International Wealth Tax Advisors
Cross Border Tax Planning Firm

Planning in the New Era of Cross Border Financial Disclosure:

international trends and developments and the U.S. position

IWP Mexico Meeting
Presented by: Jack R. Brister
September 12, 2017

Offshore Tax Enforcement

Background

Recent years have seen an expansion of reporting requirements for both U.S. taxpayers with holdings abroad and non-U.S. investors with holdings in the U.S.

As global information sharing to combat tax evasion and money laundering becomes the norm, the U.S. faces increasing pressure from FATCA partners to reciprocate.

Some of the new measures could impact a wide range of existing structures and require many non-U.S. taxpayers who previously managed to avoid direct exposure to the U.S. tax system to acquire taxpayer ID numbers.

The IRS also has broadened foreign asset reporting requirements to apply to certain domestic business entities and trusts, while offering U.S. taxpayers limited relief with respect to certain other foreign asset reporting obligations.

Trends and Developments

- **Planning for Recent Developments**
  - Offshore Tax Enforcement
  - U.S. Limited Transparency Efforts
  - Changes to Foreign Asset Reporting Requirements
  - Domestication of Offshore Structures

Offshore Tax Enforcement

FATCA IGA Enforcement Effort

- The U.S. has enjoyed considerable success with its efforts to combat offshore tax evasion and other financial crimes overseas, in large part due to cooperation from other countries.
- The Foreign Account Tax Compliance Act (“FATCA”) enacted in 2010 created third-party reporting by:
  - Requiring certain foreign financial institutions (“FFIs”) to identify, document and report their U.S. account holders to the IRS; and
  - Requiring many non-financial foreign entities (“NFFEs”) to identify their U.S. owners to withholding agents or certify that they do not have any substantial U.S. owners.
- The U.S.’s network of intergovernmental agreements (“IGAs”) with partner jurisdictions has been critical to FATCA’s success.

Offshore Tax Enforcement

Type of IGAs

- If an FFI or NFFE is a resident of a country that has an IGA with the U.S., the applicable IGA (and the country's local laws) will dictate.
- Two types of model IGAs have evolved and been adopted by FATCA partner jurisdictions:
    - Model 1 IGAs require FFIs to report to tax authorities in the partner jurisdictions rather than to the IRS, and obligate the FATCA partner to automatically exchange that information with the IRS.
    - Model 2 IGAs require FFIs to report directly to the IRS.
- Some IGAs are reciprocal. Reciprocal IGAs require U.S. FIs to collect and report information about Reportable Accounts held at the U.S. FIs by persons resident in the FATCA partner jurisdiction.

Offshore Tax Enforcement

Lack of U.S. Reciprocity

There is a considerable disparity between the information FFIs are required to provide with respect to direct and indirect U.S. owners of foreign financial accounts and the information the U.S. is required to provide.

- FFIs subject to Model 1 reciprocal IGAs are required to look through entities and report information on certain U.S. owners. No such look-through requirement is imposed on U.S. FIs subject to the same IGAs.
- Reporting by U.S. FIs does not extend to accounts held by entities and no reporting is required for non-cash U.S. accounts, whether held by individuals or entities, unless there is U.S. source income that is subject to withholding in the U.S.
- The reason for these lopsided reporting obligations is that Congress has not enacted implementing legislation allowing the Treasury Department to fully reciprocate.

Offshore Tax Enforcement

Common Reporting Standard (CRS)

Spurred by FATCA's success, the OECD developed the Common Reporting Standard ("CRS") to facilitate the collection and reporting of information about accounts held at financial institutions in participating jurisdictions.

- These standards are similar to the standards used in the FATCA Model 1 IGAs. However, unlike FATCA, CRS is not enforced by withholding tax. Instead, the automatic exchange of information will be the sole enforcement mechanism.
- Early adopters participating jurisdictions are sharing beneficial ownership information.
- More than 100 countries have signed up.
- The U.S. has not signed on to CRS, and there are no signs that they intend to do so anytime soon.

