

## IAP Private Clients 2024: Case Study 3

### The German Company with its Swiss-US-Liechtenstein Estate Plan

Ms. H

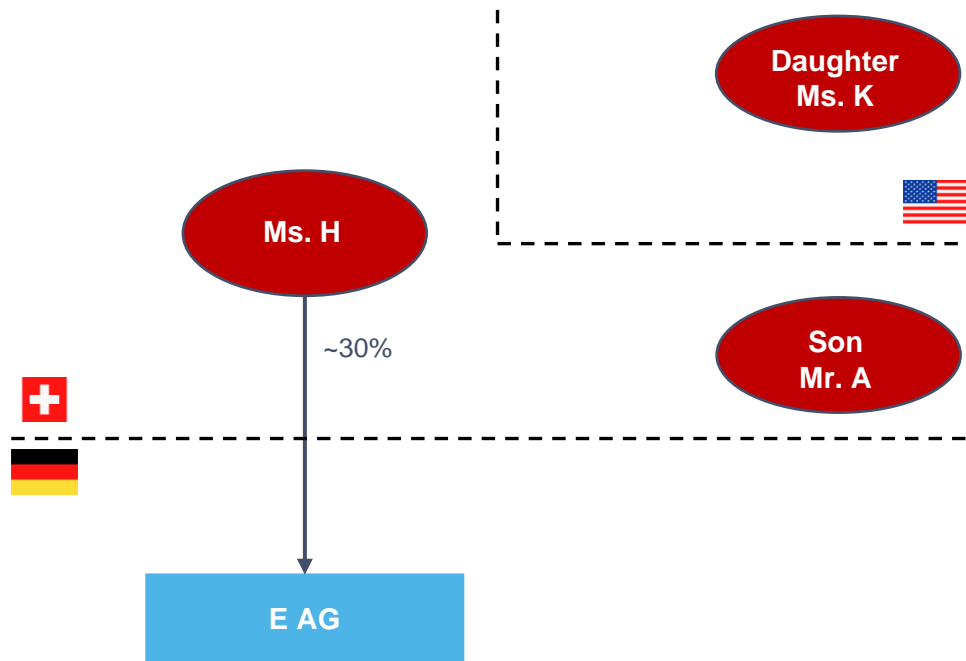
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# Initial Situation

