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Brazilians, Trusts and Moving to the US

Wealth Management Webinar Series | 10 September 2020



Presenters



Ceci Hassan
Partner | Miami

+1 305 789 8939
cecilia.hassan
@bakermckenzie.com



Flavia Gerola
Associate | Sao Paulo

+1 212 626 4495
flavia.gerola
@trenchrossi.com

Agenda

- 1 Brazilian Tax Reform
- 2 US Pre-immigration Planning for Brazilians
- 3 Brazilian Taxation of Trust Beneficiaries





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Brazilian Tax Reform



Tax Reform in Brazil is occurring in Phases:

Current Scenario



Several taxes and taxation based on “consumption”



Conflicts of jurisdiction between the federal government, States and Municipalities on the tax levied on a great number of transactions.



Excessive bureaucracy and litigation: ancillary obligations, costs to comply with tax obligations and long judicial procedures;



Main tax reform proposals in Brazil:

- General proposal: simplification and combination of all indirect taxes (federal, state and municipal) currently imposed on consumption into one single tax (the so-called “CBS” a “unified VAT”);
- Main: (1) PEC No. 45/2019; (2) PEC No. 110/2019 and PL 3887/2020.

Potential Changes to the Taxation of Individuals

Dividends

- Currently: exemption on dividends distributed from Brazilian companies
- Proposal: 15% tax rate

Closed-end funds

- Current advantages: tax deferral on accumulated gains, estate planning (usufruct of the quotas) and professional management
- Proposal: automatic taxation on earnings despite distribution to the quota holder
- Controversial: heavy burden on the first year of the automatic taxation

Transfer Tax

- Two proposals in the state of Sao Paulo, main points of attention:
- (i) increase the tax rates from 4% to 8%,
- (ii) taxation of pension plans,
- (iii) changes on the calculation basis over the transfer of companies interests (potential revaluation of assets held by the company) and real estates.

Wealth Tax

- Lack of Complementary Law
- 18 Bills of Law on going
- Tax rates range from 0,5% up to 3%
- Threshold: proposals vary from BRL 5 MM to BRL 50 MM (Brazilian and foreign assets)

Still uncertain...

- Revocation of income tax exemption over gifts and inheritance;
- CFC rules in Brazil



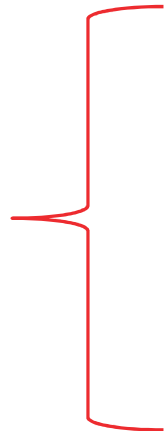
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US Pre-immigration Planning



Practical example:

A Brazilian couple resides temporarily in the USA on a student visa (F1). After one year in the US they decide to stay permanently



Financial assets in Brazil



Assets abroad



Provide consulting services for their family business (in Brazil) in the USA

Goals of US Pre-Immigration Planning

US Federal INCOME Tax Planning	US Federal ESTATE Tax Planning
<u>Minimize GLOBAL & US Income Taxation upon becoming US</u> <ul style="list-style-type: none">▪ Basis step-ups<ul style="list-style-type: none">▪ Sale / churn assets▪ “Check the box” elections▪ Foreign Tax Credit Planning<ul style="list-style-type: none">▪ Assets held directly▪ Flow-through structures▪ Anti-deferral rules<ul style="list-style-type: none">▪ <i>Controlled Foreign Corporations (CFCs)</i>▪ <i>Passive Foreign Investment Companies (PFICs)</i> <p>➤ <u>Brazilian Funds?</u></p>	<u>Protect Assets from US Federal Estate Tax</u> <ul style="list-style-type: none">▪ Trusts<ul style="list-style-type: none">▪ Excludable▪ Gifting

Who is considered a tax resident in Brazil?

