

## NOTES

### CREATION, ADMINISTRATION, AND EFFECTIVENESS OF THE "FAILSAFE" TRUST FOR NONRESIDENT ALIENS

#### I. INTRODUCTION

In recent years nonresident aliens (NRAs)<sup>1</sup> have increased steadily the flow of foreign funds into United States markets.<sup>2</sup> Several factors have stimulated foreign investment in the United States. For example, the United States provides the NRA with a secure situs for the safekeeping of his assets.<sup>3</sup> In addition to its political stability, the United States provides the NRA with an economically secure business and investment atmosphere.<sup>4</sup> In fact, the United States promotes foreign investment by providing NRAs with significant tax incentives and relatively free markets.<sup>5</sup> Thus, with the lure of high interest rates

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<sup>1</sup> A nonresident alien is an individual who is neither a citizen nor a resident of the United States. To be treated as a resident of the United States, an individual must be a "lawful permanent resident of the United States at any time" during the calendar year, or he must meet the substantial presence test. See 26 U.S.C. § 7701(b)(1) (Supp. II 1984).

<sup>2</sup> Warren, *Personal Trusts for Nonresident Aliens*, 121 Tr. & Est. 36 (Apr. 1982). For example, at the end of 1980, foreign direct investment in the United States reached a total of \$65.6 billion, and total foreign assets in the United States rose by \$61.1 billion to reach a total of \$480.9 billion. PRICE-WATERHOUSE, ACQUISITIONS IN THE U.S.A. 1, 3 (1982). By the end of 1984, foreign direct investment in the United States reached a total of \$159.6 billion, while total foreign assets in the United States reached \$886.4 billion. U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS STATISTICAL ABSTRACT OF THE UNITED STATES 1986, 797 (106th ed. 1985).

<sup>3</sup> Wyckoff, *Protective U.S. and Offshore Trusts for Nonresident Alien Grantors*, 42 INST. ON FED. TAX'N § 47.01, at 47-2 (1984).

<sup>4</sup> *Id.* NRAs have responded to significant economic factors, including the appreciation of United States real estate, the continued devaluation of the United States dollar, and the lower inflation rate in the United States relative to other nations. Mene, *Estate Planning for Nonresident Aliens*, 59 TAXES-THE TAX MAGAZINE 617-18 (Sept. 1981).

<sup>5</sup> Wyckoff, *supra* note 3, § 47.01, at 47-3; see Note, *Foreign Direct Investment in the United States: Disclosure Regulations*, 12 GA. J. INT'L & COMP. L. 193 (1982); see generally Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 80 Stat. 1539 (1966). Generally, by treating foreign capital on a basis of equality with domestic capital, the United States Government does not impose limitations on foreign investment. A few sensitive areas, however, such as communications, coastal shipping, and defense, maintain certain restrictions on ownership. PRICE-WATERHOUSE, *supra* note 2, at 3.

in the United States, the political unrest throughout parts of Central and South America, and the possibility of further political upheavals in the Middle East, NRAs have greatly accelerated the flow of foreign funds into the United States.<sup>6</sup>

The steadily increasing flow of foreign funds into the United States has necessitated the structuring of various protective investment devices to address the investment concerns of the NRA. The NRA who invests in the United States has two primary concerns when structuring an appropriate protective investment device. First, the NRA must select an investment structure which will protect his assets against both "home country" confiscation<sup>7</sup> and United States "freezing" or "vesting."<sup>8</sup> Second, the NRA must select an investment device which will preserve his United States investments during any confusion resulting from a political emergency in his native country.<sup>9</sup>

The NRA may choose from several types of protective investment structures to prevent expropriation of United States assets by his home country or "freezing" of these assets by the United States.<sup>10</sup>

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<sup>6</sup> Warren, *supra* note 2, at 36.

<sup>7</sup> Knight, "Failsafe" Legal Structures to Protect U.S. Assets of Foreign Investors, 9 INT'L BUS. LAW. 109 (1981). For example, the NRA may be concerned that a new, revolutionary government could rise to power in his native country. This new government may attempt to confiscate assets of citizens or residents of the country or to force these nationals to liquidate their international investments and bring the proceeds back to the native land. Under international law, however, United States courts may refuse to give effect to the edict of a foreign government, "so long as its refusal . . . is not arbitrary according to the rules of the conflict of laws of states that have reasonably developed legal systems." RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 9 (1965); see Dale, *Protection of Trust Assets*, in FOREIGN TRUSTS IN INTERNATIONAL PLANNING 109, 112 (H. Dale comp. 1974). Nevertheless, a protective investment device can serve as an effective means of avoiding the confusion and costly litigation which might ensue from such an edict. See Knight, *supra*, at 109.

<sup>8</sup> *Id.* Political emergencies which potentially expose the NRA's assets to the risk of confiscation by his home country or some other foreign country similarly may evoke "freezing" or "vesting" orders by the United States Government. Even though the NRA may avoid successfully the effects of foreign governmental actions, "freezing" orders may hinder or prevent the NRA from utilizing his United States assets. *Id.* at 110, 112-14.

<sup>9</sup> *Id.* at 109-10. The NRA may not be able to leave his native country and come to the United States to take care of his United States assets. Thus, he should make arrangements to ensure that these assets will be managed properly during a political emergency in his native country. *Id.*

<sup>10</sup> For example, the NRA may choose to maintain his United States assets through a holding company or a similar legal organization either within his home country or in another "offshore" country. Such investment structures, however, do not protect the NRA's assets from expropriation either by his home country or by the "offshore" country. See *id.* at 110-11.

Selection of the particular protective structure will depend upon the individual needs and desires of the NRA as well as upon his particular circumstances.<sup>11</sup> Nevertheless, of the several types of protective investment devices available to the NRA, the "failsafe" trust offers the best protection against nationalization by a foreign country or "freezing" by the United States.

Similar in nature to other trust structures, the failsafe trust provides the NRA with significant protection against expropriation and freezing. The failsafe trust device employs a trustee based in the United States or in another "safe" jurisdiction to hold legal title to trust property. The role played by the trustee may vary with a change in the beneficiaries of the trust or with the occurrence of a defined political emergency.<sup>12</sup>

Although the use of trusts in international estate and tax planning has increased significantly in recent years,<sup>13</sup> several NRAs, especially those domiciled in civil law countries, remain unaware that they may secure their assets in failsafe trusts.<sup>14</sup> These NRAs, however, should be advised of failsafe trusts as investment structures since a well-

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<sup>11</sup> *Id.* at 110. For a discussion of some of these considerations, see *infra* notes 100-01 and accompanying text.

<sup>12</sup> "A trust . . . is a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it." RESTATEMENT (SECOND) OF TRUSTS § 2 (1959). The "failsafe" trust is an investment device designed by W. Donald Knight, a partner at the law firm of King & Spalding in Atlanta, Georgia. See Knight, *supra* note 7, at 110.

<sup>13</sup> G. BOGERT, THE LAW OF TRUST AND TRUSTEES § 10 (2d ed. rev. 1984) [hereinafter BOGERT]. The use of trusts as estate and tax planning devices has risen significantly on the international level. Factors which have stimulated the interest of NRAs include increased mobility among residents of various nations around the world, greater opportunities for investment in the United States and abroad, and increased efforts to garner wealth with minimal tax burdens to intended beneficiaries. *Id.*

<sup>14</sup> Although most civil law countries do not expressly recognize the trust, some jurisdictions, such as Scotland, Quebec, South Africa, and Sri Lanka, have accepted the concept. Gold, *Trust Funds in International Law: The Contribution of the International Monetary Fund to a Code of Principles*, 72 AM. J. INT'L L. 856, 858 (1978). Nevertheless, the NRA must take note that an attempt to create a trust in certain civil law countries may result in nonrecognition or even invalidity of the trust. Newton, *Selecting a Situs for a Foreign Trust: The Key Factors; How and When to Change It*, 59 J. TAX'N 220 (1983). For example, the French civil code does not recognize the trust since its use is precluded by the concepts of community property and forced heirship. Similarly, the concept of the trust is unknown in Germany, where courts generally treat common law trusts as mere contractual relationships. BOGERT, *supra* note 13, § 9.

organized and well-managed trust can benefit the foreign investor in several ways. Trusts are the most flexible investment planning devices, providing immediate protection of assets for current use and long-term protection of assets for minor children.<sup>15</sup> Although investors traditionally utilize trusts to maintain stock and bond portfolios, NRAs also may manage real estate, commodities, and other types of assets through these investment devices.<sup>16</sup> Furthermore, the trust provides the NRA with uninterrupted expert management of investments in the United States.<sup>17</sup> Thus, the trustee can make purchases and sales, as circumstances dictate, without first obtaining approval by the beneficiary.<sup>18</sup> Finally, the failsafe trust may provide anonymity and secrecy as to ownership and disposition of assets.<sup>19</sup>

This Note will discuss the advantages and disadvantages of the failsafe trust as an investment device for the NRA. Specifically, this Note will suggest certain factors which the NRA must consider when creating and administering the trust. Finally, the Note will evaluate the effectiveness of the failsafe trust against potential United States "freezing" or home country expropriation.

## II. TRUST CREATION

### A. *The Trust Situs*

Once the NRA has decided to establish a failsafe trust,<sup>20</sup> he must determine whether to situate the device in the United States or in

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<sup>15</sup> Geller, *Estate Planning Considerations for the Nonresident Alien's U.S. Situs Assets*, 121 TR. & EST. 28, 30 (Apr. 1982).

<sup>16</sup> Warren, *supra* note 2, at 36.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> BOGERT, *supra* note 13, § 10. Other advantages of the failsafe trust include: (a) several tax benefits; (b) increased flexibility for movement of assets and/or situs; (c) safety from political claims and creditors; (d) immunity from state inheritance laws; (e) avoidance of probate administration after the settlor's death; and (f) centralized control of assets with the assistance of professional management. *Id.*; see Kanter, *Some Reasons for Use of Irrevocable Common Law Trusts in Common Law and Civil Law Countries*, in FOREIGN TRUSTS IN INTERNATIONAL PLANNING 7, 9-11 (H. Dale comp. 1974).

<sup>20</sup> When creating the failsafe trust, the NRA should consider that the Internal Revenue Code establishes the applicable standards for classifying the investment structure as either a trust or as an association taxable as a corporation. Local law, however, determines whether the legal relationships which result from the formation of the structure are such that these standards are met. 26 C.F.R. § 301.7701-1(c) (1986); see Duffy & Ferguson, *The Use of Foreign Trusts*, in FOREIGN TRUSTS IN

another country. The NRA may find it difficult to select the proper trust situs for his assets, and the Internal Revenue Code (Code) offers little help to solve this dilemma. Although the Code defines a "foreign trust,"<sup>21</sup> this definition, when read with the Code's definition of a "United States person,"<sup>22</sup> does not assist in determining whether a particular trust is a "foreign" or a "United States" trust.<sup>23</sup> Internal Revenue Service (Service) rulings and court cases, however, indicate that several factors determine whether a court or the Service will declare a trust to be foreign.<sup>24</sup> A trust normally is foreign if: (1) the trustee is foreign; (2) the trust is administered outside the United States; (3) the trust is formed by agreement or declaration which is expressly governed by foreign law; (4) the trust instrument is executed outside the United States; and (5) no discretionary agent or securities or commodity broker is present in the United States.<sup>25</sup>

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INTERNATIONAL PLANNING 35, 37 (H. Dale comp. 1974). For a structure to qualify as a trust, the Internal Revenue Service requires that the trustee be responsible for the protection of the assets belonging to beneficiaries who do not share in this responsibility, as opposed to the centralized manager of an association whose objective is to conduct business and divide the gains therefrom. 26 C.F.R. §§ 301.7701-4 (a)-(b), 301.7701-2(a) (1)-(2) (1986); see *Morrisey v. Comm'r*, 296 U.S. 344 (1935); see also *Duffy & Ferguson, supra*, at 37.

