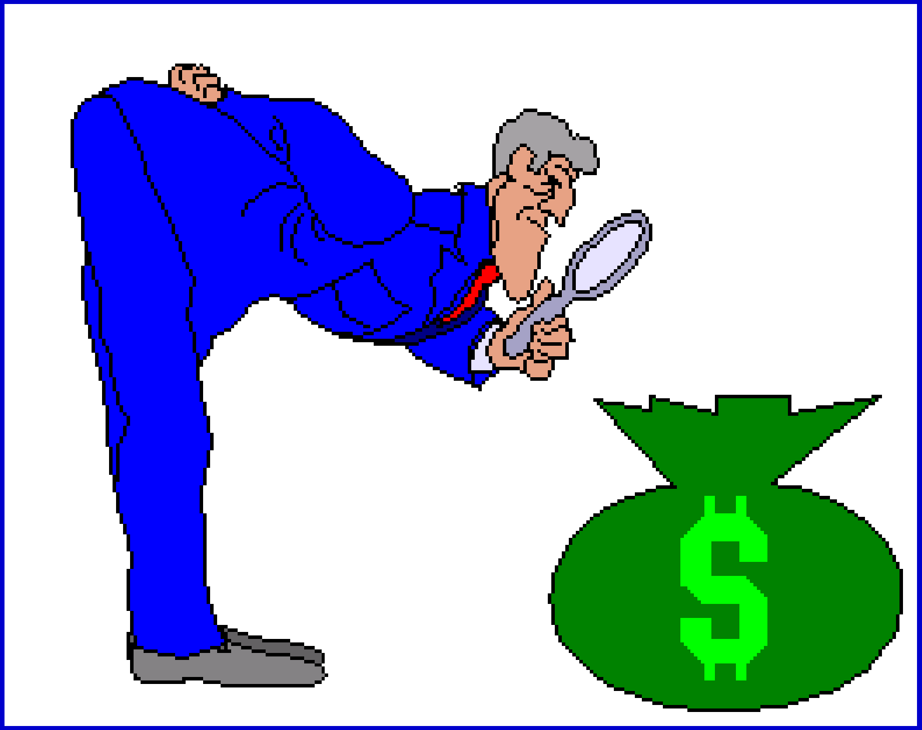
Tax Considerations – United States and Home Country

- Analysis of various types of tax systems
  - Basis upon which income and assets are subject to tax
  - Pre-residency and expatriation issues
  - Tax treaties
  - Home Country "Black List"
  - Foreign tax and earned income credit, deduction or exclusion
  - Review marital property and "forced heirship" laws

