INTERNATIONAL FILINGS
REPORTING REQUIREMENTS FOR FOREIGN
TRUSTS, U.S. GRANTORS,
U.S. BENEFICIARIES AND U.S. DONEES OF FOREIGN GIFTS

by
Dina Kapur Sanna, Esq. (updated by Sam C. Shulman, Esq.)

Day Pitney LLP
7 Times Square
New York, NY 10036
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. GENERAL OVERVIEW</td>
<td>1</td>
</tr>
<tr>
<td>A. Background</td>
<td>1</td>
</tr>
<tr>
<td>B. Applicable Definitions</td>
<td>5</td>
</tr>
<tr>
<td>II. RELEVANT FILINGS BY THE U.S. GRANTOR OF A FOREIGN TRUST</td>
<td>7</td>
</tr>
<tr>
<td>A. Form 1040 (U.S. Individual Income Tax Return), Schedule B</td>
<td>7</td>
</tr>
<tr>
<td>B. Form 3520 (Annual Return to Report Transactions with Foreign Trusts</td>
<td>8</td>
</tr>
<tr>
<td>and Receipt of Certain Foreign Gifts), Part I</td>
<td>8</td>
</tr>
<tr>
<td>C. Form 709 (United States Gift (and Generation-Skipping Transfer) Tax</td>
<td>8</td>
</tr>
<tr>
<td>Return</td>
<td>8</td>
</tr>
<tr>
<td>III. RELEVANT FILINGS BY THE U.S. OWNER OF A FOREIGN TRUST</td>
<td>9</td>
</tr>
<tr>
<td>A. Form 3520, Part II</td>
<td>9</td>
</tr>
<tr>
<td>B. FBAR</td>
<td>10</td>
</tr>
<tr>
<td>C. Form 8938 (Statement of Specified Foreign Financial Assets)</td>
<td>10</td>
</tr>
<tr>
<td>IV. RELEVANT FILINGS BY THE EXECUTOR OF A U.S. DECEDENT'S ESTATE IN</td>
<td>11</td>
</tr>
<tr>
<td>RESPECT OF A FOREIGN TRUST</td>
<td>11</td>
</tr>
<tr>
<td>A. Form 3520, Part I</td>
<td>11</td>
</tr>
<tr>
<td>B. Form 706 (United States Estate (and Generation-Skipping Transfer)</td>
<td>11</td>
</tr>
<tr>
<td>Tax Return</td>
<td>11</td>
</tr>
<tr>
<td>V. RELEVANT FILINGS BY THE TRUSTEE OF A FOREIGN TRUST WITH U.S.</td>
<td>12</td>
</tr>
<tr>
<td>OWNER OR WITH U.S. BENEFICIARIES</td>
<td>12</td>
</tr>
<tr>
<td>A. Form 3520-A (Annual Information Return of Foreign Trust With a U.S.</td>
<td>12</td>
</tr>
<tr>
<td>Owner</td>
<td>12</td>
</tr>
<tr>
<td>B. Foreign Grantor Trust Owner Statement</td>
<td>12</td>
</tr>
<tr>
<td>C. Foreign Grantor Trust Beneficiary Statement or Foreign Non-grantor</td>
<td>13</td>
</tr>
<tr>
<td>Trust Beneficiary Statement</td>
<td>13</td>
</tr>
<tr>
<td>D. FBAR</td>
<td>13</td>
</tr>
<tr>
<td>E. FATCA</td>
<td>13</td>
</tr>
<tr>
<td>VI. RELEVANT FILINGS BY U.S. BENEFICIARIES OF A FOREIGN TRUST</td>
<td>13</td>
</tr>
<tr>
<td>A. Form 3520, Part III</td>
<td>13</td>
</tr>
<tr>
<td>B. FBAR</td>
<td>14</td>
</tr>
<tr>
<td>C. Form 8938</td>
<td>15</td>
</tr>
<tr>
<td>VII. RELEVANT FILINGS FOR U.S. RECIPIENTS OF GIFTS FROM FOREIGN</td>
<td>15</td>
</tr>
<tr>
<td>PERSONS</td>
<td>15</td>
</tr>
</tbody>
</table>
# TABLE OF CONTENTS
(continued)

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Form 3520, Part IV</td>
<td>15</td>
</tr>
<tr>
<td>B. Gifts from Covered Expatriates</td>
<td>16</td>
</tr>
<tr>
<td>VIII. FILING IN RESPECT OF UNDERLYING STRUCTURES</td>
<td>16</td>
</tr>
<tr>
<td>A. Form 5471 (Information Return of U.S. Persons With Respect to Certain Foreign Corporations)</td>
<td>16</td>
</tr>
<tr>
<td>B. Form 8865 (Return of U.S. Persons With Respect to Certain Foreign Partnerships)</td>
<td>17</td>
</tr>
<tr>
<td>C. Form 8621 (Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund)</td>
<td>17</td>
</tr>
<tr>
<td>IX. EXECUTIVE SUMMARY OF REPORTING FOR A FOREIGN TRUST STRUCTURE</td>
<td>17</td>
</tr>
<tr>
<td>A. U.S. Settlor</td>
<td>17</td>
</tr>
<tr>
<td>B. U.S. Beneficiary</td>
<td>18</td>
</tr>
<tr>
<td>C. U.S. Trustee</td>
<td>19</td>
</tr>
</tbody>
</table>
I. GENERAL OVERVIEW

This outline will describe the reporting requirements applicable to U.S. persons who transfer assets to, or receive distributions from foreign trusts or who receive gifts from foreign donors.

A. Background.

1. The Small Business Job Protection Act of 1996 (the “1996 Act”)\(^1\).

   - The 1996 Act expanded significantly the reporting requirements that apply to (i) a U.S. person who creates or transfers property to a foreign trust; (ii) a foreign trust that is treated as owned by a U.S. person under the grantor trust rules; (iii) a U.S. beneficiary who receives a distribution from a foreign trust; and (iv) a U.S. beneficiary who receives a gift from a foreign person (including foreign individuals, estates, corporations and partnerships). Penalties for a failure to comply with these reporting requirements were also significantly increased. The expanded requirements are set forth in Sections 6048 and 6039F of the Internal Revenue Code of 1986, as amended (the “Code”),\(^2\) and the penalty provisions are set forth in Section 6677 of the Code. Interestingly, the statute of limitations on assessments of tax imposed under the Code does not begin to run until a return required by Section 6048 is filed in respect of an event or period related to information required to be reported.

