NORTHERN TRUST

FIRMA
Fiduciary & Investment Risk Management Association

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Fiduciary Challenges In a Global / Offshore World

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What we will cover today

- A description of cross border or “inbound” trust business
- The use of specialized jurisdictions in the U.S. for inbound trusts
- Example of an inbound trust
- Regulation of these entities
- AML / KYC processes
- Impact of the Corporate Transparency Act
- Potential regulation of virtual assets in inbound trusts

Attributes of a flexible jurisdiction for trusts

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

- Favorable tax treatment
- The ability to have long term or “Dynasty” trusts
- Trust instrument flexibility
- Directed Trusts
- Protection from creditors
- A developed body of law regarding flexible trust provisions
- Significant history and robust trust industry

Attributes of a flexible jurisdiction for trusts

Favorable tax treatment

Delaware will not impose a state level income tax on accrued income and capital gains recognized in a Delaware resident trust, as long as there are no Delaware beneficiaries (a very simplified version of the actual rule).

Nevada has no state level income tax, so Nevada does not impose a state level income tax on Nevada resident trusts (it's that simple).

This does not impact whether there will be federal income tax payable by the trust.

Even if the state where the trust is sitused does not impose a state level income tax on the trust, other states might for a variety of reasons, and you need to know the laws of the various states – e.g., source income, beneficiaries in that state, fiduciaries in that state.

Attributes of a flexible jurisdiction for trusts

Directed Trusts

Under the laws of states with directed trust statutes, a party can be named to direct the trustee on matters. This can be investments, distributions, tax compliance, or other matters.

Both Delaware and Nevada have directed trust statutes.

Attributes of a flexible jurisdiction for trusts

The ability to have long term or "Dynasty" trusts

A long term trust has advantages including the following:

- Creates a vehicle to hold trusts which increase in value over time.
- Allows the trust to benefit family members or other beneficiaries for multiple generations.
- Provides asset protection for beneficiaries over multiple generations.
- Protects U.S. beneficiaries from U.S. estate tax and U.S. generation skipping transfer tax, as long as the assets stay in the trust.

Delaware does not have a rule against perpetuities for personal property held in trusts, and real property can be held in an LLC or similar entity, thus being considered personal property not subject to a rule against perpetuities.

Nevada allows assets to be held in trust for 365 years.

Attributes of a flexible jurisdiction for trusts

Trust instrument flexibility – the ability to have a "confidential trust"

Certain jurisdictions allow a trust instrument to provide that the trustee cannot inform the beneficiaries about the trust for a period of time.

Depending on the circumstances and the "period of time" a trustee may be comfortable serving as trustee of a "confidential trust".

Inbound Trust Relationships Using Flexible Trust Laws

Concepts to keep in mind regarding inbound planning

- For this presentation we will use the following terminology.
- A person who creates a trust is the “settlor”.
- The settlor of a trust who is treated as the owner of the trust under the *U.S. income tax* rules is the “grantor”.
- A person is “foreign” if they are neither a citizen nor a resident of the United States (although the determination of whether a person is a resident differs depending on the type of tax in question – which is beyond the scope of this presentation).

Concepts to keep in mind regarding inbound planning

- For this presentation we will use the following terminology.
- The residence of a trust is either U.S. domestic, or foreign. On a later slide we discuss this in more detail.
- A trust that is treated as a separate taxpayer for U.S. income tax purposes is referred to as a “non-grantor trust”.
- A trust with flow-through U.S. income tax treatment is designated as a “grantor” trust for income tax purposes.
- A grantor trust is a foreign grantor trust if either of the following occurs:
    - The grantor has the power to revest title of the trust property in herself exercisable solely by the grantor, either without the approval of another person or with the consent of a related or subordinate party who is subservient to the grantor; or
    - Distributions from the trust may only be made during the grantor’s lifetime to the grantor or the grantor’s spouse.