Offshore Tax Enforcement

Other Transparency Efforts

Following the enactment of the Fourth European Union Anti-Money Laundering Directive on June 25, 2015 ("Fourth AML Directive"), EU member states began adopting the following measures:

- Beneficial ownership registries to share information on the ultimate beneficial ownership of trusts and business entities.
- Imposition of suspicious activity reporting requirements on lawyers, accountants and other related professionals. (A number of countries, including the UK, already had such measures in place.)
- The U.S. does not regulate the legal profession and only imposes these requirements on financial institutions.

U.S. Limited Transparency Efforts

The U.S. is a Potential Tax Haven (Exposures)

The U.S. has a few unique exposures to potential abuse; **the entity classification regulations ("check-the-box" regulations) and state laws** in certain jurisdictions allow privacy to owners of business entities and trusts and others that require minimal disclosure of beneficial owners.

- Single-member LLCs (SMLLCs) are "disregarded entities" for U.S. income tax purposes under the check-the-box (CTB) regulations, so funding an LLC – even with millions of dollars – is a non-event for federal income tax purposes and, until recently, would not have triggered any reporting obligation.
- Non-U.S. taxpayers are able to use SMLLCs to hide their income and assets from tax authorities in their home jurisdiction without triggering any tax liabilities or reporting obligations.
- They could also use SMLLCs to launder the proceeds of illegal activities (e.g., use cash to anonymously purchase real estate).

U.S. Limited Transparency Efforts

Pressure to Address Potential Exposures

The ability of wealthy foreign nationals to anonymously park large amounts of cash in LLCs and trusts in Delaware, South Dakota, Nevada and other states with, no or minimal disclosure requirements has been a significant point of contention with other countries.

- In March 2017 the European Parliament described this situation as follows: "The United States of America (USA) is seen as an emerging leading tax and secrecy haven for rich foreigners. By resisting new global disclosure standards, it provides an array of secrecy and tax-free facilities for non-residents at federal and state levels, notably in Nevada, Delaware, Wyoming, and South Dakota."
- Similar concerns were raised by the Financial Action Task Force ("FATF") in its Mutual Evaluation Report issued in December 2016.

U.S. Limited Transparency Efforts

Actions Taken by U.S. Treasury

- The U.S. has not adopted automatic disclosure of ownership of entities or trusts comparable to what many EU members have already implemented, but in the last year it has adopted more limited measures:
  - Geographic targeting orders requiring title insurers to identify the beneficial owners of shell companies;
  - Customer due diligence rules for financial institutions; and
  - IRS Form 5472 reporting requirements for U.S. disregarded entities with foreign owners.
- These measures are targeted at the exposures previously mentioned – i.e., the ability to use single-member LLCs as shell companies to hide assets without triggering any tax liabilities or reporting obligations.

U.S. Limited Transparency Efforts

Geographical Targeting Measures

The U.S. Treasury Department issued geographic targeting orders ("GTOs") requiring title insurers to determine the identities of the owners of limited liability companies, limited liability partnerships, corporations and similar business entities that buy high-end residential real estate in all cash transactions above specified dollar thresholds in designated markets.

- Individuals who directly or indirectly own 25% or more of the purchasing entity must be reported on FinCEN Form 8300.
- The GTOs do not extend to purchases made by wire transfer or purchases financed by a bank loan (which are subject to other diligence and reporting requirements) or to direct purchases by trusts.
- The original GTOs were limited to all-cash purchases in Manhattan and Miami, but have been expanded to cover purchases in other geographic areas until February 23, 2017.

U.S. Limited Transparency Efforts

Geographical Targeting Measures

U.S. urban areas covered and the accompanying USD thresholds:

- New York, NY (Manhattan)
  $3,000,000 USD
- Other New York City Boroughs (Queens, Brooklyn, Bronx, Staten Island)
  $1,500,000 USD
- Florida Counties (Miami-Dade, Broward and Palm Beach)
  $1,000,000 USD
- California Counties (San Diego, Los Angeles, San Francisco, San Mateo and Santa Clara)
  $2,000,000 USD
- Bexar County (San Antonio area)
  $500,000 USD
- Honolulu, HI (city and county added August 2017)
  $3,000,000

As of August 2017, all cash and wire transfers are reportable

U.S. Limited Transparency Efforts

FinCEN Due Diligence Requirements

On May 11, 2016, FinCEN announced new customer due diligence ("CDD") rules, effective May 11, 2018, for banks, brokers, mutual funds and futures commission merchants.