   - Unified reporting is available on I.R.S. Form 3520 so that a U.S. transferor, grantor or beneficiary may comply with all foreign trust and foreign gift reporting requirements by completing relevant portions of the same form. In addition, a foreign trust with a U.S. owner is required to file I.R.S. Form 3520-A to comply with its reporting requirements. Regulations have not been promulgated to date but the Internal Revenue Service (the “Service”) has issued guidance in the form of Notice 97-34, upon which Forms 3520 (issued after the 1996 Act) and 3520-A (revised after the 1996 Act) are based.\(^3\)

---

1 P.L. 104-188.

2 Unless otherwise provided, all Section references herein are to the Code and Treasury Regulations promulgated thereunder.

3 See I.R.S. Notice 97-34, 1997-2 C.B. 422 and Forms 3520 and 3520-A.
2. The Foreign Account Tax Compliance Act provisions of the 2010 Hiring Incentives to Restore Employment Act (“FATCA”)\(^4\).

- FATCA amended the penalty provisions of Section 6677, and also made amendments to Section 679 to broaden the circumstances in which a U.S. transferor would be treated as an “owner” of a foreign trust under the grantor trust rules. FATCA also enacted Section 6038D, which imposes a reporting requirement for U.S. taxpayers with an interest in “specified foreign financial assets” that exceed, in aggregate $50,000 in a tax year. An interest in a foreign entity, including a beneficial interest in a foreign trust, is a specified foreign financial asset if the U.S. taxpayer knows of it or has reason to know of it.

- Temporary and proposed regulations under Section 6083D were issued on December 14, 2011; the proposed regulations apply reporting to U.S. entities formed or availed of to hold specified foreign financial assets, and there is no filing requirement imposed on them at this time. When final regulations are issued under Section 6038D, those final regulations will modify the effective applicability date of the proposed regulations and reporting by U.S. entities will not be required before the date specified by final regulations, which will not be earlier than taxable years beginning after December 31, 2012.\(^5\) Thus, a U.S. trust with a foreign financial account is not required to file the Form 8938 at present, although it will be required to file an FBAR as noted below. Reporting is done I.R.S. Form 8938 which applies to tax years 2011 and forward.


- A U.S. grantor or beneficiary of a foreign trust (or a U.S. trustee of a foreign trust) may have additional filings in respect of any foreign financial accounts held directly or indirectly in the trust, on the FBAR. The FBAR requires disclosure of foreign financial accounts in which the filer has a financial interest or signature authority which exceeds in aggregate, $10,000 in a calendar year. A foreign financial

---

\(^4\) P.L. 111-147. FATCA also created third-party reporting by requiring certain foreign financial institutions (“FFIs”) and non-financial foreign entities (“NFFEs”) to identify, document and report their U.S. account holders to the Service. Depending on which category the entity falls into—either an FFI or NFFE—the compliance rules and obligations under FATCA vary. If the FFI or NFFE is a resident of a country that has an intergovernmental agreement (“IGA”) with the U.S., it may on the procedures in the applicable IGA (and the country’s local laws), which may in fact modify the reporting and withholding obligations for the trust under FATCA. A discussion of such third-party reporting is beyond the scope of this outline.

account includes a bank account, a securities account, a mutual fund or other pooled investment fund.

− The FBAR is promulgated under the Bank Secrecy Act (Title 31 of U.S.C.) but enforcement authority has been delegated to the Service. On February 24, 2011, final FBAR regulations were published. In the wake of several high profile scandals involving U.S. taxpayers hiding assets overseas in foreign financial institutions, there is increased scrutiny on FBAR compliance and in general, on foreign trust and tax reporting. The FBAR is a significant tool to find and prosecute U.S. individuals who hide assets overseas in foreign accounts or foreign entities, including trusts and corporations.

4. Voluntary Disclosure Programs with respect to foreign assets.

− There have been three separate Offshore Voluntary Disclosure Programs (“OVDP”), in 2009, 2011 and 2012. In addition, the terms of the 2012 OVDP were recently, and in some cases drastically, changed—although this is not a new program, it is referred by most practitioners, and the Service, as the 2014 OVDP. These programs are and have been designed specifically with the purpose of bringing errant taxpayers with unreported foreign income or assets, back into the fold. There is a look-back of eight years, and penalty framework for the 2014 OVDP is as follows:

− Participating taxpayers pay 27.5 percent of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the eight full tax years before the disclosure. The penalty is increased to 50 percent if (1) the taxpayer has not requested “preclearance” to apply for the program (an inquiry, essentially, of whether the taxpayer is already under investigation) by August 4, 2014, and (2) the banks or other entities that held the taxpayer’s funds have already been publicly identified as themselves under investigation.

− Participants must also pay taxes for the last eight years, an accuracy-related and/or delinquency penalty of 20 percent of the tax due, and interest on the tax and penalty.

− Although it comes at a steep cost, there is virtual assurance, though no guarantee, that the Service will forgo criminal prosecution and will not assert other civil penalties, including FBAR penalties, for taxpayers who enter OVDP.
Separately, since 2012, the Service has maintained a program officially called the Streamlined Filing Compliance Procedures ("Streamlined Program"), that offers a less expensive avenue for taxpayers to bring themselves into compliance so long as their failure to report foreign assets was due to “non-willful” conduct.

