FATCA AND NON-US TRUSTS: AN OVERVIEW

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INTRODUCTION

The enactment of the Foreign Account Tax Compliance Act (FATCA) on 18 March 2010,[1] and the final regulations promulgated by the US Department of Treasury under FATCA,[2] has established an extraordinarily complex framework for non-US entities to be compliant with US tax law. The application of FATCA to non-US trusts and non-US trust structures is especially difficult to navigate, even with the final regulations issued in 2013 and further guidance provided in 2014.[3] Trustees of non-US trusts know by now that not only they, but the trusts of which they serve as trustee and the underlying entities which hold the assets, will have obligations under FATCA.

This article provides an overview of how FATCA applies to non-US private asset-holding structures involving trusts. It examines how different types of non-US trusts and private trust companies are classified under FATCA and the reporting consequences of such classifications. Finally, this article summarises some of the

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[1] See Hiring Incentives to Restore Employment Act of 2010, Pub L No 111–147, §§ 501–541, 124 Stat 71, 97–106 (2010), codified at 26 USC §§ 1471–1474.

[2] See TD 9610, 2013–15 IRB 765 (2013); TD 9657, 2014–13 IRB 687 (2014). The Internal Revenue Service (IRS) is a bureau of the US Department of the Treasury (Treasury) and administers US tax laws.

[3] Following the final regulations, the IRS issued Notice 2013–43 to preview a revised timeline for implementation of the FATCA requirements. On 20 February 2014, Treasury and the IRS issued temporary regulations that clarify and modify certain provisions of the final regulations issued in 2013, including incorporating the revised timeline for the implementation of FATCA set forth in Notice 2013–43. TD 9657, 2014–13 IRB 687 (2014). Notice 2014–33, released on 2 May 2014, announced that calendar years 2014 and 2015 will be regarded as a transition period for purposes of IRS enforcement and administration of FATCA and good-faith efforts by withholding agents and other entities to comply will be taken into account.

differences between the US FATCA regulations and the rules applicable under the intergovernmental agreements between the USA and other jurisdictions.

OVERVIEW OF FATCA

FATCA was intended to prevent US taxpayers from avoiding disclosure of offshore assets and income by requiring third parties to report the same or similar information. In general, FATCA requires certain foreign financial institutions (FFIs) and non-financial foreign entities (NFFEs) to identify, document and report their US account holders to the Internal Revenue Service (IRS). Depending on which category the entity falls into – either an FFI or NFFE – the compliance rules and obligations under FATCA vary. For the purposes of FATCA, non-US trusts are considered foreign entities. While trusts that are NFFEs may find it easier to achieve FATCA compliance, both categories of foreign entities are subject to a 30% FATCA withholding tax on certain US source payments unless they are exempt from, or have complied (or are deemed to have complied) with, FATCA's requirements.[4] As a consequence, most non-US trusts will have reporting obligations under FATCA. However, if a non-US trust is a resident of a country that has an intergovernmental agreement (IGA) with the USA, the trustee may rely on the procedures in the applicable IGA (and the country's local laws), which may in fact modify the reporting and withholding obligations for the trust under FATCA.

A foreign entity – including a trust – is either an FFI or NFFE

A non-US trust (as well as any underlying non-US corporation held by trust) will be classified as either an FFI or an NFFE.[5]

FFI

An FFI is generally defined as any one of five different types of financial institutions listed in the regulations,[6] the most significant of which in the non-US trust structure context is the 'investment entity' category.[7] An 'investment entity' is defined as an entity that either (1) conducts a business of investing, reinvesting, or trading in financial assets or otherwise investing, administering or managing funds, money or

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4 Generally, FATCA withholding for fixed or determinable annual or periodical (FDAP) payments begins on or after 1 July 2014.

5 Compare IRC § 1471(d)(4)–(5) (2014) (defining an FFI), with IRC § 1472(d) (defining an NFFE as not an FFI).

6 Treas Reg § 1.1471–5(d)–(e).

7 A 'depository institution' which includes foreign entities that regularly provide trust or fiduciary services, is another type of FFI. Treas Regs § 1.1471–5(e)(2)(i)(D).

financial assets for customers (investment entity activities), and receives 50% or more of its gross income during the 'relevant period'[8] from such investment entity activities; or (2) is 'managed by' another financial institution and has more than 50% of its gross income during the 'relevant period' from investment entity activities.[9] An entity is 'managed by' another if the managing entity performs either directly, or through a third-party service provider, any of the investment entity activities on behalf of the managed entity.[10] In addition, the regulations clarify that a non-US trust will be an investment entity, and thus an FFI, if it is professionally managed by a financial institution (for example, if the trustee is a trust company or if the trust's assets are managed by a financial institution).[11] Therefore, the investment entity category likely covers most non-US trusts with trust company trustees or financial institutions as managers. Since, however, an individual is not an entity, a trust that has only individuals as trustees and managers of the assets will not be an FFI.

