KEY POINTS

What is the issue?

Indian migrants to the US will often maintain their connection to their home country in one form or another.

What does it mean for me?

A careful consideration of the laws of both jurisdictions is required when planning for US persons and Indian assets. Although a structuring may work perfectly from a US law perspective, it may compromise the objective of creating an estate plan in the first place from an Indian perspective.

What can I take away?

Practitioners should be alive to the onerous and undesirable consequences for US persons if estate planning does not properly factor in the regulatory and tax implications of both countries.

Strategising succession

SHABNAM SHAIKH AND EVA FARKAS-DINARDO CONSIDER PITFALLS TO AVOID FOR PRACTITIONERS CATERING TO US PERSONS INVOLVING INDIAN ASSETS

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The website **forebears.io** shows the global density of one's surname on a world map. Type in any name and the resulting map will light up in varying shades of red that indicate increasing density.

With technology making the world seem smaller, we have witnessed a surge in the migration of people across the globe. India, too, has seen an increase of migrants take off for foreign shores, with one of the most popular destinations being the US.

In the 2018 financial year, per the data released by the Department of Homeland Security in its *2018 Yearbook of Immigration Statistics*,[1] the US issued green cards to approximately 60,000 Indian citizens.

Despite the migration, many continue to maintain strong ties with their homeland. In fact, a number of them return to India permanently while holding a green card or procuring US citizenship. Such US persons (individuals living in the US/green card holders/US citizens) may be potential inheritors of Indian assets or may have extensive assets based in India. Although estate planning is a matter of substantial inertia, whenever undertaken with respect to Indian assets and US persons, the scale of US income and estate tax, along with Indian regulatory and tax implications, should be perfectly balanced.

TRUSTS IN INDIA AND TAXATION OF US PERSONS

The most common tool for estate planning in India is a trust structure, i.e. irrevocable and discretionary.

This helps in mitigating concerns surrounding asset protection and tax (including potential estate duty). When assets in a trust are settled, there is no tax in the hands of the settlor. The receipt of assets is not taxable in the hands of the trustee, provided the settlor and the beneficiaries are 'relatives' as defined under the Indian *Income-tax Act, 1961*.[2] Once the taxes on the income are paid by the trust, any onward distribution of such income is tax-free in the hands of the beneficiaries.

For US tax purposes, the concept of tax residency applies for income tax purposes and the concept of domicile applies for transfer tax purposes. US tax residents are generally subject to US income tax on their worldwide income and US domiciliaries are subject to US gift and estate tax on their worldwide assets.

Certain scenarios discussing the interplay of US and Indian laws while estate planning for Indian assets are examined below.

Settlement of Indian trust for the benefit of US persons

As noted above, there is no Indian consequence at the time of settlement of Indian assets in an irrevocable discretionary trust and/or its distribution to beneficiaries (provided taxes have been paid by the trustee). As India has robust exchange control laws – i.e. the *Foreign Exchange Management Act, 1999* (FEMA) – it is vital to plan the assets that are being settled in an Indian trust for a non-resident beneficiary. This is because, at the time of ultimate distribution of income or corpus of the trust to such person, there could be a potential FEMA implication.

From a US perspective, a trust where the settlor (grantor) is deemed to be the owner of the income and assets of the trust is referred to as a 'grantor trust'. All the income of a grantor trust is taxed in the hands of the settlor. An offshore (non-US) grantor trust that has a secondary US beneficiary will be attributed for US income-tax purposes to the non-US grantor. This may result in US tax efficiency for the US beneficiary, as such beneficiary is not deemed to be the owner for US tax purposes while the non-US grantor is still living. However, the death of the grantor (settlor) would make such a trust an offshore non-grantor trust, creating tax complexity for US beneficiaries. Such an event necessitates restructuring or migration of the trust.

Notably, there are various requirements that must be satisfied for an offshore trust to be treated as a grantor trust for US tax purposes. These rules provide a scope for structuring of an Indian trust in such a manner that it retains the characteristic of being an 'irrevocable' trust from an Indian standpoint but continues to be an 'offshore grantor' from a US tax standpoint.

> 'If an Indian trust is controlled and managed by a non-resident person, there is a concern that the ability of the Indian trust to make investments in the Indian market is suspended or limited'

Settlement of an Indian trust by US persons holding Indian assets

If the settlor is a US person not resident in India, then FEMA implication will be driven by, *inter alia*, the type of assets proposed to be settled. For instance, if the non-resident US person is proposing to settle shares of an Indian company into a trust, the settlement will be driven by a number of considerations, such as the mode of original acquisition of shares, the sector in which the Indian company is operating, etc.

The efficiency of the settlement of a non-US trust by a person with US tax indicia (such as a US green card) depends on a variety of factors, including, *inter alia*, the length of time the person has held the green card and the intention of the person to remain in or leave the US. In fact, it is possible for a person to be a US income tax resident but remain a non-domiciliary for US estate tax purposes, generating various planning options for Indian citizens with certain connections and a presence in the US.

For example, an Indian citizen who applied for but has not yet received a US green card and is still living outside the US has a good opportunity to settle a tax-efficient trust. Such person would generally not be a US income tax resident prior to arriving in the US and would not be a US domiciliary either. They could efficiently and without any US gift tax settle an irrevocable trust with various (non-US) assets. If the trust is a non-US trust and it excludes all US persons as beneficiaries, the trust would not be income taxed to the settlor and could also be excluded from their US estate. Conversely, if US persons are allowed to benefit (i.e. are not categorically excluded from benefit), the irrevocable trust could still be excluded from the settlor's US estate, but would be income taxed to them for US income tax purposes.

US person acting as a trustee of an Indian trust

Indian law on trusts accords a flexibility to appoint a person not domiciled in India, provided the instrument of trust allows such an appointment. However, from an exchange control perspective, there are certain considerations. If the US person[3] is a FEMA resident of India, there is no issue with respect to the role of a trustee being assumed by such person. However, if the US person is a non-resident, whether they can hold the Indian trust in a fiduciary capacity requires careful examination. Further, one of the crucial objectives of a trust is to grow and multiply the corpus.

If an Indian trust is controlled and managed by a non-resident person, there is a concern that the ability of the Indian trust to make investments in the Indian market is suspended or limited to those avenues where investments by an entity controlled by foreign persons are allowed under FEMA.

A US person may serve as trustee of an Indian trust and this will not result in the trust being treated as a US trust for US law purposes (as the Indian trust would fail the so-called 'court test'). However, the US person serving as trustee of the Indian trust will have various US tax-reporting obligations, including the filing of a Foreign Bank and Financial Accounts Report (FBAR) on FinCEN Form 114 and potentially other forms as well, depending on the specific circumstances.

CONCLUSION

If there is one lesson to take away, it is to always ensure flexibility in one's plans in order to maximise adaptability to changing conditions. Estate planning is a crucial area where this lesson must be applied.

A good estate plan should be amenable to such changes and developments from a legal and commercial standpoint. Inefficiency and lack of proper planning not only reduces the ultimate wealth distribution to the next generation, but also causes undue delay in receiving the same.

#TRUSTS #RESIDENCY AND DOMICILE #INDIA #US

1 bit.ly/32VhQut **2** s.2, (41): 'relative', in relation to an individual, means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual. **3** If the US person is a US citizen and the trust property comprises immovable property in India, then that may be a challenge.