Use of Offshore Structures for Asset Protection
and U. S. Income Tax and Estate Tax Planning

The primary tool utilized throughout the world for asset protection is the foreign trust (sometimes referred to as an offshore trust). Although there are many commonly used names throughout the world, there are (from a United States ("U. S.") point of view) only two (2) types of offshore trusts. One, by design, gives asset protection and the availability (if appropriate) of U. S. income tax and U. S. estate tax benefits, and is known as a Non-Grantor Trust. The other, designed solely for asset protection, is a tax neutral document in that there are no U. S. tax advantages or disadvantages. This type of foreign trust is known as a Grantor Trust.

The type of foreign Non-Grantor Trust that gives asset protection and the possibility of U. S. tax benefits is designed so that the foreign trust's assets, upon one's death (and/or one's spouse's death), go to one's intended heirs in much the same way as a typical revocable trust. The primary differences are that the:

(a) foreign trust should be irrevocable (although there are occasions where it can be revocable); and

(b) trustees of the foreign trust must not be U. S. citizens or U. S. residents.

The fact that the foreign trust is irrevocable should not give concern, as in all foreign trusts one will have the power to replace the trustee if its decisions are not within one's desires or if its activities with the funds and assets of the foreign trust are not in accordance with one's wishes. One's powers in fact are such that in all of my years of practice I have never replaced a trustee for not abiding by the wishes of the client.

The obvious first two (2) questions regarding setting up an offshore trust that has the advantages of asset protection and U. S. tax benefits are who will be the trustee and what jurisdiction will be used?

Concerning the trustee, as in any decision where independent trustees are utilized, the variations are numerous. Depending on the flexibility and work required, the trustee can be as small as a one man firm or as large as a multinational firm or bank with offices in literally every available jurisdiction. This decision is generally made after a review of the types of activities that are anticipated to be handled by the foreign trust.

Concerning the jurisdiction, one will probably want a jurisdiction that has a lower income

tax rate than the U. S., especially if one is looking for an avenue whereby U. S. income tax reduction or avoidance is contemplated. There are currently approximately forty (40) acceptable jurisdictions in the world that have a lower income tax rate (generally 0% to 2%) than the U. S.. The jurisdictions that are most commonly used by U. S. residents and U. S. citizens are Bahamas, Belize, British Virgin Islands, Cook Islands, Isle of Man, Jersey, Guernsey, Nevis, Cayman Islands, Panama, Barbados, Bermuda, and Turks and Caicos. These jurisdictions represent approximately eight-five percent (85%) of those used by U. S. individuals. The decision as to which jurisdiction to use will depend on many factors including a review of the types of activities in which the foreign trust will be involved.

When U. S. tax advantages and asset protection are the goals, the offshore trust generally capitalizes and owns one or more offshore corporations whereby the shares of stock (often bearer shares) in the offshore corporations are held as assets of the foreign trust. There are many technical reasons for utilizing foreign corporations, but suffice it to say that they are the most efficient vehicles for obtaining both U. S. tax benefits and asset protection. As with the decision of choosing the trustee and the jurisdiction of the foreign trust, similar decisions will be made as to the directors and the jurisdictions of the foreign corporations.

Once the offshore trust and the foreign corporation(s) are set up, there are innumerable activities that can be undertaken to aid further in asset protection and to confer U. S. tax benefits. For example, one can:

1. transfer one's interest in a family limited partnership to an offshore trust and/or foreign corporation (referred to hereafter collectively as the foreign structure). This may be done either by gift or by sale, with the net result that all or a portion of the family limited partnership interests will be owned by the foreign structure totally outside of the reach of creditors. In some cases this can be more beneficial then transferring a family limited partnership interest directly to one's children because it avoids any conflict should the children have creditor problems.

2. The foreign structure can loan one money, and in order to secure the promise to repay one can encumber one's assets (including one's family limited partnership interest).

3. If one's business has receivables, one can sell the receivables to the foreign structure on a discounted basis (known as factoring) with a number of advantages too complex to discuss here. Suffice it to say that the U. S. tax benefits can be extraordinary.

4. If one is involved in a business activity with any foreign nexus whatsoever, the use of a foreign structure is an ideal tool. Under certain circumstances the coordination of such a business or investment within a foreign structure can have as its goal the reduction or elimination of U. S. income taxes. The alternatives in this area are as broad as the different types of businesses or investments available, subject only to one's imagination.

This area can become extremely complicated and may involve such technical entities as Controlled Foreign Corporations, Foreign Personal Holding Companies, Foreign Sales

Corporations, Foreign Personal Holding Companies, Foreign Sales Corporations, Passive Foreign Investment Companies, and a host of others. Each business and investment must be reviewed on a case-by-case basis, but the advantages in asset protection and U. S. taxation can be staggering if it can be made to fit within the mold of a foreign structure.

