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FATCA: practical compliance for non-US private trust companies and their trusts

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Introduction

As it applies to trusts, the Foreign Account Tax Compliance Act (FATCA) provides the Internal Revenue Service (IRS) with information necessary for the IRS to determine whether US settlors and beneficiaries have complied with their US tax reporting obligations. Compliance for a foreign trust with a foreign professional trust company as trustee is relatively straightforward. The professional trust company is considered a foreign financial institution (FFI) and, in accordance with the intergovernmental agreement (IGA) between the United States and the jurisdiction in which the trust company operates, it registers with the IRS and reports as necessary on US settlors and beneficiaries of its trustee-documented trusts (for further details please see "FATCA: trustee-documented trusts are not sponsored entities"). On the other hand, a private trust company should assess its options with regard to how it and the trusts for which it acts as trustee comply with FATCA.

Application to common structure

A common foreign trust structure starts with a professional trust company in, for example, the British Virgin Islands (which has entered into a Model 1 IGA) acting as trustee of a purpose trust that holds the shares of a private trust company, also established in the British Virgin Islands for this example. That private trust company acts as trustee for one or more BVI trusts set up for the benefit of a particular family. Assume that the settlor of each trust is a non-US individual and the purpose trust is a trustee-documented trust, and thus a non-reporting IGA FFI, because its trustee is a reporting Model 1 IGA FFI. Also assume that the professional trust company has registered separately with the IRS to act as a sponsoring entity.

Non-financial foreign entities

Every non-US entity is either an FFI or a non-financial foreign entity (NFFE). There is much debate over these classifications in the case of trusts. Suppose the private trust company in the above example has only individual family members and trusted advisers acting as directors (and those individuals are all non-US persons). Suppose further that the directors wish to open an investment account with a financial institution in a Model 1 IGA jurisdiction to hold all of the assets of the trust for which it serves as trustee. The directors of the private trust company will make all of the investment decisions. Taking the position under the BVI IGA that neither the private trust company nor the trust is an 'investment entity', the directors decide that both are classified as NFFEs.

In order to open the account, the financial institution will request the trustee to provide a certificate of status for the purposes of US tax withholding and reporting: for a grantor trust, IRS Form W-8IMY and for a non-grantor trust, IRS Form W-8BEN-E (for further information on the grantor trust rules, please see the Overview). On both forms the trustee must indicate the trust's Chapter 3 withholding status (eg, a complex trust on Form W-8BEN-E or a non-withholding foreign grantor trust on Form W-8IMY) and its Chapter 4 FATCA status.

Assume that the trustee indicates on the appropriate Form W-8 that the trust's Chapter 4 FATCA status is passive NFFE. The trustee must then further certify on the form that the trust has no substantial US owners or provide the name, address and tax identification number of each substantial US owner. In addition, pursuant to the due diligence

requirements of Annex I to the Model 1 IGA, the requesting financial institution must identify the controlling persons of the trust using anti-money laundering and 'know your customer' procedures and must determine whether any of those persons is a US citizen or resident. Controlling persons in the case of a trust means the settlor, the trustee, the protector (if any), the beneficiaries or class of beneficiaries and any other natural person exercising ultimate effective control over the trust.

The result of a NFFE classification for the trust and its trustee means that additional documentation and information must be provided to the requesting financial institution on US and non-US persons. It also means that the financial institution now handles the reporting if it determines the account to be a US reportable account. The private trust company has lost the ability to oversee the reporting of information relevant to US family members.

Use of sponsoring entity

Suppose, instead, that the directors decide the trust company and the family trusts for which it acts as trustee are investment entities, and therefore FFIs. Where the private trust company receives remuneration from the family trusts and all the investments of the trusts are managed by a professional portfolio manager, this is a straightforward classification. The directors can comply with the terms of the IGA by arranging for the professional trust company that acts as trustee of the purpose trust to act as sponsoring entity for the private trust company and the trusts. This can be a comfortable fit, especially when the professional trust company knows and has a good working relationship with the family.

With a sponsoring entity in place, the private trust company can now provide the requesting financial institution with the appropriate Form W-8 showing that the trust is a non-reporting IGA FFI as a sponsored investment entity or a sponsored closely held investment vehicle under the BVI Model 1 IGA. The financial institution now has an account holder that is a deemed-compliant FFI, the account is not a US reportable account and no reporting is required with respect to the account by the financial institution.