<sup>21</sup> "The terms 'foreign estate' and 'foreign trust' mean an estate or trust, as the case may be, the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income under subtitle A." 26 U.S.C. § 7701(a)(31) (1982); see also *Wyckoff, supra* note 3, § 47.02, at 47-7.

<sup>22</sup> "The term 'United States person' means [:] (A) a citizen or resident of the United States, (B) a domestic partnership, (C) a domestic corporation, and (D) any estate or trust (other than a foreign estate or foreign trust, within the meaning of section 7701(a)(31))." 26 U.S.C. § 7701(a)(30)(1) (1982); see also *Wyckoff, supra* note 3, § 47.02, at 47-7.

<sup>23</sup> *Wyckoff, supra* note 3, § 47.02, at 47-7.

<sup>24</sup> See *Rev. Rul. 62-154, 1962-2 C.B. 148* (whether the estate of a nonresident alien decedent is a resident or nonresident alien entity of the United States for federal income tax purposes depends upon all of the facts involved). See generally *Rev. Rul. 65-311, 1965-2 C.B. 322* (determination of whether a United States corporation should withhold tax from dividends paid to an alien estate depends upon all of the facts involved).

<sup>25</sup> *Duffy & Ferguson, supra* note 20, at 39. Thus, "[a]n employees' trust created in Canada that operates exclusively in the U.S. for the benefit of U.S. employees of a Canadian organization doing business in the U.S. and subject to continuous U.S. jurisdiction is a domestic trust." *Rev. Rul. 70-242, 1970-1 C.B. 89*. Furthermore,

[w]here the property of a trust, established under the laws of a foreign jurisdiction, consists principally of securities of United States corporations and such securities are held, controlled, and traded in the United States on a domestic exchange by a trustee who is a citizen and resident of this

### 1. *The United States-Situs Trust*

The NRA may determine that a United States trust would serve best his investment needs.<sup>26</sup> By organizing a trust in the United States, the NRA may enjoy many of the same advantages that a United States citizen enjoys for his own trust.<sup>27</sup> For example, by selecting a custodian bank to oversee the trust, the NRA has access to professional, confidential, and secure investment management.<sup>28</sup> By providing continued management and experienced judgment, the trust structure also increases the effectiveness of a power of attorney in the event of the NRA grantor's disability.<sup>29</sup> Furthermore, the trust, in certain circumstances, may serve as a significant barrier against enforcement of the claims of a creditor.<sup>30</sup>

Another advantage of the United States-situs trust is that the NRA grantor may retain the freedom to remove the trustee, transfer the trust situs and assets to another state or country, control the investment, or revoke the trust entirely.<sup>31</sup> Consequently, in certain

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country, the trust is deemed to be a resident alien entity of the United States for Federal Income tax purposes.

Rev. Rul. 60-181, 1960-1 C.B. 257.

<sup>26</sup> A United States-situs trust is a trust which is situated in any state within the United States. Hendrickson, *American Trusts for Nonresident Aliens*, 123 Tr. & Est. 40 (Feb. 1984).

<sup>27</sup> *Id.* "A properly drawn and managed revocable, conditionally revocable, or irrevocable trust situated in an American island tax haven like Manhattan can retain for a non-American most of the same 'tax-haven' advantages that trusts in those other island paradises enjoy - except summery winters and coconut palms - without worrying about Cuba." *Id.*

<sup>28</sup> The bank's duties may include: (1) prompt execution of orders for trades; (2) exercise of options; (3) collection of dividends and interest; (4) issuance of tax return information and periodic statements to appropriate parties; (5) payment of bills; and (6) distributions to beneficiaries. *Id.* at 42-44.

<sup>29</sup> For a more detailed discussion concerning disability of the grantor, see *infra* note 89 and accompanying text.

<sup>30</sup> Hendrickson, *supra* note 26, at 42. Although property held in a revocable trust generally is subject to claims of the grantor's creditors, a revocable trust can impede enforcement of such claims if the terms of the trust provide that the trust is revocable only with the consent of a disinterested cotrustee or of a similar party. *Id.*

<sup>31</sup> *Id.* Although the NRA may establish a trust device which will allow him to retain control over the trust, he should consider that some trusts do not offer the grantor total control over the trust assets. Generally, however, a revocable trust offers the grantor significant control over the trust. See *infra* notes 64-73 and accompanying text. A conditionally revocable trust offers the grantor limited control over the trust. See *infra* notes 86-92 and accompanying text. An irrevocable trust, however, offers the grantor no control over the trust. See *infra* notes 93-113 and accompanying text. Ultimately, the NRA must evaluate his individual situation before deciding upon a trust structure. See *infra* notes 100-01 and accompanying text.

circumstances, the trust may serve as a will substitute following the death of the NRA grantor.<sup>32</sup> Furthermore, in the absence of applicable treaty provisions, a United States court generally will not enforce the tax claims of a foreign government against trust assets or claims under exchange control revenue laws of a foreign government.<sup>33</sup> In addition, following the grantor's death the United States-situs trust may continue for the maximum period allowed by the rule against perpetuities<sup>34</sup> or, if the trust is for charitable purposes, for perpetuity.<sup>35</sup>

The trust structure also provides the NRA with certain tax advantages. For example, the Service imposes upon the trust no federal, state, or local income, capital gain, or personal property taxes if the trust consists of assets which are "not effectively connected with the conduct of a trade or business within the United States."<sup>36</sup> Thus, although the trust may maintain some United States-situs assets, the level of actual United States tax liability remains at a desired minimum.<sup>37</sup> Furthermore, the Service levies no withholding tax on remittances to a domestic United States trust from United States sources, such as dividends from United States corporate issuers. Therefore,

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<sup>32</sup> Hendrickson, *supra* note 26, at 42. The trust is in many ways superior to a will. The trust protects the grantor's assets from probate costs and claims of creditors arising after the grantor's death. The trust file also remains completely confidential when transferred to the successor, as the assets are not subject to the publicity which often surrounds probate, succession, and notarial procedures. Furthermore, the trust is more difficult than a will for a disgruntled heir to attack and contest, and the grantor can limit or perhaps even eliminate his surviving spouse's claims to all or to an elective share of his trust assets. *Id.*

<sup>33</sup> *Id.* A state may refuse to enforce penal or fiscal claims of a foreign state. RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 89, 117, 120 (1971); see *United States v. Harden*, 1963 S.C.R. 366 (Canada refused to enforce a United States tax court judgment).

<sup>34</sup> "The rule against perpetuities prohibits the creation of a future contingent interest unless, by the terms of its creation, the interest must vest within a life or lives in being, and twenty-one years thereafter." TIFFANY, *THE LAW OF REAL PROPERTY* 142 (3d ed. abr. 1970).

<sup>35</sup> Hendrickson, *supra* note 26, at 42.

<sup>36</sup> 26 U.S.C. § 861 (1982); see generally 26 U.S.C. § 862 (1982).

<sup>37</sup> The revocable United States-situs trust can avoid United States estate and gift taxation of assets by exchanging United States-situs property for stock of a controlled or closely held foreign corporation. Hendrickson, *supra* note 26, at 42-43. *But see* *Fillman v. United States*, 355 F.2d 632 (Ct. Cl. 1966) (since every action which foreign corporations took with respect to securities was performed in the capacity of a mere custodian and depositor for the NRA, the securities held in custody accounts in the United States in the names of the foreign corporations at the time of the NRA's death were includible in the NRA's estate for federal estate tax purposes as having been owned by the NRA). *Id.*

the trustee of the United States-situs trust may receive the entire amount of the remittance.<sup>38</sup>

A further advantage of the United States-situs trust is its flexibility as an investment device. The NRA may appoint himself as the sole trustee of the trust's assets,<sup>39</sup> or he has the option of appointing a United States bank or another trustworthy individual as trustee or cotrustee.<sup>40</sup> Moreover, the NRA grantor may choose to retain the power to change the trustee or to accord the power to change the trustee to another.<sup>41</sup> Finally, the United States-situs trust can be completely irrevocable;<sup>42</sup> completely revocable<sup>43</sup> by the grantor, the trustee, or some other person; or conditionally revocable<sup>44</sup> by the grantor with the consent of the trustee or another.<sup>45</sup>

The United States-situs trust, however, does have certain disadvantages. The attachment of Iranian assets during the Iranian crisis of the early 1980's indicates that although the United States offers an attractive location for foreign investment,<sup>46</sup> assets situated in United States-situs trusts are vulnerable to "freezing" by the United States or expropriation by another country.<sup>47</sup> In addition to potential "vest-

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<sup>38</sup> Treas. Reg. § 1.441-3(f) (1960), *reprinted in* Henderson, *supra* note 26, at 43. The trustee, however, must pay withholding tax when the trust distributes these dividends to the beneficiaries. *Id.*

<sup>39</sup> Hendrickson, *supra* note 26, at 43.

<sup>40</sup> *Id.*

<sup>41</sup> For a more detailed discussion concerning changing the trustee of the trust, see *infra* notes 139-59 and accompanying text. The trustee of a United States-situs trust need not be a citizen or resident of the United States; nor must the trustee be a citizen or resident of the country in which the trust assets are kept. Hendrickson, *supra* note 26, at 43.

<sup>42</sup> For a detailed discussion of irrevocable trusts, see *infra* notes 93-113 and accompanying text.

<sup>43</sup> For a detailed discussion of revocable trusts, see *infra* notes 64-85 and accompanying text.

<sup>44</sup> For a detailed discussion of conditionally revocable trusts, see *infra* notes 86-92 and accompanying text.

<sup>45</sup> Hendrickson, *supra* note 26, at 44. "Of all the states of the United States, the one whose law is most highly developed in these matters is New York. The direction of its development has been to provide a hospitable, protective, and tax-sheltered legal environment for trusts established by nonresidents of New York." *Id.* at 40; see also Hendrickson, *Choice-of-Law Directions for Disposing of Assets Situated Elsewhere than the Domicile of Their Owner - The Refractions of Renard*, 18 REAL PROP. PROB. & TR. J. 407 (1983).

<sup>46</sup> For a discussion of the advantages of the United States for foreign investment, see *supra* notes 3-5 and accompanying text.