Concepts to keep in mind regarding inbound planning

- Is a trust a foreign trust or U.S. trust for U.S. tax purposes?
- For U.S. Federal income tax purposes, a trust is a domestic trust if it satisfies each of two separate tests – the court test and the control test.
- A trust that fails either test is a foreign trust for U.S. Federal income tax purposes, even if the trust is created under and governed by the law of a U.S. state and administered in the U.S. by a U.S. trustee for U.S. beneficiaries.

    - The **court test**. A trust meets the court test if a court within the United States is able to exercise primary jurisdiction over the administration of the trust.

    - The **control test**. A trust meets the control test if one or more U.S. persons have the authority to control all substantial decisions of the trust.[3] If a non-U.S. person, whether a trustee, protector, advisor, settlor, or even a beneficiary, has the ability to control, or even to simply veto, a substantial decision, the trust will fail the control test and be classified as a foreign trust for U.S. Federal income tax purposes.

Foreign Grantor Trust

- A **foreign trust** because at least one substantial power is held by a non-U.S. person.

- A **foreign grantor trust** because either of the two scenarios apply.
    - Distributions can be made only to the non-U.S. settlor and/or spouse.
    - If distributions can be made to other beneficiaries, the settlor must have the power to revoke the trust.

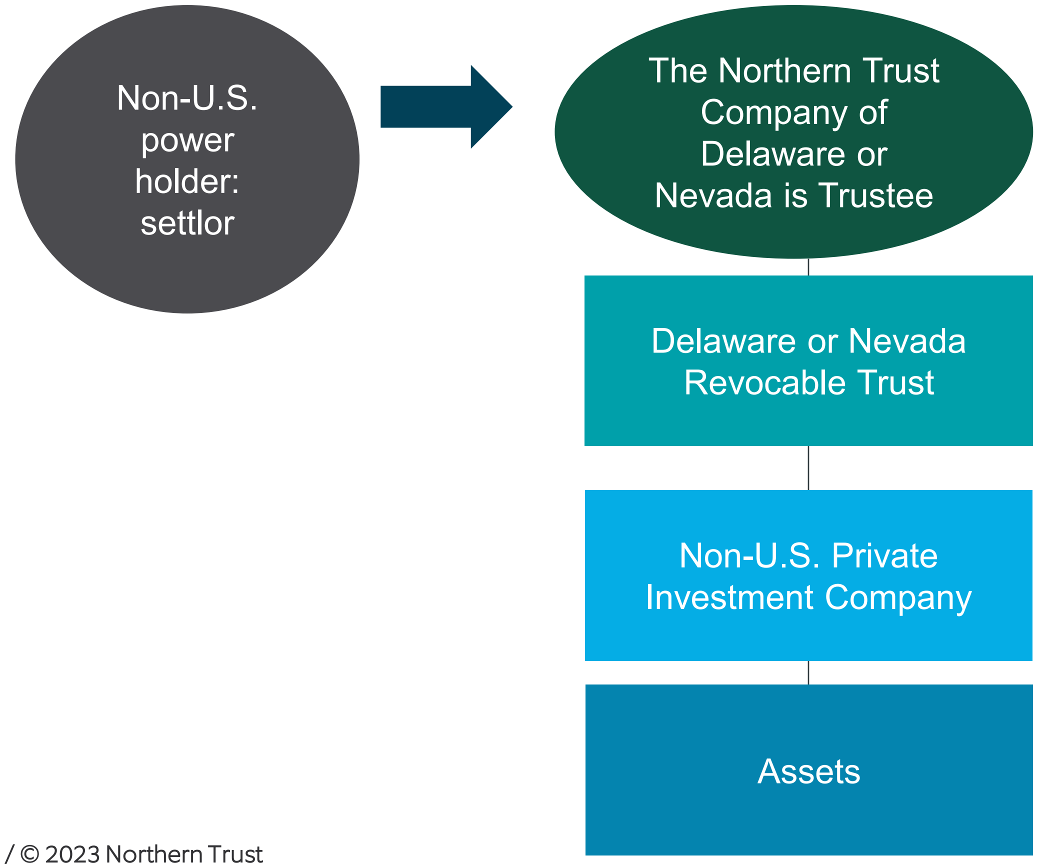
- In our scenario distributions will be made to non-U.S. settlor and / or his spouse only, pursuant to the terms of the trust agreement.