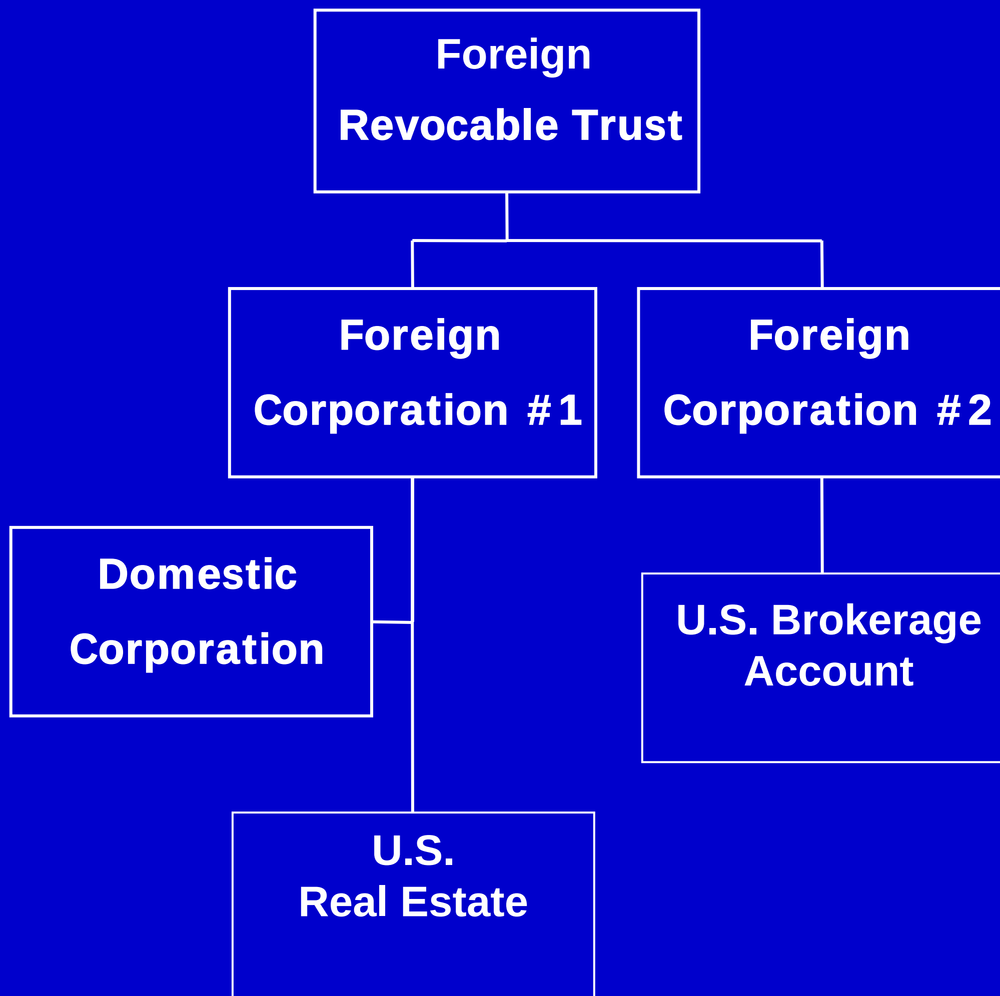
Children Moving/Moved to the U.S. or "Was it Something We Said?"



Income Taxation of The Trust and Its Beneficiaries



Common Structure For United States Situs Assets



Income Taxation of Trusts and Beneficiaries

- Grantor Trust
  - Person treated as owner of assets is subject to U.S. income tax on current income (grantor trust does not have accumulated income)
- Non-Grantor Trust
  - Trust subject to U.S. income tax except that beneficiaries are taxed on receipt of distributions of income and income required to be distributed (whether or not actually distributed)
- Foreign vs. Domestic
  - Accumulation Distributions from foreign trust subject to throwback rules – U.S. income tax and interest charge
  - Accumulated income loses character
- CFC and PFIC

