BNY MELLON
WEALTH MANAGEMENT

Wealth Planning for the Multinational Family With U.S. Connections

By Joan K. Crain, CFP,® CTFA, TEP
Senior Director Global Family Wealth Strategist

Myriam Soto
Head of International Wealth Planning and Fiduciary Services

As world economies become increasingly global, the number of families living in and financially tied to multiple countries is growing. The last decade has brought a dramatic increase in the number of wealthy professionals, corporate executives and entrepreneurs who work and live in urban areas of the United States but are not U.S. natives.

Many have established strong roots in their communities and have no plans to return to their countries of origin, though they often remain connected to their home country through relatives who remain there. Some hold green cards, while others have obtained U.S. citizenship. Another thread in this multinational tapestry is the growing population of U.S.-based beneficiaries of foreign trusts established by parents and other relatives residing elsewhere in the world. There is also a significant group of U.S. citizens with spouses who have not obtained U.S. citizenship.

In all of these circumstances and others, multinational families can face a wide range of complex tax rules and regulations with far-reaching wealth management implications. This paper provides an overview of the opportunities and challenges of gift and estate tax planning for multinational families from a U.S. perspective. However, the laws of foreign countries may also apply. To fully address these nuances, competent advice from professionals experienced in such international matters is essential. As we explain, it is crucial for multinational families to be aware of and understand available wealth transfer techniques before they make what may turn out to be irreversible and potentially costly decisions. It is not only the complexity of U.S. tax laws that makes planning and transfer decisions challenging, but also the increasing reporting requirements established by the U.S. and other governments. Additionally, this paper touches briefly on the issue of family governance, which is a critical component of any successful multigenerational wealth transfer plan, but even more so when there are multinational considerations.

Key Rules for Non-Citizen Spouses

The United States has a unified gift and estate tax transfer system. United States federal gift and estate tax rules generally govern all property in any location if it is owned by or if an interest in it is retained by a U.S. citizen or a resident alien. The 2020 federal exemption amount is $11.58 million, so with proper planning a married couple can shelter approximately $23 million, either during their lifetimes or upon their deaths. However, the current federal exemption for non-resident non-citizens is not nearly as generous — only $60,000 of U.S. situs assets can be treated as tax-exempt for bequests (there is no exemption for lifetime gifts).

Wealth transfer and estate plans of non-citizen spouses must take into account other important differences in tax rules as well. Normally, transfers between spouses do not incur any gift or estate tax due to the unlimited marital deduction. This applies to lifetime transfers as well as those at death. Property can be gifted outright or in a trust that qualifies for the marital deduction. However, the Technical and Miscellaneous Revenue Act (TAMRA), passed in 1988, eliminated the unlimited marital deduction on transfers to non-citizen spouses. The law was intended to prevent non-citizen spouses from returning to their home countries with assets that would then escape U.S. taxation. (Property left to a non-U.S. citizen spouse may otherwise escape U.S. taxation if the non-citizen spouse does not become a U.S. citizen after the death of the predeceased U.S. citizen spouse and ceases to be or never becomes a U.S. domiciliary). The restrictions have since eased up slightly, allowing for a $157,000 annual exemption for gifts made to noncitizen spouses in 2020. This limit is indexed for inflation.

In another important difference, assets left to a non-citizen spouse in a trust will only qualify for the marital deduction if the trust is in the form of a Qualified Domestic Trust (QDOT). Usually, income generated by a QDOT is distributed estate tax-free to the surviving noncitizen spouse. When the surviving noncitizen spouse dies, assets are subject to estate tax as though they had been included in the estate of first spouse to die. The accompanying sidebar offers a summary of how a QDOT works.

Considerations When Establishing a QDOT

- At least one trustee must be a U.S. citizen or domestic corporation
  - If trust assets exceed $2 million, trust must require either a bank trustee or a bond or letter of credit for a sum equal to 65% of trust's value. In determining threshold level of $2 million, personal residence up to $600,000 in value is excluded from computation
- Trust instrument must prohibit distribution of principal to non-citizen surviving spouse unless U.S. citizen trustee withholds estate taxes imposed on distribution
- Executor must make two elections to qualify QDOT: (1) elect QDOT treatment and (2) elect Qualified Terminable Interest Property (QTIP) treatment if appropriate
- If no QDOT is created in decedent's will, non-citizen spouse can establish QDOT and transfer assets to trust
  - Must be completed before due date of estate tax return (i.e., nine months from death)
- Can apply to court for reformation of trust that qualifies for marital deduction but not for QDOT treatment
- If spouse becomes U.S. citizen prior to due date of estate tax return, QDOT does not have to be elected
- If spouse becomes U.S. citizen after estate tax return is filed but before any taxable distributions have been made, QDOT requirements are eased
- Distributions of principal to non-citizen spouse on account of hardship are not subject to estate tax
  - Hardship is difficult to qualify for and cannot be used until surviving spouse has exhausted all of his or her own assets
- Section 2056A (a) and related Treasury Regulations govern QDOTs