<sup>47</sup> Following the fall of the Imperial Shah of Iran, the Ayatollah Khomeini renounced all transactions with United States industry. As a result of Khomeini's



ing” or “freezing orders,” other disadvantages of a United States-situs trust include the possibilities of less confidentiality than that found in a foreign-situs trust<sup>48</sup> and the imposition of a generation skipping tax<sup>49</sup> which would not be applicable to a foreign-situs trust.<sup>50</sup>

## 2. *The Foreign-Situs Trust*

Depending upon certain individual circumstances, the NRA may desire to establish a trust device in a foreign jurisdiction. Perhaps the greatest advantage of the foreign-situs trust lies with the establishment of the trust under the laws of a “tax haven” jurisdiction.<sup>51</sup> The NRA, however, still may choose to maintain custody of the trust securities in the United States or in a similarly secure jurisdiction, such as Switzerland, rather than at the tax shelter situs.<sup>52</sup> By maintaining the trust securities in a secure jurisdiction, the NRA receives maximum protection against expropriation and nationalization by the NRA’s home country as well as by the “tax haven” situs.<sup>53</sup>

A trust device situated outside the United States also benefits from certain United States tax advantages. The Service treats a foreign trust as an NRA not engaged in a trade or business within the United

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actions, United States corporations found themselves with expropriation and breach of contract claims estimated at approximately eight billion dollars. See Marks & Grabow, *The Presidents Foreign Economic Powers After Dames & Moore v. Regan: Legislation by Acquiescence*, 68 CORNELL L. REV. 68, 70 (1982). Seeking to recover on claims against Iran, United States corporations rushed to locate and attach any and all Iranian assets located in the United States. The United States courts awarded several of these corporations prejudgment attachment of Iranian property situated in the United States. *Id.* at 71. See Mayer & Odorizzi, *Foreign Government Deposits: Attachment and Set-Off*, 1982 U. ILL. L. REV. 289. Furthermore, the Trading with the Enemy Act empowers the President to attack and secure foreign-owned assets held within the United States in the occurrence of a declared national emergency. See Trading with the Enemy Act, 50 U.S.C. app. §§ 1-44 (1982); see also International Emergency Economic Powers Act, 50 U.S.C. §§ 1701-06 (1982). The constitutionality of these acts is supported by *Unindyne Corp. v. Iran*, 512 F. Supp. 705 (E.D. Va. 1981).

<sup>48</sup> Wyckoff, *supra* note 3, § 47.03, at 47-19.

<sup>49</sup> For a detailed discussion of the generation skipping tax, see *infra* notes 76-78 and accompanying text.

<sup>50</sup> Wyckoff, *supra* note 3, § 47.03, at 47-19.

<sup>51</sup> A “tax haven” jurisdiction is one which imposes very little or no tax on income which the trust receives from sources outside the jurisdiction or on distributions of such income to the beneficiaries of the trust. Warren, *supra* note 2, at 36.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.* For a discussion of the possible “freezing” or vesting of trust assets, see *supra* note 47 and accompanying text.

States.<sup>54</sup> Consequently, the Service taxes the gross amount of interest, dividends, and other fixed or determinable income at a thirty percent statutory rate or at the applicable treaty rate.<sup>55</sup> Furthermore, the capital gains of a trust are not subject to United States federal income tax, provided the trust is not "present" in the United States "for a period or periods aggregating 183 days or more during the taxable year."<sup>56</sup>

Like the United States-situs trust, the foreign-situs trust does have disadvantages and administrative problems. For example, when creating a foreign-situs trust, the NRA may find it difficult to ensure that the beneficiaries of the trust receive adequate monthly principal and income statements.<sup>57</sup> The NRA may encounter further difficulties in finding a United States-based nominee to hold trust securities for a foreign-situs trust.<sup>58</sup> Finally, complicated forms, computations, and record-keeping requirements create complexities which may necessitate the use of an experienced corporate fiduciary to manage the foreign-situs trust.<sup>59</sup>

When establishing the foreign-situs trust, the NRA must select carefully the proper situs for the trust. As the trust is not recognized in civil law countries,<sup>60</sup> the situs of the trust necessarily is limited to common law countries. The NRA also must be cognizant of the local perpetuities and accumulation rules of the country in which he desires to establish a trust.<sup>61</sup> Furthermore, the NRA should seek to establish

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<sup>54</sup> See Kroll, *Special Problems of Foreign Trusts*, in *THE FOREIGN TRUST: USES AND LIMITATIONS* 69, 71 (H. Dale comp. 1973).

<sup>55</sup> 26 U.S.C. §§ 641(a), 871(a)(1) (1982). The term nonresident alien individual includes a nonresident alien fiduciary. 26 C.F.R. § 1.871-2(a) (1986). The applicable treaty rate applies only to the NRA's gross income, the tax on which is limited by a tax convention. See 26 C.F.R. § 1.871-12(a) (1986).

<sup>56</sup> 26 U.S.C. § 871(a)(2) (1982). "[G]ains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such gains and losses were effectively connected with the conduct of a trade or business within the United States . . ." *Id.* See also Kroll, *supra* note 54, at 71.

<sup>57</sup> Bush, *The Foreign Trust - Drafting and Administering*, in *THE FOREIGN TRUST: USES AND LIMITATIONS* 111, 118 (H. Dale comp. 1973).

<sup>58</sup> *Id.* at 119.

<sup>59</sup> *Id.* at 118; see Barnett, *Advising Clients on Record-Keeping for Calculation of Throwback Distributions*, 5 *INST. ON EST. PLAN.* 71.1100-71.1(14) (1971).

<sup>60</sup> For a discussion concerning the effectiveness of trusts in civil law countries, see *supra* note 14 and accompanying text.

<sup>61</sup> Bush, *supra* note 57 at 111. For example, accumulation trusts in Hong Kong generally are subject to more restrictions than are trusts in other countries. In Hong Kong accumulation can be continued only for one of four alternative periods: (1) the life of the grantor; (2) 21 years from the death of the grantor; (3) the minority

his trust in a nation which imposes minimal tax burdens.<sup>62</sup> Other significant factors which the NRA should consider include: (1) freedom from currency controls; (2) political, economic, and social stability; (3) a fast, accurate communications network; (4) the availability of competent trustees; and (5) trust laws, or the potential enactment of trust laws, which may conflict with the trustee's right to administer his dispositive trust device.<sup>63</sup>

### *B. Revocable, Conditionally Revocable, and Irrevocable Trusts*

In addition to deciding upon the situs of the failsafe trust, the NRA must determine whether a "revocable" or "irrevocable" trust will serve best his investment needs. Depending upon individual circumstances, however, the NRA may conclude that a "conditionally revocable" trust will suit best these needs. Each of these three trust structures presents significant benefits and drawbacks for the NRA.

#### *1. The Revocable Trust*

A revocable trust<sup>64</sup> may serve the NRA as an effective and secure investment device. A grantor creates a revocable trust by transferring property to a trust for the benefit of at least one other person, while reserving the power to revoke the trust in whole or in part at any time.<sup>65</sup> The grantor's reservation postpones the beneficiary's complete

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of any person living at the death of the grantor; and (4) the minority of anyone who under the terms of the trust would be entitled to the income to be accumulated if of full age. *Id.* In the Cayman Islands, however, an "exempted trust" is allowed to exist for any specified period up to 100 years. *Id.* at 112.

<sup>62</sup> The countries which impose the least tax burdens include the Bahamas, Bermuda, Cayman Islands, Hong Kong, Norfolk Island, and New Hebrides. *Id.*

<sup>63</sup> *Id.* at 111-13, 116. "Factors which lead to placing situs within a particular jurisdiction are typically dynamic, not static. They vary with time and so it may become necessary to . . . [move the trust situs] to a new jurisdiction." Newton, *supra* note 14, at 220.

<sup>64</sup> "Revocation is the resumption by the settlor of possession and title to the trust property, free of any obligation to the beneficiaries." BOGERT, *supra* note 13, § 998 (2d ed. rev. 1983).

<sup>65</sup> See RESTATEMENT (SECOND) OF TRUSTS § 330 (1959).

The grantor may reserve expressly within the trust agreement a power to revoke the trust in whole or in part. Generally, a court will interpret a power to revoke the trust as inherently including a power to revoke the trust in part by withdrawing a part of the trust property from the trust. The trust instrument, however, may provide expressly that the grantor may revoke the trust only as a whole or as an entirety.

*Id.* § 330 at comment n.

enjoyment of the trust property until after the grantor's death.<sup>66</sup>

The revocable trust provides the NRA with more freedom to control his assets than do most other investment structures. For example, when creating the revocable trust, the grantor may name himself as sole trustee and beneficiary for life while still maintaining the power to end or alter the trust arrangement at any time.<sup>67</sup> Although this type of trust agreement closely resembles a testamentary disposition, the revocable trust is more advantageous for the NRA than is a will. While any disposition which can be made through a will also can be made through a revocable trust,<sup>68</sup> the trust is not subject to potentially bothersome and expensive probate proceedings.<sup>69</sup> Thus, the revocable trust avoids the publicity and costs which may accompany a probate proceeding.<sup>70</sup>

The revocable trust also benefits the NRA in other ways. Through the creation of a revocable trust, the NRA ensures the trustee's continuous management of his investments uninterrupted by the grantor's death.<sup>71</sup> In addition, the revocable trust preserves the trust assets for the grantor for life and may determine who shall receive the

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<sup>66</sup> E. CARR, REVOCABLE TRUSTS 6 (1980). A revocable trust is amendable and revocable by the grantor only. Upon revocation of the trust, the trust assets are to be returned to the grantor unless he arranges otherwise. A. CASNER, THE REVOCABLE TRUST: AN ESSENTIAL TOOL FOR THE PRACTICING LAWYER 1-2 (1977).

<sup>67</sup> E. CARR, *supra* note 66, at 6. If the grantor names himself as sole trustee, he should designate as well a successor trustee to assume the office upon his death. Nevertheless, if the grantor fails to name a successor trustee, a court having jurisdiction in trust matters will appoint a successor to the office. *Id.*

<sup>68</sup> *Id.* For example, the grantor may provide expressly within the trust agreement that at his death the trust shall continue for his spouse or for the benefit of one or more designated persons with the distribution at their respective deaths to their children and descendants. *Id.* The rule against perpetuities allows the trust to continue for more than 100 years, even after it becomes irrevocable, and if the trust is sufficiently charitable in purpose or sufficiently revocable, it could continue *ad infinitum*. Hendrickson, *supra* note 26, at 42.

<sup>69</sup> E. CARR, *supra* note 66, at 36.

<sup>70</sup> *Id.* To avoid probate proceedings, the grantor must take care not to retain, either intentionally or inadvertently, the entire beneficial interest in the trust property. Therefore, when creating the trust, the grantor must make a present gift of an equitable interest to at least one beneficiary, even though the grantor may postpone until a later time the beneficiary's enjoyment of the gift. *Id.* at 29.

