



Modern U.S. Trust Law:
*Asset Protection and Privacy in
a Transparent World*

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U.S. as a Tax and Privacy Haven?

- ▶ “The U.S. is emerging as a leading tax and secrecy haven for rich foreigners.” *Bloomberg Magazine*, January 27, 2016
- ▶ “America is the new Switzerland.” *Financial Times*, May 16, 2016
- ▶ “The United States is now becoming one of the world’s largest tax and secrecy havens.” *Washington Post*, April 5, 2016
- ▶ “The United States has become a place of choice for foreign investors.” *Daily Business Review*, April 25, 2017

The U.S. as a Preferred Trust Jurisdiction for Both Domestic and International Families

- ▶ **International Families with Ties to the U.S.**
 - ▶ Education
 - ▶ Marriage
 - ▶ Business Activity
 - ▶ Not Nefarious or Bad Actors
- ▶ **Tax and Privacy Issues**
 - ▶ Taxation Planning (NOT Tax Evasion)
 - ▶ Privacy Laws (NOT Secrecy)
 - ▶ Domestic Asset Protection v. Offshore Asset Protection
 - ▶ Uncertainty (Pandemic and Government Stability)
- ▶ **Right to Privacy, Asset Protection, and Prudent Tax Planning?**

The Pandora Papers

- ▶ Massive data breach involving 14 foreign service providers.
- ▶ 11.9 million confidential documents.
- ▶ “There is no evidence in the Pandora Papers documents that any of the foreigners with trusts in the United States sheltered criminal proceeds.”
- The Washington Post
- ▶ Irresponsible Reporting – The Rest of the Story
 - ▶ Visit our podcast page to hear the episode at: bridgefordtrust.com/podcasts

Common Reporting Standard (CRS)

- ▶ Global cooperation and sharing of financial information between and among participating jurisdictions, with enhanced transparency in multinational business and investment reporting.
- ▶ Similar to FATCA.
- ▶ As of August 2017, 102 jurisdictions have committed to implement CRS including the Cook Islands, BVI, Cayman Islands, Switzerland, Nevis, and New Zealand.
- ▶ United States NOT participating in CRS.

FATCA vs. CRS

▶ **FATCA**

- ▶ **A U.S. tax initiative** introduced by the United States Internal Revenue Service (IRS).
- ▶ Commitment: 100+ countries have signed up to FATCA.
- ▶ AIM: to reduce tax evasion by U.S. citizens and U.S. tax residents.

▶ **CRS**

- ▶ **A global tax initiative** introduced by the Organization for Economic Co-operation and Development (OECD).
- ▶ Commitment: As of August 2017, 102 countries have signed up to CRS.
- ▶ AIM: To reduce tax evasion by taxpayers of countries signed up to CRS.

FATCA vs. CRS – Key Differences

- ▶ **FATCA:**
 - ▶ FATCA aims to identify whether an account holder is a U.S. person using citizenship and tax residency.
 - ▶ Tax information is collected for U.S. account holders ONLY.
- ▶ **CRS:**
 - ▶ CRS aims to identify the tax residency of each and every one of its account holders.
 - ▶ Tax information is required for ALL account holders.

FATCA vs. CRS – Key Differences (cont'd)

- ▶ The reporting requirements of CRS are the same as FATCA with the exception of:
 - ▶ Tax residency, date, and place of birth are also reported for ALL account holders.
 - ▶ Information must be reported on the CRS schema to the local Tax Authority for onward forwarding to all countries complying with CRS.
- ▶ Similar Penalties

Corporate Transparency Act

- ▶ The Corporate Transparency Act (CTA) was enacted into law on January 1, 2021, and tasked the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) with implementation through regulations.
- ▶ Intended to prevent and combat money laundering, the proposed regulations require a "reporting company" to submit certain beneficial owner and company applicant information to FinCEN.
- ▶ Hundreds of comments/definitional confusion and lack of clarity.

“The choice of a state in which to establish a trust is as critical as the decision to create one.”

- Elizabeth Mathieu, President of Neuberger & Berman

Trust Situs Selection

- ▶ Trust laws vary significantly from state to state.
- ▶ A few states are “in a race” to establish the most progressive trust laws in an attempt to capture trust business.
- ▶ Tier 1 Trust Jurisdictions*
 - ▶ South Dakota
 - ▶ Delaware
 - ▶ Nevada
 - ▶ Alaska
 - ▶ Wyoming?



