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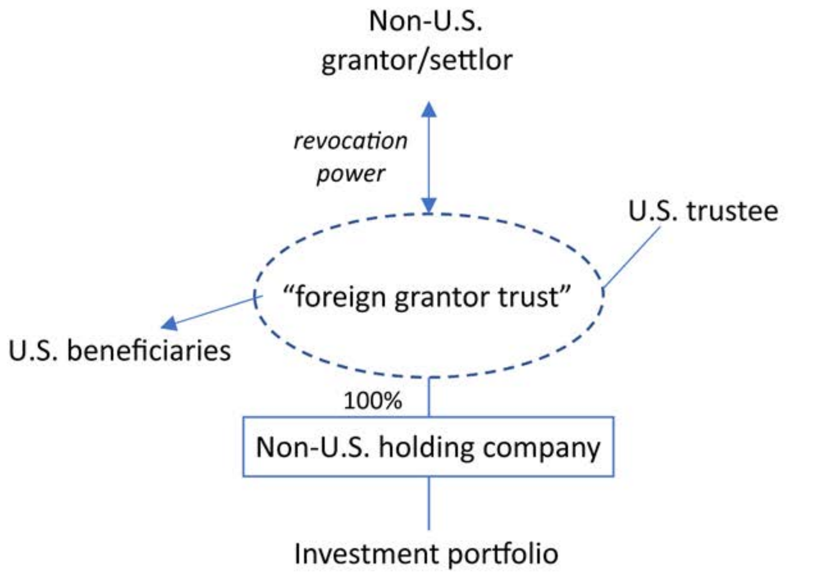
In this article, the authors discuss tax and securities law issues in inbound private client structures that could catch U.S. private advisers and their clients by surprise.

Non-U.S. individuals and families increasingly look to hold assets in the United States for many reasons, including the perceived stability of the U.S. economic system and adherence to the rule of law. Often, clients intend to use asset-holding structures to invest in U.S. and non-U.S. financial assets, and in many cases, the ultimate holding structure is a trust with a U.S.-based trustee. U.S. private client advisers nimbly weave their way through U.S. tax law applicable to trusts and their beneficiaries to allow clients to place assets with U.S. trustees but avoid creating U.S. resident trusts that would be subject to worldwide U.S. tax on investment income. However, while the tax principles of those structures are sound, implementing the client's investment objectives may reveal traps for the unwary that can lead to unnecessary or unexpected tax on investment income or limited investment options.

This article discusses possibly unanticipated tax and securities law issues in inbound private client structures that U.S. private client advisers and their clients should be aware of. Many variations are possible, but this article discusses two structures we commonly see in practice: a foreign grantor trust with a foreign corporate holding company, and an irrevocable foreign non-grantor trust with a foreign protector.

Figure 1. Prototypical Structure 1: Foreign Grantor Trust With Foreign Corporate Holding Company



Note: Oval with dotted lines indicates tax transparent entity for U.S. tax purposes; rectangle with solid lines indicates U.S. tax opaque entity.

Foreign Grantor Trust

In our experience, a foreign grantor trust is often used when the foreign grantor's heirs are U.S. persons.[1] (See Figure 1.) If the foreign grantor would be subject to U.S. estate tax on the value of the trust's U.S.-situate assets on death, a foreign corporate holding company (Forco) may be used to block that estate tax exposure. A company structure is also often desirable to trustees for nontax reasons such as liability protection and centralized investment management. In principle, an irrevocable foreign grantor trust could be structured to provide estate tax protection without using a foreign corporate holding company, but in practice we usually see foreign corporate holding companies being used instead.[2]

Like any non-U.S. investor, Forco can acquire non-U.S. stocks, bonds, exchange-traded funds (ETFs), and mutual funds,[3] but because it is a U.S.

[1] A full discussion of the foreign grantor trust rules is beyond the scope of this article; however, briefly, a foreign grantor trust is a trust whose assets are treated as owned by a nonresident alien under the grantor trust rules of IRC sections 671-679 and for which the special limitation of section 672(f) is satisfied because the grantor can revoke the trust, or because trust distributions may be made only to the grantor or the grantor's spouse during the grantor's life. A foreign grantor trust is favorable for U.S. beneficiaries because during the grantor's life, distributions of trust income are not subject to adverse throwback rules that can result in high, potentially confiscatory U.S. tax. Further, during the grantor's life, trust income is taxed to the grantor, and neither the controlled foreign corporation nor the passive foreign investment company rules will apply to adversely tax the U.S. beneficiaries. That favorable tax treatment generally ceases when the grantor dies. Additional planning is then required to mitigate the impact of the throwback, CFC, and PFIC rules and might include domesticating the trust to the United States, which is greatly simplified by having a U.S. trustee already in place.