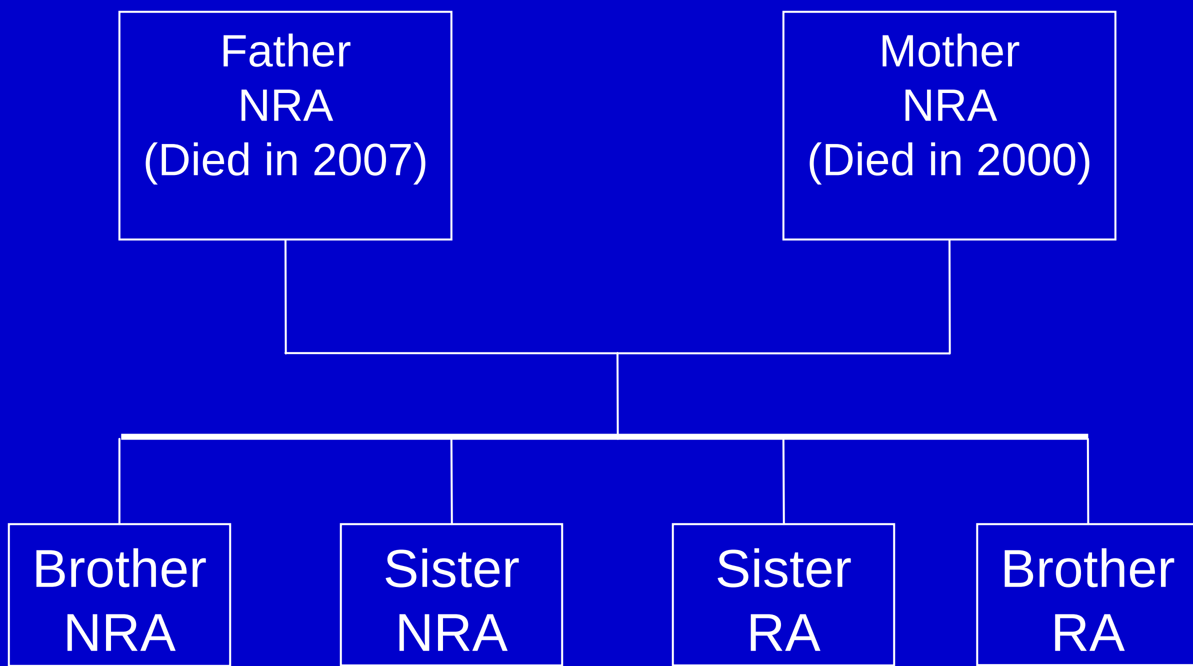
TAXATION OF UNITED STATES BENEFICIARIES OF FOREIGN TRUSTS

- Current Trust Income - Distributable Net Income (“DNI”)
- Accumulation Distributions - Throwback Rule - Undistributed Net Income (“UNI”)

Planning Issues for Foreign Trusts

- Funding of trust
- Structuring gifts during lifetime of settlor
- Loans or guarantees
- Minimizing taxation of beneficiaries

United States Resident Sibling Beneficiary "Why is Our Sister Causing All of These Problems?"



- Foundation in Liechtenstein
- Panama Company – Bearer Shares
- Home Country Will

MINIMIZING THROWBACK RULE FOR EXISTING FOREIGN TRUSTS WITH UNITED STATES BENEFICIARIES

- Distributions of Appreciated Property "In Kind"
- Distributions to Non-United States Beneficiaries
- Life Insurance
- Accounting Income Exception
- Default Calculation Rules
- Domesticating the Trust
- Sale of shares of underlying company with built-in gain to Non United States Persons

What is a controlled foreign corporation ("CFC")?

- A CFC refers to any foreign corporation in which more than 50% of the total combined voting power or 50% of the value of the stock is owned, directly or indirectly, by United States persons.
- Subpart F income only applies to CFCs.

Attribution Rules for CFCs Held by Trusts

- A foreign corporation owned by a foreign trust is a CFC if:
  - one or more United States persons directly or indirectly own more than 50% of the total combined voting power or 50% of the value of the stock in such foreign corporation.
- Stock owned, directly or indirectly, by or for by a trust may be considered as being owned by its beneficiaries in proportion to the actuarial interest of the beneficiaries of the trust.

What is a Passive Foreign Investment Company ("PFIC")?

A foreign corporation will be classified as a PFIC if, during any taxable year:

- 75 % or more of its gross income is passive income, or
- 50% or more of its assets are held for the production of passive income.

Taxation under the PFIC provisions

There are three taxation regimes under the PFIC provisions:

1. Excess distribution regime- imposes an interest charge on excess distributions from PFICs
2. QEF regime- U.S. taxpayer makes an election to be treated as receiving an annual distribution of his pro rata share of the PFICs earnings and profits.
3. Mark-to-Market regime- U.S. taxpayer makes an election to treat his stock in the PFIC as if it were sold at the end of each year.

Attribution Rules for PFICs Held by Trusts

- For purposes of the PFIC rules, stock owned, directly or indirectly, by or for a trust may be considered as being owned by its beneficiaries in accordance with their proportionate interests in the trust.

