

# STEP JOURNAL

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### US ties or not: does it matter?

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# SDTC

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International families are establishing domestic trusts at a record pace. Historically, these families would establish trusts in the US only if they had family and/or assets in the US. This strategy still remains popular for international families, but now many of these families are also forming US trusts without such traditional ties.

## Foreign grantor trusts

International grantors – non-US citizens/non-resident aliens (NRA) – are increasingly establishing foreign grantor trusts (FGTs) with trustees in the US for foreign beneficiaries and foreign property. Usually, the grantors choose modern US domestic trust jurisdictions due to their trust protector, directed trust, privacy, tax and other modern trust statutes. These modern trust jurisdictions include such states as Delaware, Nevada, South Dakota and Wyoming. The FGTs are generally revocable during the grantor's lifetime. Typical assets of these trusts are offshore entities that may own the NRA's foreign assets. If there are no US-*situs* assets, the FGT has all the protection of a US trust while minimising or eliminating US taxes. Additionally, if US-*situs* securities are involved, they will not generally be subject to capital gains taxes if the NRA grantors are not deemed US income tax residents, e.g., if they meet the substantial presence test or are green card holders. These US-*situs* securities will also not be subject to US estate taxes if owned by an offshore entity owned by the trust as an estate tax blocker. The NRA grantor/s are usually the beneficiaries of these FGTs so that they are paid income and principal during their lifetimes. At the death of the NRA grantor/s, these FGTs are typically left outright or passed to another trust for the benefit of the descendants, usually children or grandchildren (both foreign and domestic).

These FGTs with US-*situs* trusts are frequently established by NRAs who are residents of countries with political instability and/or possible forced-heirship issues. Consequently, the FGT with US-*situs* trust is a very powerful and popular option for these NRA families, whether or not the assets are US-*situs*.

## Domestic dynasty trusts

Powerful planning opportunities also exist with US trusts if an NRA has US family (that is, citizen or green card children, grandchildren or other relatives). This stems from the treatment of NRAs as it relates to US transfer taxes. NRAs have an unlimited estate, gift and generation-skipping transfer (GST) exemption versus the USD13.61 million exemption for a US person, which is due to sunset to approximately USD7 million after 31 December 2025. Consequently, these NRAs can gift an unlimited amount into a domestic NRA dynasty trust usually situated in one of the modern trust jurisdictions previously mentioned. The unlimited gift exemption generally only applies if NRAs are gifting non-US-

*situs* assets. The most popular option is cash from non-US accounts. US insurance bought on either the NRA's life and/or on the lives of the US beneficiaries is also a popular investment for these trusts. The life insurance wrapper converts the trust to a zero-tax dynasty trust both for income and capital gains generated within the trust, as well as for trust distributions because they are in the form of non-taxable life insurance policy loans. US life insurance is an US estate tax exempt asset for NRAs.

Additionally, many NRAs have currently funded trusts in offshore trust jurisdictions administered by foreign trustees. The NRA and their spouse are typically the primary beneficiaries of these trusts and their children are the contingent beneficiaries. If their children are US citizens or green card holders – and the NRA grantor dies, and the trust assets remain offshore for the benefit of the US beneficiaries – then the US tax reporting and taxes become extremely burdensome for the US beneficiaries. Consequently, a structure that NRAs may use is the formation of a US pour-over dynasty trust, nominally funded with USD10 during their lifetime, in one of the modern domestic dynasty trust jurisdictions. These trusts are then fully funded at the NRA grantor's death, at which point the foreign offshore trust pours over into the US domestic pour-over dynasty trust for the benefit of the US beneficiaries.

Another common scenario is when one NRA parent dies and the second NRA parent decides to move to the US to be with the US beneficiary children and become a green card holder and/or citizen. The surviving NRA parent may look to gift assets to a self-settled NRA dynasty trust, while the NRA parent has unlimited estate, gift and GST tax exemptions for non-US-*situs* assets. By using a self-settled dynasty trust, the NRA can also be a permissible discretionary beneficiary of the trust in addition to all the other benefits of a US trust.

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