[2] For simplicity, we have assumed a single foreign corporate blocker. In practice, client structures often have more than one blocker. For example, if the structure holds both U.S. estate taxable and non-estate taxable investments, it can be more efficient to hold those categories of investments in separate blockers to facilitate post-death tax planning. Further, because the Tax Cuts and Jobs Act eliminated the 30-day rule for CFCs, some planning techniques now involve the use of multiple foreign corporations. In all cases, it is critical to review the structure periodically during the grantor's life and consider appropriate planning after the grantor's death to ensure the U.S. beneficiaries are minimally exposed to adverse CFC and PFIC rules. Similarly, if the structure owns a U.S. corporation, it would be important to consider any planning that could make the structure more tax efficient after the grantor's death.

[3] In this article, if the context does not indicate otherwise, we use the term "mutual fund" to refer to liquid publicly offered collective investment vehicles that are not listed on an exchange, the term "ETF" to refer to publicly offered collective investment vehicles that are listed on an exchange, and the term "fund" standing alone without further description to refer to both ETFs and mutual funds. For avoidance of doubt, this article does not address private investment vehicles such as hedge funds, private equity funds, and private credit funds (often called "alternative investments" that do not have daily liquidity). Illiquid alternative investments have their own set of potential tax traps and, as a result, alternative structures may need to be considered for those investments.

estate tax blocker, Forco can theoretically also acquire U.S. stocks, ETFs, and mutual funds.[4] Clients who use these structures often intend for Forco's portfolio to hold both U.S. and non-U.S. investments. However, various factors can make a tax-efficient diversified investment portfolio across many asset classes more difficult to achieve than anticipated.

Reason 1: Mutual Fund Business Practice

As a matter of policy or practice, some U.S. mutual funds will not admit non-U.S. investors to avoid additional administrative burdens, such as U.S. withholding tax and reporting requirements on fixed or determinable annual or periodic income.[5] If the mutual fund's policy is not to admit non-U.S. investors for those tax and reporting reasons, having the trust invest in the mutual fund directly would not solve the problem because it would be treated as a foreign investor for U.S. tax purposes (even with a U.S. trustee).

A possible solution would be for Forco to form a U.S. partnership that makes the investment. That structure effectively brings the additional administrative burdens associated with non-U.S. investors within the client's structure and allows access to the mutual fund, albeit in exchange for increased structural costs and complexity.[6]

One way that could be structured is for Forco to wholly own one U.S. limited liability company (LLC1), and, say, 99 percent of a second limited liability company (LLC2). LLC1 would elect to be treated as a corporation for U.S. tax purposes under the U.S. entity classification rules and would own the other 1 percent of LLC2. LLC2 would be treated as a partnership under the default U.S. entity classification rules and as a U.S. partnership would invest in the mutual fund and receive all fund income. Forco and LLC1 would be allocated their shares of the income and LLC2 would file a U.S. federal information return reporting that income. LLC2 would also have to obtain withholding tax forms from Forco and LLC1 and withhold and remit to the IRS any amounts required for Forco's share of the income.

LLC1 would have to file a U.S. federal income tax return reporting and paying tax on its share of the income and obtain withholding tax forms from, and withhold for distributions to, Forco. Because LLC1's share of income would be subject to a U.S. effective tax rate of approximately 45 percent (U.S. corporate tax plus dividend withholding tax), LLC1 would ideally have a small interest in LLC2. However, it is important that the partnership be respected for U.S. tax purposes: The size of LLC1's interest would depend on both the U.S. tax adviser's view of the required percentage and, potentially, what the mutual fund would accept. In at least one instance, we have seen a U.S. mutual fund require a side letter agreement to reassure it that the partnership will not be dissolved post-investment, leaving the fund with a non-U.S. investor.

Again, although that structure allows the U.S. partnership to invest, it effectively shifts the withholding and reporting obligations from the mutual fund to the client. However, if the investment is sufficiently attractive, the client might accept the additional U.S. tax withholding and reporting compliance costs and complexity.

