Naming a Relative Abroad as Trustee of Your Texas Trust? Read This First

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Here are two situations we see often in North Texas. In the first, a couple signs a revocable living trust. Each spouse is trustee for the other, and after both are gone, their children take over as co-trustees. One of those children has built a career in London, Mumbai, or Monterrey. The plan looks sensible, and on the day it is signed nothing is wrong with it.

In the second, a couple came to the United States from abroad and built their life here. Their home, careers, and savings are in Texas (and possibly some other assets abroad), and their children are growing up here. Their parents, siblings, and oldest friends, though, are still back home, and there is no one in the U.S. they would trust to manage their money or look after their children's inheritance. So when they sign their trust, they name a brother, sister, or cousin in their home country as successor trustee. That choice is understandable, and it can also cause the problem this article describes.

In either case, the trouble begins when the relative living overseas takes office as trustee, usually after a death or incapacity, when the family is least prepared to deal with it. Federal tax law does not ask where the trust was signed or which state's law governs it. It asks who holds control. If enough control passes to someone who is not a U.S. person, a trust written under Texas law and holding Texas assets can be treated for tax purposes as a **foreign trust**, with no court filing and without anyone intending that result.

This article explains how that happens, where Texas trust law helps and where it can quietly work against you, and the drafting choices we use to prevent the problem.

> **AT A GLANCE**
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> - A Texas trust can be taxed as a **foreign trust** if a non-U.S. person gains control of it, no matter which state's law governs it.
> - The usual trigger is a co-trustee, successor trustee, or protector who lives abroad.
> - Careful drafting keeps control in U.S. hands while still giving family abroad a real voice.

01 The Federal Rule in Brief

Treasury Regulation § 301.7701-7 treats a trust as domestic only if it passes two tests. If it fails either one, it is a foreign trust. The tests turn on who counts as a "U.S. person." That includes every U.S. citizen, wherever he or she lives, and non-citizens who are U.S. residents for tax purposes, which generally means green-card holders and people who meet the IRS's day-count ("substantial presence") test. A relative abroad who is not a U.S. citizen is almost always a *nonresident alien* and so is *not* a U.S. person. A U.S. citizen living abroad still is one.

1 • THE COURT TEST

A court in the United States must have primary supervisory authority over how the trust is run.

2 • THE CONTROL TEST

Every substantial decision about the trust must be within the power of U.S. persons, and no foreign person can be in a position to block them.

"Substantial decisions" covers most of what a trustee actually does: distributions, choosing among beneficiaries, income-versus-principal accounting, investments, litigation, ending the trust, and hiring or firing trustees. The test also reaches anyone who holds those powers, including trust protectors, advisors, and people who can appoint or remove a trustee, and not only the named trustees.

02 Where Texas Law Helps: The Court Test

For most Texas trusts, the court test is the easy part. Texas district courts and statutory probate courts have broad jurisdiction over trust matters under Chapter 115 of the Texas Property Code, so a trust that names Texas law as its governing law and is actually administered here usually satisfies the regulations' safe harbor for this test. Three things can undermine that:

- a clause directing that the trust be administered, or its records kept, outside the United States;
- a foreign trustee who in practice runs the trust from abroad, with the accounts, records, and decisions all handled overseas; and
- **"flight" or migration clauses** that move the trust's situs out of the country automatically if a U.S. court tries to step in. These clauses show up in asset-protection forms and should not appear in an ordinary family trust.

03 Where Texas Law Can Hurt: The Control Test

Most problems come from the control test, and a few features of Texas practice make them easy to miss.

> **THE TWO-TRUSTEE TRAP**
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> Texas Property Code § 113.085 lets co-trustees act by majority unless the trust instrument says otherwise. That sounds safe, but with two co-trustees a majority means both of them. If one child lives in Dallas and the other lives abroad, the child overseas can block every decision, and that ability to block is enough to fail the control test. A document that requires co-trustees to act unanimously has the same problem at any size. The fix is structural: a U.S. majority that can act without the foreign co-trustee, or a tie-breaking power held by a U.S. person.

Successor trustee lists. Many Texas trust forms name successor trustees in a simple sequence. If the next person on the list is abroad, or has moved abroad since the document was signed, the trust can shift status on the day that person accepts the role, often right after a death or incapacity, when no one is watching for tax issues.

