



Foreign Trust Taxation and Reporting Guidance

The taxation and reporting requirements associated with foreign trust management are complex and require specific expertise from knowledgeable parties. The intent of this guidance is to provide South Dakota-chartered financial institutions with a general summary of foreign trust taxation and reporting requirements to alert them to areas of concern. Specific taxation and reporting requirements are beyond the scope of the South Dakota Division of Banking's regulatory oversight duties and responsibilities.

South Dakota has experienced extensive growth in the foreign trust market resulting in large part from the implementation of the Foreign Account Tax Compliance Act (FATCA) and automatic exchanges of information under the Organisation for Economic Co-operation and Development proposed common reporting standards (CRS). FATCA is one of the U.S. Government's primary tools to combat international tax fraud and evasion by uncovering hidden and secret foreign bank accounts, financial accounts, income producing assets, and underreported foreign income. CRS, often referred to as the global version of FATCA, or "GATCA," is an information exchange of customer data between various countries on a global scale. The goal of CRS is similar to FATCA, which is to track overseas information regarding individuals who may have hidden or be attempting to hide assets to avoid paying taxes. Although the U.S. is not a CRS partner jurisdiction, U.S. trustees must provide CRS self-certification to non-U.S. financial institutions upon their request. Additionally, the Internal Revenue Service (IRS) and Financial Crimes Enforcement Network (FinCEN) have imposed rigorous reporting requirements with respect to foreign trusts and assets.

Prior to accepting trusts created by and for the benefit of foreign nationals, or trusts that hold foreign assets, financial institutions must possess, or have access to, the expertise needed to ensure compliance with all applicable reporting requirements, including but not limited to, those of FATCA, CRS, the IRS, and FinCEN. The U.S. Department of the Treasury (Treasury Department) instructions for Form 8938 provides a description of foreign assets. The financial institution must develop and implement comprehensive written guidance to address compliance with foreign trust taxation and reporting requirements. Financial institutions should consider the maintenance of a matrix for tracking filing due dates and oversight responsibilities with respect to pertinent reporting requirements.

Foreign Account Tax Compliance Act

FATCA requires every financial institution to classify every account holder. The financial institution is generally required to have on file a Form W-9 or a Form in the W-8 series to support such classification of the account holder. Financial institutions are expected to have a current form on file for each account holder. The classification process, in part, consists of identifying whether a trust is a foreign trust or a domestic trust for U.S. tax reporting purposes. The regulations used to classify trusts are contained in the Treasury Department Regulations 26 CFR § 301.7701-7.

FATCA imposes certain reporting obligations on foreign financial institutions (FFIs); the definition of an FFI includes an investment entity. The regulations define an investment entity 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 financial assets for customers, and receives 50 percent or more of its gross income during a “relevant period” from such investment entity activities; or (2) is managed by another financial institution and receives more than 50 percent of its gross income during a “relevant period” from investment entity activities (the regulation defines the “relevant period” as the three prior calendar years for the entity or the duration of the entity’s existence, whichever is shorter). As defined by the regulations, a foreign trust, both directed and discretionary, is generally an investment entity, and thus an FFI. This FATCA status applies to a foreign trust that is professionally managed by a South Dakota-chartered financial institution if the trust meets the gross income test.

FFIs are required to register with the IRS and obtain a Global Intermediary Identification Number (GIIN); the FFI reports using the GIIN. A foreign trust holding assets professionally managed by an asset manager is an FFI unless exempted by an intergovernmental agreement. It is important to note that many foreign trust structures are composed of various underlying entities, a FATCA classification must be determined for all non-U.S. entities. These underlying entities include, but are not limited to, foreign corporations, foreign partnerships, or other foreign trusts. Some of them might be classified as FFIs, while others might be passive non-financial foreign entities (Passive NFFEs), which are also subject to FATCA withholding unless reporting requirements are satisfied. A non-financial foreign entity (NFFE) is a non-U.S. company, partnership, trust, foundation, or any other legal entity that can’t be defined as an FFI.

If the foreign trust is resident in a country that has entered into a Model I FATCA intergovernmental agreement with the U.S., the foreign trust files its FATCA reports through its home country tax or regulatory authority. If the foreign trust is resident in a country that has entered into a Model II FATCA intergovernmental agreement with the U.S., the foreign trust files its FATCA reports directly with the IRS. If the foreign trust is not resident in a country that has entered into a FATCA intergovernmental agreement with the U.S., the foreign trust files its FATCA reports directly with the IRS. A list of countries that have entered into intergovernmental agreements with the U.S. can be found on the Treasury Department website.

Written policies and procedures should address IRS filing requirements, steps for identifying and classifying any foreign account that may be an FFI, and the corresponding FATCA reporting requirements and timelines. Failure to comply with FATCA reporting requirements could subject the financial institution and its customers to reputational risks, severe civil penalties, and possibly criminal punishment.

Valid documents to support FATCA compliance (as well as withholding requirements) include confidential and sensitive personal information. South Dakota-chartered financial institutions should take extra precautions to safeguard clients’ information. The typical documents to support FATCA classification include but are not limited to the following:

- Form W-8BEN, Certificate of Foreign Status of Beneficial Owner of U.S. Tax Withholding and Reporting (Individuals)

- Form W-8BEN-E, Certificate of Status of Beneficial Owner of U.S. Tax Withholding and Reporting (Entities)
- Form W-8ECI, Certificate of Foreign Person's Claim that Income is Effectively Connected with the Conduct of a Trade
- Form W-8IMY, Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for U.S. Tax Withholding and Reporting or Business in the U.S.
- Form W-9, Request for Taxpayer Identification Number and Certification

Additional Reporting Requirements

Additional reporting may be required by a U.S. person who creates a foreign trust, transfers any money or property to a foreign trust, receives a distribution from a foreign trust, is treated as the U.S. owner of a foreign trust, or maintains custody of assets owned by a foreign entity such as an FFI. Tax consequences generally apply to the grantor, the beneficiary, and the foreign trust. The following are examples of IRS forms that are routinely filed for foreign trusts. Management, or their contracted accounting or tax advisors, should be familiar with any that are applicable to the trusts under management:

- Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation.
- Form 1040NR, U.S. Nonresident Alien Income Tax Return.
- Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons.
- Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding.
- Form 3520, Annual Return to Report Transactions with Foreign Trust and Receipt of Certain Foreign Gifts.
- Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner.
- Form 5471, Information Returns of U.S. Persons with Respect to Certain Foreign Corporations.
- Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business.
- Form 5713, International Boycott Report.
- Form 8288, U.S. Withholding Tax Return for Dispositions by Foreign Person of U.S. Real Property Interests.
- Form 8288-A, Statement of Withholding on Disposition by Foreign Persons of U.S. Real Property Interests.
- Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.
- Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b).
- Form 8858, Information Return of U.S. Persons with Respect to Foreign Disregarded Entities.
- Form 8865, Return of U.S. Persons with Respect to Certain Foreign Partnerships.
- Form 8938, Statement of Specified Foreign Financial Assets.

In addition to these IRS Forms, FinCEN requires the electronic filing of a Report of Foreign Bank and Financial Accounts (FinCEN Form 114 “FBAR”) with FinCEN to report any financial interest in, or signatory authority over, a foreign financial account, including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account exceeding certain thresholds. Please note that federal tax definition of a U.S. person is not applicable for FinCEN reporting, thus, both U.S. and foreign trusts could be subject to FinCEN filings. FinCEN is a bureau of the Treasury Department.