

## Background

FATCA imposes significant due diligence, disclosure and withholding requirements on non-US financial entities (including banks, funds, trustees, trusts and holding companies) by requiring them to determine which direct and indirect beneficial owners are US persons<sup>1</sup>, and to report information about those US persons along with information about the underlying ‘accounts.’

Most entities (including private trust structures, corporate trust structures, and fund arrangements) that are administered by trustees will need to be FATCA compliant so as to avoid being subject to a 30% FATCA withholding on US investments. Moreover, any trust or holding company that maintains a bank or investment account with a financial institution will likely need to provide properly completed Forms W-8 setting out its FATCA compliance status. As a practical matter, for most trust and holding company structures, it falls on the trustees to ensure that most (if not all) of the FATCA due diligence and disclosure requirements imposed on trusts structures are met so as to avoid FATCA withholding on US investments. It is important to stress that, to avoid FATCA withholding, every entity within a structure needs to be FATCA compliant. For trust structures with holding companies this generally means that each holding company will either need to be sponsored by the trustee (or related entity) or itself be registered with the IRS and undertake the necessary due diligence and reporting.

## Key decisions for trustees

Aside from registering the trust company, to comply with FATCA trustees should expect, at a minimum, to need to undertake the following actions with respect to each trust for which they serve as trustee:<sup>2</sup>

- Establish how the trust is classified for FATCA purposes; and
- Determine a reporting option that to the extent possible
  - i. ensures consistency where similar disclosures are required by entities within the same structure,
  - ii. does not result in duplication of information or unnecessary information about a structure being disclosed, and, most importantly,

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<sup>1</sup> For these purposes, the term US Persons includes citizens, green card holders and US tax residents.

<sup>2</sup> Note that very similar obligations will likely exist with respect to any entities owned by a trust for which the trustees serve as directors.

- iii. avoids FATCA withholding being applied on payments made to the trust or its underlying entities.

### **The importance of establishing FATCA classification**

Reporting and disclosure obligations under FATCA will vary depending on an entity's many possible classifications under FATCA. For instance, to apply the appropriate FATCA withholding regime, the trustee will need to determine whether the trust (or other entity) is a foreign (i.e., non-US) financial institution ("FFI") or a non-financial foreign entity ("NFFE"). In relevant part, an FFI is defined as an entity resident outside the US (under US residency definitions) that is professionally managed and whose gross income is primarily attributable to investing, reinvesting or trading in financial assets. Under these rules, then, most trusts with independent or institutional trust companies as trustees will be regarded as FFIs.

Where a trust is an FFI, the trustee will then need to consider whether the trust is classified as a "grantor" or "non-grantor" trust, as this may impact on the trust's US "ownership" for FATCA disclosure purposes. Accordingly, a grantor trust with a US "grantor" (i.e., settlor) will generally be treated as owned by its grantor. On the other hand, a grantor trust with a non-US grantor, or a non-grantor trust, will generally be treated as having US owners to the extent that it has made any distributions to US beneficiaries (in excess of certain de-minimis amounts).

Finally, under FATCA regulations, locally qualified charitable trusts and estates will generally be exempt from FATCA disclosure obligations. Locally qualifying pension trusts (such as ORSOs and MPFs established under Hong Kong law) may also be exempt, although absent an "intergovernmental agreement" ("IGA"), this determination will likely need to be made on an entity-by-entity basis. It is worth noting that IGAs will generally provide a more expansive list of entities that are treated as "deemed FATCA compliant," and which are not subject to FATCA disclosure obligations.

### **Deciding on a reporting option**

Once the appropriate FATCA classifications have been determined, the trustee should then consider an appropriate reporting strategy. Very generally, any FATCA reporting strategy will require the trustee to undertake the following steps:

- undertaking the required due diligence with respect to the trust (and individuals treated as owning it);
- registering (itself and potentially the trust and holding company) with the IRS using the IRS online portal;
- signing up on its own behalf to a FATCA agreement (i.e., becoming a so-called "participating FFI") with the IRS unless the trust company is itself covered by a relevant IGA;
- signing up on the trust's behalf to a FATCA agreement with the IRS, unless the trust is covered by a relevant IGA or is "sponsored" by another entity (e.g., the trustee);

- signing up on the holding company's behalf to a FATCA agreement with the IRS, unless the holding company is covered by a relevant IGA or is "sponsored" by another entity (e.g., the trustee);
- providing to the relevant IGA jurisdiction (or to the IRS) information regarding US owners (and deemed owners); and
- providing information to third party financial institutions regarding the FATCA compliance status of the trust (and underlying entities to the extent the trustees act as directors).

