Practical FATCA and CRS compliance for family trust structures

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All over the world, financial institutions are collecting information on and reporting individuals associated with a family's succession planning trust structure. The family's interests are best served when the family office and professional advisers take a proactive approach to complying with the Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard (CRS) as they apply to each entity within the family trust structure.

Background

For years, families have used trust structures to organise and manage their worldwide assets. These trust structures are perfectly legal. Although some individuals use trusts and holding companies to evade taxes and avoid creditors, the vast majority do not. Trust structures allow wealth creators to allocate decision-making responsibilities and educate younger family members, thus ensuring that assets are managed responsibly. Trust documents enumerate family values and provide details for the preservation of wealth for future generations. The goal is to:

- create an environment that encourages beneficiaries to plan for their respective futures;
- have a healthy relationship with the family's financial assets; and
- grow their human capital.

Unfettered access to wealth can have a negative influence and wealth can be readily lost if it is used to treat every desire as a need. It is important to settlors of these structures and their family offices to operate legally and with the highest regard for fiduciary responsibility. They must now find a practical way to comply with the FATCA and CRS laws, which attempt to find tax evaders and succeed in adding complexity and time-consuming paperwork.

Understand the purpose of new compliance regimes

The FATCA and CRS laws, regulations and guidance notes are voluminous and confusing. Financial institutions all use slightly different forms. Account managers often follow compliance checklists and have not been well trained on how to address individual variations from structure to structure. The family office and its advisers can best serve the family's interests by taking responsibility for compliance, applying decisions consistently and defending choices.

The overarching goal of FATCA and CRS is for a taxpayer's country of tax residence to collect information from other countries on the taxpayer's financial assets located in those other countries. The FATCA and CRS rules determine who is responsible for reporting information regarding the taxpayer and the assets. FATCA and CRS apply to entities. Entities classified as passive non-financial foreign entities (NFFEs) in the case of FATCA, or non-financial entities (NFEs) in the case of CRS, have no due diligence or reporting responsibilities; instead, the financial institutions where the NFFE or NFE has an account handle such compliance. Entities classified as investment entity financial institutions (FIs) must file the appropriate FATCA or CRS report with local authorities or, in the case of a FATCA Model 2 jurisdiction, with the US Internal Revenue Service (IRS). Entities within a family trust structure generally are or can be classified as investment entity FIs. Although this means the family office and its advisers must take on the responsibility of understanding and carrying out FATCA and CRS due diligence and reporting, it also ensures proper compliance and minimises conflicting or inaccurate reporting.

Know who and what is going to be reported

For families it is important to know what information is being reported by which financial institutions. Preventing duplicative and inaccurate reporting minimises the chance that a tax-compliant family member will be subjected to unnecessary audit inquiries or deficiency notices. FATCA and CRS reports should be consistent with and support the tax filings made by trust settlors and beneficiaries, not inaccurately contradict such filings.

For families using private trust companies, reporting by the private trust company (or by a family's carefully selected and reputable commercial trust company) at the trust level will result in full and accurate compliance. The trustee of a trust classified as an investment entity FI will be filing FATCA and CRS reports.

Settlors

A US tax resident settlor of a non-US grantor trust will be the subject of a FATCA report (the US settlor can either revoke the trust or is its sole beneficiary and so has US reporting and tax consequences). If the trust is a non-grantor trust, for US tax purposes the settlor has no ongoing US tax or reporting obligations and no FATCA report is required (for further details please see "FATCA reporting: who and what").

A settlor tax resident in a CRS participating jurisdiction will be the subject of a CRS report, if that settlor's country of tax residence is a reportable jurisdiction. Reporting is required even when the settlor is not a beneficiary.

Beneficiaries

A US tax resident beneficiary who receives a distribution from a non-US trust will be the subject of a FATCA report. That beneficiary has a US reporting obligation and may owe US income tax.

A trust beneficiary tax resident in a CRS participating jurisdiction who receives a distribution from the trust will be the subject of a CRS report if he or she is resident in a reportable jurisdiction.

Protectors

A US person acting as protector of a non-US trust is not reported under FATCA. Such person has no US tax or reporting obligations in the United States relating to his or her service as protector.

