Offshore Planning

What Does the U.S. Have Against Foreign Countries?

By Eric E. Kalnins

We are told as Americans to be global thinkers and to reach out to the rest of the world with our time, efforts and charity. Unfortunately, once we attempt to do so we are often unfairly accused of outsourcing jobs and trying to hide money in "secret" offshore accounts. Why does there exist the expectation that everyone else in the world is supposed to bring their money to the United States while we are to be shunned for taking our money and business offshore?

As an attorney that assists clients with their offshore matters ranging from the establishment of an Anguilla international business company to a Nevis offshore trust, it always surprises me to hear the uninformed comments from people when offshore matters are discussed. From the client that states, "I could never go offshore" to the bystander that quips that all offshore money is hidden in secret Swiss bank accounts, the legitimate business opportunities of the world are being overshadowed by the tax cheats, drug smugglers and money launderers that make for good headlines.

I have generally found there to be three types of people that go offshore: (1) tax cheats or scammers looking to hide money (avoid them at all cost); (2) individuals that do not intend to violate the law but are unaware of the various disclosure and compliance requirements; and, (3) fully compliant individuals that set-up structures or businesses to hold funds offshore. Although we occasionally run into the second category of individuals–particularly with regard to the IRS Voluntary Disclosure Program–we prefer to be involved from the beginning of any offshore planning to avoid the myriad of potential disclosure and compliance traps.

The reasons individuals go offshore really run the gambit. Reasons range from offshore business opportunities, estate planning and asset protection, to individuals that simply have a general distrust of American laws and society, including the threat of religious and/or ethnic persecution. Whatever the reasoning, legitimate offshore planning has nothing to do with secret accounts. Rather, good offshore planning is one of the most transparent types of transactions that exist, particularly with regard to the IRS.

The IRS has a growing number of disclosure requirements for offshore planning. One of the major disclosure requirements, IRS Form TD F 90-22.1, is a form that must be filed by anyone having signature authority or a "financial interest" in an

offshore account or accounts that aggregate a balance in excess of $10,000 during the year. If such an account exists, the individual with signature authority or financial interest must disclose the account to the IRS by June 30th of the following year. Failure to do so can result in stiff penalties and potential criminal prosecution. Unfortunately, a large number of law-abiding citizens (and probably many people reading this article) have no idea that such a requirement exists, and that their lives can be turned upside down by failing to comply with this requirement. The recent UBS matter, which largely involved the nondisclosure of foreign accounts, prompted the IRS to provide an opportunity for anyone with undisclosed offshore accounts to "come clean" pursuant to the IRS Voluntary Disclosure Program (the program ended last October).

Of course, there are those individuals that believe that they can simply setup an offshore corporation and never pay taxes again. Those are the types of individuals to avoid, though they are in my experience no more common in the foreign sector than they are in the domestic sector. Fraudulent individuals recognize no borders.

While tax evasion is certainly not permitted, tax avoidance and tax deferral opportunities are a different matter. Tax deferral, through the use of an offshore corporation, can be complicated and requires several careful considerations, including: whether or not the corporation will be considered a controlled foreign corporation ("CFC"); where the income will be sourced from (i.e., U.S. or a foreign country); what kind of income is involved (Sub-Part F income, PFIC, Personal Holding Company Income etc.); and whether or not offshore income can be deferred until a distribution is made to repatriate the money to the U.S. This type of planning can be invaluable to individuals that wish to compile profits in a low tax jurisdiction and defer U.S. taxation until the funds are distributed to the U.S. But once again, offshore corporate planning has its own tax and disclosure requirements ranging from the disclosure of the capitalization and transfer of assets to the corporation (IRS Form 926) to reporting requirements (IRS Form 5471–Annual Information Return), which must be filed each year regardless of income to avoid an annual penalty of $10,000. Many of the same disclosure requirements also exist in the partnership realm.

Proper disclosure is probably the most important element to consider when engaging in offshore planning. Nowhere in the offshore world is this more apparent than in dealing with offshore trusts. Clients organize offshore trusts for estate planning, investment and asset protection purposes. In our litigious society some individuals are more comfortable knowing that they can establish an offshore "start over" fund consisting of only a portion of their net worth that can be distributed to themselves or their loved ones pursuant to the fund's estate planning provisions.

Once again, many clients are adverse to the idea of offshore trusts because of either (1) the negative connotation offshore trusts receive by the general uninformed public or (2) the idea that one is relinquishing title to his or her own assets to a foreign trustee (though through the insertion of a trust protector, one can alleviate much of this concern). What people do not realize is that transparency is even more prevalent in a properly organized and administered offshore trust.

Furthermore, the laws of foreign nations may be advantageous in various respects, including: the nation's recognition (or lack thereof) of foreign judgments, requirements that lawsuits be tried in the foreign nation and pursuant to its laws, favorable statute of fraud provisions or bond posting requirements, and shorter statutes of limitations, among other things. Still, on the disclosure end, everything about these structures is extremely transparent and disclosure-friendly to the IRS and potential creditors. From funding of the trust pursuant to IRS Form 3520, to the annual tax return and the designation of a domestic agent for the purpose of responding to governmental inquiries (as well as disclosure of any account pursuant to IRS Form TD F 90-22.1), the U.S. government and potential creditors know exactly what is in the trust and where the trust is located. However, the foreign laws of the *situs* of such trust must be respected. Barring any fraudulent conveyance issues, the foreign trust is completely inapposite of a secret offshore account and does not depend in any way shape or form on nondisclosure or the "hiding" of assets.

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Conclusion

Offshore opportunities truly are a different world when compared to typical domestic structures. However, individuals should not limit their business, estate planning and asset protection options for fear of being unjustly labeled a "tax evader." The internet and relative ease of international travel have made the world a much smaller place. Billions of people, potential ideas and potential clients exist beyond our borders. From establishing a holding company in Luxembourg or the Netherlands, to the organization of a Chinese corporation, our world market is changing quickly and clients must be made aware of all of their options.

At the same time, expectations must be set with the client to make them aware that while many advantages to offshore planning may be obtained under the right circumstances, disclosure and strict compliance with U.S. law must be followed. Your potential dealings with the IRS depend on it. ■

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