



FATCA for Trusts and Trustees

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- Executive Summary
- Background: Why was FATCA Created
- How FATCA Works
- Impact on Private Clients
- **FATCA Reporting: FFIs and NFFEs must identify their US Reportable Accounts and annually report information on those accounts (either to their own government or directly to the IRS) or pay a 30% withholding tax on withholdable payments.**
 - What is an FFI
 - What is a Financial Institution
 - Trusts as Investment Entities
 - US Account
 - FFI Compliance/Reporting
- Are Trust Companies FFIs?
- Are Trusts FFIs?
- Collecting Information
- Key Dates

- The Foreign Account Tax Compliance ACT (FATCA) requires “*foreign financial institutions*” (“FFIs”) – such as banks, broker/dealers, investment funds, and **trusts** – to identify their direct and indirect ***US account holders***.
- As such FATCA impacts all account holders at non-US financial institutions, especially private clients, as those institutions scour their files to identify US persons and their entities.

- Curb US Tax Abuse: US investors using offshore accounts to evade US taxation
 - Evasion of US withholding tax system.
 - Failure to pay tax on income/gains.
 - Failure to comply with US tax/reporting disclosure rules.
- Enactment occurred at the same time as:
 - G20 promoting tax transparency and exchange of information.
 - Financial crisis.
 - Need for revenues.

- Congressional:
 - Enactment of FATCA to curb abuse.
- IRS:
 - Offshore account/foreign bank account reporting (FBAR) crackdown.
 - Threat of criminal prosecution
 - Offshore voluntary disclosure program.
 - Reporting of income
 - Interest
 - Civil penalties

- FATCA requires **Foreign Financial Institutions** (FFI's) and **non-financial foreign entities** (NFFEs) to identify their **US account** holders/members and either **annually report** US account holder information to their local taxing authorities who, in turn, report that information to the US and, in some cases, report directly to the IRS

or

- Suffer a new **30% US withholding tax** on US on certain payments relating to US investments (the FATCA withholding tax).
- FATCA withholding began for payments made on or after January 1, 2014. FATCA withholding for FDAP and gross proceeds will begin January 1, 2015.

- Individual client – certification of status.
- “Indicia” of US ownership, then inquiries will be deeper to verify or prove that the account is not a “US Account”
- FATCA extends to entities as well – thus FFIs will be classifying each account that they have as US or non-US.
- “Recalcitrant” accountholders – unavailable data / refusal to verify status.

- Notice 2011-34 lists six indicia of U.S. status:
 - U.S. citizenship or lawful permanent resident (green card) status;
 - A U.S. birthplace;
 - A U.S. residence address or a U.S. correspondence address (including a U.S. P.O. box);
 - Standing instructions to transfer funds to an account maintained in the United States, or directions regularly received from a U.S. address;
 - An “in care of” address or a “hold mail” address that is the sole address with respect to the client; or
 - A power of attorney or signatory authority granted to a person with a U.S. address.
- Having one of these indicia does not mean that the account is owned by a U.S. person, only that it must be given closer scrutiny.

- An **FFI** is a **foreign entity** that is a **financial institution**.
 - An NFFE is a foreign entity that is *not* a financial institution.
- **Foreign:** With respect to trusts, a trust is foreign if it is not a US trust under the “court” and “control” tests.
- Under the FATCA regulations, an **entity** means “any person other than an individual.”
- **Financial Institution:** if the trust qualifies as a “Financial Institution” then it will be an FFI; otherwise, an NFFE.

- Financial Institutions are broadly defined to include any entity that:
 - Depository institution,
 - Custodial institution, or
 - Investment entity)
- Generally, the following entities are included in the definition:
 - Banks, brokers/custodians, insurance companies, investment funds, **trust companies, trusts** for which non-individuals act as trustees.
 - Trusts for which individuals serve as trustees are “non-financial foreign entities” subject to simpler reporting.