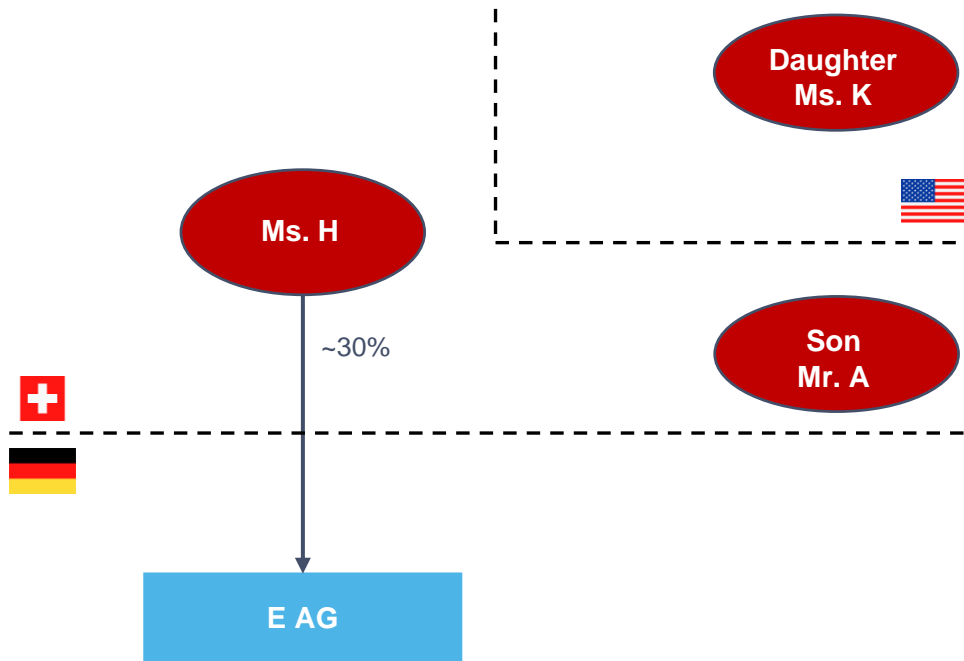
## Locations, Governance Goals



- **E AG** = German stock corporation (operating family business)
- **Ms. H**
  - German citizen and tax resident in CH (Graubünden) for >10 years
  - Subject to modified lumpsum taxation (*modifizierte Pauschalbesteuerung*)
  - Currently holds ~30% of the shares in E AG
- **Ms. K** = Ms. H's daughter
  - Lives in New York for > 10 years, not tax-resident in Germany
  - Ms. H intends pass on the full control over the E AG shares (including representation in supervisory board of E AG and decision about sale of share) to Ms. K.
- **Mr. A** = Ms. H's son
  - German citizen and a long-term tax resident in CH (Graubünden).
  - On good terms with Ms. H, but not good with money. Ms. H thinks, he should be 'protected from himself' and not have control over too much wealth
  - Mr. A and his descendants shall participate equally in the economic benefits from E AG like Ms. K and her descendants

