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Steve Leimberg's Estate Planning

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Subject: Alexander A. Bove, Jr., Building a Better Private Foundation, Wyoming's Gamble

"Wyoming is now the second state in the U.S. after New Hampshire to adopt a law allowing the establishment of a private non-charitable foundation, in a sense competing with New Hampshire. But if a comparison between the two states' laws, each seeking similar results, were viewed as a poker game, New Hampshire might be holding aces and eights, although that may not mean Wyoming holds the winning hand.

It is no secret that the nineteen states that have adopted 'self-settled spendthrift trust' laws did so to attract some of the billions of U.S. dollars that were going offshore to fund offshore asset protection trusts. Fortunately, the basic provisions of all of the domestic asset protection trust (DAPT) laws of the various U.S. states are virtually identical, and furthermore, they are all more or less copies of the major offshore trust jurisdictions. Lastly, the DAPT laws are clear and relatively easy to follow by advisors. In short, the U.S. states did not try to create a 'different animal.'

Unfortunately, such has not been the case with the private foundation. First, New Hampshire legislature created its private foundation statute and ended up with a default trust law. Now Wyoming comes along with its foundation statute and ends up with a default limited liability company law. This is not to say that a traditional foundation could not be established under Wyoming law – but it would require an advisor who has considerable knowledge of foundation law and the particular provisions that should be included in a 'family' foundation.

Unlike the DAPT statues, which one could simply follow and end up with a suitable asset protection trust, with the Wyoming law, an advisor without adequate knowledge would not know which of the provisions to override and which to keep. In my several readings of the statute, my first instinct was to recommend an instruction booklet for advisors. In short, the law is

extremely user unfriendly, unless one wants a slightly modified limited liability company that they can call a private foundation."

Alexander Bove Jr. provides members with important and timely commentary that examines the Wyoming Statutory Foundation Act that allows for the establishment of private, non-charitable foundations.

Alexander Bove is an internationally known and respected trust and estate attorney with over thirty-five years of experience in the field of trusts and estates. He is Adjunct Professor of Law, Emeritus, of Boston University Law School Graduate Tax Program, where he taught estate planning and advanced estate planning for eighteen years. In 1998 he was admitted to practice as a Solicitor in England and Wales, and in 2013, he earned his Ph.D. in Law from the University of Zurich. His practice encompasses domestic and international estate planning and asset protection planning, and he is regularly consulted by attorneys and other professionals on issues relating to cross-border estate planning in such jurisdictions as the UK, Italy, Germany, and France, among others. Mr. Bove has lectured at the annual Heckerling Tax Institute, the annual meeting of the American & College of Trust & Estate Counsel (ACTEC), the Association of Advanced Life Underwriters (AALU), the Million Dollar Round Table (MDRT), The Top of the Table, the Annual Notre Dame Estate Planning Institute, the Southern California Estate Planning Institute, and The International Academy of Estate and Trust Law. Mr. Bove was named in "The Best Lawyers in America, Trusts and Estates" for 2012 – 2014 and was elected to the National Estate Planning Hall of Fame in 2014. He has published seven books and over 1,000 articles on trust and estate-related topics. One of his books, The Complete Book of Wills, Estates and Trusts, published by Holt, NY, has over 100,000 copies in print. His latest book, Trust Protectors – A Practice Manual with Forms is available for order through Juris Publishing at:
http://www.jurispub.com/cart.php?m=product_detail&p=16855

Here is his commentary:

EXECUTIVE SUMMARY:

Wyoming is now the second state in the U.S. after New Hampshire to adopt a law allowing the establishment of a private non-charitable foundation, in a sense competing with New Hampshire.[1] But if a comparison between the

two states' laws, each seeking similar results, were viewed as a poker game, New Hampshire might be holding aces and eights,[2] although that may not mean Wyoming holds the winning hand.

Obviously, the reason any state would go to the trouble and expense to adopt such laws is to attract money and business to the state, so the stakes can be high. The reason a private foundation could attract business is two-fold. First, as explained later, the private foundation can offer benefits very similar to a trust, including what could be stronger asset protection features, but with far greater control and privacy for the "founder", and second, it is an entity completely familiar to individuals and families from civil law (as opposed to our common law) jurisdictions, which encompass a huge majority of the world population. Such familiarity, along with very favorable tax laws in the U.S. for non-U.S. persons who establish certain entities, can combine to attract huge amounts of money and investments to this new type of U.S. entity. Whether and to what extent the law of either or both states meets these requirements and will attract the money, remains to be seen, but here is one advisor's view of the Wyoming law.

COMMENT:

While New Hampshire attempted to draft a foundation law and ended up basically with a trust law[3], Wyoming, apparently consulted with experts and went to the trouble of researching foreign foundation law to use as a guide and ended up with a law that could attract the type of business it seeks, though it could definitely use some serious 'tweaking", as explained below.

