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Welcome to Ohio

Michael J Stegman provides an overview of Ohio’s trust and company laws

When wealthy families seek a jurisdiction for placement of assets, they look for stability, favourable laws and tax neutrality. Stability refers to a family's ability to have faith in a jurisdiction's long-standing democratic government, its bedrock principle of the primacy of private property, and its regulated financial institutions. Favourable laws are those that provide structures for keeping assets safe over multiple generations, allow flexibility within these structures to account for changing familial circumstances, and protect the family fortune from predators. The final criterion of a worthy jurisdiction – tax neutrality – means that the jurisdiction will not cause the family to incur any taxation that the members would not already be subject to.

The desired stability, favourable laws and tax neutrality can all be found in the heartland of the US in the state of Ohio.

Stability

Ohio is a major economic and financial jurisdiction. Its gross domestic product is USD472,344 million (US Department of Commerce, 2010). If it were a country of its own, Ohio would have the 20th largest economy in the world, just behind Switzerland, according to 2010 figures from the World Bank. Ohio's population is 11.5 million. In this prosperous and populous state, there are public and private institutions that are well-suited to the needs of wealthy families worldwide.

Ohio has a democratic government established in 1803, a state constitution that protects the primacy of private property against governmental intrusion, and an independent and impartial judiciary with roots in English jurisprudence.

In its private sector, Ohio is home to numerous banks and trust companies, whether formed under state law or US law. These closely regulated institutions are havens for the custody of assets, including private holdings, and, if the family also seeks investment advice, are capable of complex portfolio management. The post-2008 financial reforms have made these institutions stronger than ever.

Legal framework

The *Ohio Trust Code*

From its foundations as an English common-law jurisdiction, the state has advanced to a codified body of trust law found in its *Ohio Trust Code*. The features of this modern body of law include parcelling fiduciary roles among an administrative trustee (such as a bank or trust company), a trust advisor (such as a discretionary distribution advisor or committee) and a trust protector. Each of these is an office held according to fiduciary duties that protect the trust beneficiaries. The Code contains spendthrift provisions that protect the trust assets from creditors of beneficiaries. Pursuant to Ohio's unique 'wholly discretionary trust' provisions, a particular type of settlement – providing for no

standards governing the discretion of the trustee or advisor as to distributions – will be immune not only from the typical creditors of a beneficiary under the usual law of spendthrifts, but also from claims of a state or a current or former spouse. The *Ohio Trust Code* further provides that a creditor of the settlor cannot reach trust assets by claiming through a power of appointment held by a third person where the permissible class of donees includes the settlor. Ohio is one of only two US states to provide this, the other being Arizona.

In further deviation from common law, the *Ohio Trust Code* allows the settlor to opt out of the rule against perpetuities and create a dynasty trust. And, despite the trustee's normal duty to notify beneficiaries of the existence of the trust and to inform them of the value of trust assets and their management, the code permits a quiet trust concept wherein the settlor appoints an appropriate surrogate who, instead of the actual beneficiary, receives the notice and the reports. Whereas the quiet trust statutes of some other jurisdictions render the unknowing beneficiary ill-situated to enforce rights against abuse of the trust relationship, the beneficiary surrogate law imposes a duty on the surrogate to protect the interests of the otherwise unsuspecting beneficiary. The surrogate can be either the trust protector or another person or institution.

In addition, the *Ohio Trust Code* allows purpose trusts to contain a flexible decanting mechanism. This lets discretionary trusts be non-judicially reformed to account for changing circumstances over time, and allows foreign law to govern so far as it is not contrary to Ohio public policy.

The Ohio *Legacy Trust Act (2013)*

Ohio's *Legacy Trust Act (2013)* took effect on 27 March 2013. Unlike the traditional spendthrift trust, which protects the trust assets from claims of beneficiaries who did not settle or contribute property to the trust, the legacy trust protects the trust estate from most claims against the settlor. A legacy trust is an irrevocable yet flexible structure that is governed by Ohio law, provides for at least one Ohio trustee who materially participates in the administration of the trust, and requires the Ohio trustee to maintain custody of at least part of the trust assets. Furthermore, any contributor to the legacy trust must provide the trustee with an affidavit of solvency.

The legacy trust structure will thwart would-be creditors in all but a few cases. First, for reasons of sound public policy, exceptions are made for claims against the transferor to the trust relating to support of children and support of a previous spouse or a current spouse as of the date of settlement. There is also an exception for valid property claims of such a spouse on divorce. A person who marries the settlor after the transfer to the trust, however, has no support or property rights against the trust estate. Furthermore, no claims for forced heirship are permissible.

A claimant against a transferor to the trust – including one holding a foreign-money judgment that is not related to governmental taxation, fines or penalties and does not involve spousal or child support – can void the transfer if the claimant can prove by clear and convincing evidence that the transferor had the intent of defrauding the claimant bringing the action. As to claims arising post-transfer, there

is a firm 18-month limitation period. Furthermore, for claims in existence as of the date of transfer, including unaccrued and contingent claims, the claimant must bring the action within 18 months of the transfer or within six months of the date on which the creditor knew or should have known that the transfer occurred, whichever is later. To provide a firm statute of repose, however, the *Legacy Trust Act (2013)* contains two further limiting provisions on pre-transfer claims. First, notice of the claim must be served on the transferor within three years of the date of disposition to the legacy trust. Second, the statute provides a mechanism for recording the transfer of movable or immovable property to the trust in official public records, and such recording serves as notice to the world. As a result, a disposition in trust that is disclosed on the date of transfer should be free of claims after 18 months, even if a claim arose before the transfer.

Despite the irrevocable nature of a legacy trust, the settlor may nonetheless retain certain powers and interests. This includes the right to receive trust income or discretionary distributions, whether or not determined according to a standard, and to veto discretionary distributions to other beneficiaries. Furthermore, the settlor may retain the power to remove the trustee and any advisor or protector and replace that person with any party other than the settlor. The settlor is also permitted to direct the investments of the trust, subject to fiduciary duties.

Tax neutrality

Ohio does not impose its income tax on an irrevocable inter vivos trust that is settled by a non-resident of the state. Thus, foreign families will find a tax-friendly environment in Ohio.

Although under US income tax law the trust would normally be considered ‘domestic’ and be subject to federal taxation, as would any other American resident, the trust can easily be structured to be classified as foreign. To achieve this, a non-US person must hold at least one significant power under the trust instrument.

For example, if the trust protector or distribution advisor is not a US citizen or resident, the trust is classified as ‘foreign’. As such, the trust will be considered a mere ‘non-resident alien’ taxpayer subject to limited taxation, in the same way as any other foreign person. For a typical trust investment portfolio, such taxation is in most cases limited to tax on dividends paid by US corporations (but not on capital gains) and on rents and gains from US immovables. Treaty relief may be available to the trust, as it is for a foreign individual. An example of this would be the India-US tax treaty.

If a beneficiary of a foreign-classified trust is a US citizen or resident, this beneficiary would be subject to adverse US tax and reporting requirements. To avoid this, the trust can be structured as a ‘grantor’ trust for US purposes by setting a share of the trust aside for the US beneficiary and reserving in the settlor the ability to revoke that portion.

Final thoughts

The stability, favourable laws and tax neutrality of Ohio make it a worthy trust jurisdiction.

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