Reason 2: Effectively Connected Income

Some U.S. investments generate income that is effectively connected with a U.S. trade or business. While effectively connected income is often generated by an investment in, or a sale of, a flow-through entity that is engaged in business in the United States, the sale of U.S. real estate assets or U.S. companies holding significant U.S. real estate also generates ECI under the 1980 Foreign Investment in Real Property Tax Act.

Regardless of whether Forco invests in a regular or FIRPTA ECI investment, it is subject to 21 percent U.S. federal income tax on all income

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[4] Real estate investments and investments that generate effectively connected income are discussed separately. U.S. stocks generally are subject to U.S. estate tax under section 2104(a). U.S. mutual funds and ETFs are typically structured as regulated investment companies, which are U.S. corporations and therefore treated as U.S.-situate assets for U.S. estate tax purposes. Directly held federal government and agency and U.S. corporate bonds typically are exempt from U.S. estate tax under section 2105(b).

[5] FDAP is taxed on a gross basis at 30 percent for both non-U.S. individuals and corporations. It generally includes most dividends, interests, rents, and royalties. While the U.S. withholding tax rate may be reduced by treaty, in practice those structures typically use holding companies that cannot claim benefits under any treaty. Therefore, this article assumes a 30 percent withholding on tax on dividends, interest (other than portfolio interest), and other FDAP income.

[6] The partnership would also be a U.S. person for securities law purposes and could face restrictions on investing in offshore funds. *See* securities law discussion under the Reason 4 heading, *infra*.

and a 30 percent branch profits tax[7] on amounts extracted or deemed extracted from Forco, plus any relevant state and local taxes. Because the branch profits tax is meant to put U.S. and non-U.S. corporations in similar tax positions for ECI investments, it effectively applies instead of the dividend withholding tax when non-U.S. corporations make ECI investments. Further, Forco must file a U.S. federal income tax return reporting its ECI and paying those taxes.

There are several ways to manage ECI exposure. For instance, the trust could hold ECI investments through a U.S. corporation, or Forco could wholly own a U.S. corporation that makes the ECI investments. In either case, the corporation would pay U.S. federal income tax on its income at 21 percent and withholding tax would apply to dividends at 30 percent. While the effective tax rates for ECI investments held through U.S. and foreign corporations may be similar, a U.S. corporation might allow greater control in determining when amounts are deemed extracted and therefore when the dividend withholding (versus branch profits tax) applies.

However, if a U.S. corporation is used to potentially receive or accumulate investment income, it is important to consider the accumulated earnings tax and the personal holding company tax penalty regimes. When the U.S. individual income tax rate was much higher than the corporate tax rate, U.S. corporations were put in place to take advantage of the reduced corporate tax rate; further, the company often would accumulate its income so the individual shareholder did not have to pay dividend tax on a distribution. While those rules had less relevance when the top corporate rate was 35 percent and the top individual rate was 39.6 percent, the reduced 21 percent U.S. corporate rate again widened the gap between corporate and individual rates, so they might play a larger role in future planning.

A complete discussion of those rules is beyond the scope of this article. Briefly, the accumulated earnings tax rules impose a 20 percent penalty tax on a company's accumulated taxable income in addition to regular corporate income tax and shareholder-level tax on distributions. Those rules apply if a corporation is formed to avoid shareholder-level tax and it cannot prove to the IRS that amounts accumulated in the company were for the reasonable needs of the business; that evidentiary burden is higher if the company is a holding or investment company (rather than an operating business, for example).

IRS audit guidelines for the accumulated earnings tax suggest that in considering whether the company was formed to allow shareholders to avoid the dividend tax, auditors look at dividend levels in prior years, investments of undistributed earnings in assets that are not reasonably connected with the company's business, and any loans or other arrangements through which undistributed earnings are extracted from the company. The audit guidelines also suggest that to determine whether amounts were accumulated for the reasonable needs of the business, the auditor should consider things such as necessary working capital, bona fide expansion plans or stock or asset acquisitions, business risks and contingencies, and the need to fund pension or profit-sharing plans, among other things.[8]

Under the personal holding company regime, a company with five or fewer shareholders (after applying specific attribution and constructive ownership rules) is assessed a 20 percent penalty tax in addition to regular corporate income tax and shareholder-level tax on its personal holding company income, which generally includes passive income such as dividends, interest, rents, and royalties. The two 20 percent penalty tax regimes should not apply simultaneously.