Recent Guidance from the Internal Revenue Service regarding PFICs

Technical Advice Memorandum 200733024

The TAM provides:

- United States beneficiaries of a foreign nongrantor trust are currently taxable on the gain arising on the disposal of a PFIC.
- A facts and circumstances test should be the basis for determining the attribution of PFIC interest to the beneficiaries of a foreign nongrantor trust.

IRS Form 5471

- Informational Return of U.S. Persons with Respect to Certain Foreign Corporations
- The categories of persons that may be required to file:
  - US person who is an officer or director of a foreign corporation in which any US person owns or acquires 10% or more of the stock of the foreign corporation.
  - A person who becomes a US person while owning 10% or more of the stock of the foreign corporation.
  - A US person who had control of a foreign corporation for at least 30 days.
  - A US shareholder who owns stock in a foreign corporation that is a controlled foreign corporation for an uninterrupted period of at least 30 days and who owned that stock on the last day of the that year.
- Due the same day as the U.S. person's income tax return, including extensions
- Significant penalties apply

IRS Form 8621

- Return by a shareholder of a Passive Foreign Investment Company (“PFIC”)
- Directly or indirectly own any stock in a PFIC
- Must file if:
  - The taxpayer recognizes gain or the direct disposition of PFIC stock
  - Receives certain direct or indirect distributions from a PFIC; or
  - Has made a qualified electing fund (QEF) election
- Due the same day as the U.S. person’s income tax return, including extensions
- Significant penalties apply

Planning Alternatives

- Domesticate Trust and or Company
- Liquidate Company or Check-the-Box on Company as a Disregarded Entity
- Compare QEF Election versus Excess Distribution Regime
- Distributions to Nonresident Aliens
- Distributions of Income to Domestic Trust/and or Beneficiaries
- Power of Appointment
- Investments/Insurance Products
- Purchase of Tangible Property to be used by the Beneficiaries

United States Reporting Requirements and Clean-Up Jobs We'd Prefer to Have Avoided

U.S. Treasury Department Form TD F 90-22.1

- Report of Foreign Bank and Financial Accounts
- Must be filed by a US person who has a financial interest in or signature authority or other authority over any foreign financial accounts if the aggregate value of these accounts exceeds US$10,000.00 at any time during the calendar year
- Due on or before June 30th of succeeding year
- Applies to certain trust beneficiaries

IRS Form 3520

- Responsible party must file to report a “reportable event”
- U.S. person must file if:
  – Treated as the owner of any assets of a foreign trust under the grantor trust rules
  – Transferred property to foreign trust
  – Received more than $100,000 from a NRA or foreign estate (including foreign persons related to such NRA or foreign estate)
  – Received more than $10,000 (adjusted for inflation) from a foreign corporation or foreign partnership (including foreign persons related to such entity) that were treated as gifts
  – Received a distribution from a foreign trust
  – A party to certain loans
- Due the same day as the US person’s personal income tax return, including extensions
- Significant penalties apply

IRS Form 3520-A

- Must be filed by a foreign trust if a U.S. person is treated as the owner of the assets of the trust
- Sets forth a full and complete accounting of all trust activities, trust operations and other relevant information
  - Foreign Grantor Trust Owner Statement
  - Foreign Grantor Trust Beneficiary Statement
- Due the 15th day of the 3rd month after the end of the trust's tax year
- Significant penalties apply

Bank Accounts Left Offshore Before Moving to the United States
"But Our Mother Never Told Us About This!"