# Initial Situation

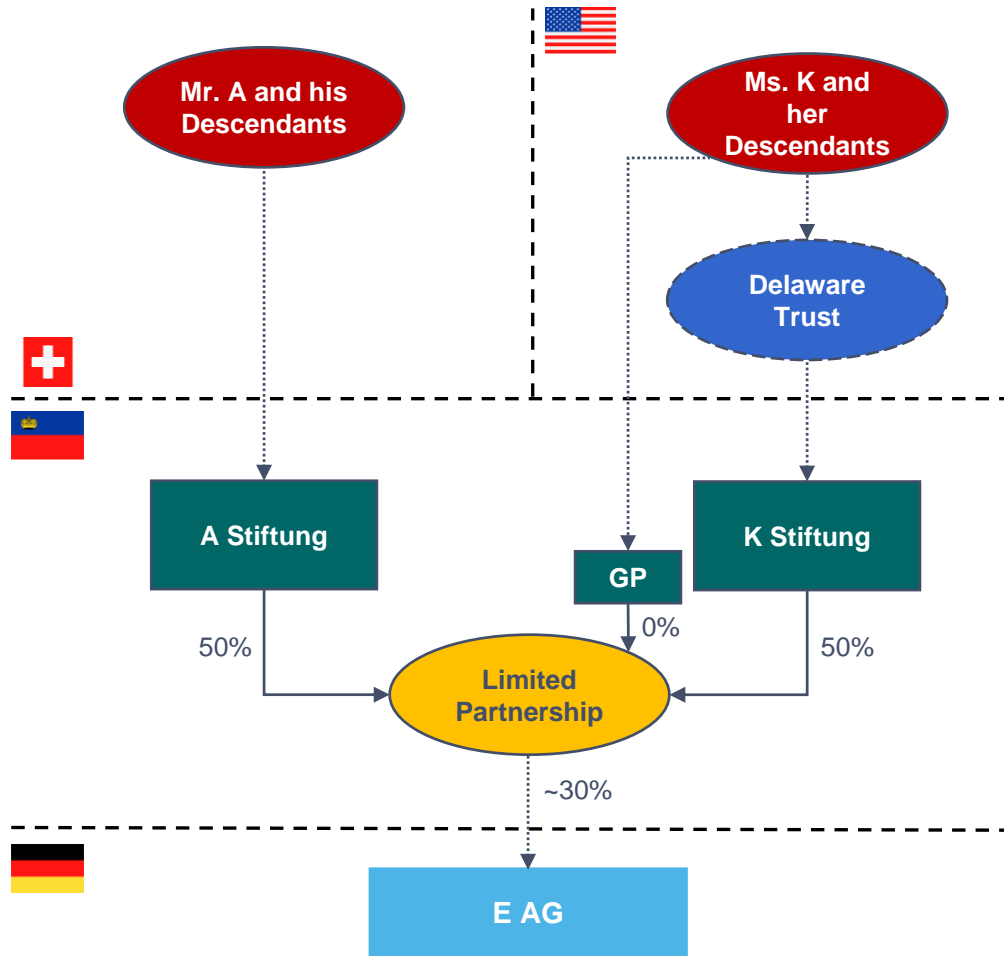
## Basic Tax Aspects



- **Income Tax (ongoing taxation of dividends):**
  - Source taxation in Germany (15% according to DTT Ger-CH), credited in CH. Final taxation in CH on the level of Ms. H
- **Capital Gains Tax (taxation of future sale of shares)**
  - No taxation in Germany (Art. 13 DTT Ger-CH)
  - Generally no taxation on the sale of private assets in CH (exceptions apply)
  - No taxation in USA (no nexus)
- **Transfer Tax**
  - Passing of Ms. H:
    - No inheritance tax in Germany under DTT (Inheritance Tax) Ger-CH
    - No CH inheritance tax if descendants are the heirs
    - No US estate tax: Ms. H not a US person, no US-located assets
  - Life-time gift:
    - Gift tax in Germany, because E AG is located in Germany – DTT Ger-CH does not apply for gifts!! → planning only possible based on transfer upon death
    - No gift tax in CH if descendants are recipients

