Breakout Session 4
Private Trusts

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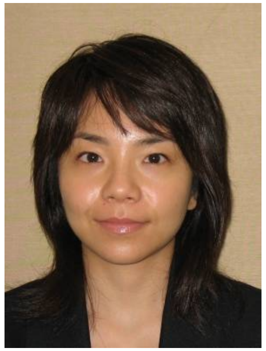

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FATCA: Key Concerns With Respect to Private Trusts

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Perspective on FATCA

the Goal to enable the US tax authorities to obtain information about the income of US persons even if they are investing through a non-US ("foreign") financial institution ("FFI")

the "Stick" 30% withholding tax is imposed upon certain "US source" income and principal of an FFI that does not participate/ cooperate

FATCA Overview

- Who is impacted?
  - All payors (including foreign payors) of "withholdable payments" made to any foreign entities
    - Withholding agents (anyone in the stream of payment) are liable for tax imposed under these provisions
  - All foreign entities, regardless of whether they have US owners, that have US source income or hold US stock or securities
  - Two categories of foreign entities
    - Foreign Financial institutions (FFI)
    - Non-Financial Foreign Entities (NFFE)

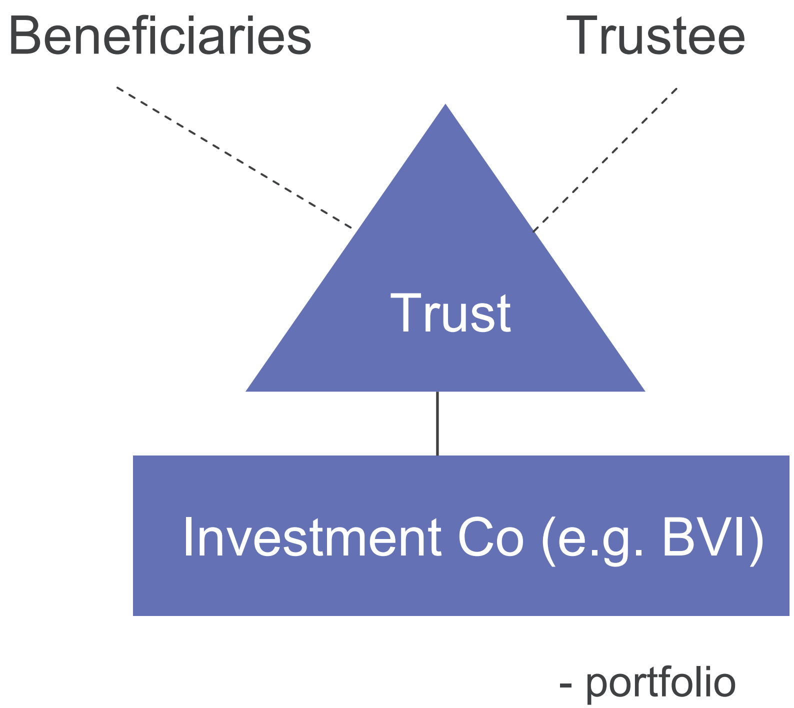
FATCA Overview (cont'd)

- What are FFIs? A foreign entity that:
  - Accepts deposits in the ordinary course of a banking or similar business such as retail banks;
  - Is engaged in the business of holding financial assets for the account of others such as investment banks; or
  - Is engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or derivatives in the above, such as mutual funds, hedge funds, private equity funds, and securitization vehicles
- Definitions of FFIs in the proposed regulations provide bright line income tests

FATCA Overview (cont'd)

- What are withholdable payments?
  - A withholdable payment is any payment of a type ordinarily subject to US withholding tax (e.g., FDAP), including interest, dividends, rents, premiums, annuities from sources within the United States
  - Also includes any gross proceeds from the sale of any property that could produce interest or dividends from sources within the United States

Application to Private Trusts



FATCA as Part of US Tax Law

- FATCA provisions are a part of the US Internal Revenue Code and will be interpreted in light of other US tax definitions and provisions, including:
  - Beneficial owner
  - US person
    - US citizen
      - Born in the US
      - In certain circumstances where one parent was US (and parent spent certain amounts of time in the US after the age of 14)
    - Green card holder
    - Resident due to physical presence
  - Entity classification
  - Grantor trust/ non-grantor trust