Alternatives to a QDOT

Exemption Trust

Since principal distributions from a QDOT are subject to estate tax, it is generally even more important to create an applicable credit trust, commonly known as an exemption trust, under the governing document. The non-citizen spouse can have some limited control over this trust, although not unfettered access to income and principal. Most important, principal distributions from this trust are not subject to the same penalties as those from a QDOT. Therefore, depending on the circumstances, even in states that impose a state estate or inheritance tax, it may be preferable in this situation to maximize the funding of the applicable credit trust up to the federal exemption level rather than limit it to the state exemption, even though a modest state estate tax may be due.

Life Insurance

In many non-citizen spouse situations, the use of life insurance can be an effective means of providing support for the surviving spouse and other family members without some of the limitations of a QDOT.

To make effective use of life insurance, keep the following considerations in mind:

- Set up an irrevocable life insurance trust to avoid insurance being part of the estate and subject to estate tax
- The trustee must purchase the life insurance policy (on either single or joint lives), pay annual premiums and name the trust as policy owner and beneficiary
- The trustee must have a separate bank account and the grantor should contribute funds annually under the protection of annual exclusion gifts
- The trust should have "Crummey" power provisions allowing beneficiaries to withdraw contributions during a limited time, so as to qualify gifts for the annual exclusion
- If a grantor is transferring an existing policy to a trust, the grantor must survive three years from the date of the transfer in order to exclude it from inclusion in his or her estate
- The trust instrument should include marital deduction and QDOT provisions

An irrevocable life insurance trust that owns a single life policy on the life of the U.S. citizen spouse can be a helpful device in providing more flexibility for the non-citizen spouse, since, unlike with QDOTs, principal distributions are not restrictive.

Note that if the primary goal is to transfer wealth to non-spouse family members who are U.S. taxpayers, one should consider using a second-to-die policy, payable at the death of the survivor spouse when estate tax will be due. Premiums on second-to-die policies are usually lower than those on single life policies.

Strategies for Successful First-Generation Americans

There is no shortage of examples of professionals and entrepreneurs who have moved to the U.S. and accumulated substantial wealth. In many instances, these successful first-generation Americans have wealthy relatives living abroad who do not intend to move to the U.S. This presents numerous wealth planning challenges but also some unique opportunities to protect family wealth from taxation under the U.S. gift and estate tax laws. There are specific strategies that can be employed to provide children, grandchildren and other family members with wide access to the use of this wealth while reducing the taxable assets of the wealth creator.

In implementing these strategies, however, it can be difficult to navigate the various IRS rules and other regulations — particularly today when the IRS and other government agencies have become more diligent about tracking the flow of foreign sources of wealth. This is why advisors, including attorneys, accountants and wealth managers, have a crucial role to play. In too many cases, people take action, or fail to act, based on bad advice and incorrect information, and the consequences can be significant.

For example, there is a common misperception that if a relative living abroad were to transfer wealth to someone in the U.S., a gift tax would be imposed. In fact, in many cases no tax may be assessed on such a transfer, although there may be some reporting requirements depending on the size of the transaction (these are discussed later in this paper). Furthermore, while it is possible that an estate tax would be imposed on the recipient in this situation, with proper planning this could be avoided.

Structuring an Effective Gifting Plan

As noted earlier, U.S. citizens and resident aliens are subject to estate tax on all assets, no matter where they are located. As a result, inheritances received from parents who are non-residents should be carefully planned. One method for reducing estate taxes is gifting assets to younger family members. Since the U.S. gift tax exemption ($11.58 million in 2020) is not available to non-resident aliens, care must be taken in the choice of gifted assets and the method of gifting.

Irrevocable U.S. Trusts

Trusts are among the most effective means of making lifetime gifts. Modern trust law has evolved so that there are various protections and tax law benefits to establishing a trust in many U.S. jurisdictions. In addition, U.S. advisors are familiar with domestic trust laws, so a multinational family may benefit from more informed advice. A U.S. trust may also provide better access to the assets and information about the trust, as well as more direct contact with the trustee. And in many instances, there is a greater level of comfort about the safety of the assets.

To avoid estate tax on U.S. situs assets, a trust should be irrevocable (which means possibilities for future changes are very limited). Otherwise, the transfer is considered incomplete until the grantor's death, at which point the IRS assesses estate tax at the same rate as if there had been no prior trust (unless the trust is a foreign grantor trust with the assets held in an underlying Personal Investment Company (PIC) as discussed later in this paper). Non-U.S. assets can be transferred to the trust with no gift tax implications.