In practice, there is no single "ideal" reporting option. Trustees will instead need to consider each structure separately and determine the most appropriate reporting strategy. The following are examples of possible reporting options which the trustees may consider depending on whether:

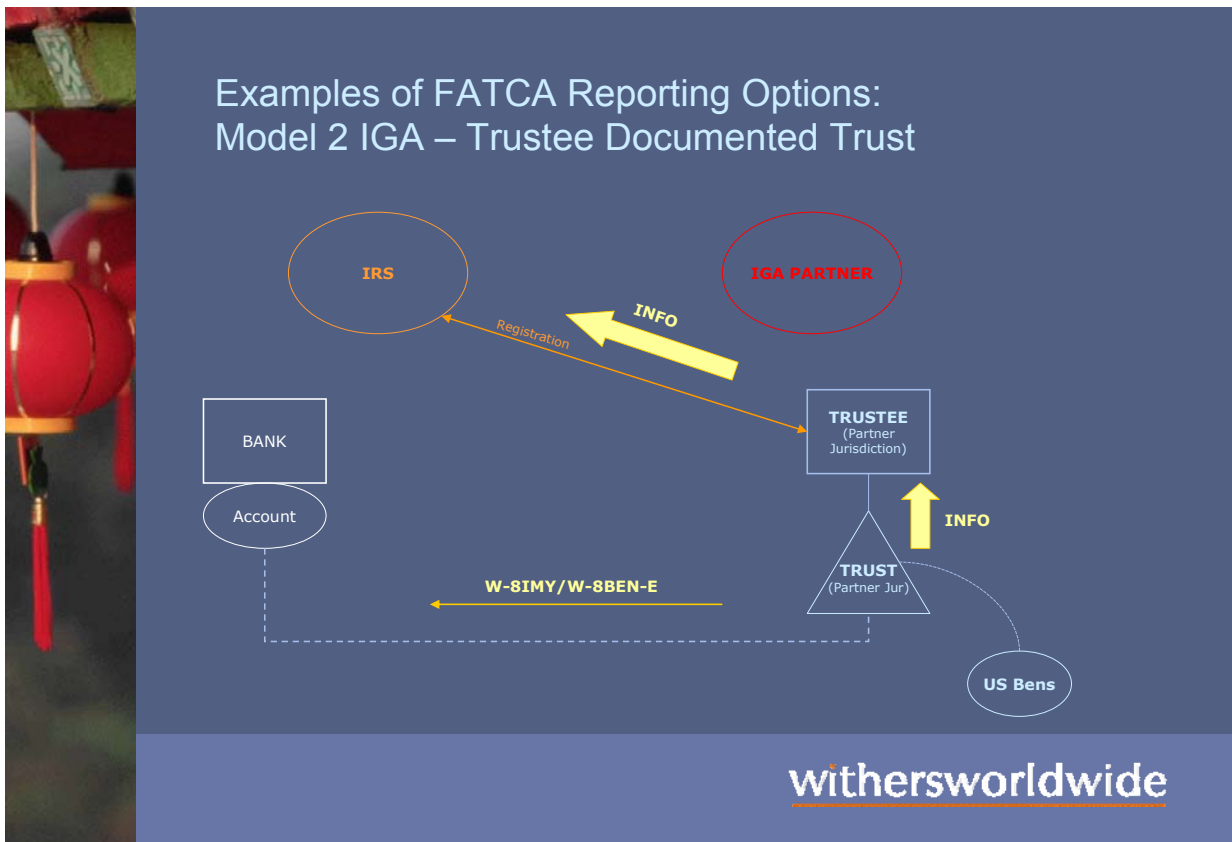
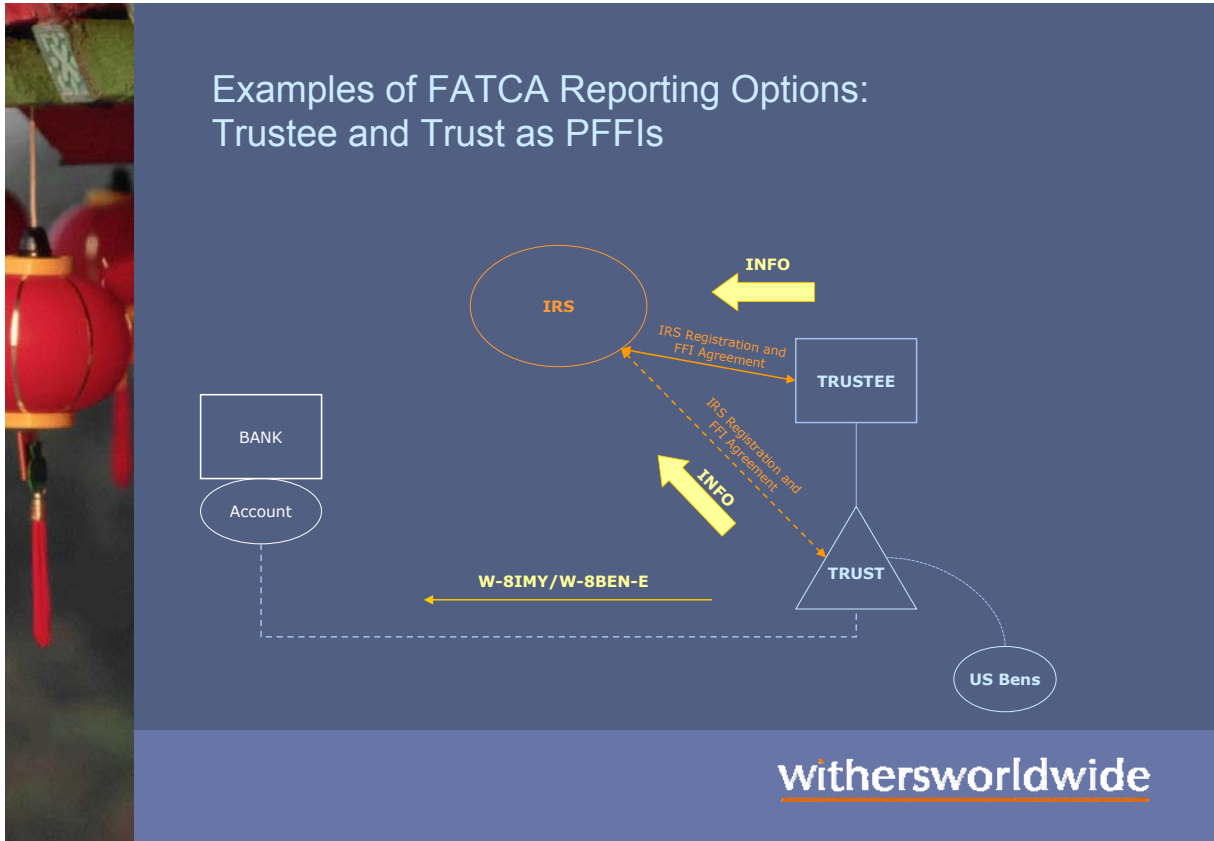
- i. the trustee and trust sign up to FATCA agreements and become participating FFIs ("**PFFIs**"),
- ii. the trustee and trust are both based in a Model 2 IGA jurisdiction and the trust is a so-called "trustee documented trust,"
- iii. the trust agrees to sponsor the trust as provided under the FATCA regulations, and
- iv. the trust is a so-called "owner documented" entity.