Our Hypothetical Family

- Non-U.S. clients establishing a trust for their own benefit as well as for the benefit of their children who have moved to the U.S.
- Wants to fund the trust with an operating company in a non-U.S. country, marketable securities, and various illiquid interests such as LLCs.
- Wants a corporate trustee to be responsible for distribution decisions, tax compliance, investment of the marketable securities, and administration of the trust.
- Wants to direct the corporate trustee regarding the operating company and illiquid assets held in the trust.
- Wants the trust to continue for the benefit of their children, grandchildren, and further generations.
- Does not want the beneficiaries to know about the trust until they reach a certain age.

Foreign Revocable Grantor Trust: Revocable During Grantor's Lifetime

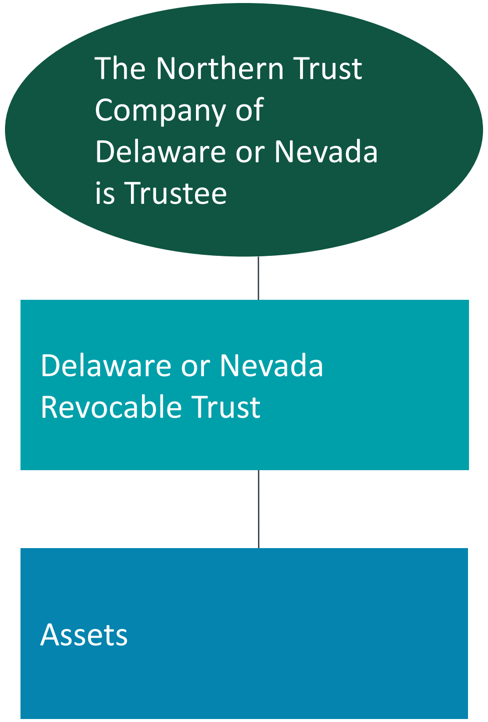
- Non-U.S. settlor establishes a revocable trust governed by Delaware or Nevada law
- Considered non-U.S. for income taxation – because foreign person (settlor) has power over the trust.
- Gifts of intangible assets by non-U.S. settlor - not subject to U.S. gift or GST taxation



- 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
- Distributions can be made from the trust for the benefit of settlor – "foreign revocable grantor trust" – all income and capital gains in the trust are attributable to the foreign grantor – not subject to U.S. fiduciary income tax
- Delaware and Nevada "directed trust" statutes allow trustee to be directed on investments or other matters – settlor or other party directs trustee to hold a non-U.S. investment company
- 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 Settlor's Death

- After Settlor's death – trust becomes irrevocable; beneficiaries are U.S. persons
- Trust is subject to U.S. income taxation, assuming there is no non-U.S. person with power to make substantial decisions.



- 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
- Distributions made from the trust 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.
- Assets no longer held in offshore investment company – trustee can still be directed on investments, or trustee can have investment responsibility.

Foreign revocable grantor trust – putting it all together

- With proper trust design and ownership of assets within a foreign grantor trust, it is possible to achieve a number of wealth-planning goals:
  - The foreign settlor can create a trust for her benefit during her lifetime and/or for U.S. beneficiaries.
  - For income tax purposes, any non-U.S. source income is not taxed by the U.S. and any U.S. source income is taxed to the settlor, not the trust.
  - Non-U.S. situs trust assets are not subject to U.S. estate tax upon the death of the settlor.
  - Upon the death of the settlor, the trust becomes irrevocable and continues for the U.S. family and friends the settlor intends to benefit.
  - Although income realized and accumulated in the trust after the settlor's death will become subject to U.S. federal income taxation, depending on the state of residence of the trust, there might be no state level income tax.
  - The trust may continue for generations as a dynasty trust not subject to future U.S. transfer taxes.

