

Preparing US tax and information returns: Forms 3520 and 3520-A

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Introduction

The Internal Revenue Service (IRS) is ramping up compliance initiatives targeting failures to file US tax and information returns. US tax attorneys and accountants are increasingly seeing IRS notifications and penalty assessments. As the new year begins, family advisers and trust officers should review succession planning structures to determine whether any entity or individual has a 15 April US reporting requirement. Most relevant to non-US trusts are Form 3520, which is filed by US settlors and US beneficiaries, and Form 3520-A, which is due 15 March and filed by trustees of non-US trusts with US grantors. Form 3520 is also filed by US persons, including US domestic trusts, which have received large gifts from non-US persons.

Do not miss filing deadlines

Form 3520 must generally be filed with the IRS by 15 April. If the US taxpayer lives and works outside the United States, including military personnel, Form 3520 is due 15 June. If the US taxpayer is granted a time extension to file their federal income tax return, the due date for filing Form 3520 is extended to 15 October.

Form 3520-A is due 15 March. Form 7004 must be filed to request a time extension to file Form 3520-A and must be submitted prior to the original due date (for further details please see "Filing Extension Request"). The US taxpayer's income tax return extension does not extend the time for the trustee to file Form 3520-A.

Independent of Form 3520 or 3520-A, the trustee must provide the US beneficiary or US settlor with the appropriate beneficiary statement by 15 March. That statement is then filed with the trustee's Form 3520-A and also submitted to the IRS along with the US taxpayer's Form 3520.

FATCA reports

Distributions from a non-US trust to a US beneficiary, whether an individual or entity, generally trigger a Foreign Account Tax Compliance Act (FATCA) report. (Certain US charity beneficiaries may be able to provide an exemption code from FATCA reporting.) Trustees of non-US trusts with US settlors who are considered owners of the foreign trust under the grantor trust rules (for further details please see "[Overview \(January 2020\)](#)") are also required to file an annual FATCA report with details of the settlor, regardless of whether the settlor received any distributions from the trust.

In many cases an offshore foreign trust will be FATCA compliant as a trustee-documented trust under a FATCA intergovernmental agreement (IGA) and the trustee will provide the IRS with the required data (for further details please see "[FATCA: practical compliance for non-US private trust companies and their trusts](#)"). The trustee of a trust established under the law of a US state that is foreign for US tax purposes may also have a FATCA reporting obligation under the FATCA Regulations (for further details please see "[FATCA documentation for US-based trusts](#)"). These FATCA reports allow the IRS to confirm that the reported US taxpayer has filed the appropriate tax

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and information returns. With the US taxpayer's name, address and tax identification number in hand, the IRS mails a penalty notification if a Form 3520 or 3520-A deadline is missed.

Penalties

A penalty applies if Form 3520 is not timely filed or if the information is incomplete or incorrect. Generally, the initial penalty is equal to the greater of \$10,000 or 35% of the value of property added to a trust by the US grantor or of the amount distributed to a US beneficiary, or 5% of the gross value of the trust property of which the US person is considered the grantor under US income tax rules. The penalty for failure to file Form 3520-A is levied on the US grantor even though it is the trustee who files the form.

US grantor of non-US trust

US grantor files Form 3520

In most cases, a US person who settles a non-US trust, known as a 'foreign grantor trust', is treated as the owner of all income earned in the trust. Every year, the settlor must file Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. Attached to the form is a 'foreign grantor trust owner statement' provided by the trustee. Additional information is filed with the form if the trustee has not appointed a US agent to act on the trust's behalf when dealing with the IRS, whose agent can be the grantor or the grantor's US accountant. The US grantor will also include any income earned in the trust and attributable to the grantor on the grantor's federal income tax return, Form 1040. Form 1040 must include a completed Schedule B, Part III, Foreign Accounts and Trusts, to report information regarding the foreign grantor trust.

Trustee files Form 3520-A and provides foreign grantor trust owner statement

Non-US trustees rarely have a US filing obligation other than FATCA reporting, but Form 3520-A is an important exception. A US person who is treated as an owner of any portion of a foreign trust under the US grantor trust rules must ensure that the foreign trust files Form 3520-A, Annual Information Return of Foreign Trust with a US Owner. As noted above, this form is due 15 March, not 15 April. Form 3520-A provides information about the foreign trust and its US grantor. Additional details and documentation are required if the trust has not appointed a US agent who can provide the IRS with relevant trust information and so designating a US agent is generally recommended. If the foreign trust fails to file Form 3520-A, the US grantor, and not the foreign trust, is subject to penalties. The trustee must also provide the grantor with a foreign grantor trust owner statement, the form of which is contained in Form 3520-A. The non-US trustee is not required to apply for a US tax identification number for the trust in order to file Form 3520-A. Instead, an alphanumeric reference ID number is established for the trust and used on both the trustee's Form 3520-A and the grantor's Form 3520.