Trust protectors and advisors. Texas Property Code § 114.0031 lets a trust give an advisor or protector real authority, such as directing investments, approving distributions, or removing and replacing trustees. That flexibility is valuable, but the control test applies to these roles too. A protector who lives abroad and holds the power to remove the trustee can turn the trust foreign even while every trustee is a U.S. citizen.

Changes after signing. Status is tested continuously, not only at signing. A trustee who gives up a green card, lets U.S. residency lapse, or renounces citizenship can change the trust's status without anyone making a new appointment.

04 What Is at Stake

A trust that becomes foreign can face several costs at once:

1. **A different tax regime.** The trust is generally taxed like a nonresident individual, with U.S. tax and withholding aimed at its U.S.-source income and income connected with a U.S. business.
2. **A deemed sale of appreciated assets.** Internal Revenue Code § 684 can treat the change in status as a taxable transfer, so the trust recognizes built-in gain on stock, business interests, or real estate that was never sold. There are exceptions, notably while a U.S. grantor is treated as the owner of the trust for income tax purposes, and assets that got a basis step-up at death may have little built-in gain at first. But appreciation after that point, and trusts that last for generations, remain exposed.

3. **Annual international reporting.** Foreign trusts and the U.S. persons connected to them may have to file IRS Forms 3520 and 3520-A under § 6048, returns that usually need an international tax preparer.
4. **Large penalties.** Under § 6677, missing or incorrect filings can bring penalties of at least $10,000 and potentially a significant percentage of the amounts involved, and the IRS may have extra time to assess them.
5. **Costlier distributions to U.S. family.** When a foreign non-grantor trust accumulates income and later pays it out to beneficiaries living in the U.S., the "throwback" rules can add an interest charge and take away favorable capital-gain rates.

It does not matter that the trust owns only Texas real estate and U.S. brokerage accounts. Where the assets are located has no bearing on whether the trust is domestic or foreign.

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05 If It Has Already Happened: Texas Tools for a Fix

The regulations give a trust that loses U.S. control by accident, for example because a U.S. trustee dies, resigns, or moves abroad, twelve months to restore U.S. control. If the fix is made within that window, the trust keeps its domestic status. In Texas, the practical ways to make the fix include:

1. **The trust's own provisions.** The foreign trustee resigns, a U.S. successor steps in, or a U.S. protector uses a removal power.
2. **Court appointment.** If the instrument does not produce a qualified successor, a Texas court can appoint one under Property Code § 113.083.
3. **Judicial modification.** Property Code § 112.054 lets a court modify administrative terms, such as how co-trustees vote or who can hold a given power, in appropriate circumstances.
4. **Decanting.** Where the trustee has the necessary discretion, Property Code §§ 112.071–.087 allow assets to be moved into a new trust with better fiduciary provisions.

Twelve months passes quickly during estate administration, and a court proceeding takes time. The better approach is to write the solution into the document from the start.

06 A Drafting Checklist for Texas Trusts

When a client wants a relative abroad involved, we typically consider:

- ✓ **A U.S.-person requirement** for any trustee, or for a controlling majority of trustees, with automatic replacement if a serving trustee stops qualifying.
- ✓ **Changing the default voting rule** so that U.S. trustees can always act without the foreign co-trustee, and never giving one trustee a veto.
- ✓ **A meaningful advisory role** for the relative abroad, as a non-binding distribution or family advisor whose views the U.S. trustees must consider but need not follow.
- ✓ **A U.S.-person trust protector** under § 114.0031, with power to remove and replace trustees and to amend administrative terms as needed to keep the trust domestic.
- ✓ **U.S. backups at the end of the successor list,** including a corporate trustee if the family has no suitable U.S. candidate.
- ✓ **A Texas governing-law and administration clause,** with no flight or migration provision.

07 Don’t Forget the Will

The same relative is often named as independent executor in the pour-over will. Under Texas Estates Code § 304.003, a person who lives outside Texas can serve as executor only after appointing a resident agent for service of process. That is not a tax problem, but it is one more reason to review every fiduciary role in the plan together.

08 The Bottom Line

Families with loved ones abroad do not have to leave them out. They need a plan that keeps legal control in U.S. hands while still giving the relative abroad a real voice. If your current trust names a trustee, successor, or protector who lives outside the United States, or might someday, it is worth a review.

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