- Affected financial institutions will be required to collect information on individuals who own (directly or indirectly) 25% or more of the equity of the entity holding the account or who have significant responsibility to control, manage or direct the entity (such as a CEO, CFO, COO, President, Vice president, Managing Member, General Partner, Treasurer or other officer with similar authority).
- **Trusts are not covered by the new rules** because they are not legal entities, so institutions are not required to report information on trust beneficiaries. However, covered institutions are required to obtain information on the trustees and any other control persons (for example, the settlor in the case of a revocable trust).

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements

On December 12, 2016, the Treasury Department and the IRS announced final regulations requiring U.S. disregarded entities (such as single-member LLCs) with foreign owners to file IRS Form 5472 information returns identifying their foreign owners and reporting certain related party transactions.

- The new reporting requirements are effective for tax year beginning on or after January 1, 2017. Thus, reporting will not be required until the following year.
- Entities covered by the new rules will continue to be disregarded, but will be "regarded" (like corporations) for Form 5472 reporting, record-keeping and other compliance requirements.
- Covered entities will be required to obtain employer identification numbers ("EINs"). This could present further complications if the owners or other responsible persons do not already have individual taxpayer identification numbers ("ITINs") or Social Security Numbers ("SSNs").

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (Expanded Scope)

The Form 5472 reporting requirements for foreign-owned disregarded entities were added to the existing Form 5472 reporting obligations for 25% foreign-owned U.S. corporations.

- The regulations not only extended the filing requirements to disregarded entities, but also greatly expanded the reportable transactions and activities that trigger a reporting obligation. **Including contributions to, and distributions from, a disregarded entity.**
- The new reporting requirements were **specifically intended to capture transactions, such as contributions to and distributions** from disregarded entities though do not otherwise have any income tax significance.
- ***NOTE: Very difficult to unwind an existing SMLLC structures without triggering a reporting obligation under the new rules.***

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (Reportable Transactions)

The term "reportable transaction" includes a broad range of transactions between the disregarded entity and any "related party" (including the owner):

- "[Any] sale, assignment, lease, license, loan, advance, contribution, or any other transfer of any interest in or a right to use any property (whether tangible or intangible, real or personal) or money, ***however such transaction is effected, and whether or not the terms of such transaction are formally documented***."
- Any services for the benefit of, or on behalf of, another taxpayer.
- Amounts paid or received in connection with the formation and dissolution of the entity, including contributions to and distributions from the entity, whether or not such amounts would otherwise be reportable.
- The regulations include transactions for which no consideration is received (e.g., rent-free use of property, interest-free loans, free services, etc.).

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (Related Party)

Only transactions with related parties are considered reportable transactions. Related parties include:

- Any direct or "indirect" 25% owner (by vote or value) of the reporting entity, including owners by attribution.
- Any person "related" to the reporting entity or an owner, including (among others):
  - Spouses, ancestors, descendants and siblings of the owner.
  - A corporation or partnership with a greater than 50% interest in the owner or reporting entity, or that either is owned more than 50% by the owner or reporting entity or under common control
  - Certain trust fiduciaries where the trust or grantor owns a requisite interest in the underlying entity

International Wealth Tax Advisors
Cross Border Tax Planning Firm

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (Attribution Rules)

Attribution rules apply in determining whether someone "indirectly" owns 25% of the reporting entity:

- Where the reporting entity is owned by a foreign corporation, partnership or (nongrantor) trust, the shareholders, partners or beneficiaries thereof will be considered to own their proportionate shares of the reporting entity (with a 10% minimum ownership threshold for attribution from a corporation).
  - A beneficiary's share of a trust's interest in the reporting entity is based on the relative actuarial value of his or her beneficial interest in the trust.
  - It is not entirely clear how a discretionary beneficiary's interest would be determined, but informal guidance in other contexts suggests one would look to the pattern of distributions, mortality assumptions and relationships among the trustees and beneficiaries (i.e., facts and circumstances).
  - Where the tax owner is a foreign grantor trust, the grantor of such trust.
- An individual may be attributed ownership of a direct or indirect interest in the reporting entity held by certain family members (spouses, children, grandchildren and parents, but *not* siblings).
- Successive attribution rules apply.