US beneficiary receiving distributions from non-US trust

US beneficiary files Form 3520

US persons who receive distributions from a foreign trust, regardless of the amount, must file Form 3520. This includes a US trust that receives a distribution from a foreign trust, not just individual beneficiaries. In addition to cash distributions, the US beneficiary's use of property held in a foreign trust, such as a holiday home, may be treated as a distribution to the beneficiary of the fair market value of the use of the property (for further details please see "Use of trust property deemed distribution").

Trustee provides foreign trust beneficiary statement

The trustee of a foreign trust must provide a US beneficiary with either a foreign grantor trust beneficiary statement or a foreign non-grantor trust beneficiary statement. These statements must contain specified items, as detailed in the instructions to Form 3520, including a statement that the trust will permit either the IRS or the US beneficiary to inspect and copy the trust's books and records. This statement is unnecessary if the trust has appointed a US agent. The trustee may use the IRS form foreign grantor trust beneficiary statement found on page 5 of Form 3520-A and attach an explanation supporting grantor trust status. A non-grantor trust beneficiary statement must be prepared by the trustee. Failure to provide the US beneficiary with a beneficiary statement or include the specified items can cause adverse tax treatment of income items attributable to the beneficiary.

US person receiving large gifts from non-US person

US persons who receive gifts from a non-US person totalling more than \$100,000 in a calendar year are required to file Form 3520. The date of the gift, a description and its fair market value are reported, but no details regarding the non-US donor are required. The threshold for reporting gifts from a foreign corporation or partnership is \$16,388 for the 2019 reporting year and is adjusted every year. The IRS generally treats payments from corporations as dividends, which are subject to

US income tax, so care must be taken to appropriately document a gift from a foreign entity. Gifts from foreign corporations or foreign partnerships are subject to recharacterisation by the IRS. The US recipient of such a gift will be required to include the name of the foreign donor company or partnership and its address on Form 3520 and answer whether there is any reason to believe the donor was acting as a nominee or intermediary for someone else.

Attention to FATCA compliance prevents penalties and incorrect reporting

Where a non-US trust has been classified as an 'investment entity' under the FATCA definitions, such as a trustee-documented trust under an IGA, the trustee must determine whether a FATCA report is required. Likewise, a US trust company serving as trustee of a US-based foreign trust, whether as trustee of a trust registered with the IRS or as that trust's FATCA sponsoring entity, must also determine whether FATCA reporting is necessary. FATCA reports include details of:

- the US beneficiary's name, address and tax identification number and the amount of the distributions; and
- the US settlor's name, address and tax identification number and the value of the trust.

Trustees under a Model 2 IGA file FATCA reports electronically with the IRS directly, as do trustees or sponsoring entities of US-based foreign trusts under the FATCA regulations. Trustees under a Model 1 IGA file the report through the local reporting portal.

If the foreign trust is classified not as an investment entity, but rather as a passive non-financial foreign entity (NFFE), the financial institutions where the trust has accounts will have been provided with the US grantor's details or details of a US beneficiary receiving distributions, as appropriate, and will file the FATCA report (for further details please see "[Practical FATCA and CRS compliance for family structures](#)").

Non-US financial institutions such as banks and investment funds are also providing the IRS with details on US account holders and investors.

US settlors and US beneficiaries should not ignore FATCA due diligence requests from trustees or financial institutions. Family advisers should assist individual family members and company directors to accurately complete FATCA certifications. Trustees should be proactive and timely in providing foreign grantor or non-grantor trust beneficiary statements and foreign trust owner statements. Experienced US accountants and tax attorneys should be consulted.

Comment

FATCA is working. FATCA reports inform the IRS about a US taxpayer's foreign financial accounts and distributions from non-US trusts. US settlors and US beneficiaries who fail to file required US tax and information returns are receiving penalty notifications. US trusts that have received distributions from offshore trusts or gifts from non-US settlors are receiving penalty notifications. Family advisers should coordinate with trustees and accountants to ensure that FATCA due diligence and US tax and information reporting is accurate and timely. If a trustee will not be able to provide a US grantor or US beneficiary with the necessary statements prior to the filing deadline, a request for extension should be filed as soon as possible. All IRS forms and explanatory materials may be found at www.irs.gov.

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