Sources of regulation and Reporting Requirements

Sources of regulation may include – for our assumed fact pattern

UNITED STATES FEDERAL RESERVE SYSTEM

OFFICE OF THE COMPTROLLER OF THE CURRENCY

UNITED STATES DEPARTMENT OF THE TREASURY
FinCEN
FINANCIAL CRIMES ENFORCEMENT NETWORK

FATF

OECD

STATE BANK COMMISSIONER, THE STATE OF DELAWARE
1919

State of Nevada, Dept. of Business & Industry Financial Institutions

Reporting requirements may include

Potential Tax Reporting and Compliance

- Income tax
- Estate tax
- Gift tax
- GST transfer tax
- Withholding tax

Potential Informational Reporting Requirements

- FBAR – Report of Foreign Bank and Financial Accounts
- FATCA – Foreign Account Tax Compliance Act
- CRS – Common Reporting Standard
- CTA – Corporate Transparency Act
- Form 3520 – distribution from a foreign trust to a U.S. person
- Form 5472 – information return of a 25% foreign-owned U.S. corporation

Due Diligence and Risk Management

Money laundering and terrorist financing – the “why”

Money laundering is an act or attempt to disguise the source of money or assets derived from criminal activity.

Those engaged in money laundering seek to

- *Conceal the true ownership and origin of criminal proceeds*
- *Disguise and change the form of the criminal proceeds*
- *Ultimately use the laundered funds for legitimate purposes*

Money laundering takes place in three stages

- *Placement*
- *Layering*
- *Integration*

Terrorist financing involves the use of legitimate funds for illegal activities

- *Motivated by ideology*
- *Expanded time horizon*
- *More difficult to detect*

Primary laws to prevent money laundering and terrorist financing in the United States

- *Bank Secrecy Act as amended by the USA PATRIOT Act*
- *Treasury Department’s Financial Recordkeeping Regulation (31 CFR Chapter X)*

Inbound wealth prospects: the context

It’s not enough that screens of the Inbound Wealth client’s background reflect no negative information. We consider how Northern Trust fits into the client’s planning.

Why is the client interested in a relationship with Northern Trust? Does the explanation make sense?	How complex is the client’s ownership structure? Does the complexity serve a purpose?	Is the client’s home jurisdiction (or any of its neighboring jurisdictions) subject to economic sanctions, or home to terrorist organizations? Does the client’s home jurisdiction lack effective AML regulations or have high levels of corruption?
Is the client involved in a high risk business? To what extent is the client’s business cash-based?	Has the client taken any measures to mask the identity of its shareholders?	Has a Northern Trust partner met the client face-to-face?

Inbound wealth prospects: the “how”

Before Northern Trust can open an account for a new Inbound Wealth client, we will collect a variety of material as part of our due diligence.

SOURCE OF WEALTH
Source of wealth should describe, in detail, the origin and economic activity which has generated the client’s net worth.

SOURCE OF FUNDS
Source of funds should describe the client’s source of funds for the specific accounts being opened (e.g., transfer from another bank, sale of property, sale of business, type of business, etc.)

INTERNET SEARCHES FOR LEGAL & REPUTATIONAL ISSUES
Perform internet searches on the client, the client’s business and any related parties or entities to determine if the client has any publicly available information that could be considered controversial or raise reputational or legal risk.

IDENTIFICATION REQUIREMENTS

- Unexpired foreign passport or comparable identification
- World Check screening

And at least one of the following:

- The three most recent months of account statements
- Written reference from a reputable financial institution
- Nature of the referral source
- Planned visit to prospect

CONTEXT
The overall context of the client’s interest in Northern Trust

INBOUND CROSS BORDER ACCOUNT – SAMPLE INFORMATION REQUESTED

- Northern reviews the source of wealth as well as the source of funds that will fund the trust.
- World Checks are run for all non-U.S. individuals and entities that will be part of the trust or funding the trust.
- All foreign institutions initiating cash transactions are reviewed.