While it might be possible to structure around those possible traps, a client's U.S. adviser should

[7] While bilateral U.S. income tax treaties can reduce the rate of branch profits tax, in practice, Forco generally is ineligible for income tax treaty benefits. Therefore, this article assumes a 30 percent branch profits tax rate.

[8] While the IRS has both the accumulated earnings tax and the personal holding company regimes on its radar after the TCJA, guidance could take some time, given other agency priorities. *See, e.g.*, David J. Roberts, "Undercompensated Shareholder-Employees and the New Rate Structure," *Tax Notes*, Jan. 14, 2019, p. 165. *See also* Eric Yauch, "IRS May Need Guidance to Clean Up Older Corporate Provisions," *Tax Notes*, June 11, 2018, p. 1651; and Jonathan Curry and Nathan J. Richman, "Treasury Weighing Impact of New Law as Guidance Plan Awaits," *Tax Notes*, Jan. 29, 2018, p. 585. *See also* Cory J. Stigile, "Now I Am a C Corp: What About the Accumulated Earnings Tax?" *Tax Notes*, Apr. 15, 2019, p. 421.

consider them, given the potentially significant effect on the overall effective tax rate. In our experience, clients are sometimes advised to make ECI investments through U.S. corporations to accumulate income without being made aware of those rules.

If a foreign grantor trust holds the U.S. corporation directly, rather than through Forco,[9] the U.S. adviser also should consider whether the foreign grantor is resident in a jurisdiction with a U.S. federal estate tax treaty (there are very few). Shares in a U.S. corporation generally are subject to U.S. federal estate tax on the grantor's death, while shares in a non-U.S. corporation generally are not.

Reason 3: Unintuitive RIC Tax Rules

Investments in U.S. ETFs and mutual funds (which typically are formed as U.S. corporations that qualify as regulated investment companies) can be tax inefficient for Forco.

A bit of background is helpful here. If Forco invests directly in a portfolio of U.S. stocks, it generally will not be subject to U.S. federal income tax on short- or long-term capital gains but will be subject to 30 percent withholding tax on dividends.[10] Further, if Forco invests in U.S. federal or corporate bonds, it generally will not be subject to tax on either short- or long-term capital gains or interest.[11] Finally, if Forco invests in non-U.S. stocks and bonds, there is generally no U.S. federal income tax because non-U.S. investors generally are not subject to U.S. federal income tax on non-U.S.-source income.

While RICs must be organized as U.S. corporations, the income they earn generally is subject to one level of tax at the shareholder level because they are effectively entitled to a distribution deduction. As a result, RICs distribute substantially all of their income and gains each year (or shortly after the end of the year). For a non-U.S. investor in a RIC, like Forco, the question is how those distributions are characterized for U.S. withholding tax purposes. Depending on its investment strategy, a RIC may earn a mixture of long- and short-term capital gains, interest, and dividends. While Forco will receive favorable U.S. federal income tax treatment for its share of a RIC's long-term capital gains, that will not necessarily be the case for its share of the RIC's short-term capital gains, dividends, or interest.[12]

A RIC's long-term capital gains receive conduit treatment and are treated as passed through to the investor. Therefore, a non-U.S. investor such as Forco should not be subject to U.S. federal income tax on its share of the RIC's long-term capital gains from standard portfolio assets — that is, stocks and bonds, but not real estate or ECI assets — whether those assets are U.S. or non-U.S.

A RIC's distribution of net short-term capital gains is classified as a dividend and subject to 30 percent withholding tax, unless the RIC affirmatively elects to classify the distributions as short-term capital gain distributions. Whether a RIC makes that election is entirely within its discretion, and it may well choose not to incur the additional administrative costs to do so. If the RIC does not make the election, Forco will be subject to 30 percent withholding tax on short-term capital gains, which would have been tax free if Forco had invested directly in the underlying securities or through a non-U.S. fund.

As noted, interest paid on most U.S. federal government and corporate bonds qualifies for the statutory portfolio interest exemption from withholding tax. However, if a non-U.S. investor invests in U.S. bonds through a RIC, distributions of interest on those bonds will be subject to 30 percent U.S. withholding tax even if interest on those bonds would have qualified for the portfolio interest exemption, unless the RIC elects to classify the distributions as interest-related dividends. Again, whether the RIC makes that election is discretionary. Even if it does, the

[9] If the foreign grantor is resident in a jurisdiction that has an income tax treaty with the United States, that structure could reduce withholding tax on dividends from the U.S. corporation.