This Streamlined Program was also recently updated. The current program, which is available to both U.S. residents and U.S. non-residents, has a look back period for taxpaying of three years and a look back period for FBAR reporting of six years. U.S. resident taxpayers must pay a penalty of 5 percent of the highest aggregate value at year end of all their previously unreported foreign financial accounts and specified foreign financial assets. U.S. non-residents pay no penalty. (A U.S. non-resident for this purpose is a U.S. citizen or green card holder that has been outside the U.S. for 330 or more days in any of the prior three calendar years and also does not maintain an abode in the U.S. under Code Section 911; for non-U.S. citizens or green card holders, it requires that the taxpayer not have met the substantial present test of Section 7701(b)(3) in any of the prior three calendar years.) Both U.S. residents and U.S. non-resident taxpayers must pay tax and interest for the prior three tax years, file complete returns for the prior three years, and file FBARs for the prior six years. (For U.S. residents, the returns must be amended returns; U.S. residents may not file original returns pursuant to the Streamlined Program.).

Taxpayers in the Streamlined Program must have failed to report their foreign accounts or foreign financial assets due to non-willful conduct. The Service defines non-willful conduct as conduct that was due to negligence, inadvertence, mistake, or good-faith misunderstanding of the law.

Taxpayers who had already filed their OVDP application (the Offshore Voluntary Disclosures Letter and Attachment) by June 1, 2014—when the new OVDP and Streamlined Program rules became effective—and who have not closed their OVDP case by signing a Form 906, and whose conduct would have been considered non-willful had they filed a Streamlined Program disclosure, can apply to have their OVDP penalty reduced to 5 percent from 27.5 percent. All of the other terms of OVDP remain the same in such cases.
Finally, for taxpayers who reported and paid tax on all foreign income, but who mistakenly failed to file all required information returns and/or FBARs with respect to their foreign entities and/or foreign accounts, there are procedures by which these taxpayers can regularize their filing obligations without any penalties for late filing.

B. Applicable Definitions.

These definitions are culled from various Code sections but based primarily on Notice 97-34, and Treasury regulations promulgated under Sections 679, 684 and 6038D of the Code.

1. “Distribution”. Broadly defined to include any direct or indirect (such as through an intermediary who is not the grantor) gratuitous transfer of money or other property from a foreign trust, including a constructive distribution such as the payment or guarantee of a U.S. beneficiary's personal obligation with trust assets. The latter includes, for example, a credit card or check drawn on a trust account. Additionally, a payment for services or property in excess of the value of such services or property is a deemed distribution, and a loan of cash or marketable securities to a U.S. beneficiary (or a “related person” within the meaning of the relevant Code section) is treated as a distribution unless it is a so-called “qualified obligation.” FATCA expanded the latter category to include the use of trust property as a distribution unless fair market rent is paid within a reasonable period of time.

2. “Foreign Trust” and “U.S. Trust”. A “U.S. trust” is a trust that meets a two-pronged test: (i) a court within the United States is able to exercise primary supervision over the administration of the trust, and (ii) one or more U.S. persons has authority to control all substantial decisions of the trust. A “foreign trust” is defined by exclusion to mean any trust other than a “U.S. trust”.

3. “Grantor”. Any person to the extent such person either (i) creates a trust or (ii) directly or indirectly makes a gratuitous transfer to a trust. If any person creates or funds a trust on behalf of another person, both persons are treated as “grantors” of the trust; however, a person who creates a trust but makes no gratuitous transfers to the trust will not generally be treated as an “owner” under the grantor trust rules.

4. “Grantor Trust”. A trust the assets of which are treated as owned by a person other than the trust under U.S. federal income tax principles. This would be the case if the grantor retained one or more “grantor powers” described in Sections 673 through 677 of the Code or if a U.S. beneficiary had a power described in Section 678 of the Code. If a person is treated as an “owner” of a trust, all items of income, deduction and credit, including capital gains realized by a grantor trust, are attributed to the person as if earned or paid directly by or to him or her whether or not actually received by him or her.
5. "Gratuitous Transfer". Any direct or indirect (such as through an intermediary) transfer to a trust, including a constructive transfer, such as an assumption or satisfaction of a trust’s obligation to a third-party. There is an exception for fair market value transfers; however, if the transferor is a grantor or a beneficiary of the trust (or a "related person" within the meaning of the relevant Code section), any obligation issued by the trust (or a related person) is disregarded, except if it is a so-called "qualified obligation".

6. "Gross Reportable Amount". The term has different meanings depending on the context in which it is used:
- The gross value of property involved in the creation of the foreign trust or the gross value of property transferred to the foreign trust.
- The gross value of any portion of a foreign trust treated as owned by a U.S. person under the grantor trust rules or includable in the gross estate of a U.S. transferor for U.S. federal estate tax purposes.
- The gross amount of distributions received by a U.S. person from a foreign trust.
- The gross value of assets deemed transferred at the time a U.S. trust (to which a U.S. person previously transferred property) becomes a foreign trust.
- The gross value of property involved in the creation of the foreign trust or the gross trust or the gross trust.

7. "Reportable Event". A "reportable event" occurs when a U.S. person creates a foreign trust or transfers property to a foreign trust (including a deemed transfer by reason of death), or when a U.S. person dies if the U.S. person was treated as the owner of any portion of the foreign trust under the grantor trust rules or if any portion of the foreign trust was included in the gross estate of the U.S. person for U.S. federal estate tax purposes.

8. "Responsible Party". A "responsible party" is (i) the grantor, in the case of the creation of an inter vivos trust; (ii) the transferor, in the case of a reportable event (other than by reason of death); or (iii) the executor, in any other case.

9. "U.S. Agent". A U.S. person that has a binding contract with a foreign trust that allows the U.S. person to act as the trust’s authorized U.S. agent, for purposes of applying Sections 602, 603, and 604 of the Code, with respect to a request by the Service to examine records or produce testimony, or a summons by the Service from such records or testimony. The appointment of a U.S. agent precludes the Service from re-characterizing (presumably in a manner that results in the greatest tax liability) the amounts required to be included in the gross income of a U.S. owner of any portion of a foreign trust or the amounts taxable to a U.S. beneficiary who receives a distribution from a foreign trust. Also, a foreign trust without a U.S. agent is required to make additional disclosures to the Service.
10. “U.S. Beneficiary”. A U.S. person that could possibly benefit (directly or indirectly) from the foreign trust. The term includes certain foreign corporations, partnerships and estates with U.S. shareholders, partners or beneficiaries, respectively. Importantly, a foreign trust with a U.S. transferor is treated as having a U.S. beneficiary unless (i) no part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, directly or indirectly, a U.S. person; and (ii) if the trust is terminated at any time during the tax year, no part of the income or corpus could be paid to or for the benefit of, directly or indirectly a U.S. person. FATCA amends Section 679 to create a rebuttable presumption that a foreign trust to which a U.S. person has transferred assets has a U.S. beneficiary. FATCA also expands the circumstances in which such a trust has a U.S. beneficiary by looking to agreements and understandings and treating them as part of the trust itself, and treating a discretionary trust as having a U.S. beneficiary, unless distributions are restricted to an identifiable closed class which does not include a U.S. beneficiary.