- Clients and all related parties are screened for Politically Exposed Persons ("PEP") status, sanctions, adverse media, and other criteria during the onboarding phase, and then nightly once the account is opened.
- It is this screening, coupled with the client's risk rating which we determine, that drives both our initial and ongoing Enhanced Due Diligence ("EDD") efforts.
- Once on-boarded, High Risk clients are subject to enhanced transaction monitoring and an annual Periodic Review (absent any trigger events that may occur mid-cycle).

- **Documentation** that are collected for each **individuals** may include the following
  - Copy of unexpired passport for each related party
  - W8's where applicable
  - 3 months of bank statements for funding source where applicable
- **Documentation** that is collected for **entities held in the account** may include the following
  - Passport for each related party / beneficial owner
  - Articles of Incorporation / Memorandum & Articles of Association / Partnership Agreement / Trust Agreement
  - Certificate of Incorporation
  - Certificate of Good Standing (if Corporate Entity has been established for more than 1 year)
  - Corporate Share Certificates (Registered)
  - Resolution of First Directors
  - Register of Members / Officers / Directors
  - Certificate of Incumbency (If Corporate Entity has been established for more than 1 year)
  - W8 for entity and any applicable individuals
  - 3 Months of bank statements
  - Relationship diagram which illustrates the organizational structure of the business

Ongoing AML screening & monitoring

Northern Trust initiates client due diligence at client onboarding and continues throughout the lifecycle of the client relationship.

ONGOING, PERIODIC DUE DILIGENCE

Takes into account that a client's money-laundering risk profile may change as the client's personal or business profile changes (e.g. expansion to new geography) or the scope of Northern Trust's relationship with the client changes (e.g. addition of products and services).

CHANGES IN CLIENT'S RISK PROFILE

If a client's risk profile has changed, Northern Trust will adjust the client's risk rating to be consistent with Northern Trust's proprietary methodology and undertake due diligence commensurate with the new risk rating.

PERIODIC OR EVENT-DRIVEN REVIEW

As part of its periodic or event-driven review, Northern Trust will determine whether it remains comfortable with the risk profile the client presents.

Ongoing AML screening & monitoring

Once an account is opened, normal AML transaction monitoring and client screening will continue.

Economic Sanctions	Nightly sanctions screening of client names Real-time screening of wire transfer transactions
Politically Exposed Person	Periodic screening to determine if the client is a PEP PEPs require Enhanced Due Diligence and transaction screening
Adverse Media	Nightly screening to determine if the client is the subject of significant financial crimes-related adverse media
Transaction Monitoring	Risk-based screening of client transactions High risk clients receive greater scrutiny
Periodic reviews	NRA clients are subject to an annual review