[10] This background and the following discussion address regular tax withholding under chapter 3 of the Internal Revenue Code and assumes U.S. Foreign Account Tax Compliance Act withholding under chapter 4 does not apply.

[11] That assumes the interest qualifies as portfolio interest, which is generally the case for the federal government and corporate bonds those clients typically buy.

[12] Section 852(a). A discussion of all rules applicable to RICs is beyond the scope of this article; major operational requirements and exceptions may apply. This article merely highlights material points for private client advisers in the context of those structures.

election applies only to U.S.-source interest. In other words, while Forco generally would not be subject to U.S. federal income tax on interest earned from investments in non-U.S. bonds directly or through non-U.S. funds, foreign-source interest earned through a RIC becomes subject to a 30 percent withholding tax simply by virtue of being routed through a RIC. Therefore, even if a RIC may be a suitable vehicle for U.S. fixed income exposure because it makes the interest-related dividends election, it will likely not be income tax efficient for non-U.S. fixed income investments.

RIC distributions attributable to dividends earned by the RIC are classified as dividends to Forco and subject to 30 percent U.S. withholding tax.[13] While that is essentially identical to Forco's tax position if it invested in U.S. equities directly, that is not the case for dividends on foreign stock. Importantly, a RIC cannot designate foreign-source dividends as such. In other words, while Forco generally would not be subject to U.S. federal income tax on dividends on non-U.S. stocks it holds directly or through a non-U.S. fund, it will be subject to U.S. federal income tax on foreign dividends earned through a RIC. As a result, a RIC is not generally the most tax-efficient vehicle for foreign investors with investment strategies that involve non-U.S. equities.

Further, funds formed in Ireland or Luxembourg often benefit from U.S. income tax treaties with those countries. If Forco invests in an Irish or Luxembourg fund for both its U.S. and non-U.S. equity exposure, it generally would not be subject to U.S. federal income tax on dividends for non-U.S. companies, and the 15 percent dividend withholding rate under either treaty might apply (instead of the standard 30 percent withholding rate that would apply if Forco held U.S. equities directly or through a RIC).

For those reasons, offshore funds and ETFs or direct investments in individual stocks and bonds are often a more tax-efficient solution for meeting a client's investment objectives. However, a RIC may be appropriate despite the potential income tax inefficiency, if, for example, the alternatives have high fees, are less liquid, have higher minimum investment requirements, or simply cannot achieve the same investment objective. Regardless, advisers must be aware of the potential U.S. federal income tax considerations and advise the client in making calculated, informed investment decisions.

Reason 4: U.S. Securities Law Considerations

Given the tax and fund practice considerations discussed above, non-U.S. mutual funds and ETFs may be a tax-efficient way to achieve the client's investment objectives. Because the trust is foreign, it would be subject to U.S. federal income tax only on U.S.-source income. Further, because it is a grantor trust, the CFC and PFIC regimes should not apply, at least during the grantor's lifetime. However, advisers should consider whether there are any U.S. securities law constraints that could prevent the trust from investing in non-U.S. funds or ETFs.