11. “U.S. Person”. This term refers to individuals who are U.S. citizens or residents, U.S. partnerships, U.S. corporations, U.S. estates and U.S. trusts. A “U.S. resident” is an individual (i) who holds a green card (whether or not he or she is physically present in the United States with the green card and for so long as such green card is not rescinded or relinquished), (ii) who is generally physically present in the United States under a 183-day count test (taking into account a fraction of the days spent in the immediately preceding two calendar years if the individual meets minimal presence requirements in the current calendar year), (iii) who makes an affirmative election to be treated a U.S. resident or (iv) with respect to Section 679, who is a dual-resident taxpayer who elects to treaty benefits.

- For FBAR purposes, the definition of “U.S. Person” as applied to U.S. partnerships, U.S. corporations, and U.S. trusts turns on whether the entity is formed under U.S. law, and is irrespective of its tax classification. Thus, a trust formed under U.S. law which is a foreign trust for tax purposes, or which is a grantor trust for income tax purposes, is a still a U.S. Person. U.S. law refers to the laws of the U.S., its territories and possessions and Indian lands.

- For I.R.S. Form 8938 purposes, the term includes nonresident aliens who are residents of a U.S. possession as well as dual-resident taxpayers electing treaty benefits.

II. RELEVANT FILINGS BY THE U.S. GRANTOR OF A FOREIGN TRUST

A. Form 1040 (U.S. Individual Income Tax Return), Schedule B.

1. A U.S. taxpayer must answer three questions on Schedule B: (1) whether the taxpayer had any foreign financial accounts during the taxable year, (2) where the foreign account(s) were located and (3) whether the taxpayer received a distributions from, was the grantor of, or transferor to, a foreign trust.

2. This, in turn, may lead to the filing of the FBAR, Form 3520 and 8938.
B. Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts), Part I.

1. A U.S. transferor is required to complete Part I of Form 3520 reporting the creation of, or transfer to, a foreign trust (a “reportable event”). In addition to an actual transfer, a “deemed transfer” can also occur by reason of (i) the transferor, who was initially a nonresident when he or she transferred property to the foreign trust, becoming a U.S. person within five (5) years of the initial transfer, (ii) a U.S. trust becoming a foreign trust while the U.S. transferor is alive, or (iii) the death of a U.S. person who was treated as the owner of the foreign trust under the grantor trust rules.

2. The Form 3520 requires the U.S. transferor to disclose the name, address and individual taxpayer identification number (“ITIN”), if any, of the foreign trust and of the settlor (if different from the transferor) and of other trust owners, if any, and to provide a description and fair market value of the cash and property transferred to the foreign trust, its tax basis at the time of transfer, and the gain, if any, required to be realized as a result of the transfer. No gain is required to be realized if the trust is treated as “owned” by a person under the grantor trust rules.

3. Importantly, unless the foreign trust has appointed a U.S. agent, the Form 3520 also requires the U.S. transferor to disclose the names, addresses and TINs of all beneficiaries, trustees and any other persons with powers over the trust, and attach a copy of the trust documents including trust instrument, amendments, letter of wishes and financial statements.

4. The U.S. transferor is subject to a penalty equal to the greater of $10,000 or 35 percent of the gross reportable amount (here, the gross value of property transferred to the foreign trust) unless the failure to file was due to reasonable cause and not willful neglect.

5. While the statute contemplates that notice be given within 90 days of this reportable event, instructions to the Form permit the notice to be filed by the due date for the U.S. transferor’s income tax return (i.e., April 15th).

C. Form 709 (United States Gift (and Generation-Skipping Transfer) Tax Return).

1. A U.S. transferor may be required to file a gift tax return and pay gift tax if the transfer to the foreign trust constitutes a completed gift for U.S. federal gift tax purposes. In 2014, the federal unified transfer tax (including gift tax) exemption is $5,340,000; and under current law this amount will be adjusted each year for inflation. In addition, each U.S. transferor can gift up to $14,000 per year per donee (the 2014 figure) without decreasing any portion of his or her lifetime federal exemption.
2. With respect to transfers in trust, the gift is complete only if the donor has no power to change the disposition of the trust property, whether for the benefit of himself or others. This requires the donor to have no power to: (1) revoke the trust; (2) revest beneficial title to the trust property in himself; (3) name new beneficiaries; or (4) change the interests of beneficiaries between themselves, unless the power is a fiduciary power limited by a fixed or ascertainable standard.

3. The U.S. federal gift tax return is due generally when the income tax return is due.

III. RELEVANT FILINGS BY THE U.S. OWNER OF A FOREIGN TRUST

A. Form 3520, Part II.

1. If the U.S. transferor retains any “grantor trust powers” over the foreign trust or if the foreign trust is treated as having a U.S. beneficiary for the year in question (under the expansive definition set out above as amended by FATCA), the U.S. transferor is treated as the owner of the foreign trust under the grantor trust rules. In this case, the U.S. owner is required to comply with additional reporting requirements in Part II of Form 3520, applicable to U.S. owners of foreign trusts, and must make an annual filing for each year in which he or she is treated as an owner. The U.S. owner must also include the income of the portion of the trust of which he or she is owner in his or her gross income and report it on Form 1040.

2. The Form 3520 requires the U.S. owner to provide the fair market value of the foreign trust the U.S. owner is treated as owning and to attach a separate statement (Foreign Grantor Trust Owner Statement) showing the amount of income attributable to him or her for U.S. federal income tax purposes.