Deemed Compliant FFIs

– FFIs can avoid 30% withholding if they are deemed compliant FFIs
– Two types: Registered and Certified
– Registered deemed certified FFIs are still required to meet certain requirements including performing diligence to identify and eliminate US accounts and registering with IRS
– Certified deemed compliant FFIs are required to certify status to the withholding agent

Trustee as an FFI

To avoid the 30% withholding a Participating FFI ("PFFI") must:

- Enter an agreement with the IRS to comply with certain requirements
- Under the agreement, a PFFI will be required to:
  - Obtain information on all account holders to determine which accounts are US accounts
  - Comply with required due diligence/verification procedures and certify completion of such procedures
  - Report information on US accounts
  - Deduct and withhold a 30% tax on any "passthru payment" to recalcitrant account holders or other FFIs that are not PFFIs or deemed compliance FFIs
  - Comply with IRS information requests
  - Attempt to obtain a waiver of applicable bank secrecy or other information disclosure limitations or close the US account

Status of a Private Trust

– Notice 2010-60 gave as a possible example of an NFFE that would not be subject to FATCA withholding or reporting a small family trust settled and funded by a single person for the sole benefit of his children. However, none of the later guidance reflects this

– Based on the Proposed Regulations and Treasury comments, many private family trusts will be FFIs

– However, many trusts may qualify for deemed-compliant status and avoid the need to enter into separate FFI Agreements provided that they meet the criteria to be treated as an "owner-documented" FFI

A Trust as an Owner Documented FFI

- The owner-documented FFI will be required to provide each withholding agent or participating FFI with which they hold an account a withholding certificate, an annual owner reporting statement (including the name and address of every person that owns an equity interest in the payee), and documentation for each individual, specified US person, owner-documented FFI, exempt beneficial owner, or NFFE that directly or indirectly holds an interest in the payee
- Will be treated as "Certified Deemed Compliant"
- Not required to register with the IRS

A Trust as an Owner Documented FFI (cont'd)

– Alternatively, instead of providing an FFI owner reporting statement and documentation for each owner of the FFI, the owner-documented FFI may provide an auditor's letter from an independent and unrelated accounting or law firm that has a US location certifying that the firm has reviewed the FFI's documentation with respect to all its owners, and that no owner that owns a direct or indirect interest is a non-PFFI, specified US person, or passive NFFE with any substantial US owners

A Trust as Account Holder: Who is a "Substantial US Owner"

- The application of these rules varies fundamentally depending upon whether the trust constitutes a "grantor trust" or "non-grantor trust" for US tax purposes
- As with all other areas of FATCA, US tax law definitions and principles apply

Application to a “Grantor Trust”

– With respect to a “grantor trust,” the determination is relatively simple because a substantial US owner is any specified US person that is treated as an “owner” of the trust for US federal income tax purposes

Application to a “Non-Grantor Trust”

– In the context of a trust, a substantial US owner is any specified US person that directly or indirectly holds more than 10% by value of the beneficial interests in the trust

– The Proposed Regulations clarify that holding a beneficial interest in a non-US trust means either (1) the right to receive, directly or indirectly (for example, through a nominee), a mandatory distribution or (2) the possibility to receive, directly or indirectly, a discretionary distribution from the trust

– Attribution rules similar to those in the controlled foreign corporation rules will apply

Application to a “Non-Grantor Trust” Where There are Rights to “Mandatory” Distributions

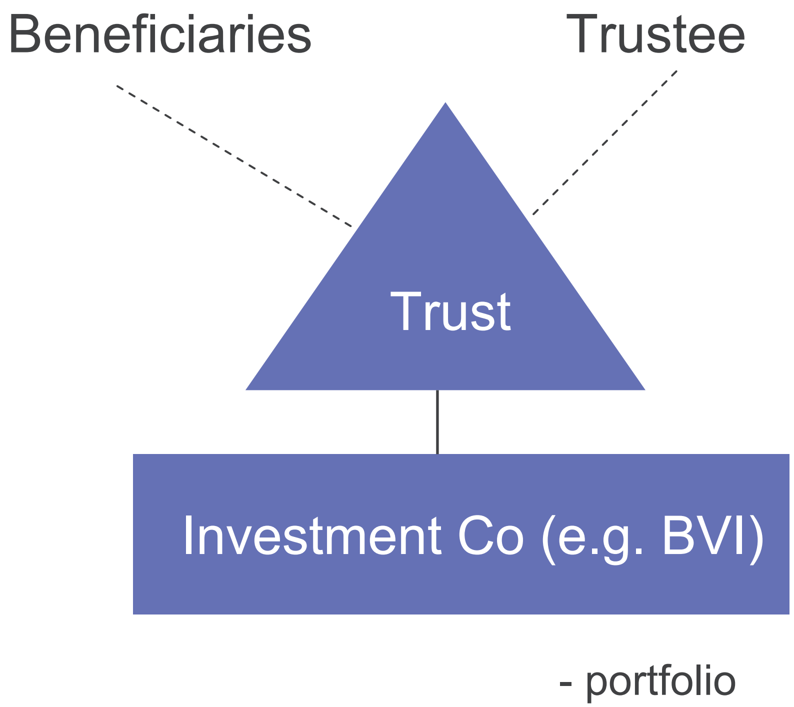
– Whether a person has a right to a “mandatory distribution” is determined by taking into account all facts and circumstances. The value of such right during the year is calculated based on specific valuation tables provided under the Code

