USA – The World's Largest Tax Haven?

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Can it be true that the nation which successfully implemented a system that forces the rest of the world to search for and report U.S. taxpayers to the U.S. Internal Revenue Service (IRS) – so successful that the OECD copied it – is to be considered the largest, growing and untouchable tax haven? The same nation that forced the Swiss parliament in August 2009 to ratify an agreement between Switzerland and the United States regarding an administrative assistance request from the IRS concerning UBS AG, according to which the IRS was to receive some 4,450 UBS client dossiers?

It is true that the United States did not sign up for the Common Reporting Standard (CRS), the transparency initiative of the OECD, which has emerged as the international standard for the exchange of data for tax purposes and which over 100 countries have committed to. It is also true that the bilateral agreements between the United States and 113 countries which were concluded in the aftermath of the Foreign Account Tax Compliance Act are insufficient for creating a level playing field with the rest of the world, because the U.S. only passes limited information to the outside partner, if the agreement is reciprocal, and only shares data with countries which meet the United States' high privacy and technical standards. It is also a fact that each state in the U.S. can determine for itself whether it wants to force its companies to collect beneficial ownership information of their owners. This led to states such as Delaware, Nevada and Wyoming without any requirements for collecting corporate ownership information becoming the center of the controversy discussed in this article.

So what has the U.S. done since it became the center of criticism right before the implementation of CRS in the rest of the world? Without going into the details of the various state regulations and their initiatives, there does seem to be a certain degree of awareness in the U.S. that regulation of anonymous entities which can be used for deceptive purposes such as the avoidance of tax could be enhanced. The Secretary of the U.S. Treasury, Jacob J. Lew, mentioned at the International Monetary and Financial Committee Meeting earlier this year (2016) that the effective implementation of international standards for the prevention of tax evasion and tax avoidance is a key issue for the U.S., and that the Treasury fully supports the call for all countries to automatically exchange financial account information. Shortly after the Secretary's statement, both the Treasury Department and the Financial Crimes Enforcement Network announced initiatives to require U.S. financial institutions to identify the beneficial owners of new customers that are companies. In addition, regulations were published that would require the beneficial owners of single-member U.S. limited liability companies to identify themselves to the IRS by applying for a tax identification number and in some circumstances filing annual returns with the IRS, thus, according to the Secretary, closing a loophole that some have been able to exploit. The Financial Crimes Enforcement Network has also issued an order for the identification of purchasers of high-end, all-cash real estate purchases in New York and Miami.

Even if not all of these initiatives have been implemented, and even if there is still much room for improvement, it is a fact that the U.S. led the world into automatic exchange of information with the enactment of the Foreign Account Tax Compliance Act in 2010. This has been recognized by the OECD, which states in its introduction to the CRS that the CRS draws extensively on the intergovernmental approach of the Foreign Account Tax Compliance Act, which has close similarities with the CRS.

So why would the author of this article as a representative of a U.S. trust company located in South Dakota raise these issues and risk of being perceived as taking advantage of one of the biggest loopholes currently in existence? Well, simply in order to clarify that there are a number of reasons why the U.S. is and has been a very attractive country for doing business in, for relocating to or for choosing as a country for investments – reasons which all have absolutely nothing to do with evading taxes or circumventing the CRS.

There are many families residing outside the United States which have a U.S. connection because their sons and daughters have obtained U.S. citizenship by birth or because family members have emigrated to the Unites States. Despite the significant number of U.S. citizenship relinquishments, which have increased from 300 in the year 2006 to over 4,000 in 2015, there still remains a large number of families outside the United States with ties to the U.S. for which U.S. entities such as trusts make perfect sense.

One significant advantage of the U.S. is that trusts are well recognized and accepted succession-planning vehicles in the U.S. They provide a very flexible means of structuring wealth, and may be used to hold all types of assets and rights without restriction. While the U.S. federal tax law defines a U.S. trust for U.S. tax purposes, the substantive laws of the 50 states govern the use of U.S. trusts and the powers, duties and liabilities of U.S. trustees.