The Wyoming Statutory Foundation Act, effective July 1, 2019, allows the formation of a private foundation, which may be charitable or non-charitable, but all comments here are directed to the non-charitable private foundation. The private foundation (herein, the "PF"), unlike a trust, is a separate legal entity, similar to a corporation, but unlike the typical corporation, it normally has no shareholders. Thus, it is the founder (the party who forms the PF) who may reserve the right to revoke or terminate it, or to amend its purpose. These rights and others must be expressly reserved in the articles of formation.[4] (This practice is the opposite of the New Hampshire law where the founder's rights are automatically reserved unless declined in the articles, which could be risky if the drafter forgets to decline them, because the assets of the PF could then be reachable by the founder's creditors.)

Along with the filing of articles of formation,[5] the board of directors would be appointed (there must be at least one director),[6] and an operating agreement must be adopted[7]. This would be very similar to a limited liability company operating agreement, as is another provision, discussed later, relating to a transfer of a beneficiary's "share". This is Wyoming's first deviation from the typical foundation. Although the Wyoming law does not specify any required contents of the operating agreement, the act notes a number of items that "may" be included in that document, such as "any provision for managing the business" and affairs of the PF.[8] Like the LLC, the operating agreement must be maintained and up to date, but it need not be filed anywhere.

One of the unique features of the typical PF, and included in the Wyoming law, is that, unlike the trust, the managers (directors of the PF) do not have the same duty to the beneficiaries of the PF as a trustee has to the beneficiaries of the trust. While some offshore jurisdictions allow a PF to have a purpose but no beneficiaries, the Wyoming act requires at least one beneficiary.[9] Despite that, the directors' fiduciary duty runs to the PF and not to the beneficiaries, reflected in the Act, which says that the directors of the PF must "act in good faith"[10] and "in a manner not opposed to the best interests of the foundation."[11] Further, the only right a beneficiary has to information, unless the operating agreement provides otherwise, is the right to see a copy of the operating agreement,[12] which contains no details of the assets of the PF or the actual operation of the PF. But there is one exception to this. If there is no protector serving, then the PF must provide the beneficiary with any information requested by the beneficiary.[13] What the beneficiary can do with this information is not clear, but at the least, it turns the situation upside down. And one could see some potential trouble where there was a temporary vacancy in the protector position and a recalcitrant beneficiary who "takes over."

Speaking of protectors, the Act provides that a non-charitable PF may (and therefore, need not) have a protector.[14] As noted above, if there is no protector, all of the PF information is available to the beneficiaries, a result quite undesirable with the traditional foundation, where the founder wishes to provide for the family but not provide them with even indirect control, detailed information about assets, or the right to interfere with the management of the PF. And once again, if there is no proterctor, it is unclear what the beneficiaries may do with all the PF information. Thus, it would be extremely imprudent to form a PF without a protector or "enforcer" of some kind. But even with a protector, the Wyoming act leaves some

important questions open. Under the provision applying to protectors, for example, the only power suggested (not mandated) for the protector is the power to veto "any specified action" of the directors.[15] Whether that means any action is unclear and could lead to unnecessary disputes, though it likely means acts specified in the operating agreement. But the bigger issue is whether that is the only power that may be given to a protector, which would be quite shortsighted, as anyone who has worked with PF's or purpose trusts is well aware of the importance of having a protector with broad powers. Why the drafters didn't simply add:*, and such additional powers as may by authorized by the operating agreement,* is a real puzzle. To add confusion to this question, a subsequent provision in the act suggests, though it does not actually state, that a protector could make a pass-through tax election.[16] Another permitted power?

Speaking of powers, as noted above, the founder's reservation of certain powers must be specific and stated in the articles of formation (powers to amend the articles or the purpose of the PF)[17], while others, such as the power to amend the operating agreement "may" be stated or they may be added to the articles of formation or operating agreement.[18] The founder's power to amend the articles of formation or the PF's purpose, however, will cease on the founder's death (if the founder is a natural person), but the Act states that the controlling documents could provide otherwise.[19] What could be "otherwise" here could be critical, because the following section of the Act provides that those powers shall not pass to the founder's heirs, spouse, or creditors.[20] These sections could certainly stand some reconsideration, if not redrafting, as it clearly restricts the founder's planning options and appear to be self-contradicting..

The section on "beneficiary" vs. "beneficiary owner" could also stand some clarification. It took a couple of readings to realize that the distinction between a beneficiary and a beneficiary "owner" (the latter missing from the section on definitions!) is that a "beneficiary" is the "normal" beneficiary one would see in a trust, where distributions are either mandatory or at the trustee's discretion, and the beneficiary holds a beneficial interest but no actual ownership rights, whereas a beneficiary *owner*, simply stated, apparently has a status corresponding to that of a member of a limited liability company, sharing "in the profits and losses of the foundation".[21] Consistent with this view, the act provides that a transferee of a beneficiary owner will only have the rights of an assignee.[22] Unfortunately, though the act also allows a beneficiary to transfer her rights[23] (something generally rare in the traditional foundation), there is no mention of the rights or status