To prevent unintended transfer tax consequences when using an irrevocable trust, it is important to make informed decisions before a transfer is made. With proper advice, a multinational family can realize significant transfer tax savings and other non-tax benefits. Foreign nationals who own non-U.S. situs assets can transfer those assets to a resident/citizen of the U.S. without any U.S. gift tax consequences, but the way in which they make that transfer can have a variety of tax results. For example, if they simply transfer the assets outright to their child living in the U.S., those assets will be added to that child's taxable base. If, however, they establish an irrevocable trust in a jurisdiction such as Delaware or Florida (which do not impose an income tax on trusts and no longer have the traditional Rule Against Perpetuities) and then transfer the assets to that trust, those assets will never be subject to U.S. gift, estate or generation-skipping taxes. The accompanying case study illustrates this concept.

Note: The following case studies are hypothetical and for illustrative purposes only.

Case Study 1: The Patel Family

Gift to Irrevocable U.S. Life Insurance Trust

Mr. Patel, an Indian citizen, plans to give $10 million to his son John, who works in New York and has a green card. If Mr. Patel waits until his death to pass the $10 million to John or his children, some or all of it may be subject to U.S. estate tax, depending on the assets and their situs.

If Mr. Patel makes an outright gift to John during his lifetime, he may be able to avoid gift tax on some or all of the assets, although the assets would be subject to U.S. estate tax at John's death. Furthermore, Mr. Patel may not be able, or willing, to give his son $10 million in one lump sum. For instance, India's exchange controls may limit the amount of money he can transfer outside of India in any given year.

In this situation, Mr. Patel could create an Irrevocable Life Insurance Trust (ILIT) in a state such as Delaware or Florida. The trustee would then acquire U.S.-compliant life insurance on John's life — the policy being the only asset of the trust. Each year Mr. Patel would transfer sufficient non-U.S. situs assets to the ILIT to pay the premiums on the life insurance policy. The ILIT would be subject to U.S. income tax, but with a compliant policy as the only asset, there would be no income taxes due during John's life and no transfer taxes upon his death.

At John's death, the death benefit on the life insurance policy would be payable to the trust, which could provide for outright distributions to John's heirs and/or retain the funds for future generations. The ILIT must file a Form 3520 if it receives more than $100,000 from Mr. Patel in a given year.

Lifetime vs. Post-Death Funding

Depending on the property involved, it may be more advantageous for Mr. Patel to fund this trust and/or make other gifts to John's children during his lifetime, as opposed to waiting to leave them the property after his death. For lifetime transfers, Mr. Patel, a non-resident alien of the United States, would only be assessed a gift tax if he were to transfer assets such as U.S. real estate or tangible property. He could fund the trust with or make outright gifts of U.S. situs intangible assets, such as stock in U.S. companies, without any gift tax. However,If Mr. Patel were to die owning more than de minimus U.S. situs intangible personal property, John's family inheritance would be reduced by U.S. estate tax as the rules change for transfers upon death.

As noted previously, lifetime gifts of U.S. real estate and tangible property are subject to U.S. gift tax. However, should Mr. Patel wish to transfer a vacation home in Colorado to John or his children, he could avoid gift tax by establishing a foreign corporation (taxed as a U.S. company) to purchase the home. This would convert the real estate to an intangible asset. Instead of giving them the home itself, Mr. Patel could gift shares in the corporation.

Using non-U.S. corporations to own assets that would otherwise be subject to U.S. estate tax is also helpful if Mr. Patel prefers to wait until his death to transfer these assets to John and his children. There are some income tax drawbacks to this arrangement, however. Some planners advocate using an LLC or partnership instead of a corporation, although the tax treatment of these entities is as yet uncertain. Given the complexity and interconnections of estate, gift and income tax rules, it is critical to work with experienced planners and advisors when structuring gifts. This is particularly important since the 2017 enactment of the U.S. Tax Cuts and Jobs Act, which provided for more extensive taxation of Controlled Foreign Corporations.

Property Transferred by Non-Resident Alien
(Note that situs rules might be varied by treaty)
U.S. Situs vs. Non-U.S. Situs

Type of Asset	Gift Tax	Estate Tax
Real Property in U.S.	Yes	Yes
Tangible Personal Property in U.S.	Yes	Yes*
Stock in U.S. Corporation	No	Yes
Stock in Foreign Corporation	No	No
American Depositary Receipts (ADRs)	No	No
Shares of U.S. Mutual Fund	No	Yes
U.S. Business Interests (Including Partnerships)	No	Yes
Deposits in U.S. Banks	No	No
Special Deposits (Brokerage Accounts)	Yes	Yes
Deposits in Foreign Banks	No	No
Cash or Property in a Safety Deposit Box in U.S.	Yes	Yes
Debt Obligations of U.S. Persons	Yes	Yes
Debt Obligations of U.S. Government	No	No
Life Insurance Proceeds	No	No

* Works of art in the U.S. solely for exhibition purposes at a public gallery or museum and items of personal property accompanying an NRA who dies while temporarily visiting the U.S. are not deemed to be situated in the U.S. for U.S. estate tax purposes.

