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FATCA: trustee-documented trusts are not sponsored entities

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Introduction

When the United States and the offshore jurisdictions negotiated intergovernmental agreements (IGAs) in order to implement the Foreign Account Tax Compliance Act (FATCA), they added a category of deemed-compliant foreign financial institution (FFI) that is not in the final FATCA regulations: the trustee-documented trust. The creation of this new category was an excellent way to handle the due diligence and reporting for the multitude of trusts that are not US domestic trusts and that have a

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professional trustee company acting as trustee. These trustees already perform know-your-customer and anti-money laundering due diligence. They are sophisticated fiduciaries well equipped to understand and handle FATCA due diligence and reporting. Financial institutions have now begun asking trustees of trustee-documented trusts to provide a FATCA certificate for the trustee-documented trust: Form W-8BEN-E for complex trusts or Form W-8IMY for grantor trusts. Such a request should be easy enough to comply with, but unfortunately the Internal Revenue Service (IRS) posted a question and answer on its website under the FATCA-FAQs General section (last updated July 29 2014) that has caused considerable confusion with regard to which global intermediary identification number (GIIN) the trustee should include on the form: its reporting IGA FFI GIIN or a sponsoring entity GIIN.

FATCA certificate of status for trustee-documented trust under IGA is provided by trustee

The trustee of a trustee-documented trust can provide a W-8BEN-E or W-8IMY identifying the beneficial owner – or flow-through entity in the case of a grantor trust – as, for example, 'ABC trust company as trustee of the XYZ trust'. The Chapter 3 entity status is complex trust or non-withholding foreign grantor trust. The Chapter 4 FATCA status is non-reporting IGA FFI. The trustee then provides the appropriate addresses and enters its GIIN. As discussed below, this should be the trustee's GIIN as a reporting IGA FFI. The trustee may also have registered as a sponsoring entity, but that sponsor GIIN is not relevant to the deemed-compliant category of trustee-documented trust.

This update first looks at the law and how it applies to a real-life example: a trust established under the law of the Jersey Channel Islands with a Jersey trust company as trustee. It then considers the problematic frequently asked question.

Professional trust companies are FATCA compliant as reporting FFIs

Jersey has entered into a Model 1 IGA with the United States, pursuant to which a Jersey resident professional trust company is required to register as a reporting Jersey FFI. A trust company may or may not also decide to register as a sponsoring entity, but it is not required to do so under the terms of the IGA. If, in addition to registering as a reporting Jersey FFI, the

trust company also decides to register as a sponsoring entity, the two registrations are separate and two different GIINs are issued. A reporting IGA FFI is not necessarily also a sponsoring entity, and similarly a sponsoring entity is not necessarily also a reporting IGA FFI.

Trusts with professional trust companies as trustee are deemed compliant under IGAs

Annex I of the Jersey IGA sets out five separate categories of investment entity that qualify as deemed-compliant FFIs. The first category is the trustee-documented trust. This entity must meet three criteria:

- It must be a trust established under the laws of Jersey;
- Its trustee must be a reporting US financial institution, reporting Model 1 FFI or participating FFI (under a Model 2 IGA); and
- The trustee must report all information required to be reported pursuant to the IGA with respect to all US reportable accounts of the trust.

Importantly, there is no mention of a sponsoring entity. The trustee is a reporting IGA FFI registered with the IRS, but the trust itself is not registered.

The second category is the sponsored investment entity. This entity must be an entity established in Jersey and must have agreed with another entity that the other entity will act as its sponsoring entity. The sponsoring entity must have registered with the IRS as a sponsoring entity. The sponsoring entity does not have to be a reporting IGA FFI. If the sponsoring entity identifies a US reportable account, it then registers the sponsored investment entity with the IRS.

The third category is the sponsored closely held investment vehicle. This category is available only for entities whose debt and equity interests are owned by 20 or fewer individuals. Under the Jersey IGA, this entity must be a Jersey financial institution (ie, an investment entity resident in Jersey) and it must have agreed with another entity that the other entity will act as its sponsoring entity. This category specifically provides that the sponsoring entity must also be a reporting US financial institution, reporting Model 1 FFI or participating FFI (under a Model 2 IGA). In other

words, for this category of investment entity the sponsoring entity must also be a reporting IGA FFI registered with the IRS. The sponsored closely held investment vehicle itself is not registered.