Brazilian Resident	Brazilian Non-resident
<ul style="list-style-type: none">▪ <u>Brazilian citizens living in Brazil;</u>▪ <u>Brazilian residents living abroad for the first 12 months subsequent to their departure, in cases where no tax clearance certificate was filed;</u>▪ Naturalized foreign nationals;▪ Foreign national holders of permanent visas and holders of temporary work visas under an employment contract with a Brazilian entity as of the date of entry to Brazil with such visa;▪ Holders of temporary visas without an employment contract with a Brazilian entity after completing 183 days of actual physical presence in Brazil within any 12-month period.	<ul style="list-style-type: none">▪ Individuals who do not reside in Brazil with a permanent manner;▪ <u>Individuals who left the country and on the day of the departure submitted the Definitive Exit Statement before the tax authorities;</u>▪ Individuals subject to non-resident conditions who enter Brazil to provide services as an employee of a foreign government agency located in the country;▪ Individuals entering Brazil on a temporary visa:<ul style="list-style-type: none">a) Who remain in the country up to 183 days, consecutive or not, for a period of 12 months;b) Until the day before the permanent visa obtained or the employment relationship established, if it occurs before completing 184 days, consecutive or not, of staying in Brazil within a period of 12 months▪ <u>Individuals absent from Brazil for more than 1 year.</u>

Brazilian Tax filings obligations upon Exit from Brazil:

- **Definitive Exit Communication:** provides the date of the definitive exit. To be file on departure or by February 28 of next year. A proxy shall be appointed for tax purposes.
- **Definitive Exit Return:** very similar to Income Tax Return.
- **Individuals that must comply with this obligation:**
 - Individuals who permanently left the country during the calendar year; and
 - Individuals who temporarily left the country and remained abroad for more than 12 consecutive months.



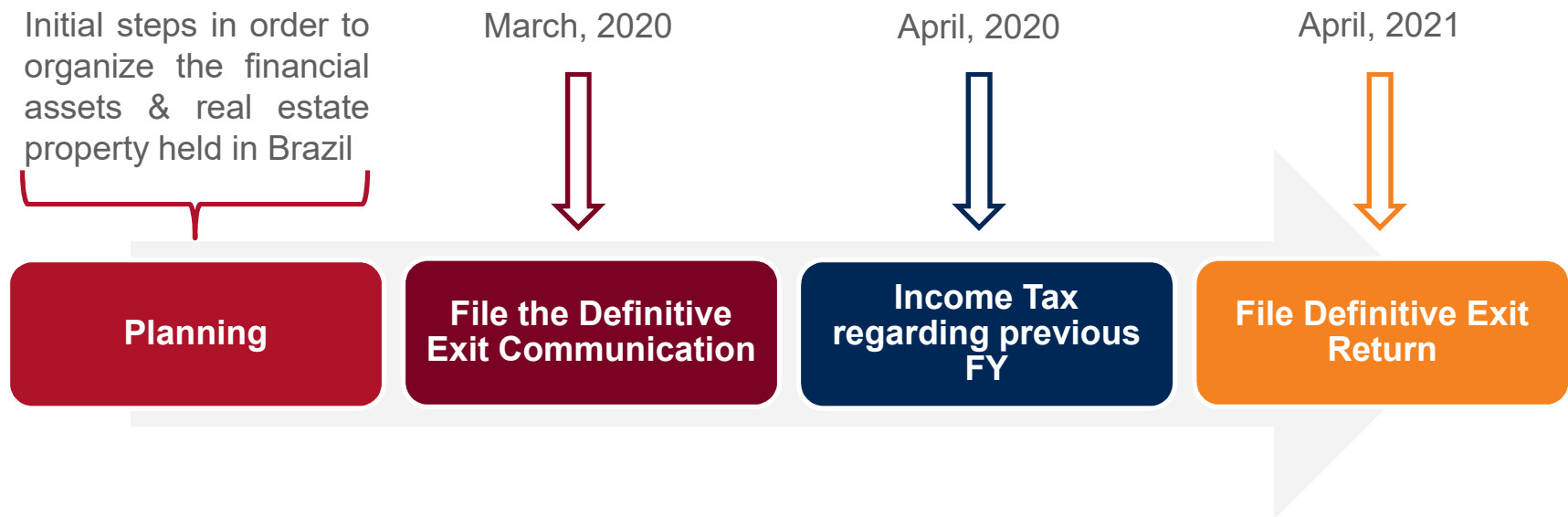
The Administrative Court of Appeals recently decided that an individual who has **continuously filed the Income Tax Return in Brazil** and that never filed the Exit Return should be deemed as tax resident in Brazil, notwithstanding the evidences that he has been living in Portugal for almost 20 years. As a result, the individual was required to collect Income Tax over its income received in Portugal, added with interest and 75% penalty.