3. The U.S. owner is also responsible for ensuring that the foreign trust makes an annual return on Form 3520-A and furnishes him (and other U.S. owners) with The Foreign Grantor Trust Owner Statement (discussed below) and the U.S. beneficiaries who received distributions in that year with The Foreign Grantor Trust Beneficiary Statement (discussed below).

4. Importantly, unless the foreign trust has appointed a U.S. agent, the Secretary may re-determine the amounts required to be taken into account with respect to the foreign trust by the U.S. owner. Thus, for example, the Secretary may find the U.S. owner of a portion of a foreign trust to be treated as the owner of the entire trust for the year in question.

5. The U.S. owner is subject to a penalty equal to the greater of $10,000 or 5 percent of the gross reportable amount (here, gross value of any portion of a foreign trust treated as owned by a U.S. person under the grantor trust rules) for failure to comply unless the failure was due to reasonable cause and not willful neglect.

6. For purposes of this filing, the Form 3520 is due on the same day that the income tax return is due, including extensions.
B. **FBAR.**

1. A U.S. owner will be required to complete the FBAR if, as a result of the transfer, he or she has a financial interest in, or signature authority over any foreign financial accounts held directly or indirectly in the trust that exceed the reporting threshold.

2. A U.S. person has a “financial interest” in a financial account if his ownership or control over the owner of record rises to such a level that the U.S. person is deemed to have a financial interest. The latter category includes foreign financial accounts in the name of a trust, if the U.S. person is treated as the owner of the trust under the grantor trust rules. If the trust owns 50% or more of corporation or has an interest in 50% or more of a partnership with a foreign financial account, the trust’s ownership is attributed to the U.S. person for FBAR purposes.

3. Penalties range from $10,000 for nonwillful violations to the greater of (i) $100,000 or (ii) 50 percent of the value of the account for willful violations.

4. The FBAR is due by June 30th of each year and is therefore a separate filing from the income tax return.

C. **Form 8938 (Statement of Specified Foreign Financial Assets).**

1. A U.S. owner is required to complete this Form if his interest in the foreign trust when combined with his other specified foreign financial assets exceeds the reporting threshold.

2. A U.S. person has an interest in a specified foreign financial asset, which includes a foreign trust, based on potential tax attributes or transactions related to the account that would be reported on the individual’s tax return. As the U.S. owner of a foreign trust is required to include the income, gains, losses, deductions, credits of the trust on his or her return, the grantor has an interest in the trust for purposes of this definition. However, there is so-called “short-form” reporting on the Form 8938 available, as the grantor is already filing a Form 3520 in respect of the same trust. In this case the grantor need only complete Part IV of Form 8938.

3. Penalties range from $10,000 to $50,000 for continued noncompliance after notification by the Service. Secondly, the negligence penalty imposed by Section 6662 is increased from 20 percent to 40 percent for a deficiency attributable to an unreported foreign financial asset. Thirdly, the statute of limitations does not run until the Form 8938 is filed with respect to events and periods related to information required to be reported on the Form. Finally, the statute of limitations on assessment is increased from three years to six years if the taxpayer omitted more than $5,000 of gross income attributable to a specified foreign financial asset even if the reporting threshold was not met.

4. The Form 8938 is due when the income tax return is due, including extensions.
IV. RELEVANT FILINGS BY THE EXECUTOR OF A U.S. DECEDENT'S ESTATE IN RESPECT OF A FOREIGN TRUST

A. Form 3520, Part I.

1. A transfer can occur as a result of the death of a U.S. person if he or she was treated as the owner of a foreign trust. In this case, the U.S. person is deemed to make the transfer the moment before death and the executor of the U.S. person’s estate will be required to file Form 3520 on behalf of the U.S. person. There is a penalty equal to the greater of $10,000 or 35 percent of the gross reportable amount (here, the gross value of the property transferred to the trust by reason of death) unless the failure to comply was due to reasonable cause and not willful neglect.

2. Additionally, an executor of a U.S. grantor’s estate may be required to file Form 3520 on behalf of the estate (i) if the U.S. grantor was treated as the owner of the foreign trust under the grantor trust rules or (ii) if any portion of the foreign trust is includable in the gross estate of the U.S. grantor for U.S. federal estate tax purposes. Although more often than not, a U.S. owner will also be subject to U.S. federal estate tax with respect to the transferred assets as a result of the grantor trust rules, the disjunctive is necessary because a defective grantor trust arises if the sole reason the U.S. transferor treated as a U.S. owner is under Section 679 of the Code. There is a penalty equal to the greater of $10,000 or 35 percent of the gross reportable amount (here, the gross value of the property transferred as a result of death or includable in the decedent's gross estate) unless the failure to comply was due to reasonable cause and not willful neglect.

3. The instructions to the Form permit the notice to be filed by the due date for the U.S. transferor’s income tax return (i.e., April 15th).

B. Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return).

1. The executor of a U.S. transferor’s gross estate may also be required to file a U.S. federal estate tax return and pay estate tax if the transfer arises as a result of death of the transferor and the property is required to be included in the transferor’s gross estate. In 2014, the federal unified transfer tax (including estate tax) exemption is $5,340,000; and under current law this amount will be adjusted each year for inflation.

2. The U.S. federal estate tax return is due within nine (9) months of the decedent's date of death unless an extension is granted.

---

6 Section 679 treats the U.S. grantor of a foreign trust as the owner of any portion of the trust that is attributable to the property transferred by such U.S. grantor (directly or indirectly), for any year in which the foreign trust has a beneficiary who is a U.S. person. Importantly, section 679 applies regardless of whether the U.S. grantor has retained any of the “grantor trust powers” enumerated in Sections 673 to 677 of the Code. A discussion of Section 679 (and its corollary, Section 684) is beyond the scope of this outline.
V. RELEVANT FILINGS BY THE TRUSTEE OF A FOREIGN TRUST WITH U.S. OWNER OR WITH U.S. BENEFICIARIES


1. A foreign trust with a U.S. owner is required to make an annual information return on Form 3520-A.

2. The Form 3520-A requires the trustee to provide a complete accounting of the activities of the foreign trust (including distributions to U.S. owners and U.S. beneficiaries and provide their names, TINs, dates of distribution and fair market values) for the year on an income statement. The income statement is required to be determined under U.S. income tax principles, often necessitating the foreign trustee to retain a U.S. accountant or U.S. tax attorney to complete the Form 3520-A on its behalf.