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (Example)

A foreign irrevocable discretionary trust is the sole shareholder of a BVI corporation that in turns is the sole member of a Delaware LLC. The LLC owns a duplex condominium apartment in New York City.

- The trust, whose late settlor was a non-US person, has two discretionary beneficiaries – the settlor's two daughters, both of whom are nonresident aliens of the U.S. Their mother and brother are not beneficiaries of the trust, but all of four of them use the apartment rent-free when they are visiting New York.
- The trust periodically advances funds to the BVI corporation, which in turn advances funds to the LLC (and sometimes pays carrying charges on behalf of the LLC). There is no history of distributions from the trust.
- As explained in the next slides, there appear to be reportable transactions not only with the BVI corporation, but also with all four living family members on account of their rent-free use of the apartment.

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (Example)

Related Parties. The BVI corporation, the trust, the two daughters, their mother and their brother likely would all be considered related parties.

- The Delaware LLC is the reporting entity. The BVI corporation, as its sole member, is a direct 25% owner. The trust, as the sole shareholder of the BVI corporation, is an indirect 25% owner of the LLC. Thus, both the BVI corporation and the trust are considered related parties.
- Since they are the only two beneficiaries, both daughters are likely indirect 25% owners of the LLC even if the trust is discretionary, particularly given their prior use of trust property which could serve as a history of distributions. Their mother is likely an indirect 25% owner as well by way of family attribution from her daughters. As such, they are all related parties.
- The brother is not an indirect owner because there is no sibling attribution or re-attribution from his mother. However, he is nonetheless a related party because he is related to three indirect owners.

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (Example)

Reportable Transactions. The following transactions are reportable:

- Both direct funding and indirect funding of the LLC is considered a reportable transaction. Thus, advances from the BVI corporation, as well as the BVI corporation's payment of expenses on behalf of the LLC, are reportable on IRS Form 5472.
- Because the two beneficiaries, as well as their mother and brother, are related parties, their rent-free use of the LLC's property would appear to be a reportable transaction. (Both the payment of rent and the rent-free use of property are considered reportable transactions.)
- *Note: If the BVI corporation dissolved the LLC and took direct ownership of the apartment, the "distribution" of the apartment would itself be a reportable transaction.*

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (Record Maintenance)

Record Maintenance Requirements. The disregarded entity would be required to keep permanent books and records sufficient to establish the correct U.S. tax treatment of any transactions with related parties, including information, documents and records of the foreign owner that may be relevant.

Penalties. The penalty for failure to timely file a correct Form 5472 is $10,000. If the IRS issues notice of the reporting entity's failure to file and no form is filed within 90 days of such notice, an additional $10,000 penalty will apply for each additional 30 days that the form is delinquent.

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (U.S. EIN Requirements)

An EIN is required to file Form 5472. If the LLC or other reporting entity does not already have an EIN, it will need to apply for one by filing IRS Form SS-4.

- If the reporting entity has a bank account, then it likely already has an EIN. Most banks will not let an LLC or other entity open an account without one.

Responsible person. The Form SS-4 instructions require the applicant to identify a "responsible person" and provide his or her taxpayer identification number. For a closely held entity, this is "the individual who has a level of control over, or entitlement to, the funds or assets in the entity that, as a practical matter, enables the individual, directly or indirectly, to control, manage or direct the entity and the disposition of its funds and assets."

- In many cases, the responsible person will be the owner.