Father
U.S. Citizen
(Former NRA)
(Died in 1990)

Mother
U.S. Citizen
(Former NRA)
(Died in 2006)

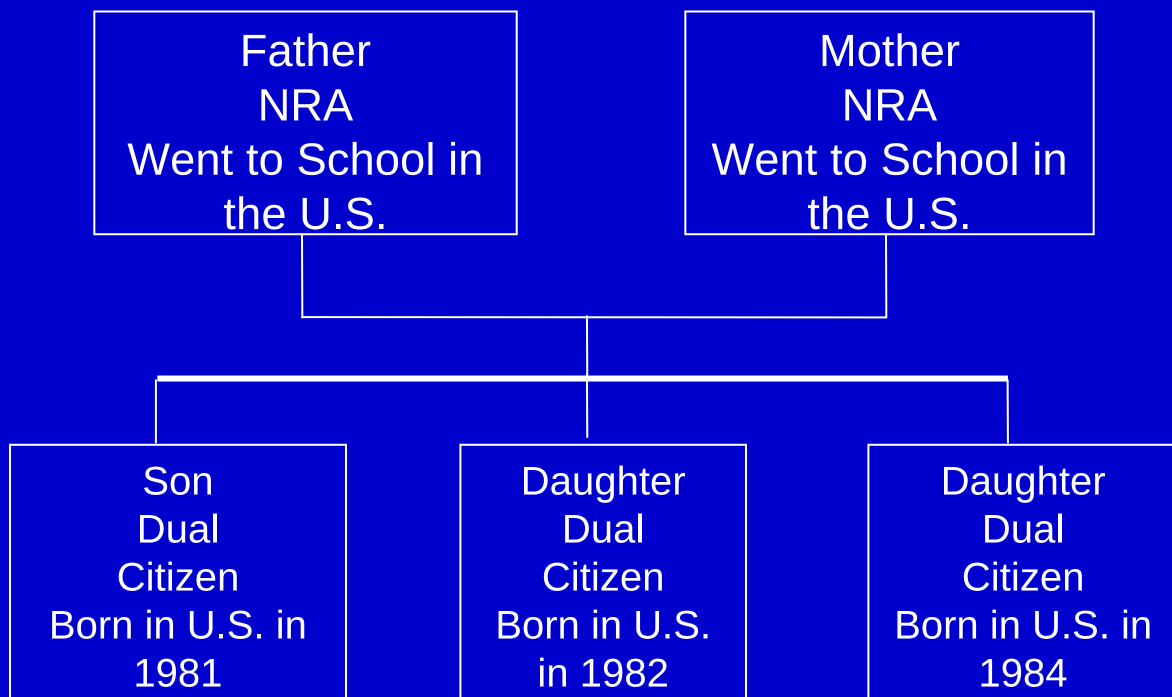
Daughter
RA
(Former NRA)

Son
RA
(Former NRA)

- Unreported Income & Gifts
- Unreported Foreign Trust
- Income Estate and Gift Tax Penalties