A protector who is tax resident in a CRS participating jurisdiction will be reported under CRS. In its frequently asked questions issued in June 2016, the designer of the CRS, the Organisation for Economic Cooperation and Development (OECD), took the express position that where a trust is a reporting financial institution, a protector "must be treated as an account holder irrespective of whether it has effective control over the trust". The Society of Trust and Estate Practitioners (STEP) has rightly pointed out that the OECD's guidance does not constitute a legally binding interpretation of the CRS. STEP has advised its members that there is a reasonable basis for reaching the opposite conclusion. Nevertheless, the family office may meet resistance from financial institutions or local regulators if it does not include protectors in its CRS due diligence and reporting.

The reporting of trust protectors is an unfortunate aspect of the CRS. It is unlikely that any country taxes protectors, in the absence of powers that effectively cause the protector to have control of trust income and property for his or her own benefit. A primary reason for a protector in a legitimate and legal trust structure is to protect the beneficiaries from good trustees gone bad and avoid the time and expense of litigation to change trustees. Protectors may now find that they must answer inquiries by tax authorities regarding financial assets that they do not and have never owned, and from which they do not benefit. Family offices and trust companies should be sure to inform protectors of any reporting and support them as necessary when faced with an inquiry by home country tax authorities.

Fortify private trust company compliance

A family's private trust company is established to carry out fiduciary responsibilities as trustee of one or more family trusts. Under the terms of the trust instrument and local law, the trustee will have the authority to manage and invest the assets of the trust for the benefit of the beneficiaries. It has always been important to tax-compliant families to maintain the integrity of that corporate fiduciary. With the roll-out of FATCA and CRS, the corporate integrity of the private trust company should be reviewed and strengthened:

- The directors of the private trust company must continue to comply with all local company laws.
- The private trust company must maintain corporate records, hold annual meetings and carry out its trustee duties to the highest fiduciary standards.
- The private trust company should be registered with the IRS as a reporting FI for FATCA purposes and enrolled on the appropriate CRS portal as a reporting investment entity FI.
- FATCA and CRS due diligence documentation should be collected and maintained just as it is by commercial trustee companies.
- Annual accounting records should be maintained and detail trustee service fees.

With compliance in place for the family's private trust company, the trust will qualify as a trustee-documented trust for FATCA and CRS purposes.

The private trust company should also be registered separately as a FATCA sponsoring entity. This will allow underlying investment entity FI companies established in a jurisdiction with a FATCA intergovernmental agreement (IGA) in place to qualify for a FATCA status of non-reporting IGA foreign financial institution (FFI). The family office must have a reply ready to counter the incorrect assertion made by many financial institutions that the sponsored entity must have its own global intermediary identification number (GIIN). There has been much confusion about this, but it is clear that the sponsor of a sponsored investment entity or sponsored closely held investment vehicle under a FATCA IGA need not register that entity until such time as a US reportable account is identified.

There are many excellent commercial trust companies that have stepped up to provide well-informed and practical FATCA and CRS compliance services for their trusts and underlying companies. If the family uses such a professional trust company, the family office and its advisers will want to work with the trust company to confirm who and what is being reported under FATCA and CRS.

Qualify for and maintain investment entity FI status for underlying companies

The trustee of a trustee-documented trust must report the full value of the trust in the case of the settlor and the amount of any distribution in the case of the beneficiary. If the underlying company is classified as a passive NFFE or NFE, the company provides its financial institutions with information on the company's substantial US owners under FATCA and its controlling persons under CRS. Those financial institutions may then have a CRS or FATCA reporting obligation. A reportable person's home country will receive a FATCA or CRS report reflecting the value of the account with the reporting financial institution. Discrepancies can, of course, be explained on audit, but families would generally like to avoid the unnecessary complication of inquiries from the tax authorities.

If the underlying company is classified as an investment entity FI, the financial institution where the company has an account has no requirement to file a FATCA or CRS report. Neither is the company itself required to file a report, because its equity interests are held by a trust classified as an FI and whose trustee will file the necessary FATCA and CRS reports.

There are many reasons for trust structures to include underlying companies. For example, separate companies can have different investment strategies with different investment managers. If a trust is divided into shares for different family branches, each share can hold its corresponding company or companies. The directors of those separate companies, or of companies owned by separate family trusts, might decide to invest together through a subsidiary. These companies are established under company law for the purposes of investing and managing the money and financial assets entrusted to them.

