FATCA documentation for US-based trusts

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Introduction

Even though a trust may be established under the laws of a US state and have a US trust company serving as trustee (hereinafter a 'US-based trust'), this does not mean that it is a US domestic trust for income tax purposes. If non-US persons make substantial decisions for the trust – for example, the trust protector, investment adviser or even the settlor – the US-based trust will be classified as a foreign trust under US tax law. Regardless of whether the US-based trust is foreign or domestic, if it has accounts with financial institutions, it must provide certification of its status for Foreign Account Tax Compliance Act (FATCA) purposes.

Relevant forms

US persons – including US citizens, green card holders and domestic trusts – use Form W-9 to certify their US tax status and provide their tax identification number. Foreign grantor trusts use Form W-8IMY and foreign non-grantor trusts use Form W-8BEN-E to certify their Chapter 3 withholding status and Chapter 4 FATCA status.

Grantor trusts

FATCA requires financial institutions to obtain certification of an entity account holder's US Chapter 3 withholding status and Chapter 4 FATCA status. To determine these statuses in the case of an account in the name of a trust, the trustee must know whether the trust is a grantor or non-grantor trust.

If the grantor is alive and has retained certain powers over the trust, the trust will be classified as a grantor trust for income tax purposes. The grantor trust rules are different depending on whether the settlor of the trust is a US or non-US individual. A grantor trust is a flow-through entity for tax purposes and all assets of the trust and income earned on those assets are attributed to the grantor (for further details regarding the US grantor trust rules please see the Overview (May 2014)).

US grantors

When FATCA documentation is requested, the US trustee of a domestic grantor trust will provide either a W-9 with the name and tax identification number of the US grantor or a W-9 with the name and tax identification number of the trust itself. This depends on which tax filing method the trustee has opted to use pursuant to Treasury Regulation 1.671-4(b)(2). The trustee may need to explain the documentation to the requesting financial institution and refer the requester to the table in the W-9 instructions explaining which name and number to give to the requester. In either case, a non-US requesting financial institution will note that it has a US reportable account and will file an annual FATCA report.

If the trust is a foreign grantor trust with a US grantor, the trustee will provide a Form W-8IMY for the trust indicating that its Chapter 3 withholding status is non-withholding foreign grantor trust, along with a Form W-9 for the US grantor. This tells the requesting financial institution that the beneficial owner of any income is a US taxpayer and therefore is not subject to US withholding tax. The foreign trust will also have a Chapter 4 FATCA status, which will depend on the circumstances of the particular trust.

Non-US grantors

If the trust is a foreign grantor trust with a non-US grantor, the trustee will provide a Form W-8IMY for the trust indicating that its Chapter 3 withholding status is non-withholding foreign grantor trust, along with a Form W-8BEN for the non-US grantor. This tells the requesting financial institution that the beneficial owner of any income is not a US taxpayer and is subject to US withholding tax on certain US source income. The requesting financial institution, if located in a country that has adopted the Organisation for Economic Cooperation and Development (OECD) Common Reporting Standard (CRS), will determine whether the non-US grantor is tax resident in a country that is a CRS partner jurisdiction and, if so, will file the necessary CRS report (for further details please see "Common Reporting Standard considerations for FATCA compliant trusts"). The foreign trust will also have a Chapter 4 FATCA status, which will depend on the circumstances of the particular trust.

Non-grantor trusts

If the grantor is deceased or the trust does not otherwise qualify as a grantor trust under the US grantor trust rules, the trust will be a non-grantor trust and a separate taxpayer. If the non-grantor trust is a US domestic trust meeting both the control and court tests (for further details please see the Overview (May 2014)), it will provide the requesting financial institution with a Form W-9 certifying its US tax status and providing its US tax identification number. The non-US financial institution has a US reportable account and will file an annual FATCA report.

If the US-based non-grantor trust does not meet the control trust, so that it is foreign for US tax purposes, the trustee will provide the requesting financial institution with a Form W-8BEN-E for the trust. The requester will then know that the trust has a Chapter 3 withholding status of complex trust and will be subject to US withholding tax on certain US source income. The trustee must determine the trust's Chapter 4 FATCA status.

Chapter 4 FATCA status of US-based trusts under FATCA regulations

Only US-based trusts that are classified as foreign for US tax purposes have a FATCA Chapter 4 status. The US trustee of a foreign trust established under the law of a US state must determine the trust's FATCA status using the final FATCA regulations. In most cases, where the trust holds financial assets and the professional trust company manages and administers the assets in accordance with the terms of the trust instrument for the benefit of the beneficiaries, the trust will be classified as an investment entity and thus a foreign financial institution (FFI).

This result is similar to the classification of most foreign trusts with an offshore trust company as trustee in a jurisdiction with a FATCA intergovernmental agreement (IGA). Under the terms of the IGA, such a trust can have a deemed-compliant status of trustee-documented trust and its trustee can handle all FATCA due diligence and reporting, if any. The foreign trust in the IGA jurisdiction need not be registered with the Internal Revenue Service (IRS).

However, the FATCA regulations do not provide for a trustee-documented trust. Unless the trust has a sponsoring entity, the trustee of a foreign US-based trust must register the trust with the IRS and the trust will be issued a global intermediary identification number (GIIN). Such a trust has a Chapter 4 FATCA status of participating FFI, which is indicated on its W-8IMY or W-8BEN-E. The trustee is responsible for FATCA due diligence and reporting, if any.