What to do with the Brazilian assets?

- **Interests in Brazilian companies:**
 - US – Classification of the Company in the US
 - Directors must be a Brazilian resident;
 - Symbolic exchange transactions and financial transaction tax (“IOF”);
 - Foreign shareholders registry at Brazilian Central Bank.
- **Bank accounts and financial investments:**
 - US – Review of investments and classify investments (Funds!), and consider sale, gift or liquidation
 - transfer the investments to **(i)** specific bank account for non-residents or **(ii)** special investor account under the rules provided by Brazilian Central Bank (Bacen) Resolution No. 4,373 (so called “Investor 4,373”);
 - Potential tax effects on the transfer of the investments.
- **Real estate in Brazil**
 - US – Foreign Tax Credit Planning (US capital gains tax rate 20%)
 - The non-resident may maintain real estate property in Brazil at the individual level or transfer to a Brazilian holding company;
 - Potential tax impact upon transfer of real estate and rental income.

Practical example, Brazilian Reporting:

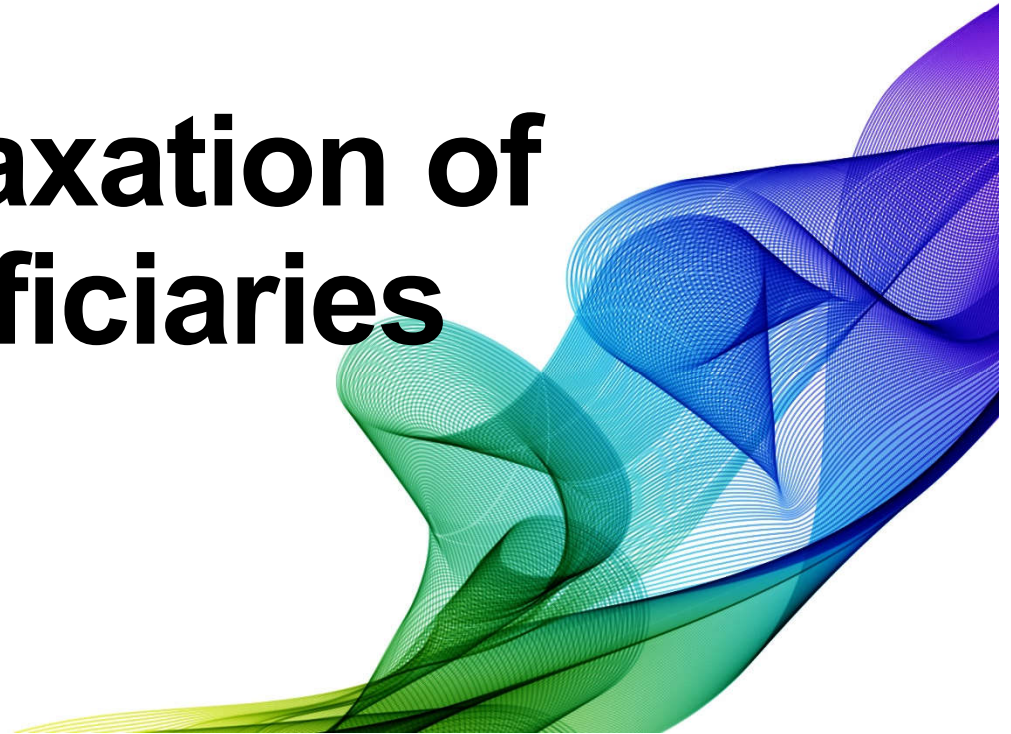
A Brazilian resident moves to the US permanently in March, 2020:





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Brazilian Taxation of Trust Beneficiaries



Tax treatment of trusts before PLR 41/2020



Tax treatment of trusts in Brazil: Controversial

Trusts are not recognized in Brazil

- Multiple tax treatments that would apply: (i) gift/ inheritance, (ii) capital contribution, (iii) earnings/ interest account;
- Specific characteristics need to be considered: nature of the assets, powers of settlor, trustee and beneficiaries;
- Brazilian Central Bank: Beneficiary's duty to keep reporting the entity abroad (annually or quarterly).



Trust/foundation reported in DERCAT (Amnesty tax return):

- Brazilian IRS provided reporting guidance for the first time.
- Dercat: report the value of the assets in the trust, option to declare the trust as "transparent";
- Reporting obligation: beneficiary or the settlor;
- Recommendations:
 - Assets on 31/12/14 or 30/06/2016: analyze whether it is possible to transfer to capital account;
 - Distributions to Settlor: Segregate in two accounts (i) capital and (ii) income;
 - Attention: Different understandings about this structure in BR.
 - Post-Amnesty: replacement by Will?



Tax treatment of trusts after PLR 41/2020

- **Still controversial, but ...**
- **March/2020:** 1st time Brazilian IRS analyzed the tax treatment of distributions from trusts to BR beneficiaries;
- **Facts:** beneficiary of a trust in Bahamas (husband was the settlor) questioned whether the amounts received from the trust due to the death of her husband should be subject to Individual Income Tax or Estate Tax in Brazil.
- **BR IRS held that:**
 1. Adopted the concept provided in art. 2 of the Hague Convention, to which Brazil is not a signatory: a trust is a legal relationship created inter vivo or after death, in which the grantor places his assets under the control of a trustee for the benefit of a specific beneficiary or purpose;
 2. IRS clarified the concepts of settlor, trustee and beneficiary and trust deed;
 3. Estate Tax out of Brazilian IRS scope;
 4. Distributions should be characterized as a “foreign income”, subject to monthly payment (so called “*cartão-Leão*”) under the ordinary income tax rate (up to 27.5%).
- **Take away / thoughts:**
 - Each situation must be analyzed individually, taking into account, among other facts, the actual instrument for the incorporation of the structure abroad and the form of contribution and segregation of the relevant assets;
 - The potential income tax exemption on the amounts received as inheritance/gifts was not analyzed, for the assets contributed to the trust;
 - Accounting and proper documents are relevant.