Trusts are Generally “Investment Entities” – FATCA Regulation Definition

- Under the FATCA Regulations, there are three types of investment entity Financial Institutions:
 - An entity that "primarily conducts as a business" specified activities "for or on behalf of a customer";
 - **An entity whose gross income is primarily attributable to specified investment activities and that is managed by a financial institution; and**
 - A collective investment vehicle or one of several different types of funds.
 - See Treas. Reg. 1.1471-5(e)(4)(i)
- Note, typically, trusts will fall within the 2nd category.

“Gross Income” and “Managed By” Tests – FATCA Regulations



- “Gross Income” Test:
 - Investing, reinvesting, or trading in financial assets if the entity's gross income attributable to those activities equals or exceeds **50 percent** of its gross income during a stated period.
 - Definition of financial assets - shares, bonds, partnership interests, insurance and annuity contracts; does not include cash.
- “Managed By” Test:
 - If specific types of other FFIs (i.e., a trust company) perform any of the following activities on behalf of the entity: financial trading, managing investments, and "otherwise investing, administering, or managing funds, money, or financial assets."

- The managed by test is illustrated in the trust context by examples 5 and 6 in the FATCA Regulations.
 - See Reg. section 1.1471-5(e)(4)(v).
- Example 5: a non-grantor foreign trust consists solely of financial assets, and all its income comes from those assets (thus meeting the gross income test). The **trustee, an individual**, manages and administers the trust's assets and does not hire a third party to perform any of the investment activities on the trust's behalf. The **trust is not an investment entity FFI because it is managed solely by an individual** (the individual trustee), who also acts as investment manager.
 - *Therefore, it is likely an NFFE.*
- Example 6: same facts as Example 5 except the **trustee is a trust company** that is an FFI. Here, because the trust is managed by an FFI, the **trust is a investment entity FFI.**

- The IGAs' definition of an investment entity differs from the corresponding definition in the FATCA Regulations. Rather than three types of investment entities, the IGAs contain only one type of investment entity:
 - Any entity that conducts as a business (***or is managed by an entity that conducts as a business***) one or more of the following activities or operations for or on behalf of a customer:
 - (1) trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;
 - (2) individual and collective portfolio management; or
 - (3) ***otherwise investing, administering, or managing funds or money on behalf of other persons.***
- 3 primary differences between the FATCA Regulations and IGA.

- “**Reportable Account**” means a “US Reportable Account” or a “FATCA Partner Reportable Account”.
- US Reportable Account means a financial account maintained by a ***reporting [FATCA partner] financial institution*** and held by one or more specified US persons or by a Non-US entity with one or more Controlling Persons that is a Specified US Person.
 - See Model I IGA, Article I (bb) and (dd).

What is a Reportable US Account?

1. Account owned by a “Specified US person”
2. Account owned by a “US-Owned Foreign Entity”
 - US-Owned Foreign Entity is any foreign entity with a “Substantial US Owner”
 - Substantial US Owner is any person who (10% test)
- Accounts owned by foreign “grantor” trusts are deemed held by their grantors and not by any US beneficiaries and thus not US Accounts.

- **Specified US person** means any US person *other than*:
 - publicly-traded corporations & their affiliates,
 - tax-exempt organizations,
 - banks, REITs and RICs; and
 - Charitable remainder trusts

- **General Rule.** An FFI is subject to FATCA unless it becomes compliant (a participating FFI) by entering into an agreement with the IRS, under which the FFI agrees to:
 - Identification
 - Annual reporting
 - Withholding
 - Compliance, OR
- **Deemed Compliant.**
- **Exempt Beneficial Owner.**

- FFIs that enter into an FFI agreement with the IRS will need to report the following information on their U.S. accounts:
 - The name, address, and Taxpayer Identification Number (TIN) of each account holder which is a specified United States person and, in the case of any account holder which is a United States owned foreign entity, the name, address, and TIN of each substantial United States owner of such entity
 - The account number
 - The account balance or value at year end
 - Gross dividends, interest and other income paid or credited to the account



Trust Companies/Trusts

- Recall that an FFI is a **financial institution** that is a **foreign entity**.
 - **Financial Institutions** are “custodial institutions” “depository institutions” or “investment entities”.
- FFIs with **US Reportable Accounts** must report certain information under FATCA.
- A US Reportable Account is a “**Financial Account** maintained by a **Reporting [FATCA Partner] Financial Institution** and **held by** one or more Specified U.S. Persons or by a Non-U.S. Entity with one or more Controlling Persons that is a Specified U.S. Person.
 - See Model 1A IGA, Reciprocal, Preexisting TIEA or DTC (November 4, 2013).