Alternatively, the trust company can register with the IRS as a FATCA-sponsoring entity. The trust company can then agree to provide FATCA due diligence and reporting for the trust, as its sponsoring entity, so that the trust will qualify for a FATCA status of sponsored investment entity or sponsored closely held investment vehicle under the FATCA regulations.

A US-based foreign grantor trust can be a certified deemed-compliant FFI as a sponsored closely held investment vehicle if its trustee is a US financial institution, which has agreed as sponsoring entity to fulfil all FATCA due diligence and reporting, and fewer than 20 individuals – in this case, the grantor – are considered to own the trust's equity interests. As such, the US-based foreign grantor trust itself need not be registered with the IRS.

A US-based foreign non-grantor trust can be a registered deemed-compliant FFI as a sponsored investment entity. Its sponsoring entity will register the trust as a sub-account of the sponsoring entity's GIIN. In the case of a sponsored investment entity, the sponsoring entity need not be a US financial institution. Some law firms and accounting firms are registered and can act as such sponsoring entities. It is possible that a US-based foreign non-grantor trust with a US financial institution as sponsoring entity would also qualify as a sponsored closely held investment vehicle, but the IRS has yet to issue guidance on how to count the number of individuals owning equity interests for such classification purposes.

Planning opportunities

A non-US settlor can establish a foreign grantor trust in a US state with a US trust company that agrees to act as a FATCA sponsoring entity, and that trust will be certified deemed compliant for FATCA purposes. The trustee can provide any requesting financial institution with a Form W-8IMY showing a FATCA status of certified deemed-compliant sponsored closely held investment vehicle. In some cases, these non-US settlors establish foreign grantor trusts with US trust companies because, following the death of the grantor, the beneficiaries are US individuals. At that time, the trust can qualify as a US domestic trust.

Given flexible state trust laws and the stable, mature fiduciary market, non-US settlors are increasingly considering using US trust companies knowing that the trust will remain foreign following the grantor's death. The trust can continue to be deemed compliant for FATCA purposes as a sponsored investment entity.

Common Reporting Standard

With FATCA compliance in place, the US trustee must comply with the non-US financial institution's request for CRS self-certification. The United States has not agreed to implement the CRS. However, IRS Commissioner John Koskinen recently told a tax industry gathering in Washington DC that it made sense for the IRS to move in the direction of participating in the CRS. Nevertheless, even if the IRS wants to participate, Congressional approval would have to be obtained first.

It is the CRS legislation in the jurisdiction where the financial institution is located that is applied to determine the status of the account holder. Although definitions of investment entity vary between the FATCA regulations, the IGAs and the CRS, a trust holding financial assets with a professional trust company as trustee will generally be an investment entity under the CRS as well as FATCA.

Assuming that the United States is not considered a CRS partner jurisdiction under the law where the financial institution is located, the financial institution in a CRS jurisdiction must gather information on an investment entity trust's controlling persons. In this case, the trustee must supply identifying information on the settlor, protector, investment adviser and beneficiaries. If such persons are tax resident in a CRS partner jurisdiction, the non-US financial institution will file a CRS report. If such persons are tax resident in the United States, they will not be reported under the CRS.

Safeguarding personal information and trust confidentiality

Advisers to multinational families who are being asked to provide personal information for family members – including tax identification numbers and copies of passports – should not hesitate to ask the requesting financial institution what safeguards it has in place to protect the confidentiality, integrity and availability of its customers' information, as identity theft is a serious concern. Safeguarding personal information is the responsibility of the financial institutions that receive, maintain, share, transmit or store such data. Reputable financial institutions should be willing to discuss these safeguards, because they help to prevent fraud and identity theft and enhance customer confidence and trust.

In cases where discretionary beneficiaries of a trust are unaware of the existence of the trust, the family adviser must insist that neither the requesting financial institution nor the trustee send a document request to such beneficiaries when such disclosure would breach the confidentiality requirements of the trust. The settlor or protector can supply identifying information for each discretionary beneficiary, as has always been done under know your customer and anti-money laundering rules. The reportable account holders of a trust classified as an investment entity under both FATCA and the CRS include discretionary beneficiaries in the year that they receive a distribution from the trust. Thus, before any distribution would take place, the discretionary beneficiary would be informed of his or her interest in the trust and asked to sign a tax certification form and consent to reporting.

Reporting by the United States

The IRS collects information from withholding agents on withholding tax assessed against non-US persons. It also collects information from US banks on interest earned in accounts held by non-US persons. Under reciprocal FATCA IGAs, this information will be exchanged with the country where the non-US person is tax resident.

Sometimes a US-based trust will own all of the membership interests of a US limited liability company (LLC) that owns the shares of an offshore holding company. The US Treasury Department has recently announced that it will issue proposed regulations requiring foreign-owned, single-member US LLCs to disclose to the IRS their beneficial owners. These regulations will likely require such LLCs to make a report, even if they own no US assets and generate no US-source income. The non-US grantor of a US-based grantor trust owning such an LLC is the beneficial owner for income tax purposes and likely for reporting purposes as well. Information regarding foreign beneficial ownership may be shared with foreign tax authorities.

The offshore holding company itself must provide FATCA and CRS documentation to financial institutions where it holds accounts. Either the company or the financial institution may have an obligation to file a CRS report with regard to non-US individuals who are tax resident in a CRS partner jurisdiction and are considered controlling persons of the company.

Comment

Families both inside and outside the United States are finding the FATCA and CRS documentation requests to be overwhelming and relentless. The two initiatives are flushing out taxpayers who have not been properly reporting income and assets in their country of tax residence. Families are well served by advisers who know the rules and can shepherd individuals through the complexity and offer solutions for becoming tax compliant.

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