Questions





Estate Planning with Third-Party and Self-Settled Asset Protection Trusts

Wealth Management Webinar Series | September 10, 2020

Glenn Fox and Olga Sanders



Presenters



Glenn Fox
Partner | New York

+1 212 626 4689
glenn.fox
@bakermckenzie.com



Olga Sanders
Associate | New York

+1 212 626 4495
olga.sanders
@bakermckenzie.com

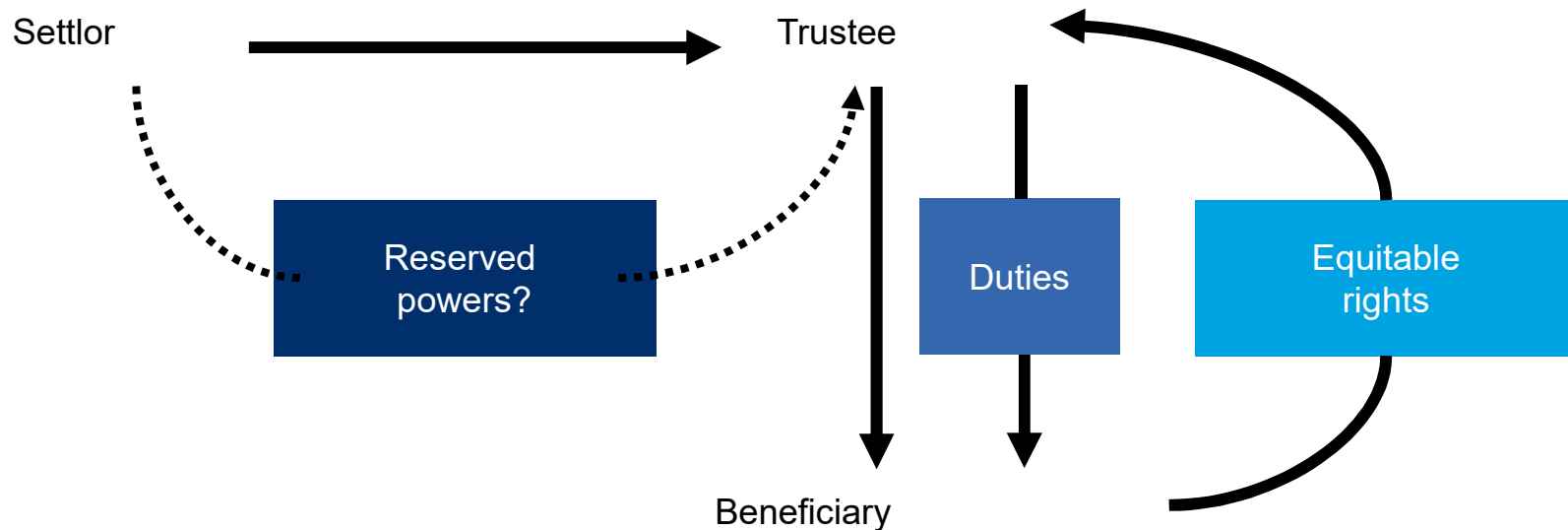
AGENDA

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WHAT IS A TRUST?

GENERAL LEGAL DEFINITION IS FOUND IN HAGUE CONVENTION:

For purposes of this convention, the term “trust” refers to the legal relationships created inter vivos or on death by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specific purpose.



WHY USE TRUSTS?

Trusts can accomplish many different objectives because trusts are often customized to fit planning needs. Among these objectives are (we are touching upon those in red in this presentation):

- **Transfer Tax Minimization**
- Avoidance of probate
- **Achieve estate planning goals**
- **Implement succession planning**
- **Income tax planning**
- **Creditor protection (asset protection trusts)**
- Administration of funds or gifts

ASSET PROTECTION TRUST (A.P.T.)

- Can be a self-settled or a third-party settled trust
- Self-settled trust – the settlor can benefit from the trust
- Third-party settled trust –beneficiaries other than the settlor can benefit from the trust (e.g., spouse and descendants)
- May be set up offshore or under the laws of a U.S. state (D.A.P.T)

DOMESTIC ASSET PROTECTION JURISDICTIONS

- Since 1997, nineteen states have enacted legislation extending spendthrift protections to a settlor-beneficiary of a discretionary trust:

- Alaska (first usable D.A.P.T. statute)
- Colorado
- Connecticut
- Delaware
- Hawaii
- Indiana
- Mississippi
- Missouri
- Nevada
- New Hampshire
- Ohio
- Oklahoma
- Rhode Island
- South Dakota
- Tennessee
- Utah
- Virginia
- West Virginia
- Wyoming

DOMESTIC SELF-SETTLED ASSET PROTECTION TRUST

D.A.P.T. statutory requirements vary from state to state. Typically:

- Irrevocable trust (cannot alter or terminate).
- Independent trustee.
- Connections to the state: (e.g., at least one trustee that is resident of the jurisdiction where the trust is formed, some of trust assets within the jurisdiction, administration and recordkeeping within the state).
- Settlor may be included in the class of discretionary beneficiaries so long as settlor has no mandatory rights (trustee has full discretion in terms of making distributions to settlor and any other beneficiaries, some jurisdictions allow distribution standards).