* *Trusts & Estates Magazine, January 2022 Issue*

What Factors are Considered when Determining Top-Tier U.S. Trust Jurisdictions?

- ▶ Asset Protection
- ▶ Dynasty Trust/Rule Against Perpetuity
- ▶ Taxation
- ▶ Privacy Rules
- ▶ Modern Trust Laws

What is a Domestic Asset Protection Trust?

- ▶ A *self-settled* trust that protects assets from creditors (including future spouse).
- ▶ Strategy that legally shields assets from third party liability (future spouse) while permitting settlors to receive *income*, retain some *control* over trust assets, AND enjoy a *discretionary beneficiary interest* during their lifetime.
- ▶ Most states do **NOT** have an Asset Protection Trust Statute.

Domestic Asset Protection States

- ▶ Several states have passed Domestic Asset Protection Statutes.
- ▶ **South Dakota, Nevada, Alaska, and Delaware** are consistently recognized as having the most robust and powerful Asset Protection Statutes in the nation.*

** **Best Situs for DAPTs in 2021** Mark Merric, Daniel G. Worthington, Paul MacArthur and John E. Sullivan, *Trusts & Estates Magazine*, January 2021*

Domestic Asset Protection States (cont'd)

- ▶ Very compelling planning tool for high-risk individuals and pre-marital planning.
- ▶ Not all Domestic Asset Protection Statutes are created equally.
- ▶ Fraudulent Conveyance (look-back):
 - ▶ South Dakota – 2 years
 - ▶ Delaware – 4 years
 - ▶ Wyoming – 4 years
- ▶ Best of both worlds – domestic and offshore asset protection in one instrument.



Domestic Asset Protection v. Prenups

- ▶ Prior to marriage, a spouse can establish a Domestic Asset Protection Trust that is fully discretionary, receive financial benefit from the trust, and protect trust assets from a spousal claim in a subsequent divorce proceeding.
- ▶ No disclosure or timing requirements. The trust can be established any time prior to marriage and never has to be revealed to the intended spouse.
- ▶ Greatly reduces the chances of a successful attack resulting in the equitable distribution of property brought to the marriage.

Domestic Asset Protection Trusts (cont'd)

- ▶ In Re Cleopatra Cameron:
 - ▶ South Dakota Supreme Court rejected even the specter of an argument that would allow support creditors to reach trust funds protected by a spendthrift provision.
 - ▶ South Dakota declined the enforcement of a California claim in South Dakota, where the legislature has rejected such enforcement.
 - ▶ A South Dakota court is not required to submit to a California judgment to compel payments from a South Dakota trust.

“For reference, in planning, “secrecy” has historically meant that no one — not even the government — sees your affairs. “Privacy” has historically meant that the public can’t see your affairs but the government can. The days of secrecy are dead. So, we talk about privacy.”

- The Worlds Best Tax Haven: The United States. Forbes, September 2019

Trust Matter Privacy

- ▶ Very important issue for high-net-worth families and closely held business owners.
 - ▶ Quiet Trust – no disclosure requirement.
 - ▶ Court Seal – Keeps trust information out of the public domain.
- ▶ South Dakota – Total Seal Forever/Not Discretionary/Quiet Trust
 - ▶ Delaware – Seal for 3 years/discretionary.
 - ▶ Most states – Open to the public.

Privacy vs. Secrecy: The Importance of KYC

- ▶ Strong and thorough KYC (Know Your Customer) is essential.
 - ▶ World checks.
 - ▶ Source of funds.
 - ▶ Verification of good character/tax compliance in home state.
- ▶ Not everyone coming to the U.S. is nefarious.
- ▶ Need for Uniformity of Regulations among trust companies and states.

South Dakota Division of Banking

- ▶ *“We are the chartering authority...if something goes wrong, we own it. From a reputational standpoint no one benefits from having something bad happen.” Bret Afdahl, Director, South Dakota Division of Banking, Financial Times, May 16, 2016.*
- ▶ The South Dakota Division of Banking has created specific policies and procedures around best practices for onboarding and administering trusts applicable to companies in the international space to develop uniform regulations designed to protect against nefarious actors and to protect the overall integrity of the South Dakota trust industry.

“The reason the United States earned the title of the “best” tax haven is that its trust law allows for the indefinite suspension of estate tax over many generations, whereas other jurisdictions can’t.”