Case Study 2: The Peng Family

Gift to Irrevocable U.S. Trust

Mrs. Peng is a U.S. citizen as are her two children. Mrs. Peng's aunt has established an offshore revocable trust for the benefit of Mrs. Peng and her children.

An offshore corporate entity is the trustee but provides very little information to Mrs. Peng. Mr. and Mrs. Peng have substantial independent wealth and their children are financially successful in their own right. The Pengs want to understand their options regarding the possible transfer of the funds of the offshore trust to the Peng family. They have two main concerns: possible U.S. gift tax on any transfer and concern that the offshore trust could be revoked at any time.

Through a series of meetings with their advisors, the Pengs learn that their previous understanding that a gift tax would be imposed was unfounded. They also learn that if the funds of the revocable trust are paid over to Mrs. Peng at some point, she would be faced with a limited ability to ultimately transfer the funds to her children without U.S. gift or estate tax consequences.

The Pengs and the grantor of the offshore trust determine with the input of their advisor that their best course of action is to have Mrs. Peng's aunt establish an irrevocable Delaware dynasty trust and fund it with the assets of her offshore trust. This provides greater flexibility in the trust agreement and greater security for the inheritance. It also provides more significant transfer tax savings than would have been achieved by having the funds directly transferred to Mrs. Peng.

Domestic vs. Foreign Trust Determination (must pass both tests to be a domestic trust)

- **Court test**: Does a U.S. court have primary jurisdiction over the trust?
- **Control test**: Do one or more U.S. persons (determined by residency) control all "substantial decisions" related to the trust?

Foreign Grantor Trusts

One of the key elements of gifting to remove property from a grantor's estate is giving up control over the property transferred. However, some people wish to retain control over some or all of their assets during their lifetime and leave these assets to their children in the U.S. at their death. In these cases, they may decide to place assets in a revocable trust, as this will afford them the lifetime control they desire while avoiding probate and facilitating the ultimate transfer process.

A grantor trust is one in which the grantor retains certain powers over the trust. The rules for a foreign trust to be considered a grantor trust for U.S. income tax purposes are more restrictive than for U.S. trusts. Under IRC Section 672(f) (3), the grantor must have the power to revoke and revest the trust in himself or herself either alone or with the consent of a related or subordinate party who is subservient to the grantor or the only amounts distributable from the trust during the grantor's lifetime are to the grantor or the grantor's spouse. Grantor trusts are treated as flow-through entities for tax purposes and all of the income and deductions attributable to the trust are treated as income and deductions of the grantor (regardless of whether or not he or she receives any income from the trust in the form of a distribution). This enables the trust to grow tax-free and any distributions to beneficiaries are also tax-free.

Foreign family members who wish to have use of trust funds during their lives (or are averse to relinquishing control) and transfer their wealth to U.S. family members in an orderly disposition upon their death, can do so through the use of a revocable foreign grantor trust. These vehicles also are tax efficient for U.S. family members receiving distributions, but must be structured properly.

Case Study 3: The Patel Family

Gift to Foreign Grantor Trust

Mr. Patel from the previous case study is concerned about making a completed gift, as he would prefer to retain control over the $10 million during his lifetime, and pass it on to John at his death.