U.S. Limited Transparency Efforts

New Form 5472 Filing Requirements (U.S ITIN Requirements)

If the responsible person is a non-U.S. person who does not already have a social security number or ITIN, then he or she will need to apply for an ITIN by filing IRS Form W-7.

- The process can take a few months and requires original or certified copies of the applicant's passport or other official documents confirming his or her identity. Only the issuing agency or a U.S. embassy or consulate can certify the documents. Recent legislation eliminated the option of using certified acceptance agents to assist individuals who reside outside the U.S. with the certification process. Now such Individuals must apply by mail or in person to an IRS employee or designee at a U.S. diplomatic mission or consular post.
- Taxpayers have been able to obtain EINs for LLCs by fax without a responsible person ITIN or SSN. However, there is a significant risk of pushback from the IRS. We strongly advise anyone who needs an EIN for a Form 5472 filing obligation to apply for one well in advance.

Changes to Foreign Asset Reporting Requirements

Summary

Recent changes to foreign asset reporting requirements have been more of a mixed bag, with the IRS expanding the classes of taxpayers subject to IRS Form 8938, but offering some relief in other areas, including an automatic extension of the filing dates for FBARs.

- **Automatic Extension of FBARs.** The Treasury Department's Financial Crimes Enforcement Network (FinCEN) announced an automatic six-month extension for taxpayers required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR).
- **Certain Entities and Trusts Now Required to File Form 8938.** Until recently, only individual taxpayers were required to file Form 8938 (Statement of Specified Foreign Financial Assets). However, certain closely held business entities and trusts are now required to file Form 8938.
- **Relief from Form 8621 and 8938 Filing Obligations.** Limited relief has been offered to dual residents and certain other taxpayers required to file IRS Forms 8621 and 8938.

Changes to Foreign Asset Reporting Requirements

FBAR Automatic Extension

Subject to certain exceptions, any United States person with an interest in, or signature or other authority over, one or more foreign financial accounts whose aggregate value exceeds $10,000 at any time during a calendar year is required to file an FBAR in the following year.

- For FBAR purposes, U.S. persons include U.S. citizens, residents, domestic trusts, estate and entities, including disregarded entities that would not otherwise be considered "persons" for most tax purposes. Thus, a U.S. disregarded entity or "hybrid trust" (discussed later) with offshore accounts or a controlling interest in an offshore entity that owns an offshore account could be required to file the FBAR.

- Foreign financial accounts include bank accounts, brokerage accounts, mutual funds and other pooled investment funds at foreign financial institutions, including many types of foreign retirement plans and life insurance policies.

Changes to Foreign Asset Reporting Requirements

FBAR Automatic Extension (continued)

Controlling Interests. For FBAR purposes a U.S. person can be treated as the owner of a foreign financial account owned (directly or indirectly) by a corporation or a partnership if the U.S. person owns more than 50% of the stock (by vote or value) of the corporation or more than 50% of the capital or profits interests in the partnership (as applicable). A U.S. person can be treated as owner if the owner of record is his agent or representative.

- The above rule also applies to a U.S. person owning (directly or indirectly) more than 50% of the beneficial interest in the income or assets of a trust. However, beneficiaries of a trust are not required to file FBARs with respect to accounts held by the trust if a U.S. trustee files the necessary returns.
- If the grantor of a trust is treated as the owner of the trust's income or assets for tax purposes under the "grantor trust" rules, the grantor is required to file FBARs for reportable accounts held by the trust.

Changes to Foreign Asset Reporting Requirements

FBAR Automatic Extension (continued)

Signature Authority. Signature authority refers to the authority to control the disposition of the assets in the foreign account by direct communication with the financial institution. A decision to allocate assets or instruct others with signature authority is not enough to trigger a filing requirement.

Automatic Extension of Filing Deadline to October 15. Until last year, FBARs were generally due on June 30th, with no automatic extensions. Recent legislation changed the standard FBAR due date to April 15th beginning with the 2016 calendar year report (due in 2017) and mandated a maximum six-month extension. In order to reduce the administrative burden and facilitate compliance, FinCEN granted all filers an automatic extension to October 15th every year, without the need for specific requests, until further notice. ***FBARs for 2016 may be submitted as late as Monday, October 16, 2017.***

- **This automatic extension is limited to FBARs.** The deadline for most IRS returns for foreign assets will not be extended unless the taxpayer files an extension request with respect to the underlying tax return.

