

STEP JOURNAL

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FAMILY BUSINESS

Including the need for governance, and the legal and financial risks of incapacity

CAREERS FOCUS

Advice on reflective practice, volunteering, workplace diversity and more

SOCIETY UPDATES

News, events and resources, including the *STEP Digital Legacy Scorecard*



The background of the cover features a stylized illustration of an airport terminal. A large departure board is the central focus, displaying flight information. Below the board, a family of four is depicted: a man in a purple shirt and light blue pants, a woman in a yellow shirt and brown pants, a young girl in a blue shirt and brown pants, and a boy in a blue shirt and red shorts sitting on a suitcase. They are all looking towards the board. The board itself has a blue header with a white airplane icon and the word 'Departures'. The table below has three columns: time, destination, and status. The destinations are 'GREEN CARD', 'RESIDENCY', 'FOUNDATIONS', 'INCOME TAX', 'DOMICILE', and 'TRUSTS'. The status column shows 'GO TO GATE', 'DELAYED', 'BOARDING', 'BOARDING', 'GO TO GATE', and 'BOARDING'. The background also shows a blue sky, a white airplane on the tarmac, and a white airport control tower.

Departures		
11:00	GREEN CARD	GO TO GATE
11:02	RESIDENCY	DELAYED
11:08	FOUNDATIONS	BOARDING
11:10	INCOME TAX	BOARDING
11:14	DOMICILE	GO TO GATE
11:20	TRUSTS	BOARDING

American connections

WHAT FAMILIES NEED TO CONSIDER
WHEN ESTABLISHING TIES WITH THE US

STEP

ADVISING FAMILIES ACROSS GENERATIONS

Regional focus

US and Canada

'Hot-tubbing' in Canada • Private derivatives for wealth structuring • Alberta's *Trustee Act*

KEY POINTS

What is the issue?

US trusts continue to be the tax- and estate-planning vehicle of choice for many Latin American families.

What does it mean for me?

Reasons for using a US trust include certainty as to the US tax treatment (if any) and the judicial interpretation of the trust instrument.

What can I take away?

The home-country tax and legal consequences for foreign settlors and beneficiaries are more uncertain and vary among Latin American jurisdictions.



Eduardo Arista
TEP is a Partner
at Holland &
Knight, US



Vehicle of choice

EDUARDO ARISTA EXPLAINS THE UTILITY OF US TRUSTS FOR LATIN AMERICAN FAMILIES

Latin American families have traditionally used non-US structures to hold wealth outside of their home countries, such as Panamanian foundations or discretionary offshore trusts accompanied by detailed letters of wishes. Those structures were often kept secret and the mere fact that the settlor had no legal title to the underlying assets was usually enough to justify excluding the assets and their income from the settlor's tax base. Unconcerned with sophisticated tax planning, these structures were typically simple, testamentary vehicles driven by political and economic risks, privacy concerns and protection against forced heirship. US trusts were rarely used, as

many families harboured an irrational fear that any US structure would trigger onerous taxation.

Trusts have been used for estate planning in the US since at least the late 19th century. Congress established the federal estate tax in 1916, under s.201 of the *Revenue Act of 1916*, and since then trust and tax laws have developed alongside each other. Over the past century, US lawyers have helped clients navigate this evolving legal landscape with the dual objectives of maximising their clients' control of and access to their wealth while minimising their family's tax burden and legal exposure.

Perceived abuses have led the US Internal Revenue Service (IRS) to challenge the desired tax treatment of various trust structures, resulting in judicial interpretations and administrative pronouncements on myriad issues that are sometimes followed by legislative 'fixes' or further administrative guidance. A similarly advanced body of robust legal guidance exists regarding beneficiaries' rights, trustees' obligations and the rights of third parties with claims against the settlor or beneficiaries. ➡

US lawyers familiar with this complex and well-trodden legal landscape who possess the language skills and cultural sensitivities to understand their Latin American clients' personal objectives and family dynamics can therefore craft a bespoke trust instrument with a high degree of confidence that:

- the desired tax treatment will be applied if the trust is subject to IRS scrutiny; and
- the settlor's wishes are captured in the document and will be respected if challenged in court.