3. The Form 3520-A requires the trustee to show all assets and liabilities on hand at the beginning of the tax year and close of tax year at their fair market values. For this purpose, an appraisal is unnecessary and a good faith estimate of value will suffice.

4. Importantly, unless the foreign trust with a U.S. owner has appointed a U.S. agent, the trustee is required to provide a summary of the terms of the trust, including oral agreement or understandings with the trustee, whether or not legally enforceable, and a copy of all trust documents, including trust instrument, amendments and letter of wishes.

5. The trustee’s failure to comply results in a penalty levied on the U.S. owner equal to the greater of $10,000 or 5 percent of the gross reportable amount (here, gross value of any portion of a foreign trust treated as owned by a U.S. person under the grantor trust rules) for failure to comply unless the failure was due to reasonable cause and not willful neglect. FATCA shifts the burden of compliance to the U.S. owner by amending Section 6048(b) to provide that the U.S. owner shall “submit such information as the Secretary shall prescribe with respect to such trust for such year,” whereas previously the U.S. owner was “responsible to ensure” that the required information was disclosed.

6. For purposes of this filing, the Form 3520-A is due by the fifteenth (15th) day of the 3rd month after the end of the foreign trust's tax year unless an extension is granted. I.R.S. Form 7004 must be filed to request an extension; it is not automatically granted with the filing of an extension request for Form 1040.

B. Foreign Grantor Trust Owner Statement.

1. The Foreign Grantor Trust Owner Statement sets forth a good faith estimate of fair market value of the assets of the trust treated as owned by the U.S. owner and the net income attributable to the U.S. owner, both determined under U.S. federal income tax principles.

2. Unless the foreign trust has appointed a U.S. agent, the Secretary may re-determine the amounts required to be taken into income with respect to the foreign trust by the U.S. owner (in a manner that results in the greatest imposition of tax).
3. The Foreign Grantor Trust Owner Statement must be provided to U.S. owners by the fifteenth (15th) day of the 3rd month after the end of the foreign trust's tax year.

C. Foreign Grantor Trust Beneficiary Statement or Foreign Non-grantor Trust Beneficiary Statement.

1. The Foreign Grantor Trust Beneficiary Statement includes, among other things, an explanation of the facts and law that establishes that the foreign trust is a grantor trust; a statement identifying whether the grantor of the foreign trust is an individual, trust, corporation or partnership and whether the grantor is a U.S. person or a foreign person; a description of the property (including cash) distributed or deemed distributed to the U.S. beneficiary during the tax year and the fair market value of such property; and importantly, unless the trust has appointed a U.S. agent, a statement that upon request, the trustee will permit the Service or the U.S. beneficiary to inspect such of the trust's books and records as are necessary to establish the appropriate treatment of any distribution or deemed distribution for U.S. federal tax purposes.

2. A Foreign Non-grantor Beneficiary Statement includes, among other things, a statement identifying whether any grantor of the trust is an individual, trust, corporation or partnership and whether the grantor is a U.S. person or a foreign person; a description of the property (including cash) distributed or deemed distributed to the U.S. beneficiary during the tax year and the fair market value of such property; an explanation of the appropriate tax treatment of any distribution or deemed distribution for U.S. federal tax purposes, or sufficient information to enable the U.S. beneficiary to establish such appropriate tax treatment; and importantly, unless the trust has appointed a U.S. agent, a statement that upon request, the trustee will permit the Service or the U.S. beneficiary to inspect such of the trust's books and records as are necessary to establish the appropriate treatment of any distribution or deemed distribution for U.S. federal tax purposes.

3. The Beneficiary Statement must be provided to the U.S. beneficiaries who received distributions in that year by the fifteenth (15th) day of the 3rd month after the end of the foreign trust's tax year.

D. FBAR.

For purposes of the FBAR, a U.S. individual or corporate trustee of a foreign trust as well as the trust itself if established under the laws of the U.S., may be required to file an FBAR in respect of the trust’s direct and indirect foreign financial accounts, as the trustee is owner of legal record and the trust is a U.S. person. As stated above, it does not matter if the trust is a grantor or non-grantor trust.

VI. RELEVANT FILINGS BY U.S. BENEFICIARIES OF A FOREIGN TRUST

A. Form 3520, Part III.

1. A U.S. beneficiary who receives a distribution from a foreign trust must report the distribution on Form 3520, Part III and obtain a Foreign Grantor Trust Beneficiary Statement or Foreign Non-grantor Trust Beneficiary Statement, as the case may be, from the
trustee. There are exceptions for (i) distributions that are taxable as compensation for services rendered that are reported on the recipient’s income tax return and (ii) distributions to U.S. charities which have an I.R.S. determination letter recognizing their tax-exempt status.

- If a complete Foreign Grantor Trust Beneficiary Statement is provided, the U.S. beneficiary may treat the distribution as a non-taxable gift.
- If a complete Foreign Non-grantor Trust Beneficiary Statement is provided, the U.S. beneficiary may determine the U.S. federal income tax consequences of the distribution in line with the information provided on the Beneficiary Statement.

2. Generally, unless a Beneficiary Statement is provided, any distribution from a foreign trust, whether of income or principal, to a U.S. beneficiary is treated as an accumulation distribution. An accumulation distribution is taxable under throwback rules at ordinary income rates and a three-out-of-five-year averaging method is utilized to calculate the tax under the throwback rules. An interest charge is levied on the tax. There is an exception to this rule that allows the U.S. beneficiary to avoid treating the entire amount received as an accumulation distribution if the U.S. beneficiary can provide certain information regarding actual distributions from the trust for the prior three years under a so-called “default method.” Under this default method, a portion of the distribution is treated as a current distribution based on the average of distributions received from the trust over the prior 3 years, with the excess amount of the distribution treated as an accumulation distribution.