# Estate Plan – Target Structure

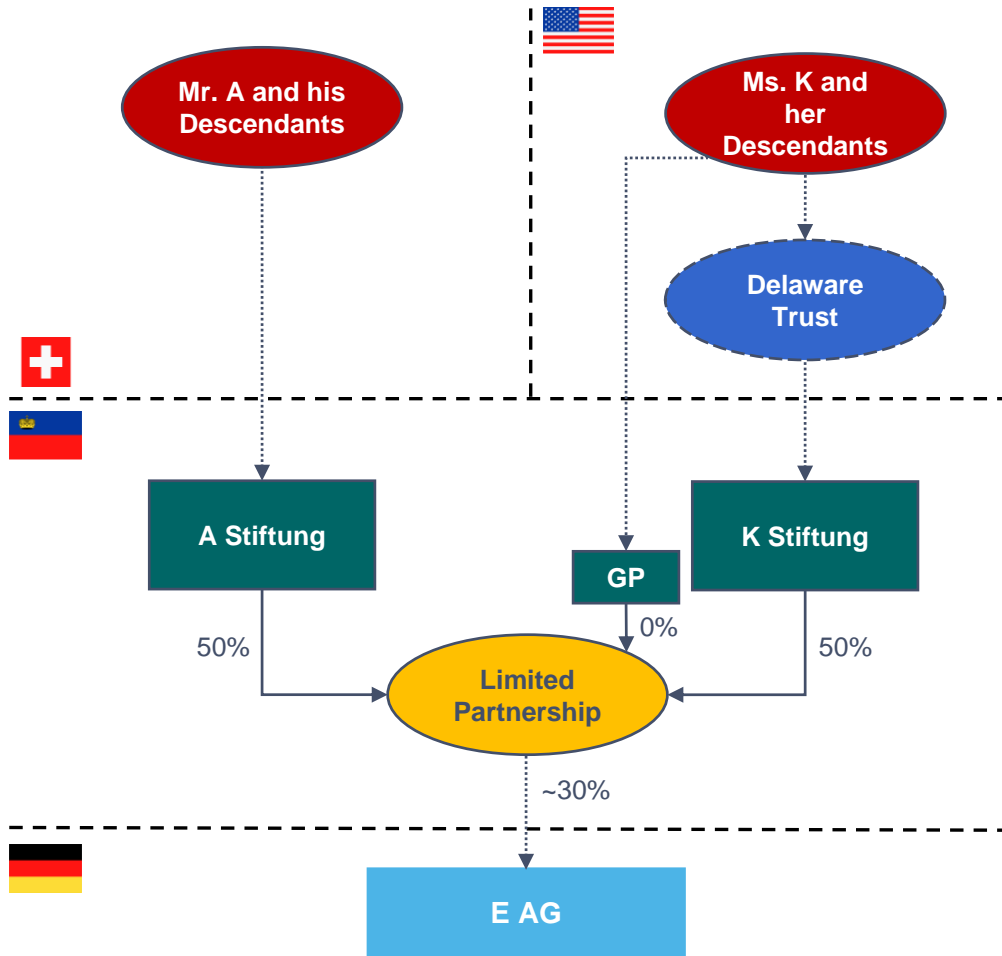
## Governance Aspects



- Use of **Liechtenstein Stiftungen** as economic shareholders for tax purposes
  - A Stiftung: Protection Mr. A from too easy availability of wealth (higher threshold for distribution >1.5m per year)
  - K Stiftung: holding vehicle for Ms. K + descendants (also after a potential future relocation back to Europe)
- **Liechtenstein LP**
  - Direct shareholder of E AG, used to pool control rights for (initially) Ms. K (LP is fully controlled by GP = Liechtenstein GmbH, to be owned by Ms. K after Ms. H's passing)
  - Fully tax-transparent
  - All income fully distributed to Stiftungen every year

# Estate Plan – Target Structure

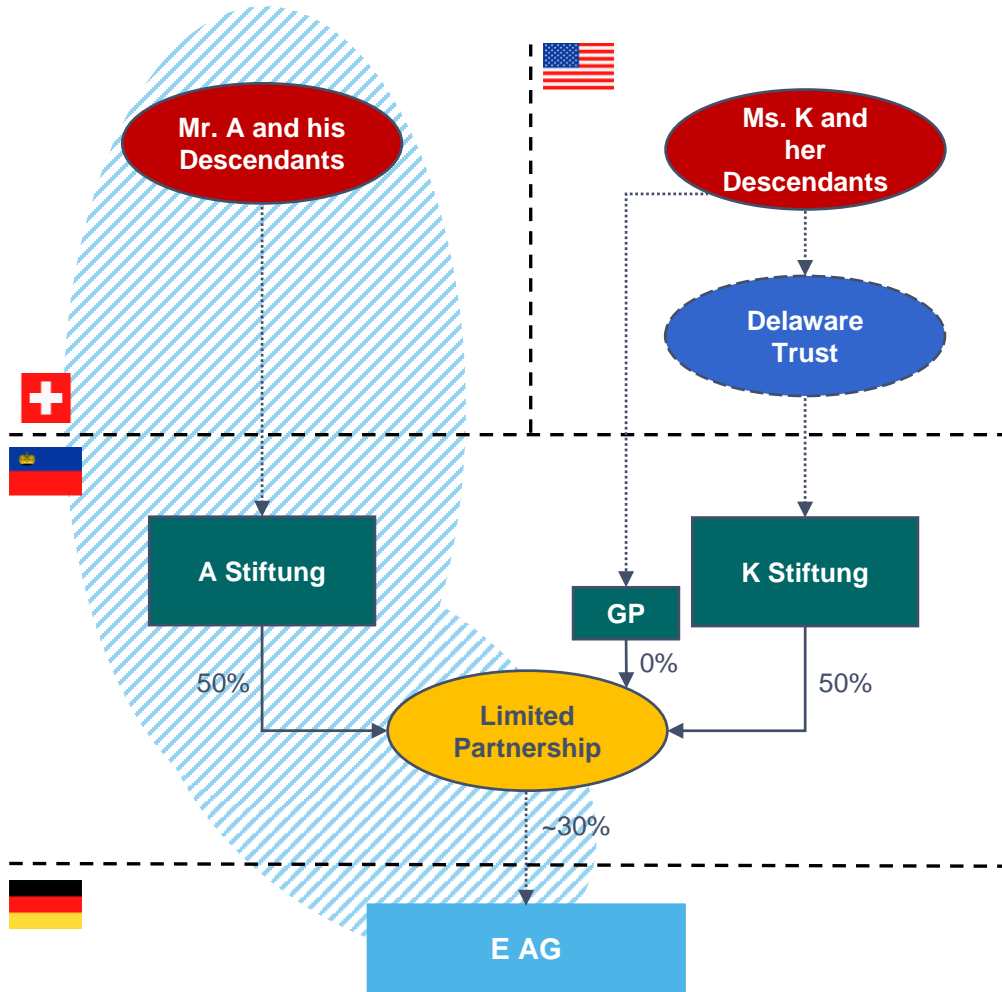
Tax Aspects: Transfer Tax upon Passing Ms. H