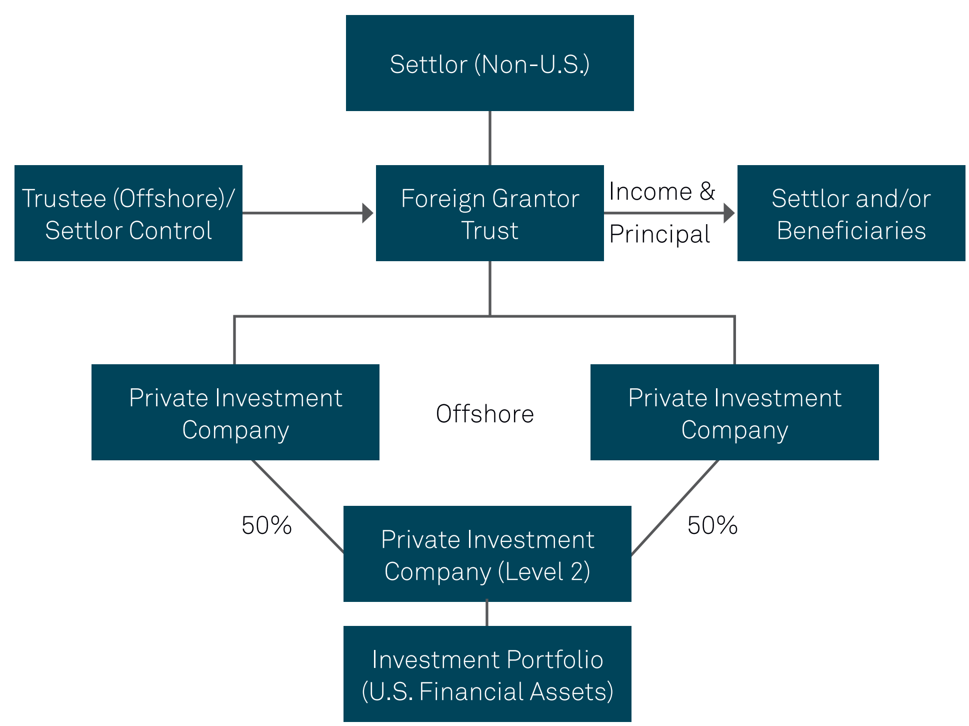
A common solution is to establish a foreign grantor trust (FGT). The trust could own certain U.S. assets, such as U.S. bank deposits, U.S. Treasuries and some types of bonds, without being subject to U.S. estate tax at Mr. Patel's death. If the trust invests in other assets such as U.S. equities and U.S. real estate, it may be necessary for Mr. Patel to establish one or more offshore Private Investment Companies (PICs) to hold these assets and avoid U.S. estate tax at this death. The trust would own shares of these PICs.

Any distributions to John during his father's lifetime would not be subject to U.S. gift tax and, if administered carefully before and after Mr. Patel's death, would avoid U.S. estate tax. The U.S. Tax Cuts and Jobs Act enacted in December 2017 added significant complications to this planning. Timely decisions and carefully sequenced tax elections may be necessary to minimize gift, estate and income tax with such structures.

Exhibit 1 illustrates one of the more commonly suggested structures for such situations. In this scenario, Mr. Patel's FGT owns shares of two offshore PICs, which in turn own 50% of the shares of a second level PIC. Elections to treat the different levels of PICs as disregarded entities are made at specific intervals before and after Mr. Patel's death. This allows John to avoid the burdensome Controlled Foreign Corporation taxes as well as minimizing capital gains taxes on the assets he inherits.

Mr. Patel has other alternatives for his FGT, including investment strategies designed to minimize embedded capital gains at his death, U.S.-compliant life insurance and separate entities for any U.S. real estate. Expert tax advice is critical.

Exhibit 1



Foreign Non-Grantor Trusts

In contrast to a grantor trust, a nongrantor trust is treated as a separate taxpayer for tax purposes. The income of such a trust is taxed either to the trust, the beneficiaries or partly to each. The allocation of taxable income is achieved by permitting the trust a deduction for distributions of current income to beneficiaries of the trust. Trusts established in tax-free jurisdictions will obviously have no tax liability. However, distributions to beneficiaries will be subject to tax and reporting. Any distribution will carry out trust income (interest, dividends and capital gains) and will be taxable to the beneficiary receiving it. U.S. beneficiaries will have the duty to report distributions received on their individual income tax returns in accordance with U.S. tax laws. The trustee chosen should understand these reporting requirements and provide the relevant information on trust income to the beneficiary in a timely manner.

Tax on Distribution of Accumulated Income (Throwback Rules)

Distributions of income accumulated in prior years (or "accumulation distributions") from non-grantor foreign trusts are subject to the so-called "throwback rules," the aim of which is to negate any tax deferral benefit to a U.S. person from the accumulation of income in such a trust. The rules are designed to tax accumulation distributions to the beneficiary at a rate equal to that which would have been paid had the income been distributed in the year it was earned by the trust. To the extent that the trust has been undistributed net income (UNI) in a given year, distributions of UNI are subject to a specially computed tax as well as an interest charge (compounded daily). UNI is distributable net income (DNI) that has not been distributed in prior years (i.e., the accumulated income of the trust). The rules do provide for a limit on the interest charge in that the interest charge, when added to the tax on the accumulation distribution, cannot exceed the amount of the accumulation distribution itself. It should also be noted that capital gains are included in the calculation of DNI of a foreign trust, whereas U.S. trusts do not include capital gains in DNI.

Furthermore, distributions of accumulated income items from a non-grantor trust "lose their character," meaning that a distribution of an accumulated capital gain would, for example, be subject to ordinary income tax rates rather than at the substantially more favorable tax rates applicable to capital gains. To avoid the onerous throwback rules, care must be taken to structure the trust as either a foreign grantor trust or a U.S. trust.