Concerning foreign Grantor Trusts, they secure asset protection but by design are U. S. tax neutral and thus have no U. S. tax advantages or disadvantages. The use of this form of foreign trust however has the same effect as a foreign Non-Grantor Trust insofar as the protection of one's assets from creditors. Depending on one's situation, this may be exactly what is needed. Again, choices such as the foreign trustee, the jurisdiction, and the types of assets to be put into the foreign trust are reviewed after a determination of one's goals, objectives, and activities.

Reporting Requirements

Probably one of the most important aspects of dealing in the international arena is compliance with any and all applicable reporting requirements of the U. S. Internal Revenue Service or other state and federal agencies. There is nothing wrong with analyzing a transaction and taking the position that one does not owe U. S. tax or that U. S. tax can be deferred until a future date. What is wrong is one's failure to disclose or report a transaction when the law requires disclosure or reporting. Remember that reporting or disclosing a transaction does not necessarily beget paying taxes on such transaction. It is not unusual to see one decide not to report a transaction based on the common knowledge that it is just too hard for the U. S. Internal Revenue Service or any other agency to discover the transaction. This is not wise and can lead to both civil and criminal penalties.

One's offshore planning should be so secure that one should be willing to give creditors (including the U. S. Internal Revenue Service) a copy of every document and details of every entry and transaction that one has used for asset protection and U. S. tax benefits. It is not that one should provide creditors with such information, it is just that the planning should be so sound that creditors simply do not have the legal ability to get at one's assets.

There are a number of reporting forms that may be involved in a foreign structure. The following briefly explains some of the major forms and their purpose.

Form 3520 - Annual Return To Report Transactions With Foreign Trusts And Receipt Of Certain Foreign Gifts.

Form 3520 currently consists of six (6) pages and the instructions for completing that form consists of eleven (11) pages. The form is the principal reporting document for foreign trusts. It deals with the creation of a foreign trust, transfers to a foreign trust, and

certain other transactions with a foreign trust. It also deals with reporting with respect to the receipt of certain foreign gifts and, needless to say, the form is quite inclusive. The

form must be filed in all cases where there is a U. S. Grantor though it may not be necessary to file a form where there is a foreign Grantor.

Form 3520 -A - Annual Return of Foreign Trust with U. S. Beneficiaries

If a foreign trust has U. S. beneficiaries, the U. S. Grantor thereof must file Form 3520-A by the fifteenth (15th) day of the third (3rd) month following the end of the foreign trust's taxable year. This form is not nearly as comprehensive as Form 3520.

Form 709 - U. S. Gift (and Generation Skipping Transfer) Tax Return.

Form 709 must be filed by U. S. transferors to report donative transfers to foreign trusts (even though the donative transfers may not be completed gifts). The U. S. Internal Revenue Service takes the position that even an incomplete gift of a future interest, regardless of value, should be timely reported on Form 709. The form is filed on April 15th of the year following the year in which the donative transfer is made.

Form 1040 - U. S. Individual Income Tax Return.

Each year all income earned by a foreign Grantor trust must be reported on the U. S. Grantor's individual Form 1040, and also on any applicable state forms.

Form TD F 90-22.1 - Report of Foreign Bank and Financial Account.

Any U. S. citizen or U. S. resident who, among other things, has custody, control, or signature power over certain foreign bank accounts must disclose the accounts to the U. S. government on this Treasury form.

Form 105 - Report of International Transportation of Currency or Monetary Instruments

U. S. Customs Form 105 must be filed with respect to transfers (including by mail) of

cash or bearer securities into or out of the U. S. in the aggregate amount of $10,000.00 or more on any one occasion. If the transfer is done through normal banking operations this form is not required to be filed.

Form 104 - Currency Transaction Report.

Any bank that transfers assets internationally in the aggregate amount of $10,000.00 or more must report such transfer to the U. S. Department of Treasury. The financial institution must file this form by the fifteenth (15th) day after the date of the transaction. This bank is subject to civil and criminal penalties for failure to file.

Form 5471 - Information Return of U. S. Persons With Respect to Certain Foreign Corporations.

Generally, any U. S. citizen or U. S. resident who owns a ten percent (10%) or greater interest in a foreign corporation must disclose such ownership interest on this form which is to be filed with the U. S. citizen's or U. S. resident's U. S. income tax return. Ownership may be attributed for purposes of this form. Civil and criminal penalties may be assessed for failure to file.

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