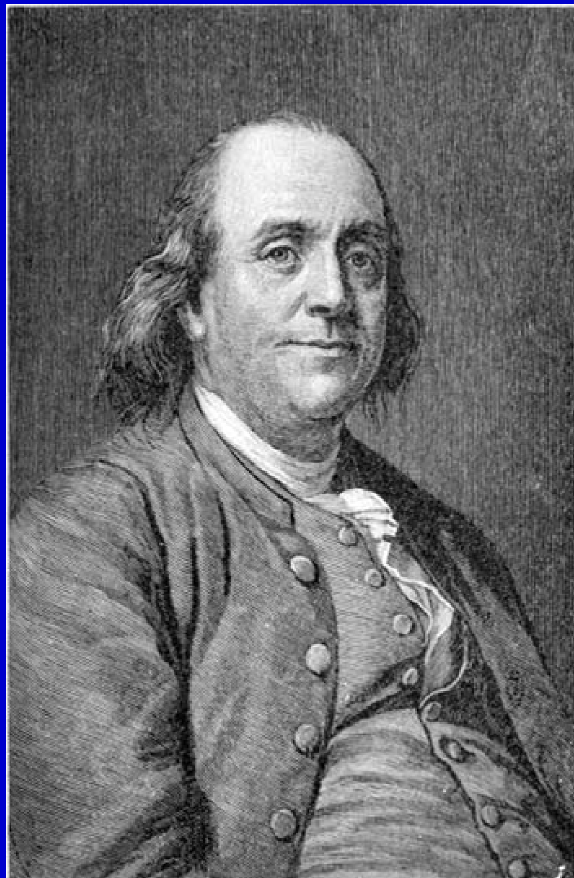
Expatriation

Expatriation



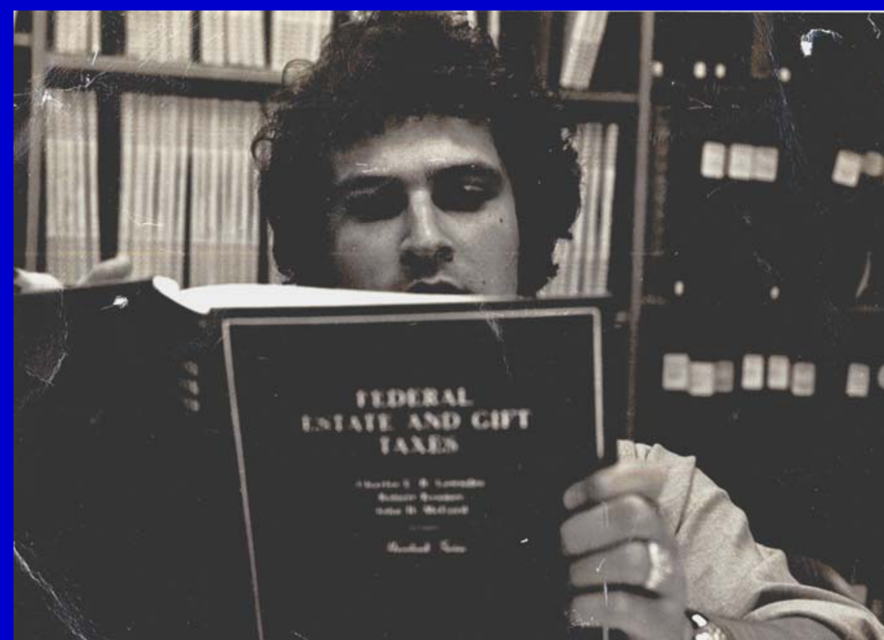
- Children born in the U.S.
- Children becoming part of family business

Proposed Legislative Developments Affecting Offshore Planning



"In this world nothing can be said to be certain, except death and taxes. "
Benjamin Franklin
Letter to Jean-Baptiste Leroy (1789-11-13)

"Change the tax laws within six months after I just graduated from NYU with an LL.M. in taxation? Is Congress joking?"
Steven L. Cantor
November 1976, upon hearing the news of the passage of the Tax Reform Act of 1976.



Sampling of Legislation

- **Stop Tax Haven Abuse Act-** (Senate) February 17, 2007; (House) May 3, 2007 +
- **Tax Reduction and Reform Act of 2007-** (House) October 25, 2007 +
- **Defenders of Freedom Tax Relief Act of 2007 -** (Senate) June 12, 2007 ; (House) October 30, 2007
- **Fairness In International Tax Act-** (House) July 24, 2007 ©
- **Act for Our Kids-** (Senate) February 12, 2007 +
- **Heartland, Habitat, Harvest, and Horticulture Act of 2007-** (Senate) October 25, 2007 •
- **Offshore Deferred Compensation Reform Act of 2007-** (Senate) October 18, 2007; (House) October 22, 2007 +

+ Committee
Passed
• Legislative Calendar

Themes

- Perceived abuses vs. actual abuses
- “Economic Substance”
- Tax Treaties and TIEAs
- Election year politics

"Many Ways in which Taxes are Dodged Today"