<sup>71</sup> Since the NRA's investments will not pass through probate proceedings at the grantor's death, the trustee continues to have full, uninterrupted authority over the trust until the trust agreement expires. Although the NRA can arrange for someone to manage his investments for an uninterrupted period without creating a revocable trust, the revocable trust is often more efficient and inexpensive than other investment structures. *See id.* at 51.

benefits of the trust upon the death of the grantor. Thus, through the creation of a revocable trust, the NRA grantor could prevent his surviving spouse from receiving upon his death marital property that she otherwise would have received absent the trust's creation.<sup>72</sup> Finally, the revocable trust is a "noncourt" trust in that it is not supervised continuously by the court. Therefore, the NRA receives even more freedom and privacy in the maintenance of his trust.<sup>73</sup>

Before creating a revocable trust, the NRA should consider the tax consequences of this investment structure. If the grantor retains a power of revocation, the Service will tax him during his lifetime as if the trust does not exist.<sup>74</sup> Upon his death, however, the trust income will be subject to federal estate tax in the same way as the income of other trusts.<sup>75</sup> The generation skipping tax<sup>76</sup> also may affect the revocable trust upon or after the grantor's death.<sup>77</sup> Depending upon the particular circumstances, the so-called generation skipping trust may invoke a tax upon certain distributions that are made from the

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<sup>72</sup> *Id.* at 52; see *Kerwin v. Donaghy*, 317 Mass. 559, 59 N.E.2d 299 (1945) (a wife's right to renounce her husband's will did not extend to personal property which the husband had conveyed during his lifetime, even though the sole purpose of the trust in question was to disinherit the wife). *But see Newman v. Dore*, 275 N.Y. 371, 9 N.E.2d 966 (1937) (holding in favor of a widow's claim to property held in a revocable trust when the grantor transferred all of his property to various revocable trusts only three days before his death). Furthermore, some states have statutes which protect the rights of a surviving spouse. *E.g.*, MO. ANN. STAT. § 474.150 (Vernon 1956) (surviving spouse may recover gifts in fraud of marital rights).

<sup>73</sup> E. CARR, *supra* note 66, at 59. "[U]nlike a trust that is established by will, . . . [a revocable trust] is not under the jurisdiction of any court . . . unless the trustee or beneficiary brings it into the court for the settlement of some trust matter. Even then, when the particular matter is settled, the court generally will not retain jurisdiction." *Id.* Furthermore, the revocable trust avoids judicial settlement of the trustee's accounts, thereby saving the beneficiaries' expense without endangering their interests in the trust. *Id.* at 59-60.

<sup>74</sup> 26 U.S.C. § 2038 (1982).

<sup>75</sup> *Id.*; *Comm'r v. Estate of Church*, 335 U.S. 632 (1949) (holding that the Service properly included the value of the trust corpus in the grantor's gross estate when the grantor reserved a life estate for himself); see also E. CARR, *supra* note 66, at 73. The trust is subject to estate tax even where the grantor retains no beneficial interest for himself.

<sup>76</sup> See generally 26 U.S.C. §§ 2601-22 (1982). The generation skipping tax is invoked when the grantor creates his trust for a younger generation beneficiary and provides that when that beneficiary's interest is terminated, the trust rights shall transfer to a still younger generation beneficiary. For example, the tax applies where a parent leaves his estate in trust for his child for life with a remainder to his grandchild. E. CARR, *supra* note 66, at 123; see 26 U.S.C. § 2611 (1982).

<sup>77</sup> E. CARR, *supra* note 66, at 122-67.

principal of the trust as it continues and upon the final distribution following termination of the trust.<sup>78</sup>

Although the revocable trust has certain tax disadvantages, it also offers the NRA several tax benefits. Unless the grantor relinquishes the power to revoke the trust, the revocable trust is not subject to federal gift tax.<sup>79</sup> Thus, by partially revoking the trust, the grantor may bestow gifts that are not subject to a gift tax.<sup>80</sup> Moreover, so long as the grantor is an NRA, no gift tax is invoked, even though the donees of such gifts may be United States citizens.<sup>81</sup>

When creating a revocable trust, the grantor must reserve specifically the power to revoke or amend the trust.<sup>82</sup> If the draftsman neglects to reserve this power expressly within the trust agreement, a court may hold the trust to be irrevocable and, under certain circumstances, may terminate the trust.<sup>83</sup> Furthermore, the trust agreement should provide expressly for the method of revocation and for the time when the revocation is to take effect.<sup>84</sup> A court, however,

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<sup>78</sup> *Id.* The generation skipping trust invokes the tax if the grantor is the initial beneficiary for life of the trust and if the trust is to continue after his death for the benefit of others. *See id.* at 123.

<sup>79</sup> 26 U.S.C. § 2501 (1982); *Burnett v. Guggenheim*, 288 U.S. 280 (1933) (gift tax does not become payable until the powers to amend or revoke the trust are released).

<sup>80</sup> *Hendrickson*, *supra* note 26, at 41.

<sup>81</sup> *See* 26 U.S.C. § 2501(a)(2) (1982). The tax is not invoked as long as the trust property is located outside the United States. *Id.* § 2511(a).

<sup>82</sup> *BOGERT*, *supra* note 13, § 1061 (2d ed. 1969). "(1) The settlor has the power to revoke the trust if and to the extent that by the terms of the trust he reserved such a power, (2) [T]he settlor cannot revoke the trust if by the terms of the trust he did not reserve a power of revocation." *RESTATEMENT (SECOND) OF TRUSTS* § 330 (1959). "The phrase 'terms of the trust' means the manifestation of intention of the settlor with respect to the trust expressed in a manner which admits of its proof in judicial proceedings." *Id.* § 220 at comment a.

<sup>83</sup> *BOGERT*, *supra* note 13, § 998 (2d ed. rev. 1983). If both the grantor and the trustee intended to insert a power of revocation within the trust instrument, and the provision for revocation was mistakenly omitted from the instrument, a court may either set aside the trust or insert a power of revocation in it. *Id.*; *see McFarland v. Bishop*, 282 Mo. 534, 222 S.W. 143 (1920) (court refused to reform trust instrument to insert power of revocation where grantor mistakenly failed to include such power but had intended to use it for an illegal purpose).

<sup>84</sup> *BOGERT*, *supra* note 13, § 1061 (2d ed. 1969). Such a provision may be worded as follows:

I reserve the right to amend or revoke this trust in whole or in part at any time and from time to time but only by written instrument delivered to Trustee in my lifetime; except that the duties, powers, and liabilities of Trustee shall not be changed without its written consent. Trustee shall deliver to me or my nominee, absolutely and free of trust, any policies or

probably will not invalidate the trust agreement if such provisions are absent.<sup>85</sup>

## 2. *The Conditionally Revocable Trust*

If the NRA decides that the revocable trust does not meet his investment needs, he may prefer to create a "conditionally revocable" trust. The conditionally revocable trust is similar to the revocable trust in all respects,<sup>86</sup> except the grantor of the conditionally revocable trust may not revoke or amend the trust without the consent of a disinterested cotrustee or some other designated person.<sup>87</sup> Although it offers the same advantages as the revocable trust,<sup>88</sup> the conditionally revocable trust offers the NRA three additional advantages.

One additional advantage of the conditionally revocable trust is that since the grantor cannot revoke the trust without the consent of another, he is restrained from exercising improvidently his power of revocation.<sup>89</sup> Another advantage of the conditionally revocable trust is that the trustee's fiduciary duty to the trust's beneficiaries obligates him to refuse to consent to revocation, if revocation would

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other assets as I may direct in writing from time to time.

*Id.* § 1062. An example of a written revocation of a trust may read as follows:

I . . . do hereby absolutely cancel and revoke all of the conditions, covenants and provisions of said trust agreement and do hereby recall unto myself all of the property now being held by the Trustee pursuant to the terms of said trust agreement and direct that the Trustee convey, transfer, assign and deliver all of such property to me . . .

I do hereby declare that all property now being held by Trustee pursuant to the terms of the aforesaid trust agreement shall be fully released from the trusts created thereby.

*Id.* § 1075.

<sup>85</sup> See RESTATEMENT (SECOND) OF TRUSTS § 330 (1959). If the grantor does not specify within the instrument the mode of revocation, he may revoke the trust "in any manner which sufficiently manifests the intention of the . . . [grantor] to revoke the trust." Generally, the grantor will communicate to the trustee his decision that the trust be revoked. However, any definite manifestation by the grantor of his intent to revoke the trust will suffice, even though the trustee may not have received this manifestation. See *id.* § 330 at comment i.

<sup>86</sup> For a detailed discussion of revocable trusts, see *supra* notes 64-85 and accompanying text.

<sup>87</sup> Hendrickson, *supra* note 26, at 40.

<sup>88</sup> For a detailed discussion of the advantages of revocable trusts, see *supra* notes 67-73 and accompanying text.

<sup>89</sup> Hendrickson, *supra* note 26, at 44. Thus, the trust assets are kept intact if the grantor seeks revocation while he is under "mental stress, undue influence, torture, duress, or the influence of alcohol or drugs, or of a gigolo or fortune hunter or golddigger, or governmental edict." *Id.*

not be in the best interests of the beneficiaries. In this manner the trustee can protect the trust property from enforcement of claims of the grantor's creditors.<sup>90</sup> Finally, the conditionally revocable trust is advantageous in that several foreign countries may treat the conditionally revocable trust as an absolute disposition of the trust property by the grantor.<sup>91</sup> Thus, the tax authorities of these countries may regard the income generated from the trust assets as not vested in the grantor, not subject to his control, and, therefore, not taxable to him.<sup>92</sup> These three additional advantages of the conditionally revocable trust give the NRA grantor of such a trust the best protection against home country expropriation and United States vesting.

### 3. *The Irrevocable Trust*

The NRA's third option is creating an "irrevocable" trust. Unlike the revocable and conditionally revocable trusts, the grantor of an irrevocable trust does not retain the right to revoke or amend the trust.<sup>93</sup> In creating an irrevocable trust, the NRA may choose from a variety of methods. First, the grantor may provide expressly within the trust agreement that the trust is irrevocable.<sup>94</sup> In addition, a revocable trust generally becomes irrevocable upon the death or incapacity of the grantor.<sup>95</sup> Finally, when a trust is not created in

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<sup>90</sup> *Id.*

<sup>91</sup> *Id.* The Netherlands and the United Kingdom treat the conditionally revocable trust in a similar manner as a revocable trust. *Id.*

<sup>92</sup> *See id.* In the United States the Service ignores the conditionality of the grantor's power of revocation and instead regards the power to revoke as unfettered and absolute. *Id.*; see 26 U.S.C. § 676 (1982); 26 C.F.R. § 1.676(a)-1 (1986); *United States v. Sorrentino*, 726 F.2d 876 (1st Cir. 1984) (the mere existence of a taxpayer's power to control distribution of trust income and trust assets was sufficient to warrant treating the taxpayer as the owner of portion of the trust).

<sup>93</sup> W. BEHRENFELD, *ESTATE PLANNING DESK BOOK* 232 (1981).

<sup>94</sup> Such a provision may be worded as follows: "This trust shall be irrevocable and I shall have no right to alter, amend, revoke or terminate this trust or any provision hereof." BOGERT, *supra* note 13, § 1095 (2d ed. 1969). Another such provision may be worded as follows: "I hereby declare this trust to be irrevocable without any rights reserved in me to revoke or amend." *Id.* § 1096.

<sup>95</sup> *Id.* § 1091. To ensure that the trust will become irrevocable upon his death or incapacity, the grantor may provide expressly within the trust agreement that such a transition is to occur upon his death or incapacity. Such a provision may be worded as follows:

Upon my death, resignation (without my appointment of another as trustee), or inability to act (as that term is hereinafter defined) as trustee, I name, as the trustee hereunder, and my successor as trustee shall have all of the powers and discretions herein given the trustee without conveyance or transfer.