NFFE

An NFFE is any foreign entity that is not an FFI.[12] A non-US trust that is not professionally managed by an FFI – for example, a non-US trust with an individual trustee who does not hire any entity as a third-party service provider to perform any investment entity activities noted above – will be considered an NFFE.[13] NFFEs, in turn, are divided into two primary categories; (1) excepted NFFEs (which are exempt from FATCA withholding); and (2) passive NFFEs (which are not exempt).[14] An active NFFE is one type of excepted NFFE that satisfies either a less than 50% passive income test or a less than 50% passive assets test.[15] With exceptions, passive income is defined to include interest, dividends, rents, and royalties, among other

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8 The regulations define the relevant period for purposes of these tests as the 3 prior calendar years for the entity or the duration of the entity's existence, whichever is shorter. Ibid, § 1.1471–5(e)(4)(iii), (iv).

9 Ibid, § 1.1471–5(e)(4).

10 Ibid, § 1.1471–5(e)(4)(i)(B).

11 Ibid, § 1.1471–5(e)(4)(v), exs 5, 6. See also Temp Treas Reg § 1.1471–5(e)(4)(v), exs 7, 8 (2014).

12 IRC § 1472(d).

13 See Treas Reg § 1.1471–5(e)(4)(v), ex 5.

14 See ibid, § 1.1471–1(b)(94) (defining passive NFFE to mean any NFFE that is not an excepted NFFE); Temp Treas Reg § 1.1472–1(c)(1) (defining exempted NFFE). The temporary regulations modified the definition of excepted NFFE to include, among other things, a direct reporting NFFE and a sponsored direct reporting NFFE. The changes were made in response to comments the IRS received requesting an election providing NFFEs with the ability to report information about their substantial US owners directly to the IRS rather than to withholding agents. TD 9657, 2014–13 IRB 687, 688.

15 See Treas Reg § 1.1472–1(c)(1)(iv); Temp Treas Reg § 1.1472–1(c)(1)(iv).

types of income. Most non-US family trusts, which primarily hold passive investments, will likely be considered passive NFFEs if they are not FFIs.

Summary of FATCA's withholding rules

In general, FATCA requires all 'withholding agents' to withhold a 30% tax on any 'withholdable payments' to FFIs and passive NFFEs unless these entities have complied (or are deemed to have complied) with FATCA's requirements.[16] FATCA defines a 'withholding agent' as any person, whether US or non-US, acting in any capacity that has control, receipt, custody, disposal or payment of a withholdable payment or a foreign 'passthru payment'.[17] IRC s 1473(1) defines a 'withholdable payment' as, subject to certain exceptions: (1) any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments and other fixed or determinable annual or periodical gains, profits and income (FDAP income), if such payment is from sources within the USA;[18] and (2) any gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends from sources within the USA (although pursuant to the final regulations, this second category of withholdable payment is effective only for sales or dispositions after 31 December 2016).[19]

Simply put, the withholding rules are triggered by payments that have a US source. Therefore, shedding US investors (or owners or beneficiaries, as the case may be) is not a way around FATCA compliance. Shedding US investments also may not prove effective if any payments are indirectly attributable to US sources, which also may trigger the withholding rules under FATCA.[20] In addition, foreign entities that attempt to avoid FATCA may find it difficult to continue relationships with FFIs who are FATCA-compliant since, as described below, those FFIs will have an obligation to collect and report certain information about their customers.

In general, an FFI is subject to FATCA's withholding tax on US source payments unless it: (1) enters into an agreement with the IRS (a participating FFI); (2) is deemed to be FATCA-compliant based on specific exceptions (a deemed-compliant FFI); or (3) satisfies the reporting obligations of any applicable IGA.[21]

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16 IRC §§ 1471(a), 1472(a); Temp Treas Reg § 1.1472–1(b)(1).

