Prepare for change

CURTIS CHILDS ON ESTABLISHING AND ADMINISTERING FOREIGN TRUSTS, SELECTING ASSET MANAGERS AND CUSTODIAN BANKS

For settlors, identifying the right trust provider is a challenge. The offshore trust market differs from the domestic market because of the multitude of legal jurisdictions, structuring possibilities and tax complexities, and the range of professional support required from trustees and other professionals. While US domestic trust companies usually include fiduciary, tax and legal services, and provide links to custody and asset management services, offshore, many trust companies only offer basic trust administration.

Given these challenges, clients in the offshore market often need to engage external tax, legal, banking and asset management advisors to complete the picture. Coordination and oversight becomes of great importance between the stakeholders to align interests, minimise cost and optimise performance. This includes an understanding of the settlor's and beneficiaries' tax domicile, the tax attributes of assets held, the consequences of investment decision-making, distribution strategies and ensuring accurate and timely tax filing.

ASSET MANAGER

While the asset manager is focused on generating optimal risk-adjusted returns, they often have the most frequent contact with the underlying client and other service providers and are therefore called on to perform tasks beyond their normal duties. A US asset manager, under the *Investment Advisers Act* of 1940, as a fiduciary, has a regulatory obligation to place the interests of the client ahead of their own when developing and implementing the investment strategy of the trust. This includes a full understanding of the trust's tax status. The strategy is determined by the trustee or investment committee of the trust. The trustee must be involved in setting this policy. However, in many offshore jurisdictions this level of involvement is not always evident.

Timing of income recognition is particularly relevant for trustees and beneficiaries when considering the US tax implications of distributions. Therefore, to achieve solid after-tax performance, the asset manager must work closely with the other professionals supporting the structure. Thus, when seeking an offshore asset manager, a trustee or investment committee should evaluate the asset manager's knowledge and understanding of US tax law, including differences between grantor and non-grantor trust investing, taxing accumulation distributions, the anti-deferral regimes (i.e. passive foreign investment companies), withholding taxes and tax treaties, qualified dividends and the taxation of certain structured products. The difference in taxing these can affect the returns realised by the trust or US beneficiary.

Even seemingly simple issues, such as a request to generate liquidity, may have important US tax implications: what asset should be sold, what is the tax consequence and how does it affect the portfolio strategy? Issues involving tax credits, particularly in the context of non-grantor trusts investing in US securities, also drive investment approach.

CUSTODIAN BANK

An asset manager cannot operate alone and the custodian bank is a valuable partner in delivering accurate US tax reporting. Trustees should identify custodians who are committed to servicing US taxable accounts by providing full IRS 1099 reports, including currency-adjusted cost-basis accounting for non-US securities. Furthermore, a strong partnership with an accountant and/or tax lawyer is important to develop policies and to maintain oversight and compliance.

Without Securities and Exchange Commission (SEC) registration, non-US banks should not communicate directly with US resident clients about investments[1]. Given the risks, banks will only accept US clients who are advised by an SEC-registered entity and who can demonstrate tax compliance. Many banks are either exiting, or contemplating exiting, the US-person market entirely. To continue providing services to trust companies, banks will be demanding far more detailed information on the beneficiaries and the registration status of the investment advisor.

INDUSTRY EVOLUTION

Regulation and tax transparency are closing in on the offshore world. Reviewing offshore trust structures for US persons is essential for fiduciaries to provide optimised advice in the best interest of their clients. With a view to the complexities and associated risks, it is necessary to work with partners who have made servicing US clients a core competency of their business. Trust structures with US persons are an important market and while many offshore providers are shying away from serving these structures, the business opportunity is significant and requires specialist skills and coordinated advice. Firms can best service this market by working together to avoid risks and provide the best solutions for clients.

US persons establishing or benefiting from offshore trusts need providers who can guide them through structuring, tax, regulatory oversight, custody and asset management to achieve cost-effective and reliable trust solutions. These providers include a trust company with US legal and tax knowledge, an asset manager registered with the SEC who has knowledge of the Internal Revenue Service (IRS) code, and a custodian bank that can produce accurate and compliant IRS reporting.

> 'REGULATION AND TAX TRANSPARENCY ARE CLOSING IN ON THE OFFSHORE WORLD'

The traditional model of establishing and administering foreign trusts, selecting asset managers and custodian banks is changing. The days of price- and performance-insensitive clients looking for confidential homes is coming to an end. All parties in the value chain are increasingly being exposed to the forces of regulation, tax and global competition. Geography and tradition no longer suffice: free markets are at work.

In a world moving rapidly towards tax transparency, trust companies, banks and asset managers will have to be more competitive on pricing, transparent on total costs, free of conflicts and focused on investment performance. Tax-declared clients have greater choice and are less tolerant of the old 'high price, service light' models. Firms will have to work harder and accept less.

Curtis M Childs is Managing Partner of Bellecapital International AG in Zurich, Switzerland

1 1.usa.gov/qxru4t