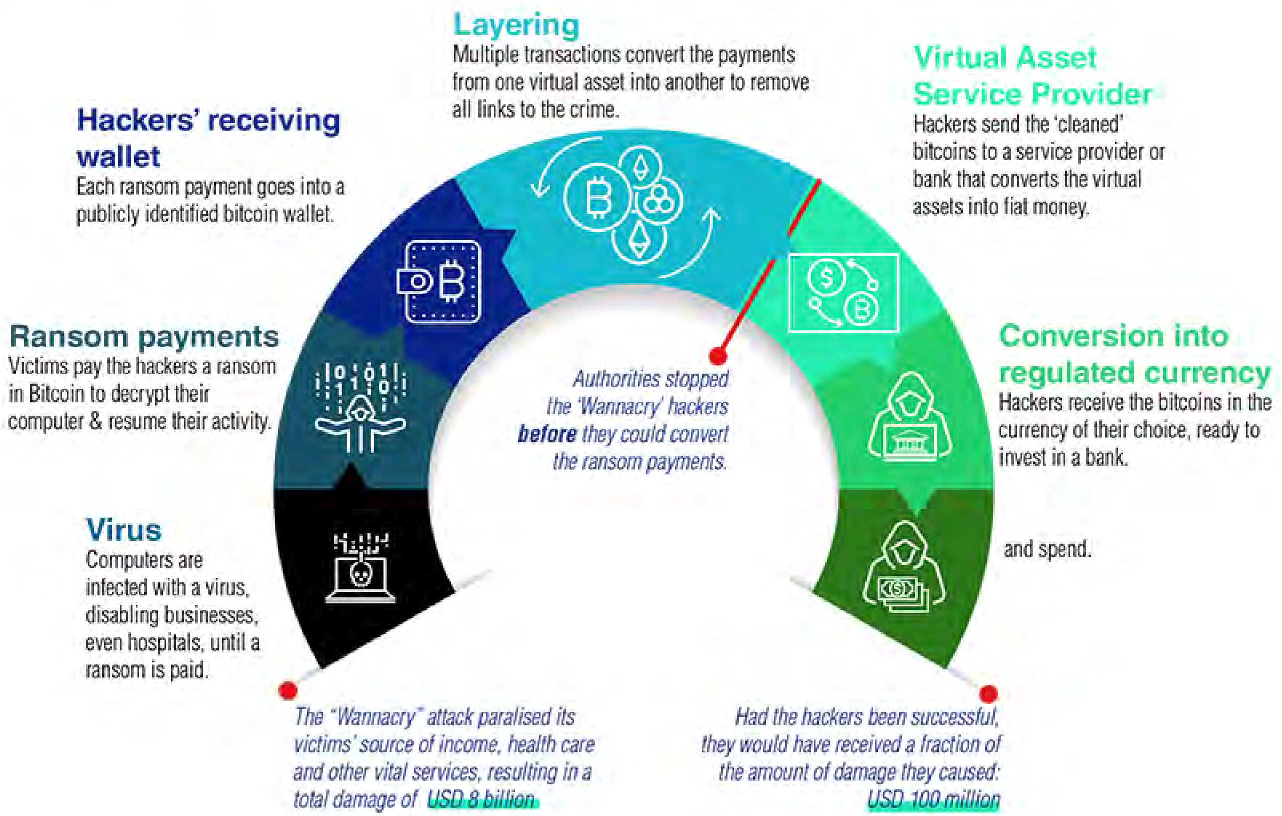
Regulatory focus on virtual assets – impact on inbound wealth

FATF focus on the role of virtual assets in criminal activities

https://www.fatf-gafi.org/en/publications/Virtualassets/Virtual-assets.html, March 2023

How can criminals misuse virtual assets?

In 2017 the 'Wannacry' ransomware attack held thousands of computer systems hostage until the victims paid hackers a ransom in bitcoin. The cost of the attack went far beyond the ransom payments, it resulted in an estimated USD 8 billion in damages to hospitals, banks and businesses across the world. Other ransomware attacks have happened since and appear to be on the rise.



OECD focus on the role of virtual assets in criminal activities

https://www.oecd.org/tax/exchange-of-tax-information/oecd-presents-new-transparency-framework-for-crypto-assets-to-g20.htm , March 2023

- In October 2022 the OECD proposed a new global tax transparency framework to provide for the reporting and exchange of information with respect to crypto assets.

- The *Crypto-Asset Reporting Framework* (CARF) responds to a G20 request that the OECD develop a framework for the automatic exchange of information between countries on crypto-assets. The CARF will be presented to G20 Finance Ministers and Central Bank Governors for discussion at their next meeting on 12-13 October in Washington D.C, as part of the latest OECD Secretary-General's Tax Report.