- Upon Ms. H's passing, Stiftungen will inherit the shares directly and will then straightaway contribute them to the LP
- **Germany:** No inheritance tax under DTT (inheritance) Ger-CH
- **CH:** No inheritance tax – ruling necessary that exception for descendants applied also for Stiftungen!
- **US:** No connection (Ms. H not a US person, E AG not US-located)

# Estate Plan – Target Structure

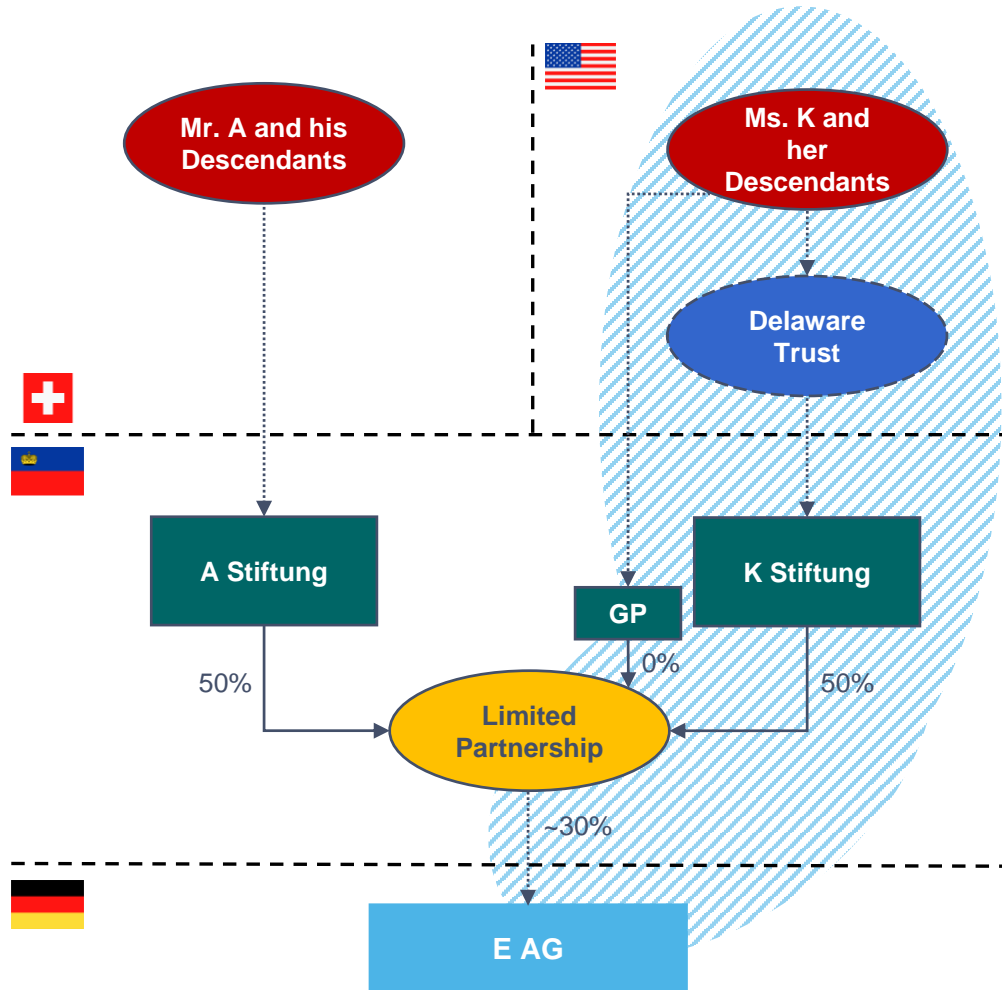
Tax Aspects: Income / Capital Gains Tax CH-Side (A Stiftung)