### Traps for the unwary

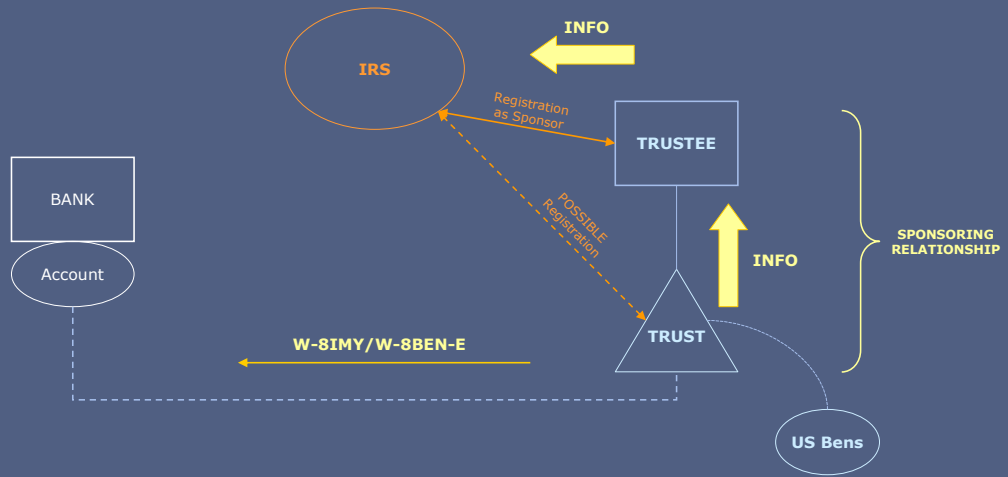
The complexities of FATCA create a number of traps for the unwary. Below we highlight three of the more common issues that trustees may encounter when navigating the FACTA compliance process.

- **NFFEs may be subject to more onerous information disclosure.** While the classification of a foreign trust (or holding company) as an NFFE will generally lower the trustees' FATCA compliance burden, trustees should take note that if an NFFE is deemed to be US owned, then the value of all of its financial accounts could become disclosable to the IRS. By contrast, a trust that is an FFI may only be required to disclose the value of the actual distributions made to its US beneficiaries.
- **IGAs and US "Controlling Persons".** The concept of a US owned account under the Model IGAs is much broader than under the FATCA regulations; it includes not only trusts with US beneficiaries, but also trusts where US persons (whether in their roles as trustees, protectors, beneficiaries, or otherwise) are able to exercise "ultimate effective control" over the trust. Trustees of trusts organized in IGA jurisdictions should therefore review their structures to identify whether any person holds a power that could fall within the meaning of "ultimate effective control," and verify that person's US status.
- **Underlying holding companies.** Unless sponsored, holding companies will themselves need to register with the IRS, even if covered by an IGA. This may come as a surprise to many trustees, as the requirements for holding companies in IGA jurisdictions is different from that of "trustee-documented trusts".

Examples of FATCA reporting options

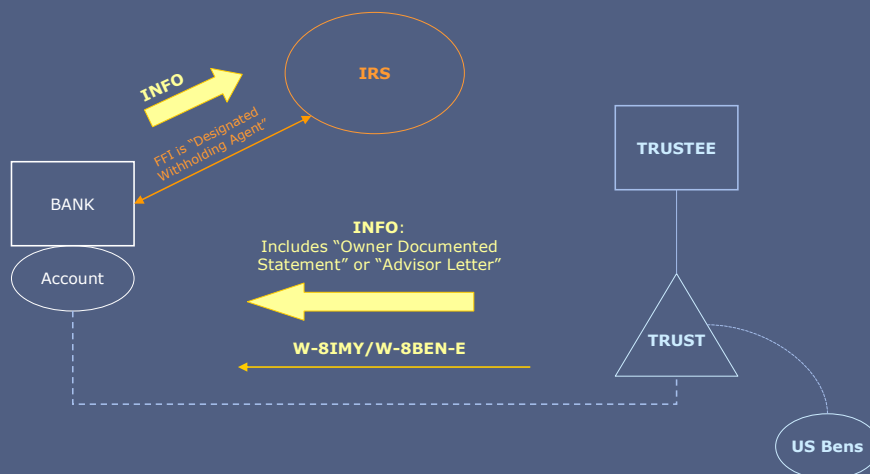


## Examples of FATCA Reporting Options: Trust as Sponsored Deemed Compliant



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## Examples of FATCA Reporting Options: Trust as Owner Documented



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For further information, please speak to your primary contact or to:

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The information and comments contained herein are for the general information of the reader and are not intended as advice or opinions to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

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