DOMESTIC SELF-SETTLED ASSET PROTECTION TRUST (cont'd)

- “Spendthrift clause”: prevents creditors from accessing the trust’s assets to satisfy the settlor’s debts or other financial obligations (without a D.A.P.T. statute, spendthrift protections are not available).
- Expressly state that validity, construction and administration of the trust are governed by the laws of a D.A.P.T. state.
- Creditors cannot enforce claims unless a fraudulent transfer or a statute of limitations is running.
- Settlers may retain some powers (e.g., veto, investment decisions, limited testamentary power of appointment) – but must be careful that tax purposes are accomplished.

REASONS FOR USING SELF- SETTLED D.A.P.T.

Transfer tax minimization:

- The idea of making an outright gift to a child or trust for the benefit of a child in order to reduce the size of one's estate, is an obstacle for many taxpayers since they do not want to relinquish the ability to personally benefit from the property.
- Generally speaking if a person transfers assets to a fully discretionary trust for their own benefit, and appoints an independent trustee, the settlor will be deemed to have a "retained interest" in the trust assets, since the laws of most states allow the creditors of a settlor to satisfy their claims from such a self-settled trust.

REASONS FOR USING SELF- SETTLED D.A.P.T. (cont'd)

Transfer tax minimization (cont'd):

- If a settlor has a retained interest in a trust, the trust assets are still included in the settlor's estate.
- However, if a self-settled trust is created in a jurisdiction or state with asset protection trust laws, the creditors should not be able to access the trust assets.
- In this case, so long as the trust is a fully discretionary trust as to the settlor, the A.P.T. should remove all of the assets (and any future appreciation) from the settlor's taxable estate.

REASONS FOR USING SELF- SETTLED D.A.P.T. (cont'd)

Protecting assets from potential future creditors:

- Especially useful for groups of people who have greater risk or exposure, e.g., doctors, lawyers, accountants, investment advisors and high-level executives of public companies.
- Some jurisdictions protect against an ex-spouse being able to reach the trust assets to satisfy alimony and/or property settlement claims.

THIRD-PARTY ASSET PROTECTION TRUSTS

- Settlor cannot benefit from the trust.
- Discretionary beneficiaries (if distributions are not discretionary, creditors may compel distributions).
- “Spendthrift clause”: prevents creditors from reaching the trust’s assets to satisfy the beneficiaries’ debts or other financial obligations.
- Powers of the beneficiaries under the trust instrument must be circumscribed .

REASONS FOR USING THIRD-PARTY A.P.T.

Instead of giving assets to beneficiaries outright, there are a number of advantages to having the assets held in trust for the benefit of the beneficiary:

- Greater control over how the assets are consumed and utilized by the beneficiary (allow distributions only upon achieving certain milestones or for certain purposes).
- Planning for minor children; planning for problem children; planning for changing circumstances.
- Creditor protection for the beneficiary (e.g., former spouses).
- Transfer tax minimization: if assets are retained in multigeneration “dynasty trusts,” the assets (and all further appreciations) will escape further transfer taxation (current exemption amount is \$11.58 million per spouse).