- **Dividends from E AG to A Stiftung:**
  - Withholding tax in Germany – unclear, whether partial reimbursement by A Stiftung possible
  - (Almost) no taxation in Liechtenstein
  - No taxation in CH (A Stiftung = opaque)
- **Capital Gains Tax (A Stiftung):**
  - No taxation in Germany (participation exemption)
  - (Almost) no taxation in Liechtenstein
  - No taxation in CH (A Stiftung = opaque)
- **Distributions to Mr. A (from A Stiftung)**
  - No withholding tax in Liechtenstein
  - Regular taxation in CH

# Estate Plan – Target Structure

Tax Aspects: Income / Capital Gains Tax US-Side (K Stiftung)



- Germany / Liechtenstein:

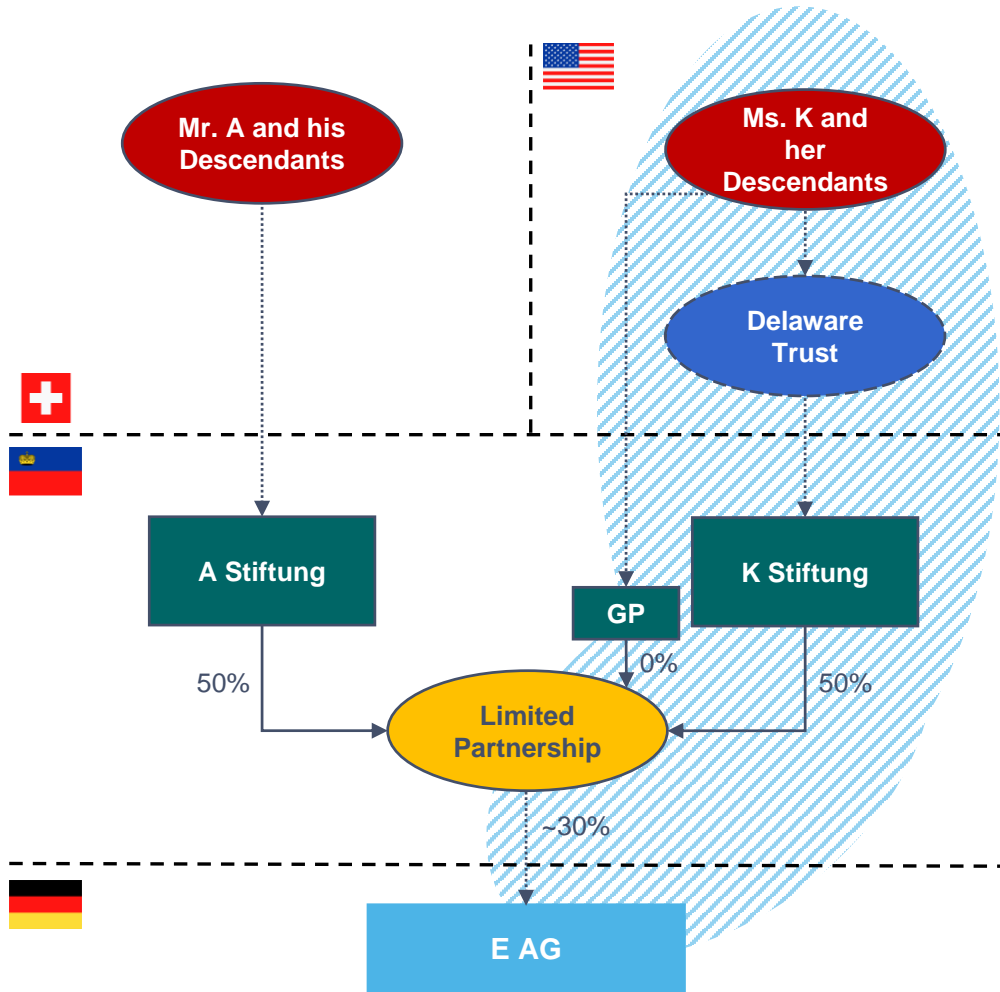
- As on the side of A Stiftung

- US aspects:

- K Stiftung treated as a foreign non-grantor trust for U.S. income tax purposes.
  - Note that the classification of a Liechtenstein Stiftung for U.S. income tax purposes will depend on the facts and circumstances.
- Delaware trust treated as a domestic non-grantor trust for U.S. income tax purposes.
  - In order to be treated as domestic trust, must be controlled by U.S. persons and subject to jurisdiction of U.S. court.
- K Stiftung distributes its income each year to the Delaware trust.
  - Delaware trust (or Ms. K, if distributed to her) pays U.S. income tax on distributions, but capital gains/qualified dividends treatment preserved and **throwback tax avoided** (see annex).
- E AG is not a CFC or PFIC.