Should a U.S. person become a beneficiary of a foreign non-grantor trust, a solution to avoid the application of the accumulations tax is for the trustee to ensure that all of the DNI of the trust is distributed on an annual basis (either to the U.S. person or other beneficiaries). If the foreign trust distributes all income annually, there will not be any "accumulated income" and the throwback rules will not apply. If it is not possible or appropriate to distribute all of the trust's income on an annual basis (for example, if this is inconsistent with the terms of the trust document or the grantor's intent as expressed in a letter of wishes), the impact of the throwback rules can still often be reduced by distributing a portion of the trust's income.

If distributions of income can be made to a separate U.S. trust that benefits only U.S. beneficiaries, this will also have the effect of reducing or eliminating accumulated income. Even though the U.S. trust will subsequently be taxed on its annual earnings, the benefits of avoiding the throwback rules will outweigh the lost deferral in many situations, and if the U.S. trust is structured properly, the trust assets will not be includible in the estate of the U.S. beneficiary.

If a distribution of DNI is not anticipated in a given year, trustees can try to keep the DNI to a minimum by either investing the trust in assets that do not produce DNI (note that capital gains in following years will form part of DNI and should be distributed at that time to avoid the throwback rules) or by purchasing a U.S.-compliant life insurance policy. The cash buildup inside the policy does not form part of DNI and, thus, can be accumulated without creating UNI.

Choice of Trustee

Regardless of the specific type of trust a non-resident selects, special attention to the choice of trustee is central to maximizing the value. While family involvement may be appropriate, there are many advantages to having a corporate trustee or co-trustee of long-term trusts. Besides avoiding the problems of mortality, a corporate trustee can provide the objectivity, experience and empathy that are keys to a successful partnership with the family over future generations. Where a foreign trust is determined to be the best vehicle, it will add great value down the road if the corporate trustee is a "global" trustee and has experience with foreign and U.S. trusts, with capabilities in both foreign and domestic jurisdictions. This can greatly assist in a seamless transition should there be a need to domesticate trusts into the U.S. for U.S. beneficiaries. Such trustees will also have a firm understanding of the rules applicable to U.S. beneficiaries of foreign trusts.

Along with the choice of trustee, there are critical decisions to be made regarding the actual terms of the trust. Since the trust document is the roadmap that the trustee(s) will follow for many years to come, it should reflect the wishes of the grantor yet be flexible enough to accommodate changing needs and norms in the future. An experienced corporate trustee, along with a skilled estate planning attorney, can be invaluable when working out these terms.

Family Governance

Starting the process of intergenerational wealth transfer during the asset owner's lifetime has significant non-financial advantages. Educating and mentoring future generations as to the meaning and means of handling wealth is as critical as astute tax planning. History is littered with examples of unprepared heirs squandering their parents' or grandparents' hard-earned fortune. The paradigm "shirtsleeves to shirtsleeves in three generations" is global in its reach. By gradually introducing children and grandchildren to family wealth, senior family members have the opportunity to coach them and develop a family synergy based on shared values, open communication and mutual trust.

In a multinational family, this process is even more critical than in the typical domestic household, where family members are in closer proximity and less likely to be faced with the complications of reconciling different cultures. One challenge, however, is that in many foreign countries, patriarchs and matriarchs keep financial affairs very private, even within their families. They may not immediately understand the value of discussing family wealth with children or grandchildren.

Other Issues to Consider

- **Treaties**. As noted in the previous U.S. situs table, treaties between U.S. and other countries can affect treatment of gifts and inheritances and should always be considered. These may be more favorable or less favorable than the standard defaults discussed in this paper.
- **Exchange Controls**. Many countries have currency control laws and limitations on how much money can be transferred to other jurisdictions. This may favor a multiyear transfer process, such as transferring maximum allowable amounts annually.
- **Forced Heirship**. Forced heirship and clawback provisions, while virtually unknown in the context of American and English estate and gift law, play a major role in planning for wealth transfers in most European, Latin American and Middle Eastern countries. Forced heirship laws mandate that a significant portion — often higher than 50% — of a deceased person's estate be divided equally among his surviving children. Parents who think they can circumvent these requirements by giving away assets prior to their deaths may be stymied by the "clawback" rules for gifts made during their lives. The length of the lookback period varies significantly between countries. It may be as little as a couple of years or as long as 10 or more years.

Forced heirship and clawback laws, long entrenched in countries following the Napoleonic code or Sharia law, are intended to promote "family solidarity." However, they are little understood in the United States and even in England, and may have unexpected and unpleasant consequences for multinational families. Forced heirship laws are not recognized by many offshore jurisdictions, such as the Cayman Islands, and attacks in the courts of these jurisdictions by heirs claiming rights under forced heirship regimes will likely fail.