Changes to Foreign Asset Reporting Requirements

Form 8938 (Report of Foreign Financial Assets)

Overview

- A "specified individual" is required to report his or her interest in "specified foreign financial assets" on Form 8938, which is filed with such individual's income tax return, if the aggregate value exceeds an applicable threshold ($50,000 on last day of tax year or more than $75,000 at any time during the year for an unmarried individual living in the U.S.).
- A specified individual is a U.S. citizen or resident (including a part-year resident), a nonresident who makes an election to be treated as a resident for the purpose of filing a joint return and a nonresident who is a bona fide resident of Puerto Rico or American Samoa.
- A "financial interest" is an asset that produces income, gains, losses, deductions, credits, gross proceeds or distributions the specified individual would otherwise report on an income tax return. A financial interest is reportable even if it produces no income, with an exception for taxpayers who are not otherwise required to file an income tax return that year.

Changes to Foreign Asset Reporting Requirements

Form 8938 (Report of Foreign Financial Assets)

Overview (continued)

- Specified foreign financial assets include depository or custodial accounts at foreign financial institutions and (if not held in an account): (1) stock or securities issued by foreign persons, (2) any other financial instrument in which counterparty is not a U.S. person and (3) an interest in a foreign entity, including a trust or estate.
- An interest in a trust is not a specified foreign financial asset unless the individual knows or should have known of it, has a mandatory interest or received a distribution.

Changes to Foreign Asset Reporting Requirements

Form 8938 (Report of Foreign Financial Assets)

Reporting Extended to U.S. Entities

Expansion of reporting to domestic entities and trusts. Last year, the IRS exercised its regulatory authority under the statute to extend Form 8938 reporting requirements to "specified domestic entities" – including certain trusts – for tax years beginning after December 31, 2015.

- A "specified domestic entity" means: (1) a domestic corporation, (2) a domestic partnership, or (3) a domestic trust (as defined for U.S. tax purposes), if "formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets."
- This test (as described below) is applied annually.

Changes to Foreign Asset Reporting Requirements

Form 8938 (Report of Foreign Financial Assets)

Reporting Extended to U.S. Entities (continued)

- **When a Domestic Corporation or Partnership is Subject to Form 8938 Filing.** A domestic corporation or partnership meets the "formed or availed of" test if

  (i) a specified individual owns directly, indirectly or constructively, (A) at least 80 percent (by vote or value) of the corporation on the last day of the corporation's tax year or (B) at least 80 percent of the capital or profits interest of the partnership on the last day of the partnership's tax year, and

  (ii) at least 50 percent of the entity's gross income for the tax year is passive income, or at least 50 percent of the entity's assets produce or are held for the production of passive income.

Changes to Foreign Asset Reporting Requirements

Form 8938 (Report of Foreign Financial Assets)

Reporting Extended to U.S. Entities (continued)

- **When a Domestic Trust is Subject to Form 8938 Filing.** A domestic trust meets the "formed or availed of" test if the trust has one or more "specified persons" as a current beneficiary. A specified person is a specified individual or a specified domestic entity.
  - A "Current beneficiary" is, with respect to the tax year, any person who at any time is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent that such power remains unexercised at the end of the taxable year). This includes any holder of a general power of appointment, whether or not exercised, that was exercisable at any time during the taxable year.
  - **Exceptions.** There are exceptions for grantor trusts because the obligation falls on the grantor, as well as for certain domestic trusts with institutional trustees who timely file annual returns for the trust.

Changes to Foreign Asset Reporting Requirements

Form 8938 and Form 8621 (Passive Foreign Investment Company)

Relief for Certain Taxpayers

Recognizing that there is little to gain in requiring dual resident taxpayers who elect under a tax treaty to be taxed as nonresident aliens to comply with burdensome reporting requirements targeted at U.S. taxpayers, recent regulations and other IRS guidance have eliminated a few foreign asset reporting requirements for dual residents and other taxpayers.