*Id.* § 1071.



writing,<sup>96</sup> a court often will presume that the trust is irrevocable, even though the grantor may have received no consideration for creating the trust.<sup>97</sup> A party, however, may rebut this presumption with evidence establishing that the grantor desired at the time of the trust's creation to reserve a power of revocation, although he did not reserve expressly such power.<sup>98</sup>

Since the grantor of an irrevocable trust cannot exercise any power over the trust once it is created,<sup>99</sup> the NRA who wishes to establish an irrevocable trust should evaluate several emotional and factual considerations prior to the creation of the trust. For example, the grantor should consider whether he can afford to part permanently with the funds to be deposited in the trust.<sup>100</sup> Further, the grantor

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<sup>96</sup> Resulting and constructive trusts are enforceable even if they are not evidenced by a written instrument. RESTATEMENT (SECOND) OF TRUSTS § 406 comment a, § 40 comment d (1959). "A resulting trust arises where a person makes or causes to be made a disposition of property under circumstances which raise an inference that he does not intend that the person taking or holding the property should have the beneficial interest therein . . . ." *Id.* § 404.

A constructive trust is a relationship with respect to property subjecting the person by whom the title to the property is held to an equitable duty to convey it to another on the ground that his acquisition or retention of the property is wrongful and that he would be unjustly enriched if he were permitted to retain the property. *Id.* § 1 at comment e.

<sup>97</sup> See *id.* § 330 comment c (1959). Among the relevant factors which may be significant in determining whether the grantor intended to reserve a power to revoke the trust are: (1) the relationship between the grantor and the beneficiary; (2) the grantor's purpose in creating the trust; (3) whether the grantor informed the beneficiary of the creation of the trust; (4) the character of the trust property; (5) the effect that the power of revocation would have upon the liability of the grantor of his estate for taxes; and (6) the fact that the creation of the trust without the power of revocation would be an unwise act on the part of the grantor. *Id.*

<sup>98</sup> See *id.* Cf. *Liberty Trust Co. v. Weber*, 200 Md. 491, 90 A.2d 194 (1952) (statements of the grantor that at the time of trust creation he believed that he had retained the power to revoke it does not alone suffice to reform the instruments so as to permit him to revoke the trust).

<sup>99</sup> Once he has created the irrevocable trust, the grantor cannot dissolve it until he establishes at least one of the following: (1) incompetence or mistake of the grantor or fraud or deception used upon him at the inception of the trust; (2) terms of the trust which are illegal or impossible to fulfill; (3) a merger of the legal and equitable interests; or (4) the consent of all of the beneficiaries of the trust. Furthermore, the court must determine that no material purpose of the grantor is impaired substantially by the termination. Sargent, *Should a Trust be Irrevocable?* 4 REAL PROP., PROB. & TR. J. 176 (1969).

<sup>100</sup> *Id.* One attorney has proposed a test consisting of two questions which he asks clients before drafting irrevocable trusts for them: (1) Would you do the same thing if it did not save you any money in taxes . . . [and] (2) Can you take the calculated risk that under no set of conceivable circumstances will you need these funds for the period of the trust? Unless both questions are answered in the affirmative, the attorney refuses to draft the irrevocable trust for his clients. *Id.* § 178.

must evaluate his confidence in the trustee, his satisfaction with the situs of the trust, and his comfort with the beneficiaries of the trust. The grantor also may find it advantageous to assess the likelihood that he will survive the designated beneficiaries. Finally, the grantor should consider his alternatives to creating an irrevocable trust.<sup>101</sup>

The grantor of the irrevocable trust benefits from many of the same advantages enjoyed by grantors of revocable<sup>102</sup> and conditionally revocable<sup>103</sup> trusts. The NRA, however, may enjoy other significant tax advantages through the creation of an irrevocable trust. Whereas federal income tax laws usually ignore the revocable trust structure for tax purposes,<sup>104</sup> the Service generally treats the irrevocable trust as a separate United States taxpaying entity.<sup>105</sup> Through the person of the trustee, the trust is taxed on all gross income and is allowed appropriate deductions, e.g., a deduction for amounts distributed.<sup>106</sup> Thus, by serving as a separate taxpayer, the irrevocable trust allows the accumulation of income or realization of capital gain at United States tax rates which may be lower than if the trust distributed income to the beneficiary by other means.<sup>107</sup>

The irrevocable trust also benefits the NRA by allowing the grantor to pass trust property down along family generations.<sup>108</sup> In this manner the grantor may avoid paying federal income tax at his own tax rate,

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<sup>101</sup> *Id.* A more complete list of emotional and factual considerations can be found in Benjamin, *Irrevocable Trusts*, in *USING TRUSTS IN ESTATE PLANNING* 71 (N. Crandell ed. 1969).

<sup>102</sup> For a detailed discussion of the advantages of revocable trusts, see *supra* notes 67-73 and accompanying text.

<sup>103</sup> For a detailed discussion of the advantages of conditionally revocable trusts, see *supra* notes 88-92 and accompanying text.

<sup>104</sup> For a detailed discussion of federal income tax treatment of revocable trusts, see *supra* notes 74-81 and accompanying text.

<sup>105</sup> See 26 U.S.C. §§ 673, 676 (1982). Because the power of revocation potentially allows him to receive all of the assets of the trust, the grantor of a revocable trust is taxed as if the trust structure does not exist. The structure of the irrevocable trust, however, prevents the grantor from recalling the assets of the trust. Thus, the grantor of the irrevocable trust does not pay taxes on the income made by the irrevocable trust. See *Helvering v. Clifford*, 309 U.S. 331 (1940) (husband who declared himself trustee of certain securities, but retained the right to accumulate income and complete control over the principal fund, is the owner of the fund and is taxable thereupon).

<sup>106</sup> See 26 U.S.C. §§ 671, 673, 676 (1982).

<sup>107</sup> *Hendrickson*, *supra* note 26, at 44. The Service imposes a lower tax rate to the extent that the trust does not distribute its income to the beneficiaries. *Id.*

<sup>108</sup> *Id.*

which probably will be higher than the tax rates of his children.<sup>109</sup> Furthermore, through the irrevocable trust the NRA can postpone for an infinite period some generation skipping taxation.<sup>110</sup> Therefore, the NRA may use the irrevocable trust to obtain similar United States income, gift, estate, and generation skipping tax avoidance and deferral advantages that citizens of the United States enjoy.<sup>111</sup>

The NRA further benefits in that he may elect to subject his irrevocable trust to United States income, gift, estate, and generation skipping tax treatment in the same manner as if he had created a revocable trust.<sup>112</sup> To obtain revocable tax treatment, the grantor simply retains at least one rather limited interest or power, while keeping the trust irrevocable for all practical purposes.<sup>113</sup> Thus, the NRA may choose from both possible tax worlds, depending upon the demands of his individual situation.

### III. TRUST ADMINISTRATION

After the NRA creates the trust, political, economic, and personal events may necessitate a change in the trust structure. To facilitate any future modifications in the trust structure, the NRA should provide expressly within the trust agreement how and upon what circumstances such modifications are to occur. Thus, when drafting the trust agreement, the NRA should include provisions within the trust instrument that specifically address the possibility of a future need to change the situs of the trust and/or trust assets or to change

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<sup>109</sup> *Id.* Because the beneficiaries of the irrevocable trust must pay taxes on any amount received from the trust, the NRA shifts the burden of paying taxes on trust distributions to his children by naming his children as beneficiaries of the irrevocable trust. Since the NRA's children generally are in a lower tax bracket than the NRA, he may save several "tax dollars" through the creation of an irrevocable trust. If the irrevocable trust accumulates income which it subsequently does not distribute, however, the trust itself is required to pay income tax on such gain. *Id.*

<sup>110</sup> For a discussion of generation skipping taxation, see *supra* notes 76-78 and accompanying text.

<sup>111</sup> Hendrickson, *supra* note 26, at 44.

<sup>112</sup> *Id.* at 45. For example, the NRA may prefer that the Service tax an irrevocable insurance trust as if it were revocable so that he may deduct interest paid by the trust without having to include the trust corpus as gross income. *Id.*

<sup>113</sup> *Id.* For example, the grantor may require that the trustee apply any trust income to pay the premiums on insurance policies on his life which are owned by the trustee. Thus, the Service treats the grantor as the owner of the trust property, but he need not include this property in his gross estate. 26 U.S.C. § 677 (1982). This technique often is used in insurance trusts. Hendrickson, *supra* note 26, at 44; see *supra* note 112 and accompanying text.

the trustee. Furthermore, the NRA may desire to include within the trust instrument a provision which addresses the possibility of termination of the trust.<sup>114</sup>

*A. Changing the Situs of the Trust and/or Trust Assets*

When drafting the trust instrument, the NRA should include provisions to govern the transfer of the trust situs and/or assets as well as the mechanical means of effecting such transfer.<sup>115</sup> Due to the stability of the United States government and economy,<sup>116</sup> NRA's generally have omitted change of trust situs provisions in trust instruments for United States-situs trusts.<sup>117</sup> The incessant threat of international conflict, however, demands that the NRA include change of situs provisions within his trust agreement as a precautionary measure.

Transfer of trust situs provisions, also referred to as *force majeure*,<sup>118</sup> "escape" or "flee" clauses,<sup>119</sup> typically are designed to protect the trust and its assets against the possibility of expropriation or appropriation of property, political coups, or other similarly disruptive acts of political instability.<sup>120</sup> These protective clauses also seek to prevent the imposition of adverse taxation or exchange or blockage controls which were not in effect at the time of the trust's creation.<sup>121</sup> Finally, transfer provisions also allow a grantor to change trustees quickly and efficiently.<sup>122</sup>

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<sup>114</sup> Because of the close interrelationships between the trust, its assets, and the trustee, any change affecting one of these entities necessarily may affect the others. For example, if the trust situs is changed, the grantor in most situations will need to find a new trustee to control the trust assets. Despite the interrelationships between the trust entities, this Note will attempt to address possible modifications of each entity separately; however, some overlap in the process of discussion is inevitable.

<sup>115</sup> See generally Wyckoff, *supra* note 3, § 47.01, at 47-2.

<sup>116</sup> For a discussion concerning the desirability of foreign investment in the United States, see *supra* notes 3-6 and accompanying text.

<sup>117</sup> Wyckoff, *supra* note 3, § 47.04, at 47-28.

<sup>118</sup> See Kanter, *Special Clauses of Deed Settlement*, in *FOREIGN TRUSTS IN INTERNATIONAL PLANNING* 22 (H. Dale comp. 1974). *Force majeure*, translated from French to mean a "superior or irresistible power," is defined as an event which results from the forces of nature, rather than from the acts of human behavior. *Force majeure* clauses frequently are found in construction contracts to protect the parties from non-performance resulting from causes extraneous to the control of the parties which could not have been avoided through the exercise of due diligence. *THE GUIDE TO AMERICAN LAW* 268 (Vol. 5 1984).

<sup>119</sup> See Wyckoff, *supra* note 3, § 47.04, at 47-25.

<sup>120</sup> Kanter, *supra* note 118, at 22.

<sup>121</sup> Wyckoff, *supra* note 3, § 47.04, at 47-25.

<sup>122</sup> *Id.* For a detailed discussion concerning the change of trustees, see *infra* notes 139-59 and accompanying text.