- Trust company – will generally be an FFI (typically, “investment entity”).
- If the trust company is classified as an FFI - 30% withholding tax unless it becomes a Participating FFI or a Deemed Compliant FFI
 - See Model 1 IGA Annex II, paragraph IV.
- What about a Trust that is managed by a Trust Company?

Is a Trust Managed by a Trust Company an FFI? IGA View

- Recall definition of “investment entity”
 - See Model 1 IGA, Article 1, Section 1(j).
- Trust managed by a corporate trustee

- **While there is considerable doubt about whether most trust companies should be classified as “Investment Entities” under the IGAs, “trust companies would do best to assume that they are.”**
 - See Peter A. Cotorceanu, “FATCA and Offshore Trusts: A Second Bite of the Elephant”, Tax Notes 1019 (September 2, 2013).

Is a Trust Managed by a Trust Company an FFI? Treasury Regulations

- While the IGA may leave some doubt as to whether a trust’s “management” by a corporate trustee is sufficient to classify it as an investment entity, Treasury Regulations Section 1.1471-5(e)(4)(i) provides better guidance:
- Example 6: An entity is an investment entity (and therefore a “Financial Institution”)...
 - (B) the entity’s gross income is primarily attributable to investing, reinvesting, or trading in *financial assets* and the entity is managed by another entity that is considered a “Financial Institution” **or that primarily conducts as a business one or more of the following “investment” type of activities on behalf of a customer:** trading in money market instruments, foreign currency, foreign exchange, interest rate, and index instruments; transferrable securities or commodity futures; individual or collective portfolio management; or otherwise investing, administering or **managing funds, money or other financial assets on behalf of other persons.**
- “Investment Entity” under the IGA omits the gross income test

Is a Trust Managed by a Trust Company an FFI? Another Example

- Example 1, Regulations Section 1.1471-5(e)(4)(v):
 - Fund manager which, among its various business operations, organizes and manages a variety of funds.

Is a Trust Managed by a Trust Company an FFI?

- If the trust is managed by a FI, then it too can be an FFI.
- If, however, the trust is not managed by a FI, it may be an NFFE.

- Trusts that are NFFEs must determine if they are ‘Active’ or ‘Passive’ NFFEs. (Active NFFEs are defined by the gross income and gross assets tests under the IGA).
- **IGA** definition of **active NFFE** (trust must meet various requirements):
 - < 50% passive income and passive-income producing assets.
 - Substantially all of the activities of the NFFE consist of holding the outstanding stock of, and providing financing and services to, one or more **subsidiaries** that engage in trades or businesses other than the business of a Financial Institution (+ exception)
 - Note, “passive income” is not defined within the IGA.

- **Treasury Regulations** definition of active NFFE includes:
 - Any income from interest, dividends, rents, or royalties that is received or accrued from a ***related person*** to the extent such amount is properly allocable to income of such related person that is not passive income.
 - “Related person” is defined by reference to section 954(d)(3).

- A pre-condition to FFI status in each instance is that the entity being tested have gross income “primarily” attributable to financial assets.
- “Financial assets” are securities, whether public or private, registered or unregistered, currencies and the like.
 - Example 1, Regulations Section 1.1471-5(e)(4)(v):
 - United Kingdom’s HMRC advice makes clear that an “Investment Entity whose assets consist of non-debt direct interests in real property, *even if managed by another Investment Entity* would not be an Investment Entity”
 - See HMRC, Implementation of International Tax Compliance (United States of America) Regulations 2013 Guidance Notes, § 2.28.