3. It is not clear whether loans from a foreign trust which are not “qualified obligations” or below market use of trust property, both of which are “deemed distributions”, are reportable if the trust is a grantor trust. Under Section 643(i), this deemed distribution rule does not apply to grantor trusts; however, the Foreign Grantor Trust Beneficiary Statement which is page 4 of the Form 3520-A appears to require such reporting of such transactions. As a policy matter, since distributions from foreign grantor trusts are reportable, there is no reason to treat deemed distributions differently.

4. The failure to comply results in a penalty levied on the U.S. beneficiary equal to the greater of $10,000 or 35 percent of the gross reportable amount (here, gross value of distribution) for failure to comply unless the failure was due to reasonable cause and not willful neglect.

B. FBAR.

1. If a U.S. beneficiary has a more than 50% present beneficial interest in the assets of the trust or receives more than 50% of the current income of the trust, he or she is deemed to have a financial interest in the foreign financial accounts held directly and indirectly in the trust for purposes of FBAR reporting. The preamble to the final FBAR regulations clarifies that (i) discretionary beneficiaries who receive no distributions from a trust, and (ii) remainder beneficiaries, do not meet the threshold for FBAR reporting.
2. A U.S. beneficiary may not have to file an FBAR to report financial accounts of the trust if the trust, trustee or agent of the trust is a U.S. person and files an FBAR report in respect of the accounts held directly and directly in the trust.

C. Form 8938.

There are special rules for valuing interests in foreign trusts and estates. Under the valuation rules, a beneficial interest in a foreign trust or foreign estate is not a specified foreign financial asset unless the U.S. individual knows or has reason to know of it based on readily accessible information. Receipt of a distribution from the foreign trust or foreign estate is deemed to be actual knowledge of the interest. Once established as a specified foreign financial asset, the value is the sum of (i) the fair market value of all property distributed to the beneficiary during the year plus (ii) the value of the beneficiary’s right to receive mandatory distributions from the foreign trust as determined under IRC Section 7520. It is not clear whether a U.S. beneficiary of a grantor trust owned by another person, whether or not a U.S. or foreign person, would be subject to Form 8938 filing as the tax attributes of the trust reside with the grantor. However, it is the Service’s position that such U.S. beneficiary has a Form 8938 filing.

VII. RELEVANT FILINGS FOR U.S. RECIPIENTS OF GIFTS FROM FOREIGN PERSONS

A. Form 3520, Part IV.

1. A U.S. recipient of a gift from a foreign person that exceeds certain “threshold amounts” must report the gift on Form 3520, Part IV. There are exceptions for “qualified transfers” under Section 2503(e) or trust distributions otherwise reportable under Section 6048. A U.S. non-grantor trust must report the receipt of a distribution from a foreign trust on Form 3520, Part IV; a U.S. beneficiary of the trust does not have to report unless he is treated as the owner under the grantor trust rules, e.g., he has a Section 678 withdrawal power.

2. The threshold amount is $100,000, in the case of a foreign individual or foreign estate donor. By comparison, the threshold amount is $10,000 (this amount is indexed for inflation and is $15,358 for 2014), in the case of a foreign partnership or foreign corporation donor.

3. Aggregation of gifts is required if the U.S. recipient knows or has reason to know the foreign donors are related (within the meaning of the Code). If the threshold amount is met, the recipient is required to identify separately each gift in excess of $5,000, but not the donor. In contrast, the $10,000 threshold requires identification of each gift and each donor.

4. If a gift is not reported, the Secretary may determine the tax consequences of the gift. In addition, the recipient is subject to a penalty equal to 5 percent of the reportable amount (here, the value of the gift) for each month the gift is not reported (but not to exceed 25 percent).

5. Gifts from foreign partnerships and corporations may be re-characterized as taxable distributions under the Code and should be avoided.
B. Gifts from Covered Expatriates.

1. A U.S. recipient of a “covered gift or bequest”\(^7\) may have to pay tax on it at the highest marginal rate in effect for gifts and bequests, if it does not fall within one of the exceptions for annual exclusion gifts, marital and charitable transfers and is not otherwise reported on the foreign donor’s gift or estate tax return as a gift of a U.S. situs asset.

2. Form 3520, Part IV asks whether the U.S. donee received a gift or bequest from a covered expatriate. If the answer is “yes,” I.R.S. Form 708 (U.S. Return of Tax for Gifts and Bequests Received from Expatriates) must be filed, but the Form is not yet available.

3. The U.S. recipient must answer three questions on Schedule B of Form 1040: (1) whether the taxpayer had any foreign financial accounts during the taxable year, (2) where the foreign account(s) were located and (3) whether the taxpayer received a distribution from, was the grantor of, or transferor to, a foreign trust.

VIII. FILING IN RESPECT OF UNDERLYING STRUCTURES

If the foreign trust in question holds an underlying foreign corporation or partnership through which the assets are held, the U.S. beneficiary or U.S. grantor may have additional reporting requirements on Forms 5471, 8865 and/or 8621 each of which is mentioned briefly below. A detailed discussion of the same is beyond the scope of this outline.

A. Form 5471 (Information Return of U.S. Persons With Respect to Certain Foreign Corporations).

1. A U.S. person who owns more than 50 percent of the vote or value of a foreign corporation, or who acquires 10 percent of the same, or who is a “U.S. shareholder” of a Controlled Foreign Corporation (“CFC”),\(^8\) may be subject to annual Form 5471 filing requirements. The Form 5471 filing requirements are complicated and the level of disclosure varies, depending on which category the filer falls into.

2. Form 5471 is due when the income tax return is due, including extensions.

---

\(^7\) Section 877A enacts new rules applicable to U.S. citizens and so-called “long-term residents” who surrender their citizenship or green cards and meet certain net worth or income tax liability thresholds at the time of expatriation or cannot certify tax compliance for the 5 prior years. One of the rules is the imposition of a succession tax on future gifts or bequests made by such “covered expatriates” to U.S. persons. Section 2801(e). A discussion of the covered expatriation tax regime is beyond the scope of this outline.