The grantor may affect change of situs by any of of several methods. For example, the trust instrument may provide that the transfer of situs is to take effect automatically upon the occurrence of specified events such as war, nationalization, or the imposition of exchange controls.<sup>123</sup> The ambiguousness of the terms "war" and "nationalization", however, may lead to definitional problems. Thus, automatic transfer of situs provisions are not advisable unless the draftsman of the trust specifically defines these terms within the trust instrument.<sup>124</sup>

Rather than requiring that the transfer of situs occur automatically upon the occurrence of certain events, the NRA should provide the trustee, or a "trust protector,"<sup>125</sup> or both, with discretionary power to transfer situs if necessary.<sup>126</sup> If the grantor creates a revocable

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<sup>123</sup> Wyckoff, *supra* note 3, § 47.04, at 47-25. A *force majeure* clause might read as follows:

In the event of removal of the Trustee, or in the event of imposition of exchange control restrictions on currency accounts as may be maintained for any Trust Fund hereunder, for any other change of circumstances such as may be caused by war, nationalization or other *force majeure* which shall frustrate the purposes of this Settlement . . . the Trustee, or, in the event of inability of the Trustee to so do, then the beneficiary may at any time or times and from time to time during the Trust Period by Deed declare that this Settlement shall from the date of such declaration . . . take effect in accordance with the law of some other place . . . [T]he laws of the country named in such declaration shall be the laws applicable to this Settlement and the courts of that place shall be the forum for the administration thereof but subject to the power conferred by this sub-clause and until further declaration is made hereunder.

Kanter, *supra* note 118, at 22-23.

<sup>124</sup> Wyckoff, *supra* note 3, § 47.04, at 47-26. Thus, the trust instrument may include a provision which specifically defines the terms within the instrument. For example, the provision may read as follows: "For purposes of this agreement, 'war' is defined as: hostile contention carried on between, nations, states, or rulers, or between parties in the same nation or state, the effect of which may endanger the maintenance and the livelihood of the trust property governed by this agreement." See BLACK'S LAW DICTIONARY 1754 (4th ed. 1957).

<sup>125</sup> For a discussion of trust protectors, see *infra* notes 151-55 and accompanying text.

<sup>126</sup> Wyckoff, *supra* note 3, § 47.04, at 47-26. A transfer of situs provision may read as follows:

The situs of the trust estate may be transferred to such other place as the trustee deems it to be for the best interests of the trust estate. In so doing the trustee may resign and appoint a successor trustee by giving 10 days' written notice to each income beneficiary. The trustee may, however, remove each successor trustee so appointed and appoint another, including itself, at will. Each successor trustee so appointed may delegate any and all trustee powers, discretionary and ministerial, to the appointing trustee as its agent.

BOGERT, *supra* note 13, § 1307 (2d ed. 1969).

trust, he also should provide himself with the power to transfer situs.<sup>127</sup> A provision which calls for transfer at a party's discretion, rather than for an automatic transfer, benefits the grantor by allowing the trust to change situs only after careful deliberation by a party concerned with the welfare of the trust and its beneficiaries.<sup>128</sup>

If the trust agreement does not contain a transfer of situs provision, a United States court generally will not object to a change in the trust situs if the court determines that the change will benefit the administration of the trust or will be in the best interest of the beneficiaries.<sup>129</sup> Furthermore, some state statutes expressly authorize the courts to transfer the assets of the trust to a trustee in another state following a change of trust situs.<sup>130</sup> Several of these statutes significantly benefit the NRA by allowing the transfer of the trust to a foreign state.<sup>131</sup> Therefore, even if the grantor does not include a transfer of situs provision within the trust instrument, he still may be able to affect a change in trust situs.<sup>132</sup> Nevertheless, the NRA should include a transfer of situs provision within the trust instrument to avoid costly and time-consuming litigation.

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<sup>127</sup> Should the grantor decide to establish a revocable trust, he should include within the trust instrument provisions similar to those included in notes 123 and 126; the draftsman of the provisions, however, should replace "trustee" within the provisions with "grantor."

<sup>128</sup> See generally Wyckoff, *supra* note 3, § 47.04, at 47-26.

<sup>129</sup> BOGERT, *supra* note 13, § 861 (2d ed. rev. 1982). For example, a court may find that it would be advantageous to change the trust situs in order to bring the trust closer to the trustees or beneficiaries. See *In re Weinberger's Trust*, 250 N.Y.S.2d 887, 21 A.D.2d 780 (1964) (allowing transfer of the trust since administration of the trust had become difficult due to the location of the trust assets and the location of the trustees). Public policy does not prevent a transfer in the absence of contrary intent on the part of the grantor. *Id.*; see also *In re Henderson's Will*, 40 N.J. Super. 297, 123 A.2d 78 (1956) (application for removal of trust granted where assets of the trust consisted of cash and securities, no realty was owned by the trust, and the trust had no business interests in the state).

<sup>130</sup> See, e.g., ALA. CODE §§ 19-3-190 to 19-3-192 (1975); ARIZ. REV. STAT. ANN. § 14-7201 (1975); CAL. PROB. CODE §§ 1138.1, 1139-1139.7 (West 1981); CONN. GEN. STAT. ANN. § 45-90 (West 1981); FLA. STAT. ANN. § 737.305 (West 1983); KY. REV. STAT. ANN. § 386.170 (Baldwin 1981); MASS. GEN. LAWS ANN. ch. 204, § 3, ch. 206, §§ 29-30 (West 1958); MICH. COMP. LAWS ANN. §§ 700.835, 706.4-706.6 (West 1980); NEV. REV. STAT. 164.130 (1985); N.J. STAT. ANN. § 3A:23-1 to 3A:23-5 (West 1953); 20 PA. CONS. STAT. ANN. § 725 (Purdon 1975); VT. STAT. ANN. tit. 14, § 2311 (1974); VA. CODE ANN. § 26-64 (repl. vol. 1985).

<sup>131</sup> See, e.g., CAL. PROB. CODE §§ 1132, 1139-39.7 (West 1981); MICH. COMP. LAWS ANN. § 700.835 (West 1980) (transfer allowed to state of beneficiary's residence only); N.C. GEN. STAT. § 36A-15 (1984).

<sup>132</sup> For a discussion of judicial attitude toward change of trust situs, see *supra* note 129 and accompanying text.

Once the grantor, trustee, or trust protector decides to transfer the trust situs, he must decide upon a location to re-establish the trust. Since the exigencies of the NRA's situation might demand that a transfer occur immediately, he should establish a second trust in a different jurisdiction at the same time that he creates the first trust.<sup>133</sup> This "fallback" trust would have a written provision concerning the acquisition of the first trust. Such a provision would permit a virtually automatic transfer of responsibility for administration of the trust from a politically or economically unstable locale to a more stable one.<sup>134</sup>

Even if the trust instrument does not identify a specific "fallback" jurisdiction to which the trust may be transferred, the instrument should provide some limitations on the jurisdiction in which the trust may be relocated.<sup>135</sup> For instance, the instrument should include a provision which ensures that the transfer to another jurisdiction will not result in a violation of the rule against perpetuities.<sup>136</sup> The instrument also should include a provision which allows transfer only to a jurisdiction which will not enlarge or diminish the rights of the trust beneficiaries to the trust assets.<sup>137</sup> Finally, the instrument should provide that the jurisdiction in which the trust is relocated will not impose any restrictions on the investment power of the trustees.<sup>138</sup> By including these provisions within the trust instrument, the NRA ensures that a change of situs will not change significantly the powers of the trustee or the rights of the beneficiaries.

### *B. Changing the Trustee*

Following the creation of the trust, the NRA grantor may desire to change the trustee of the trust. Any one of several reasons may necessitate a change of trustee. First, the grantor's or a beneficiary's dissatisfaction with the trustee's exercise of his fiduciary responsi-

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<sup>133</sup> Kanter, *supra* note 118, at 23-24; Wyckoff, *supra* note 3, § 47.04, at 47-25. For example, several Bahamian trust companies have organized sister trust companies or subsidiaries in Jamaica, the Channel Islands, or the Cayman Islands. These subsidiaries typically maintain records, usually on microfilm, of the trust instrument and the significant trust accounts. At least one copy of these records is held in safekeeping in a Swiss, United States, or Canadian bank. Kanter, *supra* note 118, at 24.

<sup>134</sup> *Id.*

<sup>135</sup> See Wyckoff, *supra* note 3, § 47.04 at 47-27.

<sup>136</sup> *Id.* For a discussion of the rule against perpetuities, see *supra* note 34.

<sup>137</sup> Wyckoff, *supra* note 3, § 47.04, at 47-27.

<sup>138</sup> *Id.*

bilities may lead to a disruptive relationship between the trustee and the grantor and/or the beneficiary.<sup>139</sup> Second, the possibility of the trustee's resignation,<sup>140</sup> incapacity,<sup>141</sup> or death,<sup>142</sup> may necessitate a change of trustee.

Moreover, political, economic, and social changes may require a transfer of the trust situs,<sup>143</sup> which, in turn, may necessitate a change of the trustee to ensure efficient management of trust assets.<sup>144</sup> In addition, the beneficiary of the trust may move to another jurisdiction, thus making it difficult, or at least inconvenient, to consult with the trustee regarding the beneficiary's investment needs and thus necessitating a change of trustee.<sup>145</sup> Finally, the beneficiaries of a trust may change over time, and a different trustee may be desirable to take care of the possible changing needs of these "successor-beneficiaries."<sup>146</sup>

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<sup>139</sup> Kanter, *supra* note 118, at 25. Compatibility between the trustee and the beneficiary is significant, especially where the trust agreement provides the trustee with broad discretionary powers with regard to the investment, distribution, and accumulation of trust assets. As a practical matter, as more discretionary power is allotted to the trustee, the possibility of the grantor's or beneficiary's dissatisfaction with the trustee's exercise of his discretion increases, and thus, the need for a provision concerning the change of trustees increases. *See id.*

<sup>140</sup> *See, e.g.,* Kenady v. Edwards, 134 U.S. 117 (1889). The trustee has the right to resign his office so long as he uses an established legal mode to do so. *Id.* at 125. Thus, the trustee cannot resign from his office or from the responsibilities attached to that office unless such resignation is sanctioned by decree of a court having jurisdiction in the premises, by a provision within the trust instrument, or by the consent of all of the trust's beneficiaries who have the capacity to give consent. RESTATEMENT (SECOND) OF TRUSTS § 106 (1959).

<sup>141</sup> *See id.* § 107. The court may remove a trustee who becomes bankrupt or insolvent but is not required to do so. *Id.* § 107 at comment d. *See, e.g.,* In re Strasser's Estate, 220 Iowa 194, 262 N.W. 137 (1935) (allowing appointment of successor trustee where original trust company became insolvent after receiving the trust).

<sup>142</sup> "Upon the death of one of several trustees, the title to the trust property is in the survivors as trustees." RESTATEMENT (SECOND) OF TRUSTS § 103 (1959). "Upon the death intestate of a sole trustee, the title to the trust property passes subject to the trust, if realty, to his heir, and, if personalty, to his personal representative, unless it is otherwise provided by the terms of the trust or by statute." *Id.* § 104. "Upon the death of the sole trustee who has devised or bequeathed the trust property, the title to the trust property passes subject to the trust to the devisee or legatee, unless it is otherwise provided by the terms of the trust or by statute." *Id.* § 105.

<sup>143</sup> For a discussion of transfer of trust situs, see *supra* notes 115-38 and accompanying text.