Reporting Requirements

The reporting requirements for gifts from non-U.S. sources, including foreign trusts, have increased and changed rapidly in recent years. Importantly, this now includes assets and income from anywhere outside the United States, including countries such as Canada and members of the European Union. U.S. beneficiaries of foreign trusts and U.S. taxpayers owning non-U.S. assets are encouraged to discuss their reporting and tax obligations with experienced advisors. The penalties for non-compliance are severe and enforcement is increasing.

Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of Foreign Gifts

U.S. citizens and resident aliens are required to notify the IRS on a Form 3520 if certain "reportable events" occur. The Form 3520 is required to be filed to report the transactions by the due date of the U.S. taxpayer's income tax return for the year in which the reportable event occurred.

Form 3520 should be filed with the federal income tax return with a copy also sent to a separate IRS address in Utah. There is no gift or income tax due on receipt of gifts or bequests, but penalty for failure to file Form 3520 is equal to the greater of $10,000 or 35% of the gross value of distributions received from a foreign trust or transferred to a foreign trust and 5% of the gross value of the portion of the trust's assets treated as owned by a U.S. person.

Reportable Events that Trigger Form 3520

- The formation of a foreign trust by a U.S. person
- The transfer of cash or other assets by the U.S. settlor/grantor to a foreign trust
- The receipt of any distributions by a U.S. person from a foreign trust — the U.S. beneficiary must compute the amount of the distribution to be treated as an accumulation distribution and any applicable interest surcharge. Taxable distributions must also be reported on the U.S. beneficiary's income tax returns.
- The receipt by a U.S. person of a gift or bequest from a foreign individual in excess of $100,000
- The receipt by any U.S. person of a gift from a foreign partnership or corporation in excess of $16,388 in 2019
- Loan transactions between a foreign trust and any U.S. beneficiary

Gifts or bequests from related individuals or entities must be aggregated to determine if they meet the threshold.

Form 3520-A: Annual Return of Foreign Trust with a U.S. Owner

If a U.S. person is considered to own any part of a foreign trust, either because he or she is the grantor or has added funds to a foreign trust with U.S. beneficiaries (and is thus treated as a grantor of that portion of the trust), it is the duty of the trustee to complete and file this return. The Form 3520-A is essentially like the income tax return of a U.S. trust and requires the disclosure of the income and expenses of the trust and a balance sheet listing all of the assets and liabilities of the trust.

If the foreign trustee does not prepare the form, it is still the duty of the U.S. grantor to prepare and file the return. A failure to file the form will subject the owner of the trust assets (the U.S. grantor) to a penalty of the greater of $10,000 or 5% of the value of the trust assets owned by the trust. The form must be filed by the 15th day of the third month after the end of the trust's tax year.

Increased Regulatory Scrutiny

As part of sweeping anti-money laundering, anti-terrorism and tax collection efforts, oversight and scrutiny of foreign assets is growing exponentially on both a national and global basis. This is leading to increasingly strict and onerous reporting requirements, particularly for U.S. citizens and residents who have bank accounts, trusts or other funds outside of the United States.

Foreign Bank Account Reporting (FBAR)

The Financial Crimes Enforcement Network (FINCEN) requires that Form 114a be filed by any "U.S. person" (defined as an individual or an entity such as a corporation) with a financial interest in, signature authority or other authority over at least one financial account located outside the U.S.

A financial interest for the purpose of FBAR includes an owner of record, an agent for an owner of record, a foreign entity in which a U.S. person owns more than 50%, and trusts. Owners and beneficiaries of IRAs or qualified retirement plans are not considered to have a financial interest for FBAR reporting.

Form 114a (formerly Form TD F 90-22.1) is required by the Bank Secrecy Act of 1970 and must be filed electronically by April 15 for any year when the aggregate of all accounts exceeds $10,000 at any time during the year regardless of whether there was income to report. For grantor trusts, the grantor must file, whereas for non-grantor trusts, any beneficiary with more than a 50% beneficial interest must file.

Penalties for failure to file are severe and can include both civil (up to the greater of $100,000 or 50% of the account value) and criminal consequences. For trusts in particular it is advisable to consult with an attorney due to the lack of clarity as to who "has an interest in" a trust and whose responsibility it is to file.

Foreign Account Tax Compliance Act (FATCA) and Form 8938

FATCA is a further step in the U.S. government's war on offshore tax evasion. Included in the HIRE Act of 2010, FATCA imposes extensive reporting requirements for individuals, entities and trusts that own financial assets outside of the United States.

Under FATCA, a U.S. person with an interest in "specified foreign financial assets" must file IRS Form 8938 annually if the value of these assets exceeds $50,000 (single) or $100,000 (married) at year-end, or if the value exceeds $75,000 (single) or $150,000 (married) at any time during the prior year. Higher thresholds apply to U.S. persons living abroad.