17 IRC § 1473(4); Treas Reg § 1.1473–1(d)(1).

18 IRC § 1473(1)(A)(i).

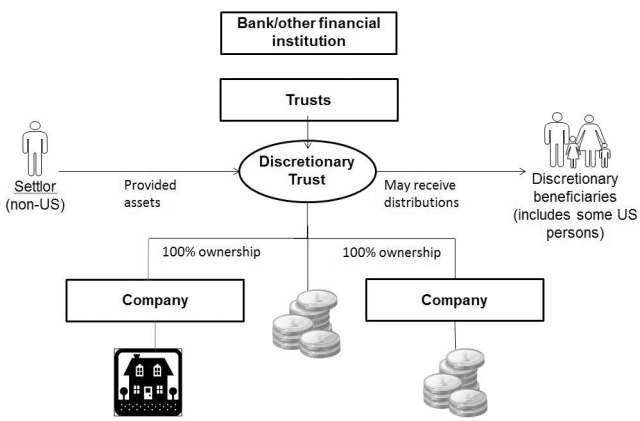
19 IRC § 1473(1)(A)(ii); Treas Reg § 1.1473–1(a)(1)(ii).

20 See IRC § 1471(d)(7). The final regulations refer to a 'foreign passthru payment' but the definition of the term is expressly reserved for a future date. See Treas Reg §§ 1.1471–1(b)(54), 1-1471-5(h)(2).

21 See IRC § 1471(a), (b); Treas Reg § 1.1471–5(f)(1); Temp Treas Reg § 1.1471–1(b)(91). There are

A passive NFFE is subject to FATCA's withholding tax on US source payments unless it can demonstrate to the withholding agent that: (1) it, or another NFFE, is the beneficial owner of the payment; (2) it does not have any substantial US owners, or it has identified any substantial US owners; and (3) the withholding agent agrees to report the information it receives from the NFFE to the IRS.[22] In other words, passive NFFEs are only required to provide information on their substantial US owners to the withholding agents.

APPLICATION OF FATCA TERMINOLOGY TO FOREIGN TRUST STRUCTURES



A typical trust-based holding structure for a client is illustrated above, and involves the establishment of a non-US trust with one or more wholly owned non-US corporations to hold the assets. While the trust serves as a will substitute, the non-US corporation provides the benefit of limited liability, confidentiality, and in certain circumstances, protection from estate tax.

In each case, a practitioner will need to examine the rules and the relevant facts and circumstances to determine the FFI or NFFE status of the trustee, the trust itself and the corporation.

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limited exclusions for certain non-profit entities and non-financial group entities from the definition of financial institution. See Treas Reg § 1.1471–5(e)(5); Temp Treas Reg § 1.1471–5(e)(5).

22 Treas Reg § 1.1472–1(b)(1). See also Temp Treas Reg § 1.1472–1(b)(2) (providing certain transitional relief for withholdable payments made prior to 1 July 2016 with respect to pre-existing obligations). It is also possible for passive NFFEs to report directly to the IRS in respect of their substantial US owners. See Temp Treas Reg § 1.1472–1(c)(3).

Foreign trustees

Based on the final regulations, we believe the following characterisations would apply to foreign trustees:

– If the trustee is a non-US institution, the trustee will be an FFI.[23]

– If the trustee is a private trust company, it likely will be considered an FFI, although the answer is not free from doubt. The characterisation ultimately depends on whether a private trust company, as a business, is engaged in trading, portfolio management, investing, administering or managing financial assets on behalf of a customer. A private trust company that acts solely as the trustee of trusts created by a single family arguably may not be engaged in a manner that satisfies this test, but if it acts as the trustee of trusts created by different branches of an extended family, it may well be.

– If the trustee is an individual, the trustee should be neither an FFI nor an NFFE, since the definition of entity in the final regulations expressly excludes individuals.[24]

Foreign trusts

If a foreign trust's gross income is primarily attributable to its investment assets and it is managed by a financial institution then, with limited exceptions, the trust itself will be an FFI.[25] As noted, one entity is managed by another if the managing entity performs, either directly or through another third-party service provider, any of the investment entity activities identified above.[26] A foreign trust with a trust company serving as trustee will therefore be classified as an FFI.[27] This should be the case whether or not the trust company invests the assets of the trust itself, delegates its investment responsibility to a third-party or, under the law governing the trust, is directed by a third-party as to investments. The examples in the Treasury Regulations make clear that the 'managed by' test can be met for either the trust or its assets.[28] Moreover, it should not matter if the investments are held through an underlying corporation because stock of that corporation is a financial asset, and if dividends are paid regularly from the corporation to the trust, it is likely the trust

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23 See Treas Reg § 1.1471–5(e)(2)(i)(D).