<sup>144</sup> *See* Kanter, *supra* note 118, at 26.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*



Therefore, when drafting the trust instrument, the NRA may find it advantageous to include provisions which expressly permit a change of trustee. When drafting the change in trustee provision, the NRA must consider how and upon what circumstances such a change is to occur.<sup>147</sup> For example, similar to the transfer of trust situs provision,<sup>148</sup> the trust instrument may provide that the change of trustee is to take effect automatically upon the occurrence of specified events. The problems associated with defining "triggering events," however, indicate that drafting an automatic change of trustee provision may be very difficult.<sup>149</sup>

Rather than requiring the change of trustee to occur automatically upon the occurrence of specified events, the NRA should provide that the grantor or the beneficiary may change trustees at their individual respective discretion.<sup>150</sup> In addition to giving the grantor or the beneficiary the discretion to remove the trustee, the NRA also may give another person acting as a "trust protector" the same discretion.<sup>151</sup> The primary advantage of giving the trust protector such discretion is that he provides an additional protective element for the trust.<sup>152</sup> The trust protector acts independently of the trustee, and therefore, he can protect the trust in situations in which the trustee in the local jurisdiction may be incapable of acting.<sup>153</sup> One disadvantage

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<sup>147</sup> Dale, *Protection of Trust Assets*, in FOREIGN TRUSTS IN INTERNATIONAL PLANNING 111, 121 (H. Dale comp. 1974).

<sup>148</sup> *Id.* For a discussion of automatic transfer of situs provisions, see *supra* note 123 and accompanying text.

<sup>149</sup> For a discussion of the definitional problems of "triggering events," see *supra* note 124 and accompanying text.

<sup>150</sup> See Dale, *supra* note 147, at 121. For example, a change of trustee provision may read as follows: "The beneficiary for the time being of each separate trust hereunder may remove any trustee thereof with or without cause by delivering to the said trustee a written instrument signed by such beneficiary PROVIDED that such written instrument shall concurrently appoint a successor . . . trustee as hereinafter provided." Kanter, *supra* note 118, at 27.

<sup>151</sup> Wyckoff, *supra* note 3, § 47.04, at 47-27.

<sup>152</sup> *Id.* In many respects the trust protector acts as a "watchdog" on the trustee. Specifically, the NRA can provide within the trust instrument that the trust protector will have the powers to remove the trustee and to name a successor trustee, to approve any investments made by the trustee, to approve distributions of the trust income and capital, and to transfer the situs of the trust and/or the trust assets to a new jurisdiction. *Id.*, § 47.04, at 47-29.

<sup>153</sup> *Id.* § 47.04, at 47-27. Thus, the NRA should appoint a trust protector who is located in a state other than that in which the trustee is located. Furthermore, to ensure that the trust protector has the best interests of the grantor or the beneficiary in mind, the trust protector generally should be a close relative or friend of the grantor or the beneficiary. *Id.* § 47.04, at 47-29.

of designating a trust protector, however, is that the trust protector's commissions may elevate the cost of administering the trust.<sup>154</sup> Furthermore, the NRA may be hesitant to provide the trust protector with such broad powers of discretion and control over the enjoyment and transfer of the trust, particularly if the trust protector is also a beneficiary of the trust.<sup>155</sup>

If the NRA does not provide expressly within the trust instrument for a change of trustee, a court of equity may in its discretion remove a trustee for good cause.<sup>156</sup> A court, however, is unlikely to remove a trustee appointed by the grantor upon a ground known to the grantor at the time of the trustee's appointment,<sup>157</sup> unless such removal is necessary for the proper administration of the trust.<sup>158</sup> Thus, a court will not discharge a trustee from his office merely for leaving the jurisdiction of the trust, although a court may justifiably discharge a trustee where his departure from the trust jurisdiction has interfered with the administration of the trust.<sup>159</sup> Nevertheless, since litigation over trust administration may be costly and time consuming, the NRA should include a provision within the trust agreement which expressly provides for the change of trustee.

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<sup>154</sup> *Id.*

<sup>155</sup> *Id.* Therefore, the NRA may opt to establish a purely advisory trust protector with whom the trustee is requested, but not required, to confer before taking any actions which would affect the trust. *Id.*

<sup>156</sup> See, e.g., *Brown v. Memorial Nat'l Home Found.*, 162 Cal. App. 2d 513, 329 P.2d 118 (1958) (diversion of trust funds for unauthorized uses, inefficiency, mismanagement, hostility to beneficiaries, and assumption of an adverse trust are good grounds for removal of trustee); *Boyd v. Frost Nat'l Bank*, 145 Tex. 206, 196 S.W.2d 497 (1946) (court may intervene to prevent trust from being devoted to an unauthorized purpose and may compel a recusant trustee to act or may remove a faithless or inactive trustee and appoint another).

<sup>157</sup> RESTATEMENT (SECOND) OF TRUSTS § 107 comment f (1959).

<sup>158</sup> See, e.g., *In re Guardianship of Brown*, 436 N.E.2d 877 (Ind. App. 1982) (removal of trustee held proper where record revealed atmosphere of distrust and animosity between trustee and beneficiaries); *Brown v. Batt*, 631 P.2d 1346 (Okla. App. 1981) (removal of trustee held proper where extreme hostility between trustee and all beneficiaries had existed from inception of trust and had escalated in intensity). *But see* *Succession of Noe*, 398 So.2d 1173 (La. App. 1981), *cert. denied*, 405 So.2d 530 (1981) (allegations of hostility which amounted to nothing more than allegations of social or family animosity or incompatibility were insufficient, without more, to warrant removal of trustee).

<sup>159</sup> E.g., *Letcher's Trustee v. German Nat'l Bank*, 134 Ky. 24, 119 S.W. 236 (1909) (court which appoints a trustee has the power to remove her and appoint another in her stead when she goes out of the jurisdiction of such court); see *Blumenstiel v. Morris*, 207 Ark. 244, 180 S.W.2d 107 (1944) (removal of a trustee because of his absence is in the sound discretion of the trial court).

### C. Terminating the Trust

Finally, the NRA may desire to include within the trust agreement a provision allowing for the termination of the trust. A trust may be terminated prior to the expiration of its scheduled term only by the grantor's exercise of a power of revocation<sup>160</sup> or by a power of termination.<sup>161</sup> The power of termination exists where a party other than the grantor<sup>162</sup> may close the trust and distribute the trust assets to the grantor, the beneficiaries, or others, such as creditors or assignees.<sup>163</sup> A party may exercise the power of termination only in accordance with a provision within the trust agreement, the acts of beneficiaries of the trust, or the decree of a court.<sup>164</sup>

Generally, implied reservations for trust termination are not available to the grantor.<sup>165</sup> Thus, the NRA who desires to retain the power to terminate the trust should provide for such power expressly within the trust instrument.<sup>166</sup> When drafting the termination of trust provision, the NRA must consider how and upon which circumstances the termination is to take effect. For example, the NRA may provide that termination of the trust will take effect automatically upon the occurrence of specified events.<sup>167</sup> As in the case of automatic change

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<sup>160</sup> For a discussion of revocable trusts, see *supra* notes 64-85 and accompanying text.

<sup>161</sup> BOGERT, *supra* note 13, § 998 (2d ed. rev. 1983).

<sup>162</sup> Generally, any termination of the trust by the grantor is viewed as a revocation of the trust. When the grantor is the sole beneficiary of the trust, however, he can compel the termination of the trust, even if the purposes of the trust have not been fully accomplished and regardless of whether the trust is revocable, conditionally revocable, or irrevocable. RESTATEMENT (SECOND) OF TRUSTS § 339 (1959).

<sup>163</sup> BOGERT, *supra* note 13, § 998 (2d ed. rev. 1983).

<sup>164</sup> *Id.* See *infra* note 170 and accompanying text.

<sup>165</sup> Nevertheless, a few state statutes allow the grantor to revoke the trust by notice to the trustee unless the trust was expressly made irrevocable. See, e.g., CAL. CIV. CODE § 2280 (West 1985); OKLA. STAT. ANN. tit. 60, § 175.41 (West 1971); TEX. PROP. CODE ANN. § 112.051 (Vernon 1984). Most state statutes, however, provide that a trust is irrevocable unless expressly made revocable. See, e.g., GA. CODE ANN. § 53-12-3 (1982); LA. REV. STAT. ANN. § 9:2041 (West 1981); MONT. CODE ANN. § 72-23-502 (1985); NEV. REV. STAT. § 163.560 (1985); N.D. CENT. CODE § 59-02-18 (1985); S.D. CODIFIED LAWS ANN. § 55-3-6 (1980).

<sup>166</sup> BOGERT, *supra* note 13, § 1000 (2d ed. rev. 1983).

<sup>167</sup> An automatic termination clause may read as follows:

In the event that [*state condition, such as: war is declared by or upon the nation in which said trust is located*], trustee may terminate such trust and distribute the principal and any accrued or undistributed net income of such trust [*specify distributee(s), such as: to the income beneficiary of such trust*].

AM. JUR. LEGAL FORMS (SECOND) REVISED § 251.475 (1984).

of situs and automatic change of trustee provisions, however, automatic termination of trust provisions generally are not desirable.<sup>168</sup>

Rather than requiring that the trust terminate upon the occurrence of specified events, the NRA should provide expressly within the trust instrument that the trustee, beneficiary, or trust protector, or a combination of all three, shall have the power to terminate the trust at their individual respective discretion.<sup>169</sup> Furthermore, the NRA should provide expressly for the method by which the power of termination is to be exercised.<sup>170</sup> However, if the termination provision does not specify the procedure for termination, most courts probably

<sup>168</sup> For a discussion of the undesirability of automatic change of situs and automatic change of trustee provisions, see *supra* notes 123-24, 148-49 and accompanying text.

<sup>169</sup> BOGERT, *supra* note 13, § 1000 (2d ed. rev. 1983). Even though by giving the trustee and/or the trust protector the power to authorize distribution of the trust assets to the beneficiaries, the grantor empowers the trustee and/or the trust protector to terminate the trust partially, such authority does not allow the trustee and/or the trust protector to transfer all the trust principal at one time, thereby terminating the trust. See *Jordon v. Campbell*, 19 N.C. App. 97, 198 S.E.2d 96 (1973), *cert. denied*, 283 N.C. 753, 198 S.E.2d 722 (1973); *Buchanan v. Paterson*, 188 N.Y.S.2d 161, 159 N.E.2d 661 (1959); see also BOGERT, *supra* note 13, § 1000 (2d ed. rev. 1983). When drafting the termination of trust provision, the NRA might use the following clause:

[specify party(ies) to have power of termination, such as: The beneficiaries] of this trust shall be entitled to terminate the trust in whole or in part at any time on delivery to trustee of a written demand signed by [all] of the then beneficiaries. Trustee shall then pay the trust estate, together with its accumulations, or the part thereof for which demand is made, to the then beneficiaries.

AM. JUR. LEGAL FORMS (SECOND) REVISED § 251.473 (1984).

If the NRA decides to use a trust protector to "watch over" the trust, he may want to include the following provision:

Beneficiaries [or whomever the grantor wishes to designate] shall have the right, on due demand therefor by instrument in writing filed with trustee and with consent in writing of [trust protector], to terminate this trust. Thereupon, the trust property then in trustee's possession shall be distributed to beneficiaries.