- The Worlds Best Tax Haven: The United States. Forbes, September 2019

Dynasty Trust

- ▶ Definition – A trust that is not subject to the rule against perpetuities and, therefore, lives forever.
- ▶ Driven by state law.
- ▶ South Dakota allowed for the first Dynasty Trust in the nation in 1983 by abolishing the rule against perpetuities.

Dynasty Trust (cont'd)

- ▶ Dynasty Trusts avoid federal taxation on trust assets forever because there is never a forced distribution of assets.
- ▶ Very important planning tool that protects family wealth over generations.
- ▶ Not all states have abolished or amended the Rule Against Perpetuity, clearing the way for Dynasty Trusts.
- ▶ State constitutional issues.
- ▶ Dynasty Trust states are not created equally.

State Trust Taxation

- ▶ Income retained in a trust is taxed in most states at applicable income tax levels.
- ▶ A handful of states do not have an income tax and, therefore, do not tax retained income in trusts, including South Dakota.
 - ▶ Kaestner Case
 - ▶ ING Trust
 - ▶ Community Property Trusts



Tax Trust Planning

A **COMPELLING** tax planning opportunity exists to:

- ▶ Avoid federal estate taxation forever through a forced distribution (Dynasty Trust).
- ▶ Avoid state taxation on capital gains low-cost basis assets (ING).
- ▶ Avoid state taxation on undistributed income.
- ▶ Reduce state insurance premium taxation.
- ▶ Obtain a 100% step-up for marital property.

SIMPLY BY SELECTING THE PROPER TRUST SITUS.

“Legal experts contend that there have been more changes in trust law in the last twenty years than have taken place in the prior two centuries. These changes promise to affect every aspect of how trusts are administered for years to come.”

- Joseph F. McDonald, Esq III, Trusts & Estates Magazine, February 2012

Modern Trust Laws

- ▶ Directed Trusts
- ▶ Trust Protector
- ▶ Family Advisor
- ▶ Decanting

Directed Trusts

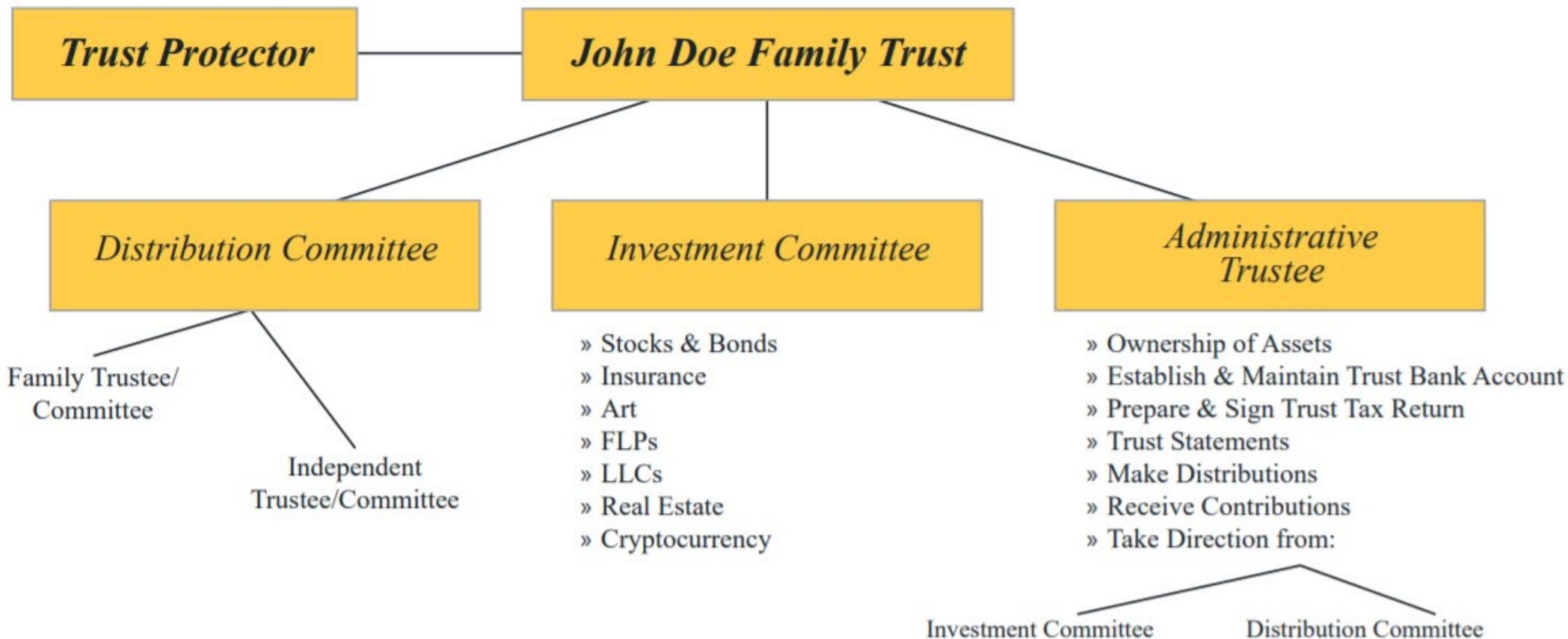
- ▶ Through **bifurcating liability**, the Directed Trust model creates a legal framework allowing trustees and beneficiaries to work with asset managers and independent trust companies of their choosing.
- ▶ Directed Trusts provide a family with maximum **flexibility and control** regarding the trust's asset allocation, diversification, investment management, and distributions.