– The 10% test is met if such value is both more than $50,000 and more than 10% of the value of all of the assets that the trust held during that year

Application to a "Non-Grantor Trust" That is a Discretionary Trust

- With regard to a discretionary, non-grantor trust, the Proposed Regulations specify that **attribution is to be based on prior year distributions subject to a $5,000 de minimis threshold**
- For "discretionary distributions," the value of the beneficial interest equals the fair market value of the currency and other property distributed from the non-US trust to the specified US person **during the prior calendar year**
- The 10% test is met if such value is both more than $5,000 and more than 10% of the value of all distributions made by the trust during that year

Application to Underlying Investment Company



FATCA Due Diligence

- For accounts that exceed $1 million, a manual file review for U.S. indicia must be performed, including an inquiry of the actual knowledge of any relationship manager associated with the account. The term "relationship manager" may be interpreted broadly.
- A PFFI is entitled to rely on the documentation received from the account holder unless the PFFI knows or has reason to know that the information contained in such documentation is unreliable or not correct.

FATCA Due Diligence (cont'd)

Indicia of potential US status:

1. Identification of any account holder as a US citizen or resident
2. A US address associated with an account (residential or correspondence address)
3. A US place of birth
4. An "in care of," "hold mail," or PO box address that is the sole address on file
5. A power of attorney or signatory authority granted to a person with a US address
6. Standing instructions to transfer funds to an account maintained in the US
7. A US telephone number

Compliance Verification

– Certifications required of a *responsible officer*

  – To the best of responsible officer's knowledge, from 6 August 2011 until the date of the *FFI Agreement*, no formal or informal practices or procedures were in place to assist account holders in the avoidance of FATCA;

  – Within one year of the effective date of the *FFI Agreement* – the responsible officer is required to certify to the IRS that the *participating FFI* has completed the review of all high value accounts; and

  – Within two years of the effective date of the *FFI Agreement* – the responsible officer is required to certify to the IRS that the *participating FFI* has completed the review of all other accounts.

Compliance Verification (cont'd)

– The Proposed Regulations rely primarily on internal, rather than external, procedures to verify compliance, noting a model FFI agreement will be set forth in a future Revenue Procedure that will include the requirements that

i. the FFI adopt written policies and procedures for complying with its obligations;
ii. the FFI conduct periodic internal reviews of its compliance; and
iii. the FFI periodically provide certification of its compliance by its responsible officers.

– Third-party audits will not be required on a regular basis to verify compliance

Compliance Verification (cont'd)

- If the IRS has concerns about the PFFI's compliance based on the above reporting and certification or if the PFFI repeatedly fails to comply, additional verification requirements may be imposed, including external audits of the PFFI's compliance by IRS-approved third-party auditors
- Under especially egregious circumstances, the PFFI could be determined to have defaulted on its FFI agreement. The precise conditions of a default will be set forth in the FFI agreement

Compliance Verification (cont'd)

– Avoiding potential problems under criminal law
– Importantly, if an FFI complies with the obligations set forth in its FFI agreement, it will not be held strictly liable for failing to identify a US account

Circular 230 Disclosure

Pursuant to requirements relating to practice before the Internal Revenue Service, any tax advice in this communication (including any attachments) is not intended to be used, and cannot be used, for the purpose of (i) avoiding penalties imposed under the United States Internal Revenue Code, or (ii) promoting, marketing, or recommending to another person any tax-related matter.

Q&A

Thank you

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