- **Abusive Tax Shelters** – Using complex investment schemes with no real business purpose other than to evade tax
- **Corporate Inversions** – Companies pretending to move their headquarters to an offshore tax haven just to avoid their U.S. tax bill
- **Foreign Tax Havens** – Using bank accounts and shell entities in foreign tax havens to escape detection while dodging taxes
- **Structured Finance Transactions** – Companies using shell entities in convoluted setups or improper transfer pricing schemes to avoid taxes

Establish Presumptions to Combat Offshore Secrecy

By allowing U.S. tax and securities law enforcement to presume that non-publicly traded, offshore corporations and trusts are controlled by the U.S. taxpayers who formed then or sent them assets, unless the taxpayer proves otherwise.

IRS

Impose Tougher Requirements on U.S. Taxpayers Using Offshore Secrecy Jurisdictions

34 Offshore Secrecy Jurisdictions - Initial list of jurisdictions was taken from IRS court filings identifying them as probable locations for U.S. tax evasion.

Anguilla
Antigua and Barbuda +
Aruba +
Bahamas +
Barbados *
Belize
Bermuda +
British Virgin Islands +

Cayman Islands +
Cook Islands
Costa Rica +
Cyprus *
Dominica +
Gibraltar
Grenada +
Guernsey/Sark/Alderney +
Hong Kong

Isle of Man +
Jersey +
Latvia *
Lichtenstein
Luxembourg *
Malta
Nauru
Netherlands Antilles +
Panama

Samoa
St. Kitts and Nevis
St. Lucia +
St. Vincent and the Grenadines
Singapore
Switzerland *
Turks and Caicos
Vanuatu

*** Existing Tax Treaty**
+ Existing TIEA

Authorize Special Measures to Stop Offshore Tax Abuses

By giving Treasury the authority to take special measures against foreign jurisdictions and financial institutions that impede U.S. tax enforcement

Authorize special measures against foreign jurisdictions, financial institutions, and others that impede U.S. tax enforcement. (§102 of STHAA)

- Currently, Treasury has the authority under §311 of the Patriot Act (31 U.S.C. 5318(a)) to impose financial sanctions on foreign jurisdictions, financial institutions, or transactions found to be of "primary money laundering concern."

- STHAA would authorize Treasury to impose the same sanctions on the same types of entities if Treasury finds them to be "impeding U.S. tax enforcement."

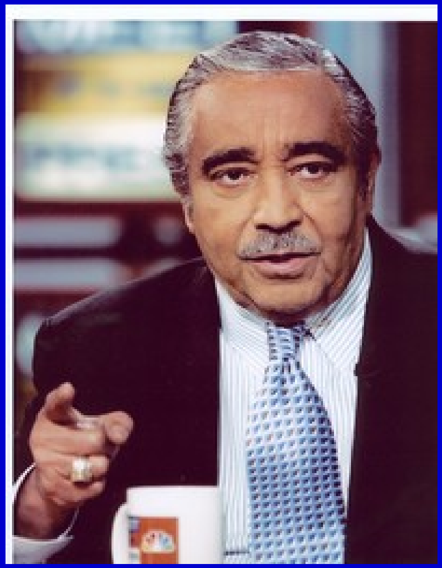
- The bill would also add to the list of possible sanctions the ability to deny foreign banks the authority to issue credit cards for use in the United States.

Close Offshore Trust Loopholes

By taxing offshore trust income used to buy real estate, artwork and jewelry for U.S. persons and treating as trust beneficiaries those persons who actually receive offshore trust assets.

Tax Reduction and Reform Act of 2007 (H.R. 3970)

- Bill would:
  - Prevent hedge fund managers from using offshore corporations to defer taxes on compensation and would require to take deferred compensation into account as it accrues.
  - Require US corporations that defer income through CFCs to also defer the deductions associated with the income.
  - Repeal worldwide allocation of interest.
  - Limit treaty benefits for certain deductible payments.