Directed Trusts (cont'd)

- ▶ A Directed Trust can be used by a settlor who wants to fund an irrevocable trust with a closely held company or a specialized asset, but who also wants to **place control** of such assets in the hands of a particular individual (or group of individuals) familiar with the company's operations or that type of specialized asset.
- ▶ The Directed Trust concept **unbundles** functions (asset management and trust services) that have traditionally been bundled by large bank-based corporate trustees.

Typical Modern “Directed” Trust Structure



The Trust Protector – A Super Trustee

- ▶ The Trust Protector, often used in conjunction with a **Directed Trust**, delivers far more **control** to settlors of trusts, beneficiaries, and their advisors than ever before.
- ▶ The inclusion of a Trust Protector allows the settlor, beneficiaries, and their advisors to **modify** and **control** many important aspects of the trust and provide direction to the trustee with respect to investment management, jurisdiction, and trust distributions.



The Trust Protector (cont'd)

Reasons why a settlor may wish to appoint a Trust Protector include:

- ▶ The settlor wishes for a mechanism to easily replace the trustee or change trust situs.
- ▶ Protectors allow for a great degree of **flexibility** when dealing with changes in circumstances, including both factual circumstances (death, premature divorce, previously unknown children) and legal changes (any legal changes, but most frequently changes to applicable revenue laws).

The Trust Protector (cont'd)

Reasons why a settlor may wish to appoint a Trust Protector include (continued):

- ▶ The settlor may be concerned that the trustee may not pay sufficient attention to his wishes.
- ▶ The settlor wishes certain powers to be withheld from the trustees.
- ▶ The settlor wishes a third party to act as a main point of contact between the beneficiaries and the trustees.

Family Advisor – Trust Protector Light

- ▶ Appropriately referred to as a “Trust Protector Light,” because of its non-fiduciary status and limited powers.
- ▶ Excellent option for settlors of trusts and beneficiaries who may want family advisors, such as attorneys, CPAs, or investment advisors, to have some control and input over important aspects of trust administration without elevating the position to that of a fiduciary.



Family Advisor (cont'd)

The Family Advisor role, similar to the Trust Protector, has the power to **modify**, **control**, and **participate** in many important aspects of trust administration.

The powers that may be granted to the Family Advisor are:

- ▶ **Remove and appoint** a *trustee*, a fiduciary provided for in the governing trust instrument, *trust advisor*, *investment committee member*, or *distribution committee member*.
- ▶ **Appoint a successor trust protector or a successor family advisor.**

Family Advisor (cont'd)

- ▶ Advise the trustee on matters concerning any beneficiary; receive trust accountings, investment reports, and other information from the trustee or to which a beneficiary is entitled; attend meetings, whether in person or by any other means, with the trustee, investment trust advisors, distribution trust advisors, or other advisors, whether in person or by any means, electronic or otherwise; and to consult with a fiduciary regarding both fiduciary and non-fiduciary matters or actions, all without any power or discretion to take any action as a fiduciary.
- ▶ Provide direction regarding notification of qualified beneficiaries pursuant to § 55-2-13.

What is Decanting?