24 Ibid, § 1.1471–1(b)(39) (excluding an individual from the definition of an entity).

25 Ibid, § 1.1471–5(e)(4)(i)(B).

26 Ibid, § 1.1471–5(e)(4)(i)(B).

27 See ibid, § 1.1471–5(e)(4)(v), ex 6.

28 Ibid, § 1.1471–5(e)(4)(v), exs 5, 6; Temp Treas Reg § 1.1471–5(e)(4)(v), exs 7, 8.

would be an FFI on the basis that the dividends paid are income from investing in financial assets and the trust, therefore, has gross income from its investment entity activities.[29]

If all of the trustees and investment managers of a foreign trust are individuals, the trust will not be considered to be managed by an entity. Thus, it is likely to qualify as an NFFE even though the trust's gross income may be primarily attributable to the investment and reinvestment of financial assets.[30] An example in the final regulations confirms that a trust holding solely financial assets and having an individual trustee will not be an FFI so long as the trustee does not hire any entity as a third-party service provider to perform any investment entity activities for the trust.[31] Unfortunately, since individual trustees often hire a third-party service provider entity to manage the investments, this may cause a number of trusts with individual trustees to fail to qualify as NFFEs. However, if the individual trustees retained a third-party service provider entity to provide only advice with respect to the investments (with no direct authority to act with respect to the trust's holdings), the trust may still qualify as an NFFE because advice alone should not rise to the level of managing the trust.[32]

Foreign corporations

Many foreign corporations will likely be FFIs on the basis that they are investment entities, because their investments are actively managed either by a third-party investment manager hired by the trustee or by their directors (who, generally, are individual employees of the trust company or corporate directors wholly owned by the trust company and therefore the corporation may be considered indirectly managed by the trust company).[33]

AVOIDING FATCA WITHHOLDING

NFFE: A trust that is a passive NFFE may find it relatively straightforward to avoid FATCA withholding by certifying that it has no substantial US owners or by identifying them to all of its withholding agents.[34]

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29 Ibid, § 1.1471–5(e)(4)(ii).

30 See ibid, § 1.1471–5(e)(4)(i)(B).

31 Ibid, § 1.1471–5(e)(4)(v), ex 5.

32 See ibid, § 1.1471–5(e)(4)(v), exs 1, 2.

33 Ibid, § 1.1471–5(e)(4)(i)(B). It is possible that the non-US corporation also may qualify as an investment entity under § 1.1471–5(e)(4)(i)(C). Temp Treas Reg § 1.1471–5(e)(4)(v), exs 6, 7.

34 Treas Reg § 1.1472–1(b)(1).

FFI: A trust or foreign corporation that is an FFI can avoid FATCA withholding by becoming a participating FFI or a deemed-compliant FFI. An additional incentive for a trust to become a participating (or deemed-compliant) FFI is so that it may apply for a refund of any overwithheld tax, as there is no mechanism under FATCA for a complex trust that is not FATCA-compliant to claim a credit or refund of withheld tax (except to the extent otherwise required by a treaty obligation of the USA).[35] However, foreign entities resident in a country with which the USA has an IGA may rely on the procedures therein (and local law) to become FATCA-compliant.

Participating FFIs

A participating FFI's agreement with the IRS will require it to gather information sufficient to enable it to identify which of its accounts are US accounts, meaning those financial accounts held by one or more 'specified US persons' or 'US owned foreign entities' and to report information with respect to certain accounts annually.[36] For this purpose, a financial account includes not only what one might typically think of as an account, but also any debt or equity interest in certain FFIs (other than interests regularly traded on an established securities market).[37] The agreement will further require the participating FFI itself to withhold 30% of certain payments it makes to any account holder who fails to provide information or to any other FFI that is not FATCA-compliant.[38]

The regulations generally provide that, in order for withholding not to apply, a participating FFI must register with the IRS through an online portal and obtain a Global Intermediary Identification Number (GIIN). A withholding agent must obtain an FFI's GIIN for payments made after 30 June 2014, and must confirm that the GIIN appears on a published IRS FFI list. A special rule, however, provides that a withholding agent does not need to obtain a reporting Model 1 FFI's GIIN for payments made before 1 January 2015.[39]

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35 Ibid, § 1.1474–2(a)(1), 1.1474–5(a). See EK Harrison, 'FATCA withholding rules for trusts and estates' (2013) 9 Inst on Int'l Est Plan, at pp 6–8. A complex trust is a trust that is not required to distribute its income currently or that makes a principal distribution in addition to distributing income.