of a transferee of a "plain" beneficiary. And there are other problems with the transferability of the beneficial interest – two major ones. First, such transferability makes the beneficiary's interest reachable by the beneficiary's creditors, again, a feature carefully avoided in the traditional PF, though the Act does allow the operating agreement to override this.[24] In this regard, however, the important question of the rights of a creditor/transferee of a beneficiary are not addressed in the statute. Second, one of the central questions that has plagued the offshore foundations for years is whether it should be treated as a trust or a corporation for U.S. tax purposes. The key question was, does it have more of the characteristics of a corporation than a trust? And one of the most important issues is this regard was whether the beneficiaries could transfer their interests, similar to a shareholder of a corporation. Wyoming is taking quite a gamble in dangling this feature for use by founders and advisors. (The IRS ruling on this is noted later). Therefore, an unsuspecting founder or advisor making uniformed choices allowed by the Act could unintentionally end up with a corporation instead of a trust or even an LLC (which the default provisions in the Act would cause).

Further to the creditor issue, the act states that "the transfer of property (to the PF)…shall not (be) rendered ineffective for any reason",[25] and that the property of the PF "shall not be subject to the claims of a founder's creditor". [26] While such language is not unusual in PF laws, some jurisdictions make it clear, and drafters of PF documents should be aware, that this language would not prevent a founder's creditors from reaching PF property if the transfer to the PF was found to be a fraudulent or voidable transfer.

One of the better features of the act is its privacy. The identity of the founders, directors, beneficiaries, or protectors of the PF do not need to be filed or recorded anywhere for the public to see, as is traditionally the case with offshore foundations, a feature that would be attractive to offshore founders of a Wyoming PF. There are no special provisions, however, for an existing foreign PF to emigrate to become a Wyoming PF, which is actually fine, because such a move is complicated and generally unwise due to the different laws applying to the "two" foundations. The New Hampshire PF law attempted to do this, and it produced an awkward and unattractive result where key parties to a foreign PF would have to disclose their identities in a public filing, and the foreign PF would have to adopt unfamiliar laws that could be contrary to its own.[27]

From a tax standpoint, the PF could be a pass-through entity, such as an LLC or a grantor trust, or a separately taxable entity, depending on the powers reserved by the founder, the identity of the beneficiaries, the directors and the protector, and the terms of the operating agreement. In this regard, a reading of the Act's provisions and options suggests either that the drafters were not sure what they wanted, or that they intended to offer an LLC entity dressed up as a private foundation. Again, this could be a dangerous gamble because it is not likely that advisors and drafters will have the requisite knowledge and experience to discern which of the numerous options to take and the tax and legal consequences of their choices. The "typical" foundation, however, which in practice has many features of a trust, will likely be taxed as a trust, and the IRS has suggested the same in a 2009 legal advice memo.[28] Nevertheless, as suggested in the comment above regarding "beneficiary owner," drafters should be aware that the default PF could be regarded as an LLC for tax purposes.

Conclusion

It is no secret that the nineteen states that have adopted "self-settled spendthrift trust" laws did so to attract some of the billions of U.S. dollars that were going offshore to fund offshore asset protection trusts. Fortunately, the basic provisions of all of the domestic asset protection trust (DAPT) laws of the various U.S. states are virtually identical, and furthermore, they are all more or less copies of the major offshore trust jurisdictions. Lastly, the DAPT laws are clear and relatively easy to follow by advisors. In short, the U.S. states did not try to create a "different animal".

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Unlike the DAPT statues, which one could simply follow and end up with a suitable asset protection trust, with the Wyoming law, an advisor without adequate knowledge would not know which of the provisions to override and which to keep. In my several readings of the statute, my first instinct

was to recommend an instruction booklet for advisors. In short, the law is extremely user unfriendly, unless one wants a slightly modified limited liability company that they can call a private foundation.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Alexander A. Bove, Jr.

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CITATIONS:

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[1] Wyoming statute annotated (herein "WSA") 17-30-101, et seq (sometimes, the "Act"), (2019), New Hampshire RSA 564-E (2017).

[2] The poker hand said to be held by Wild Bill Hickok when he was murdered, hence nicknamed the dead man's hand.

[3] See Alexander A. Bove Jr., *Building a Solid Foundation*, Trusts & Estates, July, 2018.

[4] WSA 17-30-401.

[5] WSA 17-30-303.

[6] WSA 17-30-501.

[7] WSA 17-30-309.

[8] Id.

[9] WSA 17-30-201 (c) (ii).

[10] WSA 17-30-501 (d) (i).

[11] WSA 17-30-501 (d) (ii).

[12] WSA 17-30-701 (a).

[13] WSA 17-30-701 (b).

[14] WSA 17-30-503 (b).

[15] WSA 17-30-503 (d).

[16] WSA 17-30-505 (c) (i).

[17] WSA 17-30-401 (b).

[18] Id.

[19] WSA 17-30-401 (c).

[20] WSA 17-30-402.

[21] WSA17-30-602 (e).

[22] Id.

[23] WSA 17-30-603.

[24] Id.

[25] WSA 17-30-103 (b).

[26] WSA 17-30-801.

[27] See note 3, supra.

[28] 2009 TNT 199-22.