Dual Residents. Eligible dual resident individuals of the U.S. and certain treaty countries may invoke treaty "tie-breaker" provisions to determine their U.S. federal income tax liabilities as nonresidents (for example, to avoid being taxed in the U.S. on foreign source income). However, they are still considered U.S. residents for other tax purposes and often are required to file foreign information returns even when there is no associated tax liability.

- New rules introduced at the end of 2016 and 2014 exempt dual residents from the obligation to file (i) IRS Form 8621 to report an interest in a passive foreign investment company for the part of the year that they are treated as nonresidents, and (ii) IRS Form 8938 if they compute their tax liability as nonresidents as of the end of the tax year.

Changes to Foreign Asset Reporting Requirements

Form 8938 and Form 8621 (Passive Foreign Investment Company)

Relief for Certain Taxpayers (continued)

30 Day De Minimis Rule. U.S. taxpayers who hold interests in a PFIC for less than 30 days during a slightly extended taxable year (the 423 day period beginning 29 days before and ending 29 days after the taxable year) are no longer required to report such interests on IRS Form 8621 if (a) they have not disposed of received certain distributions from the PFIC during the taxable year, and (b) they have not made a Qualified Electing Fund election or a Mark to Market election with respect to the PFIC.

PFICs Held in Foreign Pension Funds. Under an existing reporting exception, U.S. beneficiaries of a foreign pension fund are not required to file IRS Form 8621 with respect to PFICs held by a foreign pension fund classified as a trust for U.S. tax purposes if, under an applicable treaty, income earned by the pension is not taxable to the beneficiaries in the U.S. until distribution. This exception was recently expanded to include all treaty-protected pension funds, without regard to whether they are classified as trusts for U.S. tax purposes.

Domestication of Offshore Structures

Reasons for Domesticating Offshore Structures

It is becoming increasingly common for nonresident individuals to settle trusts in U.S. jurisdictions with strong privacy laws and minimal disclosure requirements, such as Delaware and South Dakota. There are often good tax or other planning reasons to do this, particularly where U.S. beneficiaries or assets are concerned, but there are also some more questionable ones.

Tax Planning. There are a number of situations where establishing a trust in the U.S. could be more tax efficient than a non-U.S. trust. For example:

- If the trust has U.S. beneficiaries, punitive tax rules could apply to distributions of accumulated income earned in prior years to the U.S. beneficiaries.
- A trust that will hold U.S. real estate can be structured to provide the same estate tax protections as a foreign blocker corporation (assuming the settlor will not retain any "impermissible strings"), while preserving long-term capital gain treatment (if applicable) when the property is sold.

Domestication of Offshore Structures

Reasons for Domesticating Offshore Structures

Hybrid Trusts. A foreign trust may be structured as a "hybrid" trust – e.g., with an institutional trustee in a jurisdiction like Delaware or South Dakota, but with a feature, such as a foreign protector, that causes the trust to be considered a "foreign" trust for U.S. income tax purposes.

- This might be desirable where the trust is structured as a foreign grantor trust during the non-U.S. grantor's lifetime, but will become a nongrantor trust with U.S. beneficiaries upon the settlor's death, in which case a foreign nongrantor trust would be tax-inefficient for the U.S. beneficiaries.
- In order for a trust to be a U.S. trust for tax purposes, (i) a court in the U.S. must be able to exercise primary (but not exclusive) jurisdiction over the administration of the trust, and (ii) U.S. persons must control all "substantial decisions" of the trust (such as power over distributions, appointment and removal of trustees, etc.). One can settle a trust in the U.S. and keep it "foreign" for tax purposes by appointing a foreign protector with control over a substantial decision, such as the power to remove and replace trustees.

Domestication of Offshore Structures

Reasons for Domesticating Offshore Structures

Avoiding CRS. More questionably, some individuals have begun to look to the U.S. as a possible "haven" from reporting in their home countries.