In addition, foreign financial institutions must report to the IRS financial information for accounts of U.S. taxpayers and for foreign entities in which U.S. taxpayers hold a substantial interest. The U.S. imposes a 30% withholding "penalty" on payments from U.S. sources to foreign financial institutions that don't comply with this reporting.

Under the FATCA regime, a series of Intergovernmental Agreements (IGAs) have been entered into with various countries. Those IGAs that are Model 1A versions are "reciprocal" in that the U.S. will exchange certain information with the IGA country with respect to its tax residents. However, the IRS will not look through an offshore company to its beneficial owners so that only accounts in individual name will end up being reported (or for example, an account of a foreign grantor trust that is a pass-through entity for tax purposes).

FATCAs broad reach, punitive actions and failure to achieve equivalent levels of reciprocity with partner jurisdictions have been widely criticized. However, the challenges to FATCA have not resulted in significant changes.

Automatic Exchange of Financial Information in Tax Matters, the "Common Reporting Standards" and Registries of Beneficial Owners

Building upon the regulatory framework created by FATCA on a global basis, the OECD developed the Common Reporting Standard (CRS). There are currently over 100 countries, including all of the major offshore financial centres, committed to CRS. Reporting began in 2017. Notably, the United States is not currently a participant in CRS. However, under CRS rules, entities located in non-participating jurisdictions that have accounts in participating jurisdictions will be looked through to determine who the controlling persons of the entity are. These controlling persons may be subject to CRS reporting if the participating jurisdiction and the home country of tax residence of the controlling person have agreed to exchange information under CRS.

Many developed countries, particularly those in the European Union, are also creating Registries of Beneficial Owners, which are lists of the individuals who own or have significant control over corporations, partnerships, trusts and other entities. In many cases, these registries are open to the public. Again, the U.S. has not embraced this movement.

Conclusion

As the complexity of the global wealth management arena continues to grow, there is a heightened need for communication and cooperation among a multinational family's advisors as well as the dissemination of information on this topic in a timely fashion. The choice of the type and situs of a trust will depend on a family's objectives and comfort level, as well as consideration of the various alternatives available to them. There are unique opportunities for wealth preservation, which can eliminate or reduce transfer taxes with the increased trend toward generational wealth transfers.

About the Authors

Joan K. Crain, CFP,® CTFA, TEP
Senior Director, Global Family Wealth Strategist

As a senior director and global family wealth strategist, Joan works closely with families and their advisors to provide comprehensive wealth planning. She specializes in multinational planning, business succession, family governance and philanthropy.

With more than 25 years of experience working with large, multi-generational families, she is frequently invited to speak to clients and professional groups such as the American Bar Association, the Hong Kong American Chamber of Commerce and numerous estate planning councils throughout the United States, Canada, the Middle East and Asia. She has recently been featured in various publications and broadcast media including The Wall Street Journal, Trusts & Estates magazine, the American Journal of Family Law and CNBC-Asia. Joan received her MBA (Finance) from Rollins College, her Bachelor of Education from Queens University, and her Bachelor of Music from McGill University.

She holds the designations of Certified Financial Planner, Certified Trust & Financial Advisor and the international trust and estate designation TEP. She was named 2017 Industry Thought Leader by Global Finance magazine and was a founding contributor to The GCC Governance Code of the Family Business Council-Gulf.

Myriam Soto
Head of International Wealth Planning and Fiduciary Services

As Head of International Wealth Planning and Fiduciary Services, Myriam works directly with clients across the world and provides oversight and leadership to BNY Mellon's Global Fiduciary Services teams based in the Cayman Islands, New York and Miami. Myriam leverages the broad capabilities of BNY Mellon to provide global families tailored wealth planning solutions. She frequently works in coordination with our clients' professional advisors to holistically approach the multijurisdictional issues impacting families and family offices.

Myriam has over 20 years of experience in financial services. She most recently served as a Sr. Wealth Advisor in the JP Morgan Latin America Private Bank where she worked with high and ultra-high net worth international individuals and families to develop and implement wealth transfer strategies.

Prior to this, Myriam spent the majority of her career with BNY Mellon where over a 16 year period in NY and Miami she held various roles within International Wealth Management with the most recent being Head of Global Fiduciary Planning and Development and the President and Chairman of the Board of the BNY Mellon Trust Company Cayman.

Myriam received her Bachelor's Degree in Liberal Arts from Hofstra University, Juris Doctor from Pepperdine University School of Law and LL.M Taxation from New York University School of Law. She is a full member of the Society of Trust and Estate Practitioners and is on the Board of Directors for the BNY Mellon Trust Company (Cayman) Limited.

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