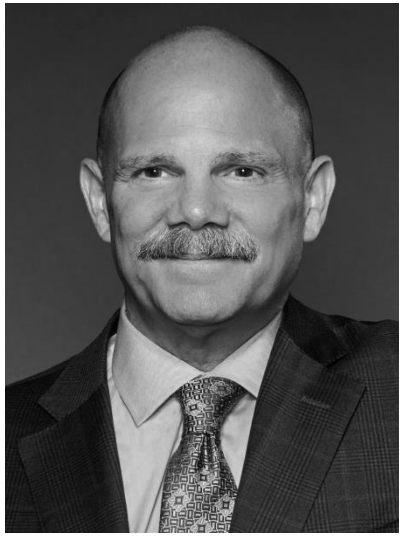
- The new transparency initiative, developed together with G20 countries, comes against the backdrop of a rapid adoption of the use of crypto-assets for a wide range of investment and financial uses. Unlike traditional financial products, crypto-assets can be transferred and held without the intervention of traditional financial intermediaries, such as banks, and without any central administrator having full visibility on either the transactions carried out or on crypto-asset holdings. The crypto market has also given rise to new intermediaries and service providers, such as crypto-asset exchanges and wallet providers, many of which currently remain unregulated.

- The CARF contains model rules that can be transposed into domestic legislation, and commentary to help administrations with implementation. Over the next months, the OECD will be taking forward work on the legal and operational instruments to facilitate the international exchange of information collected on that basis of the CARF and to ensure its effective and widespread implementation, including the timing for starting exchanges under the CARF.

- The OECD has also put forward to the G20 a set of further amendments to the CRS, intended to modernise its scope to comprehensively cover digital financial products and to improve its operation, taking into account the experience gained by countries and business. As with the CARF, this work will be complemented with an update to the international legal and operational mechanisms for the automatic exchange of information pursuant to the amended CRS, as well as with a coordinated timelines to bring the agreed amendments into effect.

Thank You

BIOGRAPHY



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"Trust laws are always evolving and I help clients and their advisors use these flexible laws in trust and estate planning."

EXPERIENCE

Dave is the President of The Northern Trust Company of Delaware, a Delaware limited purpose trust company in Wilmington, Delaware. Prior to managing Northern's Delaware office, he served as the National Trust Specialist for Northern, developing client solutions involving Northern's Nevada and Delaware trust capabilities. He is Chair of the Board of Directors for The Northern Trust Company of Delaware and on the Board of Directors for Northern Trust Cayman International and The Northern Trust Company of Nevada.

Prior to joining Northern, Dave was an attorney with Gordon, Fournaris & Mammarella (GF&M), where he focused on the unique aspects of Delaware trust law. Prior to practicing law with GF&M, Dave was with J.P. Morgan for 25 years. There he began his career as a trust officer and ultimately served as Managing Director & President of J.P. Morgan Trust Company of Delaware.

EDUCATION

Dave holds a Juris Doctor degree from The University of North Carolina School of Law and an M.B.A. and B.A. from The University of Miami

CREDENTIALS

Dave is a Fellow of the American College of Trust and Estate Counsel (ACTEC).

He is a member of the Society of Trusts and Estates Practitioners (STEP), and the Estate Planning Council of Delaware. He has earned a Certified Financial Planning® designation.

He is a member of the New York and Pennsylvania bars, and Associate Member of the Delaware Bar.

EXPERTISE

With over 30 years of experience in the trust, wealth, and estate management industries, Dave works with domestic and international clients who are seeking guidance on ways to leverage various jurisdictions in the United States. He publishes articles and speaks to audiences regularly on these topics. Dave is an adjunct professor of estate planning at The University of Delaware.

INTERESTS

He is married to a veterinarian, and he and his wife have many animals including horses and German Shepherds. He enjoys listening to all types of music, whether recorded or at live events.

COMMUNITY INVOLVEMENT

Dave is a past President of the Palm Beach Easter Seals Society, and past member of the Florida Easter Seals Society. He participated in Leadership Delaware, a program administered by the Delaware Community Foundation to connect business leaders with charitable organizations.

3 THINGS PEOPLE ASK ME

- **Why are states like Delaware and Nevada so popular for creating trusts?**
- **Should I include trusts in my overall planning?**
- **How do I provide for my children and grandchildren without spoiling them?**

DISCLOSURES

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