- As more and more jurisdictions commit to the automatic exchange of information under CRS, there has been growing interest in the U.S. as one of the few remaining holdouts among developed countries with stable financial systems.
- A foreign trust settled in the U.S. with a foreign settlor or protector, as noted above, would not be subject to CRS reporting requirements. It would instead come under the FATCA reporting regime. If there are no U.S. beneficiaries, there would be nothing to report to the IRS. However, as discussed in the next two slides, we offer some words of caution for both would-be settlors and their advisors.

Domestication of Offshore Structures

Limitations on Domesticating Offshore Structures

- If the trust owns any entities or accounts in one of the more than 100 jurisdictions that have adopted CRS, then there is a good chance that the Controlling Persons will have their information reported back to their home countries anyway because the trust itself would be considered a passive NFE for CRS purposes (even if its FATCA classification was as an FFI).
- If a resident of a CRS jurisdiction funds a U.S. trust that owns solely domestic entities and domestic accounts, CRS reporting may be avoided. However, sometimes the use of a foreign entity is important to avoid U.S. estate taxes, particularly if the settlor wishes to retain any degree of control over the trust.
- If the trust is structured as a hybrid trust (i.e., such that it still is a foreign trust for U.S. tax purposes), then any U.S. disregarded entity (such as a wholly owned limited liability company) owned by the trust will be subject to the new Form 5472 reporting requirements for foreign-owned disregarded entities.

Domestication of Offshore Structures

Limitations on Domesticating Offshore Structures (continued)

- U.S. FIs, tax advisors and other U.S. persons will want to carefully consider their own exposure to being implicated in an arrangement to avoid payment of foreign taxes. If a nonresident approaches a U.S. advisor for help in setting up a trust in the U.S., to what extent is the U.S. advisor obligated to make sure that the client has complied with all applicable tax reporting obligations with respect to the funds that will be transferred to the trust? Are U.S. tax advisors precluded from recommending the use of structures that avoids CRS reporting?
- A basic question one should be able to answer when assisting a client in domesticating an offshore structure is why they are choosing the U.S. as a jurisdiction. This may be evident where U.S. beneficiaries and/or assets are involved, but a structure with no apparent U.S. nexus might give one pause.
- One may need input from local counsel on compliance with tax laws and other requirements in the client's home country. In some cases, remedial action may be required before the client can fund the structure.

Thank you

Professional Profile

Jack R. Brister, TEP

Jack has more than 25 years of experience. He specializes in U.S. tax planning and compliance for non-U.S. families with international wealth and asset protection structures which include non-U.S. trusts, estates and civil law foundations that have a U.S. connection; and non-U.S. companies wanting to do business in the U.S.

Jack also specializes in non-U.S. persons investing in U.S. real property, and other U.S. assets, pre-immigration planning, U.S. expatriation matters, U.S. persons in receipt of gifts and inheritances from non-U.S. persons, non-U.S. account and asset reporting, offshore voluntary disclosures, FATCA registration and compliance (W-8BEN-E and Form 8966) and executives working and living abroad.

Jack has been widely published, in addition to speaking at numerous international engagements. Jack has also been named a Citywealth Top 100 U.S. Wealth Advisor.

jbrister@iwtas.com
www.iwtas.com

Professional Profile

Alicea Castellanos, CPA, TEP

Alicea has more than 15 years of experience. She specializes in U.S. tax planning and compliance for non-U.S. families with international wealth and asset protection structures which include non-U.S. trusts, estates and foundations that have a U.S. connection; and executives living and working abroad.

Alicea also specializes in non-U.S. persons investing in U.S. real property, and other U.S. assets, pre-immigration planning, U.S. expatriation matters, U.S. persons in receipt of gifts and inheritances from non-U.S. persons, non-U.S. account and asset reporting, offshore voluntary disclosures, FATCA registration, and non-U.S. companies wanting to do business in the U.S.

Alicea has been published and spoken at numerous events on U.S. cross border tax matters. Alicea is fluent in Spanish and has a working knowledge of Portuguese.

acastellanos@iwtas.com
www.iwtas.com