- ▶ Decanting is the **distribution of assets** from an **irrevocable trust** into a **new** trust with different, and presumably more desirable and flexible provisions, leaving the unwanted provisions in the original trust and not binding on the trust assets.
- ▶ Decanting has emerged as a **powerful planning tool for planners** relative to adapting family wealth plans to changes in the wealth planning landscape and family dynamics, **without the need for court intervention.**



When to use Decanting

- ▶ Transfer trust situs to a more favorable trust jurisdiction state.
- ▶ Correct drafting errors.
- ▶ Enable trusts to be subdivided among beneficiaries.
- ▶ Switch trust from grantor trust status for tax purposes to non-grantor status.
- ▶ Include asset protection provisions.
- ▶ Change administrative terms of the trust.
- ▶ Change trustees.
- ▶ Expand trustee powers.
- ▶ Create a Directed Trust (Investment and Distribution Committees).

Decanting not available in Majority States

- ▶ New York was the first state to enact a decanting statute in 1992.
- ▶ Currently 22 states have decanting statutes:
 - ▶ South Dakota, Nevada, New Hampshire, Delaware, Tennessee, Arizona, Ohio, Alaska, Wyoming, Illinois, Virginia, South Carolina, Missouri, Kentucky, North Carolina, Texas, Rhode Island, Wisconsin, New York, Michigan, Florida, and Indiana.

Decanting Statutes are not Created Equally

- ▶ Only South Dakota allows trustees to decant from a trust with an ascertainable standard of distribution into a trust with absolute discretion to distribute and also remove a mandatory income interest.
- ▶ Only 7 states have statutes that **do not require notice** of decanting to beneficiaries.
- ▶ Selecting the proper decanting statute is essential.

Duty to Decant?

Ferri v. Powell-Ferri, SJC-12070 (Massachusetts Supreme Court)

- ▶ No notice given to beneficiary (spouse), who had right to withdraw 75%.
- ▶ Decant used to protect trust from soon to be divorced.
- ▶ Trustee had a **“duty to decant if the trustee deemed decanting to be in the beneficiary’s best interest.”**
- ▶ Does a trustee have a fiduciary duty to decant? Malpractice?

Is There a Fiduciary Duty to Create or Move Trusts to a Top-Tier Trust Jurisdiction?

- ▶ Uniform Probate Code § 7-305 (1969)
- ▶ “A trustee is under a continuing duty to administer the trust at a place appropriate to the purposes of the trust and to its sound, efficient management. If the principal place of administration becomes inappropriate for any reason, the Court may enter any order furthering efficient administration and the interests of beneficiaries, including, if appropriate, release of registration, removal of the trustee and appointment of a trustee in another state.”

Fiduciary Duty (cont'd)

- ▶ Restatement (Third) of Trusts § 76(2)(c)
- ▶ “In administering the trust, the trustee's responsibilities include performance of the following functions: ... (c) managing the trust estate to provide returns or other benefits from trust property.”
- ▶ See also Scott on Trusts, §§ 613-615

Fiduciary Duty (cont'd)

- ▶ Comments to Restatement (Third) of Trusts § 76(2)(c)
- ▶ “A trustee's duty to administer a trust includes an initial and continuing duty to administer it at a location that is reasonably suitable to the purposes of the trust, its sound and efficient administration, and the interests of its beneficiaries.”
- ▶ “Under some circumstances the trustee may have a duty to change or to permit (e.g., by resignation) a change in the place of administration. Changes in the place of administration by a trustee, or even the relocation of beneficiaries or other developments, may result in costs or geographic inconvenience serious enough to justify removal of the trustee.”

Asset Protection, Privacy, and Prudent Tax Planning Alternative: Private Placement Life Insurance

- ▶ Private Placement Life Insurance (PPLI) is a powerful wealth planning tool used by family offices and high-net worth individuals to invest in a tax efficient manner and transfer wealth to future generations more effectively.
- ▶ Unlike traditional “retail” insurance, PPLI is a unique type of insurance that takes advantage of insurance rules to avoid income taxation on internal income and taxation on the proceeds at the death of the insured.

Private Placement Life Insurance (cont'd)

- ▶ Who benefits from PPLI?
 - ▶ Clients in high tax bracket and/or high tax states.
 - ▶ Clients looking to allocate to tax inefficient assets.
 - ▶ Clients with grantor trusts.
 - ▶ Clients with charitable intent, mostly for U.S. clients.
 - ▶ Clients who have long-term investment horizons and wealth transfer goals for subsequent generations.