It will now be the sponsoring entity which will make a determination as to whether the trust has any US reportable accounts, and likewise whether the private trust company has any such accounts. The professional trust

company, working with its know your customer and anti-money laundering records, the directors of the private trust company and the family, has or can update its due diligence with regard to the personal details relevant to the citizenship and tax residence of the settlor, the beneficiaries and the directors. The family knows the officers at the professional trust company and feels confident that confidentiality will be maintained.

Only if the sponsoring entity identifies a US reportable account of the trust will it be required to file a FATCA report. In the case of a trust, under the Model 1 IGA its accounts are its "equity interests" which are considered to be held by any person treated as a settlor or beneficiary of all or a portion of the trust, or any other natural person exercising ultimate effective control over the trust. A US person is treated as a beneficiary for these purposes if he or she has the right to receive a mandatory distribution or may receive a discretionary distribution from the trust.

If the trust has a class of discretionary beneficiaries that includes US individuals, when the trust makes a distribution to a US beneficiary that individual has an obligation to file Form 3520 with the IRS and report the receipt of the distribution from a foreign trust. The family's US tax adviser can work with the directors of the private trust company to provide the US beneficiary with a foreign grantor trust beneficiary statement or foreign non-grantor trust beneficiary statement, as the case may be, and with the officers of the sponsoring entity to file the FATCA report. The IRS will have the information it needs to confirm that the US individual has filed his or her Form 3520 and reported any income that is required to be reported on a US income tax return. Information on all non-US family members remains with the professional trust company and the directors of their private trust company. Every entity in the structure knows its FATCA status and can provide the appropriate certificate so that an account is not marked recalcitrant or non-participating, causing it to be subject to 30% FATCA withholding on US withholdable payments.

As for the private trust company, its accounts are also its equity interests and the sponsoring entity confirms that 100% of the shares are owned by the purpose trust. This purpose trust is deemed compliant as a trustee-documented trust so the private trust company has no US reportable accounts. The purpose trust has no named beneficiaries, its stated

purpose being to hold the shares of the private trust company. Therefore, the trustee reviews due diligence on the settlor and confirms that he or she is a non-US person. The purpose trust also has no US reportable accounts.

Private trust company registers as reporting IGA FFI

Suppose that the professional trust company serving as trustee of the purpose trust has not been very involved with the family. Rather than enter into a sponsoring entity agreement with that trust company, the directors might decide to register the private trust company as a reporting Model 1 FFI. The registration process is simple. The directors decide who will be the FATCA-responsible officer and that person provides the name of the private trust company, its mailing address and the name of the responsible officer to the IRS through the online registration portal, and then receives a global international identification number (GIIN).

The directors of the private trust company can now provide the appropriate Form W-8 to the requesting financial institution to open the investment account, indicating that the trust is a trustee-documented trust and providing the GIIN of its reporting Model 1 FFI trustee (for further details please see "FATCA: trustee-documented trusts are not sponsored entities"). The financial institution checks the GIIN against the published IRS FFI List (also online).

Now it is up to the directors of the private trust company to carry out the due diligence for the trust and file FATCA reports if necessary. Similarly, the directors carry out due diligence on the holder of the equity interests of the private trust company itself and request a Form W-8BEN-E from the trustee of the purpose trust. Working with the family's US tax adviser, the directors can continue to provide fiduciary and management services to the family and can move easily in the global financial community. The directors continue to safeguard the personal details of the family members and to ensure that any US family members are tax compliant. If there are no US family members at present, there are no US taxpayers for whom the IRS needs information and no FATCA reports for the directors to file. At some point the IRS may require the registered private trust company to certify, through the company's online account, that it is compliant with its due diligence responsibilities, but this has not yet been established.

Comment

The draft guidance notes to the BVI IGA are thoughtful and practical. The notes acknowledge that even if a private trust company is not considered to be an investment entity in the business of administering trust assets, it may be administratively convenient for the private trust company to register as a reporting Model 1 FFI. If not so registered, all of the family trusts for which the private trust company acts as trustee will not be able to utilise the trustee-documented trust deemed-compliant classification and will be required to register with the IRS, find a sponsoring entity that is registered with the IRS or pursue an owner-documented status with each financial institution requesting documentation. Accordingly, the guidance notes provide that a private trust company that does not fall strictly within the definition of an FFI may still elect to be treated as an FFI. Rather than a gnashing of teeth over the technicalities of the various classifications, advisers to international families should consider practical solutions for compliance that best suit the realities of the family, its investments and its succession planning goals.

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