There are a variety of reasons why a client may want to establish a U.S. trust:

Succession-planning vehicle for U.S. beneficiaries: International families require for their U.S. family members established vehicles which offer maximization of succession-planning benefits. A U.S. trust is commonly used for the implementation of a variety of legitimate succession-planning techniques. U.S. tax law recognizes the trust as a valid instrument for such purposes.

Domestication of a foreign trust into the U.S.: In order to avoid negative income-tax consequences and onerous reporting requirements for U.S. beneficiaries of “foreign trusts”, it may be more advantageous to domesticate a foreign trust into the U.S. By bringing the foreign trust into the regulated U.S. environment, benefits exclusive to U.S. structures are made available to the U.S. beneficiary.

Recipient of income arising from a foreign trust: U.S. beneficiaries may prefer to receive their beneficial interest in a foreign trust directly to their own U.S. trust. This will allow them to take advantage of the succession-planning benefits available to them in the U.S.

Pre-immigration planning tool: A settlor with the intention to move to the U.S. may establish a domestic U.S. trust prior to formally emigrating. Depending on the settlor’s home country, the trust may provide more testamentary freedom and easier administration than is available in the settlor’s home country or in the country where the settlor’s assets are situated.

Recognized structure for U.S. situs investments: U.S. trusts are often used by foreign investors to structure investments in U.S. situs assets. In addition to protecting the foreign settlor and foreign beneficiaries from U.S. federal estate tax, if structured properly, a U.S. trust may provide further unique benefits.

For every planning desire mentioned above, there is a special type of trust available in the U.S.:

Dynasty trust: The so-called dynasty trust is a perfect vehicle for leaving assets to a U.S. beneficiary while at the same time avoiding probate procedures in the U.S. The dynasty trust can continue perpetually for the U.S. beneficiaries with no limitation for duration.

Foreign grantor trust: A foreign grantor trust is established by a non-U.S. settlor for the benefit of U.S. and non-U.S. beneficiaries. It can have a U.S. trustee and can be subject to U.S. law, but can be structured in a way that it remains “foreign” for the lifetime of the non-U.S. settlor, thereby retaining all benefits of an offshore trust.

Non-grantor trust: A U.S. non-grantor trust provides a variety of advantages for its beneficiaries: The U.S. beneficiaries are only taxed on what they receive from the trust. It protects the U.S. beneficiaries from U.S. estate tax. If structured properly, it can also protect the beneficiaries from future creditors.

Directed trust: A directed trust allows an international family to appoint an external investment advisor/manager in charge of the trust’s investment management who also directs the trustee as to how the trust assets must be invested, usually pursuant to a defined investment policy. As this U.S. trust relieves the trustee from all investment responsibilities, it permits greater investment freedom than would ordinarily be permissible in a “regular” trust.

Life insurance trust: A life insurance trust purchases U.S. life insurance for the benefit of its beneficiaries. Properly structured, life insurance can defer federal income taxes and allow federal- and state-income-tax-free withdrawals by the U.S. beneficiaries.

Charitable and purpose trusts: Most states in the U.S. allow the creation of trusts for charitable, educational, religious or other public-use purposes. The grantor of the trust maintains the power to enforce the charitable trust or may designate persons for such purposes.

Qualified domestic trust: A qualified domestic trust is a unique instrument for preserving the marital deduction on transfers from a decedent to his or her surviving spouse, which is otherwise not available where the recipient spouse is not a U.S. citizen.

The above is just a selection of many possibilities which a globally oriented, internationally connected family with U.S. ties may seek in reality. The reality described herein is a much different reality from the one which the tabloids are currently publishing on the U.S. as a tax haven. Even though there are certain facts which may lead to the conclusion that the U.S. still has a lot of work to do in terms of transparency, especially when comparing it to the largest financial centers outside of the U.S., there are at least as many other reasons why families have legitimate reasons and motives to, and will continue to, enter the United States or solve their existing U.S. ties with U.S. entities such as trusts.

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