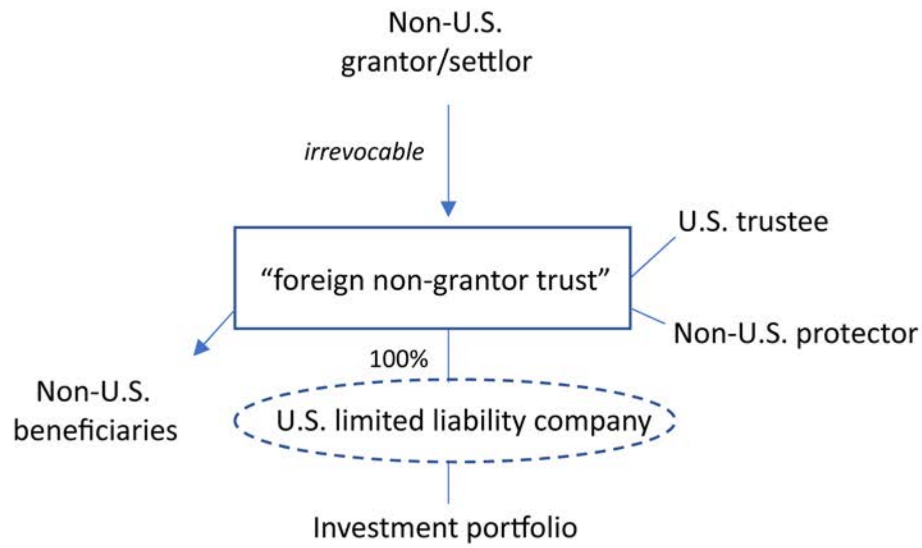
Many non-U.S. funds rely on Regulation S, which generally exempts offerings and sales that occur outside the United States from registration under section 5 of the Securities Act of 1933.[14] A full exemption analysis is outside the scope of this article,[15] but for many non-U.S. funds, an integral — and in some cases, threshold — question is whether and to what extent the offering or sale involves a U.S. person. Importantly, client advisers should be aware that the definition of U.S. person under Regulation S differs from that under federal income tax laws. For example, under Regulation S, rule 902(k)(1), a U.S. person is defined to include any natural person resident in the United States, any partnership or corporation organized or incorporated under U.S. law (including LLCs), and any trust of which any trustee is a U.S. person.

[13] U.S. investors receive conduit treatment for qualified dividends eligible for the long-term capital gain tax rate. However, for non-U.S. investors such as Forco, the dividend withholding tax rate is the same for qualified and nonqualified dividends.

[14] 17 C.F.R. section 230.901.

[15] Regulation S is unavailable to offers and sales of securities issued by open-end investment companies or unit investment trusts registered or required to be registered or closed-end investment companies required to be registered, but not registered, under the Investment Company Act of 1940. It is also unavailable for any transaction or series of transactions that although in technical compliance with the rules, is part of a plan or scheme to evade the registration provisions of the Securities Act. *See* 17 C.F.R. sections 230.901-230.905 and Preliminary Notes.

Figure 2. Prototypical Structure 2: Irrevocable Foreign Non-Grantor Trust With Foreign Protector



Note: Oval with dotted lines indicates tax transparent entity for U.S. tax purposes; rectangle with solid lines indicates U.S. tax opaque entity.

Despite rule 902(k)(1), Regulation S provides an exception to the definition of U.S. person for trusts of which any professional fiduciary acting as trustee is a U.S. person if a trustee who is not a U.S. person has sole or shared investment discretion over the trust assets, and no trust beneficiary (or settlor if the trust is revocable) is a U.S. person.

In that structure, the U.S. trustee will be a U.S. person under the Securities Act. Because that structure is often used when beneficiaries are U.S. residents, it might not be possible for the trust itself to qualify as a non-U.S. person under the exception. However, the non-U.S. holding company, through which most (if not all) investments are made, will not be a U.S. person under the Securities Act unless it was formed by a U.S. person principally to invest in securities not registered under the act.

Often, the tax adviser involved in setting up the structure was unaware of Regulation S and the securities law implications. While specific legal advice is needed in each circumstance, it would generally seem that in many cases the non-U.S. holding company should not be precluded from investing in non-U.S. funds that rely on Regulation S for SEC registration exemption.

Because other structuring options may be available depending on the intended investment allocation, the legal or tax adviser might want to consider in advance whether Regulation S (and how it is interpreted and applied by non-U.S. funds) will make it difficult for the client to implement its investment objectives.

Irrevocable Foreign Non-Grantor Trust

An increasingly common structure used by non-U.S. clients is an irrevocable trust governed by U.S. law with a U.S. trustee. (See Figure 2.) A foreign trust is one that is not a U.S. trust because it fails either the court or control tests in IRC section 7701(a)(30)(E). Although having a U.S. trustee means the trust might pass the court test for U.S. tax resident trust status, the trust is still foreign for U.S. income tax purposes if it fails the control test. The control test is failed if a substantial trust decision is not controlled by U.S. persons — intentional failure is often accomplished by having a non-U.S. person act as trust protector with the power to remove and replace the U.S. trustee.

As a foreign trust, the trust will be subject to U.S. income tax only on its U.S.-source income — even, for example, if the trustee is a Delaware institutional trustee and the trust is governed by Delaware law. While that structure would generally be tax inefficient for a trust with U.S. persons as beneficiaries, it is often used when no U.S. persons are anticipated as beneficiaries.