36 Temp Treas Reg 1.1471–4(a)(3), (d)(1).

37 Treas Reg § 1.1471–5(b)(1)(iii)(A).

38 IRC § 1471(b)(1)(D).

39 See Treas Reg § 1.1471–3(d)(4)(iv)(B); Temp Treas Reg § 1.1471–3(d)(4).

Deemed-compliant FFIS

Among the categories of deemed-compliant FFIs, the most relevant for foreign trusts and foreign corporations that are not resident in a FATCA partner jurisdiction (see IGAs, below) are the owner-documented FFI, the sponsored investment entity and the sponsored, closely held investment vehicle. The owner-documented FFI and sponsored closely held investment vehicle do not require the sponsored entity to register with the IRS (certified deemed-compliant FFI), whereas the sponsored investment entity requires both the sponsoring entity and sponsored entity to register (registered deemed-compliant FFI). To qualify, a trust or corporation must meet the specific requirements provided in the final regulations requiring, in each case, the agreement of another entity (either a withholding agent or sponsoring entity) to do the FATCA reporting on its behalf.[40] However, these categories may provide options to streamline the reporting within a foreign trust structure. Very generally, the sponsored investment entity and sponsored closely held investment vehicle categories are FFIs where another financial institution has agreed to undertake reporting obligations on the sponsored FFI's behalf. An entity can only qualify as a sponsored closely held investment entity if 20 or fewer individuals own all of the debt and equity interests in the entity. In the case of both the sponsored investment entity and the sponsored closely held investment vehicle, the sponsoring FFI (for example, the trustee) must be able to manage the trust and enter into contracts on its behalf. In contrast, an owner-documented FFI allows an unconnected third party financial institution that is also a withholding agent to undertake reporting on behalf of the FFI. The FFI trust in that instance must provide to each withholding agent an owner reporting statement identifying the beneficiaries, foreign and US alike, and an accompanying Form W-9 for each specified US person who has an interest in the trust. Payments made through these withholding agents would then not be subject to withholding.

DETERMINING BENEFICIAL INTERESTS

To comply with FATCA, a determination will have to be made whether any specified US person has a beneficial interest in a foreign trust. While both the trustee

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[40] The requirements for an owner-documented FFI appear in Treas Reg § 1.1471–5(f)(3), and a withholding agent may treat a payee as an owner-documented FFI if it receives the documentation and meets the due diligence requirements as provided in Treas Reg § 1.1471–3(d)(6). The requirements for a sponsored FFI appear in Treas Reg § 1.1471–5(f)(1)(i)(F) (sponsored investment entities) and Temp Treas Reg § 1.1471–5(f)(2)(iii) (sponsored, closely held investment vehicles). A withholding agent may treat a payee as a sponsored FFI if it receives the documentation and meets the due diligence requirements as provided in Treas Reg § 1.1471–3(d)(4) (sponsored investment entities) and Temp Treas Reg § 1.1471–3(d)(5)(ii) (sponsored, closely held investment vehicles).

and the trust itself may have due diligence and reporting obligations under FATCA, in practice the burden of making the determination will fall on the trustee.

For a trustee to be a participating FFI, for example, it will be required to collect information and report with respect to its US accounts, meaning those financial accounts maintained by the trustee and held by one or more specified US persons or US owned foreign entities, which will include the trusts of which it is a trustee. A trust is a US owned foreign entity if: (1) the trust is treated as owned by any specified US person under IRC ss 671–679; or (2) any specified US person has more than a 10% (or in certain cases more than a 0%) direct or indirect ownership or beneficial interest in the trust, determined as discussed below.[41]

Additionally, a foreign trust that is an FFI will be required to collect information and report with respect to its US accounts and, for this purpose, an account includes an equity interest in the trust.[42] A person has an equity interest in a trust that is an FFI if he: (1) is treated as owning any portion of the trust under IRC ss 671–679; or (2) has received a discretionary distribution during the year or is entitled to mandatory distributions from the trust.[43] A beneficiary who is eligible to receive a discretionary distribution but does not, in fact, receive one, will not be considered as holding an equity interest in the trust for these purposes.[44]

A foreign trust that is a passive NFFE will have to report its substantial US owners, meaning those specified US persons who are: (1) treated as owning any portion of the trust under IRC ss 671–679; or (2) holding, directly or indirectly, more than 10% of the beneficial interests of the trust.[45] For this purpose, ownership or beneficial interests of related persons must be aggregated.[46]

The first step in determining beneficial interests in a foreign trust is to determine the grantor trust status of the trust and, if the trust is a grantor trust, whether the grantor is a US person. If it is a grantor trust in its entirety as to a specified US person and if the trust is an NFFE, no other US beneficiaries are treated as owning

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41 Temp Treas Reg § 1.1471–5(a)(3)(i), (c); Treas Reg § 1.1473–1(b)(1)(iii), (b)(5). See Harrison op cit n 35, above, at pp 7–8 and nn 44–46.

42 IRC § 1471(d)(2)(C); Treas Reg § 1.1471–5(b)(1)(iii).

43 Treas Reg § 1.1471–5(b)(3)(iii)(B); ibid, § 1.1473–1(b)(1)–(5). There is a special rule applicable to FFIs that are investment entities. Under this rule, in determining the interest of a beneficiary of a trust that is an investment entity, if any specified US person holds directly or indirectly any beneficial interest in such investment entity, then a greater than 0% threshold applies.