# Estate Plan – Target Structure

## Tax Aspects: Transfer Tax US-Side (K Stiftung)



- Assets held in Delaware trust not subject to U.S. estate tax at Ms. K's death because Ms. K does not hold any powers that would cause estate tax inclusion.
- Any distributions made from trust that are held by Ms. K at her death will be subject to estate tax.
- Delaware trust not subject to generation-skipping transfer tax because funding of trust not subject to estate or gift tax.
- Because Delaware has no rule against perpetuities, assets can continue to be held in trust for future generations without the imposition of a transfer tax.



## **Annex:** US Tax Background

# U.S. Transfer Tax Background

- Gratuitous transfers of property by U.S. citizens or residents (and sometimes non-U.S. citizens/residents) are subject to a transfer tax.
- There are three types of transfer taxes imposed by the U.S. federal government:
  - **Gift Tax:** A tax on the transfer of property during one's life.
  - **Estate Tax:** A tax on the transfer of property at death.
  - **Generation-Skipping Transfer ("GST") Tax:** A tax on the transfer of property, whether during life or at death, to an individual who is two or more generations younger than the transferor (*i.e.*, grandchild or more remote descendant); this tax is in addition to the gift or estate tax.
- The highest marginal federal rate for all three transfer taxes is 40%.
- Some states (like NY) also have additional state transfer taxes to take into consideration.
- U.S. transfer tax is imposed on non-U.S. citizens/residents in the following situations:
  - **Gift Tax:** Transfer of tangible/real property with a U.S. situs.
  - **Estate Tax:** Transfer of all U.S. situs property, with limited exceptions.
  - **GST Tax:** Only applies if transfer subject to U.S. gift or estate tax.
- For estate tax purposes, the assets of a trust are generally not included in a beneficiary's estate if the beneficiary is not entitled to and does not have unrestricted control over the distribution of trust assets.
  - A beneficiary can have certain limited powers without triggering estate tax inclusion, including the power to control investment decisions.

# U.S. Income Tax Background

- Taxation of trusts:
  - **Grantor Trust:** Trust treated as disregarded entity; income flows through to the settlor.
    - Can only apply while the settlor is alive and limited availability when settlor is foreign.
  - **Non-Grantor Trust:** Trust treated as its own taxpayer.
    - To the extent current year's income is distributed or required to be distributed to a beneficiary, the income is taxed to the beneficiary, not the trust.
- Special rules for foreign non-grantor trusts with U.S. beneficiaries:
  - If the trust's income in a given year is not distributed to a U.S. beneficiary, the trust will only pay U.S. income tax on U.S. source income.
  - However, if accumulated income from a prior year is distributed to a U.S. beneficiary, the U.S. beneficiary is assessed a "throwback" tax (tax at highest income tax rate, with no capital gains/qualified dividend preferential rate, plus interest deferral charge).
    - If foreign trust distributes income to U.S. beneficiary each year, the U.S. beneficiary pays regular income taxes on the income (with capital gains treatment preserved if applicable).
  - U.S. beneficiary also must file Form 3520 when receives distribution, or penalty applies.
- Special considerations where U.S. person (including trust) owns interest in foreign corporation:
  - **Controlled Foreign Corporation ("CFC"):** More than 50% of corporation by vote or value owned by U.S. shareholders (each of whom owns at least 10% of corporation).
    - U.S. shareholders pay income tax on certain income of corporation, even if no distributions made to shareholders.
  - **Passive Foreign Investment Company ("PFIC"):** At least 75% of income is passive or at least 50% of assets held for investment.
    - "Excess" distributions from PFIC subject to interest charge and no capital gains treatment on disposition of shares, but alternative treatment may be available with election.