Managed by

Often, a family will use professional investment advisers with discretionary management authority over a company's financial assets. A company holding financial assets that are managed by an investment entity FI is itself easily classified as an investment entity FI under FATCA and CRS. Even if the investment adviser does not have discretionary authority, many companies will be managed by some other investment entity FI, such as a trust company or the family office. The trust company, as discussed above, is compliant as an investment entity FI. The family office likewise is often a corporate entity providing investment advice to family members.

Some families consolidate investment decisions in the family office, which then directs the investment entity FIs holding the company's financial accounts. There is no requirement under FATCA or CRS that an investment entity FI have discretionary authority over all of the company's investments, so families could consider arranging with the family's third-party investment providers to assume some discretionary authority. The family must, of course, have confidence in the investment provider, but can set guidelines and oversee the exercise of such discretionary authority.

Alternatively, the family office itself may be an investment entity FI. If the family office is in fact administering and managing financial assets and money for various entities in the family structure, then it may have a FATCA and CRS classification as an investment adviser for assets held in the name of the family entity with a custodian or other financial institution. Such a family office provides investment advice only to family clients and does not hold itself out to the public as an investment adviser. Although it may have employees who are unrelated to the family, the family office entity is wholly owned by family clients and exclusively controlled by family members and family entities. Nonetheless, a family office that is compensated for such services fits within the FATCA and CRS definitions of an investment entity FI that provides investment advisory or management services, even though all financial assets are held in accounts with commercial financial institutions. Compliance for such a family office should be handled accordingly:

- maintain all corporate records and books;
- put in place service agreements between the family office and the entities for which it provides investment advice; and
- include details of a services fee on the annual accounts of the family office.

The family office itself has no reporting requirements under FATCA and CRS. It assists its family client entities, classified as investment entity FIs, with their FATCA and CRS compliance and reporting.

In the business of

In other cases, neither a family office nor another investment entity FI is used. Instead, the underlying company itself is established for the purpose of administering and managing the assets entrusted to it by the trustee of the trust. Again, treat the company as the business entity that it is:

- comply with all local laws (eg, confirm the registered agent has filed a register of directors and provided information to the online beneficial owner register where required);
- maintain all corporate records and books and hold annual meetings;
- register the company on the appropriate CRS portal as a reporting investment entity;
- enter into a written FATCA sponsoring entity agreement with the private trust company;

- prepare written FATCA and CRS policies and procedures;
- include language in the memorandum and articles of association detailing the services to be provided and the fees to be collected;
- annual accounts should summarise investment performance and detail service fees; and
- FATCA and CRS due diligence on equity interest holders should be gathered and maintained.

Comment

Attorneys, accountants and compliance officers worldwide have differing views on the application of the various FATCA and CRS classifications. Rather than becoming frustrated with the various interpretations, make a common sense decision for each entity in the particular family structure and maintain the documentation supporting that decision. As jurisdictions are implementing the CRS, they are including regulations allowing local authorities to make inquiries and inspect compliance documentation. Be sure each entity is ready to respond.

There are likely to be further transparency laws enacted and some commentators are advocating for a trust registry. Mere registration of a trust does not guarantee responsible and transparent management of a structure holding a family's wealth. Those who wish to evade and avoid tax laws or creditors will manipulate the documentation and aggressively interpret the rules. What good is a mountain of due diligence and reporting with regard to an individual who does not feel compelled to answer truthfully?

It is unfortunate that the current environment seems to assume tax avoidance and defrauding creditors is inherent in all trust structures, that families who use trust structures are bad actors and that any effort seeking to collect additional information is good. In reality, as those who practice in this arena well know, most hard working families have earned their wealth though honest business practices. Managing a family's assets for future generations is serious business. Entire financial and service industries are dependent on properly managed and compliant structures. The majority of settlors do not want to defraud creditors, evade taxes or allow family members to shirk individual responsibility. They are proud of their family values and seek structures that will hold and use the family's wealth to assist future generations in realising their dreams and becoming responsible members of society. They fear for family members living in countries where governments are corrupt and known to share information with kidnappers and others who might physically harm family members. To take advantage of the legal benefits of a family trust structure, it is the responsibility of the family and their fiduciaries to comply with a country's ever changing laws. Tax-compliant families will continue to do so even though burdened with the additional, complicated regulations and volumes of paperwork now required.

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