44 Ibid, § 1.1471–5(b)(3)(iii)(B).

45 IRC §§ 1472(a)-(b), 1473(2)(A)(iii); Treas Reg § 1.1473–1(b)(1)(iii).

46 Temp Treas Reg § 1.1473–1(b)(2)(v).

beneficial interests.[47] It is not entirely clear whether this rule applies to a direct interest in a trust that is an FFI.[48] Nevertheless, if the trust is a grantor trust in its entirety as to a non-resident alien, or if any portion of the trust is not a grantor trust, then the interests of the beneficiaries must be considered in each case.

The second step is to determine the percentage interests of the beneficiaries in the trust. A specified US person has a beneficial interest in a foreign trust if such a person has (directly or indirectly) the right to receive a mandatory distribution or receives a discretionary distribution from the trust.[49] To determine whether the greater of 0% or 10% threshold is satisfied, consider:

– If a US person has a right to receive any mandatory distributions from a trust, the value of such a person's beneficial interest in the trust is determined in accordance with IRC s 7520.[50]

– If a US person is a discretionary beneficiary of a trust, the value of the US person's beneficial interest in the trust is equal to the fair market value of all of the distributions from the trust to him: (1) during the prior calendar year if the trust is an NFFE; or (2) during the current calendar year if the trust is an FFI.[51] The relevant percentage threshold is met if such distributions exceed 10% for a trust that is an NFFE (or 0% for a trust that is an FFI) based on either the value of all of the distributions made by the trust during that year or the value of the assets held by the trust at the end of that year.[52]

– If a US person is both entitled to any mandatory distributions and receives discretionary distributions, the value of the US person's beneficial interest is the sum of the value of the mandatory interest determined under IRC s 7520 and the value of all discretionary distributions made to such a person during the prior year. In this situation, the relevant percentage threshold is met if that total value exceeds either 10% (or 0%) of the value of distributions made by the

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47 Treas Reg § 1.1473–1(b)(4)(ii).

48 Ibid, § 1.1471–5(b)(3)(iii)(B) states that the equity interests of beneficiaries in a trust that is a financial institution are determined in accordance with § 1.1473–1(b)(3). § 1.1473–1(b)(4) contains the exception that allows US beneficiaries to not be treated as owning beneficial interests if the trust is a grantor trust in its entirety with respect to a specified US person, and it is not clear if the exception also applies for purposes of § 1.1471–5(b)(3)(iii)(B). We believe that the better interpretation is that these provisions should be construed together.

49 Ibid, § 1.1473–1(b)(3)(i).

50 Ibid, § 1.1473–1(b)(3)(ii)(B).

51 Ibid, § 1.1473–1(b)(3)(ii)(A), (b)(5).

52 Ibid, § 1.1473–1 (b)(3)(ii)(A), (b)(5).

trust during the prior calendar year or 10% (or 0%) of the value of the assets held by the trust at the end of the year.[53]

– There is a de minimis amount or value exception under which a US person is not treated as a substantial US owner. This exception applies if: (1) the US person receives $5,000 or less during the year from the trust; and (2) the US person is entitled to receive mandatory distributions and the value of such person's interest in the trust is $50,000 or less.[54]

To the extent that a foreign corporation is used in a foreign trust structure to hold investments and is an FFI, the corporation will have to collect information and report on its US accounts (including any US person treated as owning an equity interest in it). If the foreign corporation is owned by a trust that is a participating FFI or a deemed compliant FFI (other than a type of deemed compliant FFI known as an owner-documented FFI), then even if US persons have beneficial interests in the trust, they should not be deemed to have interests in the corporation for reporting purposes.[55] In that case, it appears that the corporation (as a participating FFI) would not have to report information on US persons based on their interests in the trust to the IRS.[56]

In every other case, including if the trust that owns the corporation is an NFFE, the foreign blocker corporation will have to look through the trust to report its substantial US owners. In determining the persons who will be considered to have equity interests in the foreign blocker corporation, indirect ownership rules will apply and interests of related parties will be aggregated.[57] Any grantor treated as the owner of the trust (under IRC ss 671–679) and the beneficiaries of the trust will be deemed to own the stock of the corporation in proportion to their interest in the trust.[58] However, in determining the proportionate interest of the grantor and beneficiaries in this case, the rules for determining beneficial ownership in trusts described above, which rely on past distributions or mandatory rights to distributions, would not apply. Instead, a facts and circumstances test is employed to determine a US person's proportionate interest in the trust (and therefore, indirectly, in the non-US corporation) and arrangements that artificially decrease

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53 Ibid, § 1.1473–1(b)(3)(ii)(C), (b)(5).