Deemed-Compliant FFIs (Trustee-Documented Trust)

- “**Trustee-documented**” trust = “deemed-compliant”.
- How to qualify for “trustee-documented” trust status:
 - Established under laws of FATCA partner country,
 - Trustee is “Reporting US [Financial Institution], Reporting Model 1 FFI, or Participating FFI,
 - Trustee agrees to report all information that trust would be required to report
- If it qualifies as trustee-documented, the trust should qualify as a ***non-reporting FFI*** under the IGA.
 - See Model 1 IGA Annex II, Paragraph IV “financial institutions described in paragraph A [trustee-documented trust] through E ... are non-reporting... financial institutions that shall be treated as deemed-compliant”
- As to the responsibilities of a trustee with respect to the deemed-compliant (thus non-reporting) entity’s accounts: See IGA, Article I, Section (y)
- Thus, accounts held by a deemed-compliant (i.e., non-reporting) FFI are therefore simply non-reportable.

Equity Interests in a Trust May be Reportable Accounts

- Beneficial interests of their respective beneficiaries may be reportable.
- **IGA:** a “Specified U.S. Person” has an “equity interest” in the trust “if such person has the *right to receive* directly or indirectly a *mandatory distribution* or *may receive*, directly or indirectly, a *discretionary distribution* from the trust.”
- **Treasury Regulations:** a person is considered to have an “equity interest” in a trust if:
 - (i) *treated as the owner* of all or a portion of the trust under the *grantor trust rules*;
 - (ii) entitled to a *mandatory distribution* from the trust; or
 - (iii) may receive a *discretionary distribution* from the trust (including by way of the exercise of a power of appointment), but, *in the case of a discretionary beneficiary, only if that person actually receives a distribution in the relevant calendar year.* See Treas. Reg. § 1.1471-5(b)(3)(iii).
- United States citizen and/or resident beneficiaries may be considered to have “equity interests” in the trust in the year in which he/she receives a distribution.
- Trustee should report distribution when trust makes a discretionary distribution to its US Beneficiaries

Deemed Compliant: Small Family Trusts

- Such a trust would generally be a FFI.
- However, **Notice 2010-60** provides that small family trusts settled and funded by a single person for the sole benefit of his or her children may be “deemed compliant” provided the Withholding Agent identifies each individual, specified person, or excepted NFFE that has direct or indirect ownership in the entity; obtains the documentation that it would be required to obtain if such person were a new account holder of the Withholding Agent; and reports any specified U.S. person.

- IRS forms
- Form W-9 and the various Forms W-8
- Forms 1042 and 1042-S
- Form 8966
- Form 8938, *Statement of Specified Foreign Financial Assets*

- Form W-9 - revised in December 2014 to conform to the provisions of FATCA.
- Revisions to the new form:
 - New line to enter exemption code to claim exemption from FATCA reporting for accounts maintained outside of the US.
 - Clarification that a disregarded LLC should indicate the tax classification of its first regarded owner.

Key Dates

2014	2015	2016	2017
<p><u>January 1:</u> Assignment of Global Intermediary Identification Numbers (“GIINs”)</p>	<p><u>January 1:</u> Withholding effectively begins on noncompliant “New Accounts” and prima facie FFIs</p>		<p><u>January 1:</u> First date that withholding could begin on foreign passthru payments</p>
<p><u>April 25:</u> Last day to register to appear on initial list of participating FFIs by July 1</p>	<p><u>March 31:</u> Deadline for participating FFIs to file information reports for 2014</p>		<p><u>January 1:</u> Withholding begins on 1471(a)(ii) payments (gross proceeds from sales and dispositions)</p>
<p><u>June 2:</u> Posting of initial list of participating FFIs</p>	<p><u>June 30:</u> Deadline for identifying “High Value” Preexisting Accounts</p>	<p><u>June 30:</u> Deadline for identifying “Lower Value” Preexisting Accounts</p>	
<p><u>July 1:</u> Grandfather date for existing obligations; first effective date for FFI agreements; Withholding begins on 1471(a)(i) payments and payments to NFFEs</p>			
<p><u>December 31:</u> Deadline for identifying prima facie FFIs among entity account holders and payees</p>	<p><u>December 31:</u> Deadline for identifying entities other than prima facie FFIs</p>	<p><u>December 31:</u> Expiration of deemed compliant status for limited-life entities</p>	