These are three separate categories, each with specific criteria (the final two deemed-compliant categories, neither of which is relevant here, are investment advisers and regulated collective investment vehicles). To be deemed compliant as a sponsored closely held investment vehicle, the entity must have a sponsor and that sponsor must also be a reporting FFI. To be deemed compliant as a sponsored investment entity, the entity must have a sponsor – there is no requirement that the sponsor also be a reporting FFI. To be deemed compliant as a trustee-documented trust, the trustee of the trust must be a reporting FFI – there is no requirement that the trustee also be a sponsoring entity.

Guidance notes describe options for trusts

The crown dependencies issued draft guidance notes explaining that a trust that is an investment entity may be able to use one of three categories of financial institution to simplify the registration and reporting process:

- trustee-documented trust;
- sponsored investment entity; or
- owner-documented financial institution.⁽¹⁾

The guidance notes state that in practice, all crown dependency resident trusts that are managed by a crown dependency-regulated trust company may qualify as a trustee-documented trust, provided that the trustee is a reporting US, UK, crown dependency, Model 1 or Model 2 financial institution. Nevertheless, the guidance points out that any trust that is an investment entity, even if professionally managed by such a regulated trust company, may instead appoint a sponsor to undertake its due diligence, registration and reporting responsibilities.

The registration requirements for trusts depend on how the trust is categorised: "If a trust is a trustee-documented trust, the trustee is obliged to register in its own right as it is a financial institution." There is no requirement for details of the trust to be registered or disclosed. "A trustee

will be required to register in its own right if it is a financial institution even if it does not identify a specified US person in any of the trusts that it manages or administers."

It is clear that the trustee-documented trust option hinges on the status of the trustee as a reporting IGA FFI, not whether that trustee has also (or alternatively) registered as a sponsoring entity. To date, the UK guidance notes and draft BVI guidance notes take a similar position.

FFI agreement requires Model 2 IGA trust companies to report US accounts of trusts

Outside the plain language of the IGA and accompanying guidance notes, there is support for the position that it is the trustee, as a reporting IGA FFI and not as a sponsoring entity, which is responsible for the due diligence and reporting of the trust. Suppose the trust established in Jersey has a Swiss reporting IGA FFI as its trustee. The Swiss professional trust company, pursuant to the Swiss IGA, will have registered with the IRS and will be subject to an FFI agreement. Those provisions can be found in Revenue Procedure 2014-38. Section 6.02(A)(3) specifically provides that "a participating FFI that is the trustee of a trustee-documented trust (as defined in an applicable Model 1 or Model 2 IGA) must report each US account maintained by the trust as if the participating FFI maintained the account". Again, the reference is to a participating FFI, not a sponsoring entity.

Instructions to Forms W-8BEN-E and W-8IMY require trustee's GIIN

Even the instructions to Form W-8BEN-E and W-8IMY support the position that it is the trustee, as a reporting IGA FFI, and not as a sponsoring entity, that completes the FATCA certificate. Line 9a of W-8BEN-E and Line 9 of W-8IMY ask for a GIIN. The instructions state that if the provider of the form is a "trustee of a trustee-documented trust... you are required to enter *your* GIIN" (emphasis added). As discussed above, the trustee, when it registered as a reporting FFI, was issued a GIIN. Providing that GIIN on the form – not a sponsoring entity GIIN – allows the requesting financial institution to confirm that the trustee is in fact a reporting IGA FFI, the criteria necessary for the account holder trust to be deemed compliant for FATCA purposes as a trustee-documented trust.

IRS posts confusing FAQ on trustee-documented trusts

The question posted on the IRS website reads: "How do Trustees of Trustee-Documented Trusts register?"⁽²⁾ The question itself is confusing. As demonstrated above, a trust can qualify as a trustee-documented trust only if its trustee is a reporting US financial institution, reporting Model 1 FFI or participating FFI (under a Model 2 IGA). So how do trustees of trustee-documented trusts register? The same way every other reporting FFI registers. Does the answer say this? Unfortunately not.