54 Ibid, § 1.1473–1(b)(4)(i). It is not entirely clear the de minimis exception applies to direct interests in trusts that are FFIs.

55 Ibid, § 1.1473–1(b)(2)(i); Temp Treas Reg § 1.1471–5(a)(3)(i).

56 Temp Treas Reg § 1.1471–4(d)(2)(ii)(A); Treas Reg § 1.1471–4(d)(3), (d)(9), ex 2.

57 Temp Treas Reg § 1.1473–1(b)(2)(v).

58 Treas Reg § 1.1473–1(b)(2)(i).

such a person's interest are disregarded.[59] Such a test is difficult to apply in the case of a wholly discretionary trust, which is the most common form of foreign trust and therefore may be unworkable in practice.

IGAS

IGAs entered into between the USA and the governments of other countries (partner jurisdictions), are meant to streamline the implementation of FATCA and reduce compliance impediments and costs for FFIs in those partner jurisdictions. There are two types of IGAs the USA enters into: Model 1 and Model 2. The table below provides the list of IGAs the USA currently has with other countries:

Model 1 IGA Jurisdictions	Model 2 IGA Jurisdictions
Australia	Austria
Belgium	Bermuda
Canada	Japan
Cayman Islands	Switzerland[60]
Costa Rica	Chile
Denmark	
Estonia	
Finland	
France	
Germany	
Gibraltar	
Guernsey	
Hungary	
Honduras	
Ireland	
Isle of Man	

[59] Ibid, § 1.1473–1(b)(2)(iv).

[60] In May 2014, the Swiss Government announced its intent to negotiate a Model 1 IGA with the USA.

Israel	
Italy	
Jamaica	
Jersey	
Latvia	
Liechtenstein	
Luxembourg	
Malta	
Mauritius	
Mexico	
The Netherlands	
Norway	
Slovenia	
South America	
Spain	
United Kingdom	

In addition, several other jurisdictions have reached agreements 'in substance,' meaning that they will be treated as having an IGA in effect on 1 July and Model 1 FFIs in those jurisdictions will have additional time to register and obtain a GIIN.[61]

FATCA in Model 1 jurisdictions

FFIs in Model 1 jurisdictions still need to register with the IRS and obtain a GIIN, but as noted, the deadline for doing so is extended. A Model 1 FFI will not need a GIIN in order to be FATCA compliant (and so avoid withholding on US source payments) until 1 January 2015. Until that time, it can simply self-certify as a Model 1 FFI.

It is important to note that Model 1 FFIs do *not* have to comply with US FATCA legislation – their reporting obligations arise under domestic legislation which incorporates the relevant IGA. Although the Model 1 IGA does provide for the

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[61] See IRS Announcement 2014–17 (2 April 2014), and list published at http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA-Archive.aspx.

possibility of a Model 1 FFI electing to comply with the Treasury Regulations if doing so would be less onerous than compliance with local legislation, this is not automatic (for example, in the UK this is permitted only at the discretion of Her Majesty's Revenue & Customs (HMRC)).

Given that the Treasury Regulations are significantly more comprehensive than either the IGAs or – in most cases – the relevant domestic legislation, reference to the Treasury Regulations may nonetheless be helpful in clarifying obligations under a Model 1 IGA, even if they are not binding on a Model 1 FFI.

In many cases, however, compliance with a Model 1 IGA will be less onerous than compliance with the Treasury Regulations. For example:

- The Model 1 (and Model 2) IGA contains a sub-category of deemed compliant FFI created specifically for trusts: the trustee documented trust. This will apply to any foreign trust that is an FFI where the trustee is also a participating FFI or a reporting FFI and the trustee reports the information required by the IGA to the relevant IGA partner. This allows the trustee to satisfy any FATCA reporting obligations on behalf of the trusts it administers without the trusts having to register with the IRS or obtain GIINs.

- Model 1 FFIs are not obliged to operate withholding on payments that they make to non-compliant account holders. Nor are they required to close the accounts of recalcitrant account holders (although they must report them).

- The definition of an 'investment entity' is arguably slightly narrower in the context of managed investment entities.[62] There is no gross income test (the test instead looks to the Financial Action Task Force definition of 'financial institution'). A managed investment-holding entity (ie one which is not itself 'in business') will only be an investment entity if either itself or its assets are managed by another investment entity (rather than any other financial institution). (This is probably of marginal benefit, however, given the breadth of the definition of 'investment entity'.)