THIRD-PARTY ASSET PROTECTION TRUSTS

- Unlike self-settled A.P.T.s, third-party A.P.T.s can be settled in any jurisdiction (but must contain the spendthrift clause unless settled in a jurisdiction treating trusts as spendthrift by default).
- D.A.P.T. jurisdictions are typically desirable because they have favorable trust features (e.g., no rule against perpetuities, no income tax, enforceable in terrorem clauses, directed trustee, trustee decanting authority to modify the trust, etc.).
- In addition, some D.A.P.T. jurisdictions prohibit creditors from reaching assets subject to a presently exercisable general power of appointment held by a non-settlor beneficiary

COMPARING A FEW D.A.P.T. STATUTES

	Statute of Limitations (Existing Creditor)	Statute of Limitations (Future Creditors)	Exception for Ex- Spouses?	Provision for Decanting Trust Into State?	Allowable Duration of Trusts
Alaska	4 years or 1 year after transfer was or could reasonably have been discovered	4 years	No exception for alimony; exception for property division upon divorce if assets were transferred during or less than 30 days prior to marriage	Yes	Up to 1000 years
Delaware	4 years or 1 year after transfer was or could reasonably have been discovered if claim based upon intent to defraud	4 years	Exception for alimony and property division if ex-spouse was married to settlor before or on funding of trust	Yes	No limit for personal property; 110 years for real estate
Nevada	2 years or, if longer, six months after transfer could reasonably have been discovered if claim based on intent to defraud	2 years	No	Yes	Up to 365 years

DON'T YOU DARE CHALLENGE MY WILL OR TRUST... IN TERROREM CLAUSES

- An in terrorem clause discourages disgruntled beneficiaries from filing litigation to thwart the decedent's estate plan by challenging the validity of the Will and/or Trust.
- Typically enforceable with exceptions for good faith and probable cause, but strictly construed.
- State law varies on favorability (Alaska enforces in terrorem clauses even if the legal action is instituted and maintained in good faith and based on probable cause, New Hampshire has broad enforcement provisions).

TRUST TAXATION DIFFERS AMONG STATES

- States that do not impose any income taxes on trusts are Alaska, Florida, Nevada, New Hampshire, South Dakota, Texas, and Washington.
- Examples of states that do impose income taxes on trusts, but have flexible exceptions, are Delaware, New York, and New Jersey.

CHOOSING JURISDICTION: FOREIGN AND DOMESTIC A.P.T.s

- Historically, A.P.T.s were settled in foreign jurisdictions: Cayman Islands, Jersey, Cook Islands, Nevis.
- More and more U.S. states adopt D.A.P.T. statutes and D.A.P.T.s are utilized by both U.S. and foreign settlers.

ADVANTAGES OF D.A.P.T.s COMPARED TO OFFSHORE ASSET PROTECTION TRUSTS

- Use of offshore trust generally highlights the settlor's motive of seeking principally "asset protection" and may give rise to inference that transfer is a fraudulent transfer (as offshore trusts historically have not been traditional gift and estate planning vehicles for US persons).
- For U.S. settlors greatly enhanced US tax reporting with respect to offshore trusts, including FATCA reporting.
- Concerns about political security and economic stability of non-US asset protection jurisdictions.

ADVANTAGES OF D.A.P.T.s COMPARED TO OFFSHORE ASSET PROTECTION TRUSTS (cont'd)

- Generally, more expensive to establish and maintain offshore trusts than U.S. trusts.
- Foreign settlors of third-party APTs can take advantage of favorable trust features in a D.A.P.T. jurisdiction without exposure, during their lifetime, to the income tax regime applicable to U.S. Persons.
- In case of U.S. Person beneficiaries, no enhanced reporting and no punitive foreign non-grantor trust tax regime upon death of foreign settlor.

SELF-SETTLED D.A.P.T. CHALLENGES

Potential override of states' asset protection trust statutory protections when the settlor does not reside in a D.A.P.T. jurisdiction because of:

- Conflicts of laws:
 - The settlor's state of residence may have a strong public policy against D.A.P.T. asset protection
 - Settlers should not transfer real estate in a state without D.A.P.T. laws to a trust created in a D.A.P.T. state, since courts of former state will likely not respect the trust
 - *In re Huber*
- "Full Faith and Credit Clause" – may be not followed if trust property is not located in a D.A.P.T. state.
- "Supremacy Clause" – federal courts do not have to follow state law.

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QUESTIONS?

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