In the first sentence of the answer the IRS says: "Trustees needing to register Trustee-Documented Trusts (a certified deemed-compliant status for FFIs under the Model 1 and Model 2 IGAs) should use the same procedures Sponsors use to register Sponsored Entities." There is no requirement that a trustee-documented trust be registered. In fact, the last sentence of the answer says just that: "The Trustee-Documented Trust itself will not be registered and does not need to obtain a GIIN." So the first sentence and the last sentence of the answer contradict each another.

The second sentence of the answer then switches from talking about registering the trust to talking about the trustee's registration. The answer says that the trustee is to select 'sponsoring entity' when it registers. Why? A trustee-documented trust needs a reporting IGA FFI as its trustee, not its sponsor. The answer then goes on to say: "Please note that if a trustee is required to register itself based on its own applicable status as an FFI, it will do so on a separate registration." If? As above, a trust simply cannot be a trustee-documented trust unless its trustee is registered as an FFI.

The answer then says that the trustee "thus will have two separate GIINs], one for such use [as an FFI] and another for use in its capacity as a trustee of a Trustee-Documented Trust". Again, the capacity of the trustee of a trustee-documented trust is that of a reporting IGA FFI, not a sponsoring entity. The IRS's instructions to the requester of Form W-8BEN-E and W-8IMY explain that the requester must review the form for completeness and accuracy with respect to the claims made on the form. Supplying a sponsoring GIIN on a W-8 for a trustee-documented trust does not allow the requester to check that the trustee is a reporting IGA FFI, which is the seminal qualification for status as a trustee-documented trust.

Comment

Frequently asked questions (FAQs) are not published guidance. The IRS published guidance – which includes regulations, revenue rulings, revenue procedures, notices and announcements – can be relied on by taxpayers and is given deference by courts. FAQs do not include contact names, as published guidance does, so it is not known who writes a FAQ or to what level of review a FAQ is subjected before its posting. Certain FAQs include an explicit statement that they provide general information and should not be cited as legal authority, but not all. When IRS-published guidance supports a particular reporting position, a FAQ that on its face conflicts with that position should not be relied on when FAQs may not meet the standard of reliance for court cases and taxpayers may be unable to avoid penalties based on FAQ reliance. Concerns regarding the trustee-documented trust FAQ have been submitted to the IRS and it is hoped that the FAQ will be corrected or clarified. However, given the workload of the IRS personnel dealing with the implementation of FACTA, it may be some time before this is addressed. In the meantime, since it is the FATCA status of the trustee that determines whether a trust is deemed compliant as a trustee-documented trust, such status should be confirmed on the relevant W-8 certification by using the GIIN issued to the trustee as a reporting IGA FFI.

For further information on this topic please contact Jennie Cherry or Stanley A Barg at Kozusko Harris Duncan's New York office by telephone (+1 212 980 0010), fax (+1 212 751 0084) or email (jcherry@kozlaw.com or sbarg@kozlaw.com). Alternatively, contact George N Harris Jr or Stephen K Vetter at Kozusko Harris Duncan's Washington DC office by telephone (+1 202 457 7200), fax (+1 202 318 4446) or email (gharris@kozlaw.com or svetter@kozlaw.com). The Kozusko Harris Duncan website can be accessed at www.kozlaw.com.

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Endnotes

- (1) A separate issue is whether a foreign grantor trust can qualify for the deemed-compliant category of sponsored closely held investment vehicle. Under the so-called 'US grantor trust rules,' the IRS treats the settlor of a grantor trust as the owner of the trust, which would seem to allow the trust to meet the requirement that 20 or fewer individuals own all of the debt and equity interests of the trust. However, the fact that the guidance notes do

not list closely held investment vehicle as one of the options for a trust may argue against such an interpretation. In the Model 1 IGA jurisdictions there is little difference between the two sponsored categories when a trust has no US reportable accounts, but the IRS should clarify this point.

(2) The full text of the FAQ (last reviewed or updated on July 29 2014) can be found on the IRS website under FATCA-FAQs General, Registration Update, Q3: www.irs.gov/Businesses/Corporations/Frequently-Asked-Questions-FAQs-FATCA-Compliance-Legal.