\(^8\) A CFC is defined as a foreign corporation that has more than 50 percent of either the vote or the value of its stock owned (or treated as owned) by U.S. shareholders. For these purposes, a “U.S. shareholder” is defined to include any U.S. person (including a U.S. citizen or resident) who owns, directly, indirectly (e.g., through an interest in a trust), or constructively, 10 percent or more of the voting stock of the foreign corporation. The U.S. shareholders of a CFC are subject to current U.S. federal income taxation, at ordinary income tax rates, on their proportionate shares of the corporation’s “Subpart F income.” Subpart F income is defined to include most passive types of income such as dividends, interest, royalties, rents, annuities, net gains (not net losses) from trading in stocks and securities, net gains from certain commodities transactions and certain foreign currency gains.
B. Form 8865 (Return of U.S. Persons With Respect to Certain Foreign Partnerships).

1. A U.S. person who owns, directly or indirectly, more than 50 percent of the capital or profits interest in a foreign partnership, or who acquires 10 percent of a partnership owned more than 50 percent by U.S. persons, among others, may be subject to Form 8865 filing requirements.

2. The Form 8865 is the corollary to Form 5471, applicable to U.S.-owned foreign partnerships instead of foreign corporations.

C. Form 8621 (Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund).

1. A U.S. direct or indirect shareholder of a Passive Foreign Investment Company (“PFIC”) may be required to make a return on Form 8621 for any year in which he or she directly or indirectly disposes of PFIC stock or receives a so-called “excess distribution” with respect to the PFIC stock, or for any year in which he or she makes Qualifying Electing Fund (“QEF”) election to include the income and gains of the PFIC into the U.S. shareholder’s current income or a mark-to-market election for PFIC stock which is regularly traded on an exchange or market.

2. FATCA amended the Code to require an annual filing of Form 8621, even in the absence of a taxable transaction for tax years. On December 31, 2013, temporary and proposed regulations were issued which included guidance under Section 1298(f) on the annual filing requirements for shareholders of PFICs. The regulations generally are effective for taxable years of shareholders ending on or after December 31, 2013.

IX. EXECUTIVE SUMMARY OF REPORTING FOR A FOREIGN TRUST STRUCTURE

A. U.S. Settlor.

A U.S. Settlor of a foreign trust:

– Must report the creation of the trust and any transfer of property to the trust on Form 3520, Part I;

---

9 A PFIC generally is defined to include any foreign corporation where, for a given taxable year, the foreign corporation either derives 75 percent or more of its gross income from passive sources, or 50 percent or more of the foreign corporation’s assets produce passive income or are held for the production of passive income. In the absence of applicable elections, the default regime is that all U.S. shareholders of a PFIC, regardless of their percentage of stock ownership whether direct or indirect (such as through a trust), generally are subject to U.S. federal income tax, at ordinary income tax rates, on any gain from the direct or indirect sale or exchange of, and certain direct or indirect distributions in respect of, their stock in a PFIC. However, a “U.S. shareholder” of a CFC will not be subject to the PFIC rules with respect to the same stock.
− Must report all the income and gain of the trust on his U.S. income tax return, if the trust is a grantor trust with respect to him on Form 3520, Part II;

− Must ensure that the trustee files Form 3520-A with the Service, furnishes the Settlor with a Foreign Grantor Trust Owner Statement, and furnishes each U.S. beneficiary who receives a distribution with a Foreign Grantor Trust Beneficiary Statement, if the trust is a grantor trust;

− May be subject to U.S. income tax on an indirect disposition of PFIC stock held by the trust or an “excess distribution” received by the trust with respect to that PFIC stock (unless he has made an election to be taxed on income of the PFIC currently) or Subpart F inclusion of any underlying CFCs and have reporting on Forms 8621 and 5417 respectively;

− May be subject to U.S. income tax on a deemed sale of the trust assets at his death under Section 684, unless the trust assets are included in his U.S. taxable estate for estate tax purposes;

− May be subject to U.S. estate tax at his death on the value of trust assets included in his estate unless he has made a completed gift on funding the trust and required to file either Form 706 or 709 respectively;

− Will have to file an FBAR with respect to foreign financial accounts held by the trust; and

− Will have to file a Form 8938 with respect to the trust.

B. U.S. Beneficiary.

A U.S. beneficiary of a foreign trust:

− Must report any distribution received from the trust on Form 3520, Part III;

− Must receive either a Foreign Grantor Trust Beneficiary Statement or a Foreign Non-grantor Trust Beneficiary Statement from the trustee if he receives a distribution from the trust;

− May be subject to U.S. income tax on trust income or gain earned by any portion of the trust over which he has an unrestricted right of withdrawal under Section 678 (in which case he would generally be subject to the rules applicable to U.S. owners of foreign trusts);

− If the trust is a non-grantor trust, may be subject to U.S. income tax on an indirect disposition of PFIC stock held by the trust or an “excess distribution” received by the trust with respect to PFIC stock (unless he has
made an election to be taxed on income of the PFIC currently) or Subpart F inclusion with respect to a CFC, if he is deemed to indirectly own any stock;

− May be subject to U.S. estate tax at his death over any portion of the trust which he can appoint to himself, his estate, his creditors, or creditors of his estate;

− May have to file an FBAR to report his interest in foreign financial accounts held by the trust if he has more than a 50% interest in the income or assets, unless the U.S. trustee or trust files in respect of same; and

− May have to file Form 8938 to report his interest in the trust if he receives distributions or otherwise has a mandatory right to them.

C. **U.S. Trustee.**

A U.S. trustee of a “foreign trust”:

− Must file Form 3520-A annually and provide the U.S. grantor with a Foreign Grantor Trust Owner Statement and U.S. beneficiaries who receive distributions with either a Foreign Grantor Trust Beneficiary Statement or a Foreign Non-grantor Trust Beneficiary Statement; and

− Must file an FBAR (if the trust is formed under U.S. law, it will have to file an FBAR as well) to report financial interest in foreign financial accounts held by the trust. At present, there is no Form 8938 filing imposed on the U.S. trustee.