- The threshold for reporting substantial US owners of passive NFFEs (or, as defined under the Model 1 IGA, US controlling persons) may be higher than the 10% threshold under the Treasury Regulations, as the IGA looks to the local territory's application of Financial Action Task Force guidance on controlling persons, which in certain territories (for example, the UK) requires

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[62] Guidance notes issued by Canada significantly narrow the definition of 'investment entity' with respect to trusts, excluding many private trusts created for the benefit of one family. Canada Revenue Agency, *Guidance on enhanced financial accounts information reporting* (20 June 2014), at § 3.21.

only the identification of 25% owners. However, other territories may impose a below 10% threshold, which would be more onerous than under the Treasury Regulations.

- Under the amended Annex II to the Model 1 IGA, a sponsored investment entity in a Model 1 territory is not required either to register with the IRS and obtain a GIIN, or to file any reports unless or until it has any US reportable account. Once it has a US reportable account, it has 90 days to register.

However, in other ways compliance with a Model 1 IGA may be more onerous than compliance with the Treasury Regulations (although in these circumstances it is theoretically open to the FFI to opt to comply with the Treasury Regulations if the implementing legislation so provides):

- For discretionary trusts, there is no de minimis level for the disclosure of discretionary distributions to US persons – all such distributions on or after 1 July 2014 must be reported. Arguably, even if a US person *could* receive a distribution from a discretionary trust this is reportable, even if he does not actually receive one. This may not in practice be the case, however, the guidance published by HMRC regarding the UK/US IGA, for example, makes it clear that US discretionary beneficiaries of UK trusts are reportable only to the extent that they actually receive distributions.

- The definition of US controlling persons of trusts that are passive NFFEs specifically includes protectors, irrespective of their level of control over the trust or its assets. Whereas under the Treasury Regulations, a US protector of a trust that is an NFFE will only be reportable if it satisfied the substantial ownership test.

- The definition of what constitutes a 'financial account' for the purposes of a trust that qualifies as an FFI includes not only the trust's settlor and beneficiaries, but also 'any other natural person exercising ultimate effective control over the trust'. This definition is not found in the Treasury Regulations and could, in certain circumstances, be construed as including an individual protector who otherwise has no beneficial interest in the trust or its assets.

- In the UK, according to UK domestic legislation, even if an FFI has no US reportable accounts, it must still file an annual report with HMRC disclosing this fact.

FATCA in Model 2 jurisdictions

The Model 2 IGA shares many of the same features as the Model 1 IGA, including:

- The slightly narrower definition of an 'investment entity'.
- With the exception of the Swiss/US IGA, the 'trustee documented trust' sub-category of deemed compliant FFI (this would apply, for example, to a Mexican property-holding trust (fideicomiso)).
- No requirement on Model 2 FFIs either to close recalcitrant account holders or to operate withholding.

However, for FFIs in Model 2 territories, there is no extension of the deadline for obtaining a GIIN (which remains 1 July 2014) and they are under an obligation to report directly to the IRS rather than to their local revenue authority. In addition, there is no ability for a sponsored investment entity in a Model 2 jurisdiction to defer registration with the IRS until such time as it has a US reportable account (although registration is deferred until 31 December 2015).

Under the Model 2 IGA, contrary to the Model 1 IGA, it is possible for a Model 2 FFI to elect to apply the US Treasury Regulations (without the specification that this may only be with the permission of the relevant authority in the Model 2 territory).

Finally, the Model 2 IGA definition of a 'financial account' in relation to a trust that is an FFI looks to the Treasury Regulations, and therefore does not include the additional wording referred to above in relation to the Model 1 IGA of 'any other natural person exercising ultimate effective control over the trust'. It should not therefore include any protector of the trust who is not also a settlor or beneficiary.

FATCA in multiple IGA countries

Each IGA jurisdiction can select whether its IGA will apply to entities organised in its jurisdiction or to entities resident in its jurisdiction. This means that it is possible that an entity organised under the laws of one country but tax resident in another technically may have to report to both governments under their respective IGAs. Recently issued draft guidance notes in one IGA jurisdiction take the position that multi-jurisdictional trustees may forego reporting for a resident trust in its jurisdiction if such trustees have actual knowledge (in the form of written confirmation) that the information is being reported by another financial institution.[63] Hopefully, other IGA jurisdictions will follow suit.

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[63] Taxation (International Tax Compliance) Crown Dependency Regulations 2014, Draft Guidance Notes (1 April 2014), at § 7.3.

CONCLUSION

In an era of growing transparency, FATCA represents a sea change in the way non-US entities will do business with each other and their clients. With the first category of FATCA withholding scheduled to come into effect on 1 July 2014 for most non-US entities, those working with non-US trust structures have a limited period of time to consider FATCA's rules and reporting obligations and select from the menu of compliance options available.

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