Defenders of Freedom Tax Relief Act of 2007 (H.R. 3997)

- Bill would alter the expatriation rules as follows:
  - All property of an expatriate would be treated as sold on the day before the expatriation for its fair market value.
  - Distributions of property from a nongrantor trust to an expatriate would be subject to 30% withholding of the taxable portion of the distribution and gain would be recognized to the trust if the fair market value exceeds the adjusted basis.

Gifts & Bequests From Expatriates (H.R. 3997 continued)

- Bill would impose a tax equal to the product of the highest rate of gift tax and the value of the gift or bequest if received from an expatriate.
- Tax imposed would be reduced by amount of any gift on estate tax paid to a foreign country.
- Bill would also apply to gifts or bequests made to domestic and foreign trusts by expatriates.
- Passed by House and Senate. Joint Committee is currently resolving differences between House and Senate Bills.

Parent Foreign Corporations (H.R. 3160 – Fairness in International Tax)

- With more than 50 co-sponsors, the "Fairness in International Tax" bill would curb treaty abuses by foreign parent corporations.

- The bill would require that corporations pay the higher of the withholding rates of

  1. Payments made directly to the parent foreign company;

     or

  2. Payments made to the subsidiary in the tax treaty country.

Tax Haven Foreign Company (Sen. Bill 554 - Act For Our Kids § 7875)

- Bill would define a Tax Haven Foreign Company as a foreign corporation which
  - (a) was created or organized under the laws of a tax haven country, and
  - (b) is a controlled foreign corporation for an uninterrupted period of 30 days or more during the taxable year.

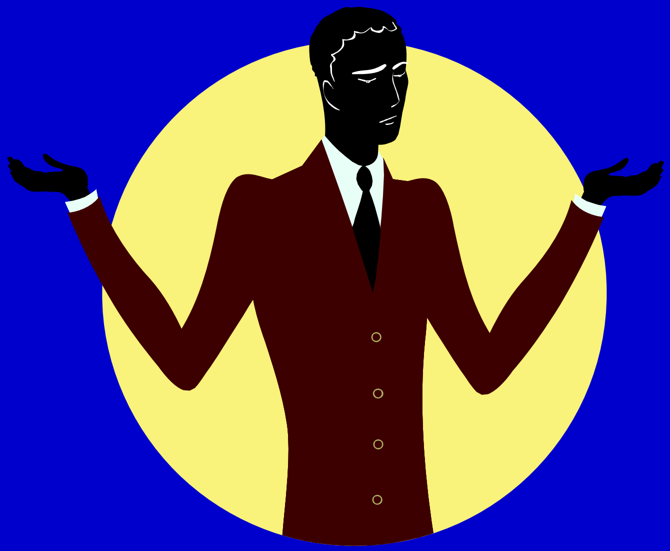
- Bill would:
  - deny deferral benefits to companies that locate subsidiaries in tax haven countries.
  - treat U.S. controlled foreign subsidiaries as domestic entities for U.S. tax purposes even if established in a tax haven countries.

Economic Substance Doctrine (Heartland, Habitat, Harvest, and Horticulture Act of 2007) (Sen. Bill 2242)

- Approved on October 4, 2007 by the Senate Finance Committee.
- This legislation would codify the economic substance doctrine and would impose a 30% penalty on understatements related to a non-economic transaction.
- The economic substance doctrine would be satisfied only if a transaction changes in a meaningful way a taxpayers position and only if the taxpayer has a substantial non-Federal tax purpose for entering into such transaction.
- This anti-abuse doctrine would be used to deny tax benefits associated with tax-motivated transactions.

Effects on the Advisor Community

WHAT ARE WE GOING
TO DO?



Contact Information

- Steven L. Cantor, Esq.
- Cantor & Webb P.A.
- 1001 Brickell Bay Drive, Suite 3112
- Miami, FL 33131
- Phone: (305) 374-3886
- Fax: (305) 371-4564
- Emails: steve@cantorwebb.com
- Website: www.cantorwebb.com