THE OTHER SIDE OF THE COIN

US trusts started appearing on the radar of more Latin American families as capital from the region kept finding its way into the US financial system or in the form of real estate investment. Increased global mobility and more family members becoming US tax residents also make US trusts a more natural alternative for keeping family wealth. As a result, Latin American families now realise that a carefully designed and maintained US legal structure can provide the same or greater benefits as their traditional structures without triggering additional US taxation.

However, the home-country tax and legal consequences for Latin American settlors and beneficiaries are much more uncertain and vary wildly among jurisdictions. In fact, most of the civil-law systems found in Latin America never contemplated a common-law trust until quite recently. Today, the legal and tax treatment of a trust can range from entirely disregarding the trust as a separate legal entity to legislation specifically directed at trusts established in the US or elsewhere.

No country in the region has yet developed a full set of rules that comes close to covering all the tax and legal nuances that drive the engineering of a well-drafted US trust. Nevertheless, several countries are now moving quickly to establish rules by legislation, executive fiat or administrative guidance from their tax authorities. Even where rules regarding trusts have been established, judicial interpretation is scarce and administrative pronouncements are just starting to appear. Enforcement remains a challenge as many judges have never even heard of a trust and most revenue agents have not yet been trained on how to apply the new rules.

HOME COUNTRY TECHNICAL ISSUES AND PRACTICAL CONSIDERATIONS

A comparative analysis of how each Latin American country might treat a particular US trust is beyond the scope of this article and, in some countries, this is very much a moving target. In addition to the US tax and legal considerations, here are

some of the major home-country issues to consider when using US trusts in Latin America:

- What are the home-country tax consequences upon creating or funding a trust? Will the transfer be subject to gift tax? How does the analysis change when funding the trust using an underlying company?
- How does the home-country income tax treat the receipt of a distribution from a trust? Is there a distinction between a tax-free distribution of principal versus income? What happens to undistributed income currently and upon future distribution?
- Notwithstanding income, are trust assets subject to home-country wealth taxation? Are the trust assets included in the wealth tax base of the settlor or the beneficiary? What form of wealth tax is being used? For example, is the tax *ad valorem*, based on a change in net worth, or imposed upon transfers of wealth?
- US trusts and trustees are generally not subject to the Common Reporting Standard but many Latin American settlors and beneficiaries are. How might they have to report their relationship with the trust and its assets?
- Trusts are not reporting entities for the purposes of the US *Corporate Transparency Act*. However, underlying US companies are reporting entities, including single-member limited liability companies that might be otherwise disregarded for tax purposes. How should this be reconciled with a client's need for privacy?
- What are the legal and tax consequences of serving as a trust protector or distribution advisor of a directed trust? For example, does that make the trust the equivalent of a home-country controlled foreign corporation subject to anti-deferral tax rules?
- Will home-country assets held by a US trust be subject to claims against the settlor/beneficiaries? What other local remedies will a forced heir have even if they are unsuccessful in penetrating the US trust?
- Is a US trust a permissible shareholder of a Latin American company? What

are the issues if a US or third-country holding company is interposed between the US trust and the Latin American company/asset?

- If the settlor of a revocable trust dies or becomes incapacitated, or the trust decants to another trust or changes *situs*, will that trigger taxation in Latin America?
- Does a purely discretionary beneficiary have any fiscal responsibility for the trust's assets?

WORKING TOGETHER

US trusts continue to be the tax- and estate-planning vehicle of choice for many Latin American families. However, setting up a trust that works as intended from both the Latin American and US perspectives requires close collaboration between all parties involved. A US trust should always be drafted in English, for example, so extra time is required to explain everything to the client and their home-country attorney in their native language, and then listen carefully to their responses to fine-tune the draft, as appropriate. This process often involves helping a client overcome their cultural aversion for having anything less than full control of their assets during their lifetime, so as to permit the application of legal standards, such as those required for avoiding attribution of trust assets for tax purposes.

Beyond language capabilities, US practitioners must also possess the cultural sensitivity and patience that many Latin American clients require before they feel comfortable enough to open up about their multi-generational family dynamic and wealth ecosystem. This includes awareness of the current political and social environment such clients find themselves in, as well as having experience with the wonderful diversity of national cultures across the region and even subcultures that can vary substantially between cities within the same country.

#CROSS-BORDER ESTATES

#ESTATE PLANNING

#INTERNATIONAL CLIENT

#LATIN AMERICA #TAXATION

#TRUSTS #US