*Id.* § 251.474.

<sup>170</sup> See RESTATEMENT (SECOND) OF TRUSTS § 330 (1959). See, e.g., *Gamage v. Liberty Nat'l Bank & Trust Co.*, 598 S.W.2d 463 (Ky. App. 1980) (when a trust instrument expressly provides for a specific method of revocation, the grantor must comply with the expressed method for the revocation to be effective); *Funk v. Funk*, 24 Wash. App. 19, 598 P.2d 792 (1979) (when a trust agreement specifies the method of revocation, only the expressed method may be utilized to revoke the trust); *Hibernia Bank v. Wells Fargo Bank*, 136 Cal. Rptr. 60, 66 Cal. App. 3d 399 (1977) (trust not revoked effectively where the trust instrument expressly provided for revocation by written, notarized notice to the trustee signed by both the grantor and her attorney, but the grantor actually sent to the trustee a written statement which had not been notarized nor signed by the grantor's attorney).

will allow any reasonable procedure.<sup>171</sup> Most courts also will allow a termination which the grantor did not reserve expressly within the trust instrument, if the circumstances demand such a revocation.<sup>172</sup>

Once the trust is terminated, whether by the expiration of its fixed term, revocation, by court decree, or otherwise, the trust continues to operate for a reasonable time.<sup>173</sup> During this time the trustee has the authority and responsibility to perform those acts which are appropriate for the "winding up" of the trust.<sup>174</sup> When winding up the trust, the trustee continues to protect and preserve the trust property and, in some circumstances, may convert the trust property to cash for distribution to the trust beneficiaries.<sup>175</sup> The trustee, however, may not make new and permanent investments without prior approval of the beneficiaries unless such investments are connected directly with the winding up of the trust and distribution of the assets to the beneficiaries.<sup>176</sup>

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<sup>171</sup> See, e.g., *In re Estate of Craft*, 320 So.2d 874 (Fla. App. 1975) (a new trust agreement, which provided for the object and subject matter of the trust, as well as a subsequent letter confirmation, was sufficient to revoke a prior trust); *In re Gifford Estate*, 18 Pa. D. & C.2d 769, 9 Pa. Fiduc. 631 (1959) (where no method of revoking a revocable trust is set forth in the instrument, the trust may be revoked informally and orally without consulting the trustee).

<sup>172</sup> RESTATEMENT (SECOND) OF TRUSTS § 336 (1959). "If owing to circumstances not known to the settlor and not anticipated by him the continuance of the trust would defeat or substantially impair the accomplishment of the purposes of the trust, the court will direct or permit the termination of the trust." *Id.*

<sup>173</sup> See, e.g., *American Cancer Soc'y v. Hammerstein*, 631 S.W.2d 858 (Mo. App. 1981) (trustee not liable for postponing distribution of the trust assets beyond termination where litigation involving the trustee was pending); *Cogdell v. Fort Worth Nat'l Bank*, 537 S.W.2d 304 (Tex. 1976) (trustee not liable for postponing distribution of trust assets beyond termination when trust was involved in litigation at the time of termination).

<sup>174</sup> RESTATEMENT (SECOND) OF TRUSTS § 344 (1959). The trustee has the responsibility to wind up the administration of the trust with reasonable care and prudence. BOGERT, *supra* note 13, § 1010 (2d ed. rev. 1983).

<sup>175</sup> *Id.* If the trustee delays in making distributions upon the termination of the trust, he may be held liable for interest. *In re Ducker's Will*, 161 N.Y.S.2d 549, 3 A.D.2d 852, *reargument denied*, 164 N.Y.S.2d 995, 3 A.D.2d 937 (1957) (interest was assessed where trustee unreasonably delayed in accounting and in paying over trust funds). *But see* *Continental Ill. Nat'l Bank & Trust Co. of Chicago v. Roan*, 617 F.2d 1217 (7th Cir. 1980) (trustee not liable for failure to convey the trust property promptly upon termination where there had been protracted negotiations regarding the proper distribution of trust assets among various beneficiaries).

<sup>176</sup> *McBride v. McBride*, 262 Ky. 452, 90 S.W.2d 736 (1936) (upon termination of the trust, the duty of the trustee to persons beneficially entitled is to take appropriate steps for winding up the estate by making distributions, and thereupon the power to make further investments ordinarily ceases).

## IV. CONCLUSION

Although the properly planned and managed failsafe trust offers the NRA several attractive benefits, the effectiveness of this investment device for the protection of assets from local and foreign governmental action is still a matter for conjecture.<sup>177</sup> Ultimately, the NRA must assess several subjective and factual considerations to determine whether a failsafe trust will serve effectively his investment needs.<sup>178</sup> If he decides to establish a failsafe trust, the NRA must then determine how to structure this device so as to meet these needs.

Although the United States provides the NRA with a politically and economically secure investment situs,<sup>179</sup> expert management for the trust,<sup>180</sup> and several tax advantages,<sup>181</sup> the NRA probably will benefit more from a trust situated in a foreign situs. Despite the political stability of the United States, the United States government has a history of involvement, either directly or indirectly, in the political conflicts of other nations. Thus, ironically, the occurrence of a home country political emergency could prevent the NRA grantor from benefiting from a United States investment device which he structured in anticipation of such an occurrence.<sup>182</sup>

To ensure the security of his investment, the NRA must select carefully the proper foreign situs for the trust.<sup>183</sup> By situating the trust in one of several "tax havens,"<sup>184</sup> the NRA will protect best his investment needs. Before selecting a particular tax haven in which to situate the trust, however, the NRA should thoroughly investigate this country.<sup>185</sup> For example, it is essential that the NRA examine

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<sup>177</sup> Wyckoff, *supra* note 3, § 47.04, at 47-25.

<sup>178</sup> For a discussion of the relevant factors which may be significant in determining whether to establish a failsafe trust, see *supra* notes 100-01 and accompanying text.

<sup>179</sup> For a discussion concerning the desirability of investment in the United States, see *supra* notes 3-5 and accompanying text.

<sup>180</sup> For a discussion of the advantages of management by a United States trustee, see *supra* note 28 and accompanying text.

<sup>181</sup> For a discussion of the tax advantages provided within the United States, see *supra* notes 36-38 and accompanying text.

<sup>182</sup> Knight, *supra* note 7, at 114.

<sup>183</sup> For a discussion of the advantages and disadvantages associated with a foreign-situs trust, see *supra* notes 51-63 and accompanying text.

<sup>184</sup> For a discussion of tax havens, see *supra* note 51 and accompanying text.

<sup>185</sup> A. STARCHILD, *TAX HAVENS* 24 (1979). In particular, the NRA should investigate the charges imposed by the country for maintenance of the trust, the flexibility of the corporate structure within the country, exchange controls and monetary freedom within the country, accessibility to and around the country, professional services within the country, and the possibility for local business activities within the country. *Id.* at 25-28.

the past and current political and social developments within the country.<sup>186</sup> Although some jurisdictions may be undesirable for the creation of the trust, several tax havens exist which are secure economically and politically and which appear to remain secure in the future.<sup>187</sup>

Once he selects the trust situs, the NRA also may encounter difficulty in deciding whether to select a revocable, conditionally revocable, or irrevocable trust. Although the NRA receives the best tax advantages through the irrevocable trust,<sup>188</sup> the conditionally revocable trust<sup>189</sup> probably presents the most effective protection against home country expropriation or United States freezing. Once the NRA creates an irrevocable trust, he forfeits all personal power over the trust,<sup>190</sup> thus making it difficult to prevent expropriations. Similarly, the NRA may be powerless to prevent expropriation of assets within a revocable trust if a political emergency occurs within his home country. By creating a conditionally revocable trust and by providing for a trust protector situated in another country with discretionary power to transfer the situs of the trust,<sup>191</sup> the NRA best maintains the opportunity to prevent expropriation of his trust property.

When drafting the trust agreement, the NRA also should include provisions concerning the transfer of situs, the change of trustee, and the termination of the trust. Ambiguity in defining the events which would trigger an automatic modification indicates that automatic transfer of situs, change of trustee, and termination of trust provisions are undesirable.<sup>192</sup> Thus, to ensure efficient and expedient

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<sup>186</sup> *Id.* at 28-31.

A country that is involved in a civil war, or that regularly changes governments "by bullet," or that has a strong socialist political faction is hardly to be trusted to keep investment assets secure. A political upheaval, or even a change in legislation introducing taxes or other restrictions on corporations or trusts, may take away everything.

*Id.* at 29.

<sup>187</sup> Examples of such tax havens include the Bahamas, Barbadoes, Bermuda (despite past political tensions), the British Virgin Islands, the Cayman Islands, Costa Rica, Hong Kong, Liberia, Liechtenstein, and Netherlands Antilles. *Id.* at 225-46.

<sup>188</sup> For a discussion of the tax advantages associated with irrevocable trusts, see *supra* notes 102-13 and accompanying text.

<sup>189</sup> For a discussion of conditionally revocable trusts, see *supra* notes 86-92 and accompanying text.

<sup>190</sup> For a discussion of the limitations of the irrevocable trust, see *supra* notes 93, 99 and accompanying text.

<sup>191</sup> For a discussion of trust protectors, see *supra* notes 151-55 and accompanying text.

<sup>192</sup> For a discussion of automatic provisions, see *supra* notes 123-24, 148-49, 167-68 and accompanying text.

modifications, the NRA should provide that any change or transfer will take effect at the discretion of the grantor, the beneficiary, the trustee, a trust protector, or a combination of these parties.<sup>193</sup> Such discretionary provisions ensure that a transfer or change will occur at the discretion of a party acting for the benefit of the trust and its beneficiaries.

In summary, the NRA will serve best his investment needs by creating a conditionally revocable, foreign-situs trust located within a politically secure tax haven. Furthermore, the trust agreement for this investment structure should include several precautionary provisions which will enable the trust to adapt to future events.<sup>194</sup> The NRA, however, should realize that little can be done, excepting normal legal procedures, to protect property actually located in a country which is subject to a political emergency.<sup>195</sup> Therefore, if the NRA is concerned about the political or economic stability of a particular country, he should maintain as few assets as possible within that country to avoid seizure of his property.<sup>196</sup>

Furthermore, timing is of the essence for the NRA wishing to invest abroad. The NRA should investigate thoroughly the countries in which he wishes to situate his investment structures so that he may predict with some degree of certainty the events of the future. The NRA's safest investment plan would be to disburse his assets into several different investment devices within several different countries. Thus, the NRA might create one or more United States-situs trusts as well as one or more foreign-situs trusts. The trust instruments for these trusts would include provisions which would allow for a countless number of trust situs, assets situs, and trustee changes, as well as for the potential termination of the trust.<sup>197</sup> By maintaining his investments in several devices and jurisdictions, the NRA ensures that a single political or economic catastrophe will not lead to a depletion of his entire estate.

*Andrew H. Prussack*

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<sup>193</sup> For a discussion of discretionary provisions, see *supra* notes 125-28, 150-55, 169-72.

<sup>194</sup> Hendrickson, *supra* note 26, at 46.

<sup>195</sup> Kanter, *supra* note 118, at 24.

<sup>196</sup> *Id.*

<sup>197</sup> Hendrickson, *supra* note 26, at 46.