As with the other prototypical structure, these trusts often use a holding company, generally an LLC formed under the laws of a U.S. state, for liability protection and management centralization. Because a wholly owned LLC is a disregarded entity under the default U.S. entity classification rules, the LLC does not affect the U.S. income taxation of income and gains the LLC earns on investments.

If under the trust terms and administration, trust assets are not includable in the U.S. gross estate of the grantor or trust beneficiaries, then the structure is at least theoretically a versatile way to invest in an array of U.S. and non-U.S. vehicles to achieve the client's investment objectives without U.S. estate tax exposure.

Further, it may be possible to use a trust the assets of which are not estate-includable to invest directly in ECI investments. While the ECI would be taxed directly to the trust (which would have to file a U.S. income tax return), the trust would pay only one level of tax on ECI at ordinary rates up to 37 percent (potentially reduced by the section 199A passthrough deduction) and be eligible for 20 percent long-term capital gain treatment.

Again, however, the adviser should be aware of several tax and nontax challenges that could unexpectedly limit the universe of investment options.

Reason 1: Mutual Fund Business Practice

As described above, as a matter of practice or policy, many U.S. mutual funds will not admit non-U.S. investors. Because the mutual fund's reason for prohibiting U.S. investors generally stems from its desire to minimize its obligations to comply with U.S. withholding tax and reporting, the mutual fund will look through the disregarded LLC to the foreign trust to determine whether the proposed investor is foreign. As explained, the foreign trust may be able to use a U.S. partnership instead of the disregarded LLC, although that shifts the withholding and reporting obligations to the client's U.S. partnership, increasing the structure's costs and complexity. Further, if the trust terms and operation do not provide U.S. estate tax protection, the U.S. partnership itself might be a U.S. situs asset for estate tax purposes.

Reason 2: Unintuitive RIC Tax Rules

As described, even if the U.S. mutual fund accepts a non-U.S. investor, the manner in which a non-U.S. investor is taxed on income and gains through the U.S. mutual fund (assuming it is a RIC) may mean the investment is U.S. tax inefficient, depending on the investment objectives and fund profile. As described above, this analysis also applies to U.S. ETFs that are RICs.

Reason 3: U.S. Securities Law Considerations

In this structure, the U.S. LLC will be a U.S. person under the Securities Act because it is organized under U.S. law. As a result, many non-U.S. funds may claim that they cannot avail themselves of a Regulation S exemption and therefore avoid offering securities to those kinds of investors. Non-U.S. funds might apply a blanket rule that U.S. persons under the Regulation S definition cannot acquire interests directly or on the secondary market. Alternatively, some non-U.S. funds might allow a U.S. person to invest, but only with affirmative agreement to the exception by the fund managers or board of directors and only in reliance on some other U.S. securities registration exemption. While we have not seen any clients attempt to qualify for that kind of exception, it might be cumbersome at best and unavailable at worst.

However, unlike in the first prototypical structure, the trust beneficiaries in this structure are typically not U.S. persons under either the U.S. income tax definition or the Regulation S definition. Therefore, an adviser might want to consider whether investments in Regulation S-reliant funds might be made at the trust level under the above exception that applies to a trust with a U.S. person trustee if a non-U.S. person trustee has sole or shared investment discretion and no beneficiary (or the settlor if the trust is revocable) is a U.S. person.

One way to qualify for that exception might be for a non-U.S. family member to act as a co-trustee with sole or shared investment discretion.

Further, an adviser might consider whether a directed trust in which a non-U.S. family member holds the investment direction powers would meet the exception. In either case, consideration must be given to whether making investments at the trust level rather than at an underlying holding company level undermines other objectives of the structure.

Conclusion

While U.S. advisers are familiar with many of the complex U.S. income and estate tax provisions that apply to the two common structures discussed in this article, other more nuanced tax and nontax considerations should be taken into account in designing a structure to best serve the client's family, asset protection, and investment objectives. A careful adviser will consider the possible implications of U.S. mutual fund business practice, the quirks of the U.S. taxation of income from RICs, U.S. corporate tax penalties that may apply to passive or accumulated income, and U.S. securities law considerations. Structural changes such as adding a U.S. partnership, investing in offshore funds at the trust level with a non-U.S. co-trustee, or using a non-U.S. holding company may increase the client's investment options. It could also avoid the unpleasant surprise of implementing a structure to act as a long-term family vehicle only to realize that the client is limited in achieving her investment objectives. ■