South Dakota v. Nevada

	South Dakota	Nevada
Dynasty Trusts	Yes <i>Ranked as #1 ⁽¹⁾</i>	Yes <i>Ranked as #2 ⁽¹⁾</i> <i>State constitution prohibits modification to RAP ⁽²⁾</i>
State Income Taxation	No	No
Community Property Trusts	Yes ⁽³⁾	No
Domestic Asset Protection Statute	Yes ⁽⁴⁾ <i>2 year statute of limitations; Exception for child support</i>	Yes ⁽⁴⁾ <i>2 year statute of limitations; No exceptions for child and spousal support</i>
Trust Protector	Yes	Yes
Directed Trusts	Yes	Yes
Decanting Statute	Yes <i>Ranked as #1 ⁽⁵⁾</i>	Yes <i>Ranked as #2 ⁽⁵⁾</i>
Trust Privacy Provision	Yes - Total Privacy Seal Forever <i>Automatically attaches</i>	No Total Privacy Seal ⁽²⁾ <i>Subject to judge discretion</i>
Special Purpose Entity	Yes ⁽²⁾ <i>Codified by statute</i>	No
Family Advisor	Yes	No
State Fiscal Health	Ranked as #1 ⁽⁶⁾	Ranked as #29 ⁽⁶⁾

* Denotes superior distinction among jurisdictions.

South Dakota v. Delaware

	South Dakota	Delaware
Dynasty Trusts	Yes <i>Ranked as #1 ^[1]</i>	Yes <i>Ranked as #7 ^[1]</i>
State Income Taxation	No	No <i>Only for non-residents</i>
Community Property Trusts	Yes ^[3]	No
Domestic Asset Protection Statute	Yes ^[4] <i>2 year statute of limitations; Exception for child support</i>	Yes ^[4] <i>4 year statute of limitations; Exceptions for child and spousal support</i>
Trust Protector	Yes	Yes
Directed Trusts	Yes	Yes
Decanting Statute	Yes <i>Ranked as #1 ^[5]</i>	Yes <i>Ranked as #3 ^[5]</i>
Trust Privacy Provision	Yes - Total Privacy Seal Forever <i>Automatically attaches</i>	Yes - Three Year Privacy Seal ^[2] <i>Subject to judge discretion</i>
Special Purpose Entity	Yes ^[2] <i>Codified by statute</i>	No
Family Advisor	Yes	No
State Fiscal Health	Ranked as #1 ^[6]	Ranked as #38 ^[6]

* Denotes superior distinction among jurisdictions.

South Dakota v. Wyoming

	South Dakota	Wyoming
Dynasty Trusts	Yes <i>Ranked as #1 [1]</i>	Yes <i>Ranked as #5 [1]</i> <i>State constitution prohibits modification to RAP [2]</i>
State Income Taxation	No	No
Community Property Trusts	Yes [3]	No
Domestic Asset Protection Statute	Yes [4] <i>2 year statute of limitations; Exception for child support</i>	Yes [4] <i>4 year statute of limitations; Exception for child support</i>
Trust Protector	Yes	Yes
Directed Trusts	Yes	Yes
Decanting Statute	Yes <i>Ranked as #1 [5]</i>	Yes <i>Ranked as #14 [5]</i>
Trust Privacy Provision	Yes - Total Privacy Seal Forever <i>Automatically attaches</i>	No Total Privacy Seal [2] <i>Subject to judge discretion</i>
Special Purpose Entity	Yes [2] <i>Codified by statute</i>	No
Family Advisor	Yes	No
State Fiscal Health	Ranked as #1 [6]	Ranked as #48 [6]

* Denotes superior distinction among jurisdictions.

Regulated v. Unregulated Trust Companies

- ▶ Regulation ensures a trust company is financially sound and administering trusts correctly.
- ▶ Regulation protects the integrity of the trust.
- ▶ South Dakota regulators are collaborative and supported.
- ▶ Privacy is not an issue.

U.S. Trust Company v. International Trust Company

- ▶ International trust companies opportunistically come to the U.S. and obtain trust powers.
 - ▶ Lack experience with U.S. law and regulatory requirements.
 - ▶ Perform in-house functions prohibited in the U.S.
 - ▶ Underserve trusts.

A U.S. based trust company is the superior option for international families coming to the U.S. for trust planning.

Additional Information

As an independent, full-service trust company with South Dakota Trust powers, Bridgeford Trust Company provides trust and fiduciary services to domestic and international families across the country and the world.

Contact David A. Warren, JD, Co-Founder & Chairman of Bridgeford Trust Company at dwarren@bridgefordtrust.com or by calling (605) 224-9189.

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