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Analyzing Foreign Trusts

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Overview

I. Preview of Issues
II. Identifying Trusts
III. Foreign vs. Domestic Trusts
IV. Grantor Trust vs. Non-grantor Trust
V. Common Foreign Trust-like Entities
What is at stake?
Setting the Stage

Income Tax Considerations – A Brief Overview

• Regimes for taxation of corporations and partnerships are very different than the tax rules for trusts

• Foreign Trusts or Non-Resident Non-U.S. Citizen Grantor
  – Only subject to U.S. income tax on FDAP & ECI:
    • Fixed, Determinable, Annual, or Periodical (FDAP) income (generally US source dividends, interest, rents, royalties and other portfolio income, as well as certain types of services income), which is subject to 30% withholding at the source on a gross basis with no offsetting deductions
    • Income that is effectively connected with the conduct of a US trade or business (“effectively connected income” or “ECI”), which is taxed at graduated rates of up to 37%

• Domestic Trusts and U.S. Citizen or Resident Grantors
  – Subject to U.S. tax on worldwide income
Setting the Stage

Income Tax Considerations – A Brief Overview (Cont’d)

• Foreign Grantor Trusts (“FGTs”)
  - Grantor trust treated as an extension of the grantor – grantor treated as owning all trust assets directly
  - Distributions from a FGT are not generally taxable to a U.S. person recipient

• Foreign Non-grantor Trusts (“FNGTs”)
  - For non-grantor trusts, recipient pays US tax to the extent that income is distributed to them
  - For foreign non-grantor trusts, income that is accumulated when earned and distributed later can trigger “throwback” tax – high tax rate plus interest charge to reflect the deferral
  - U.S. beneficiaries of FNGTs are taxed on (1) the lesser amount of cash or the basis of property other than cash received from a FNGT in a particular year and (2) the recipient’s share of the taxable portion of the trust’s “distributable net income” (“DNI”) for the year. DNI that is not distributed each year becomes “undistributed net income” in following years

• The Throwback Tax
  - U.S. beneficiaries are subject to tax on accumulation distributions from FNGTs to the extent of the FNGT’s UNI – punitive regime that attempts to tax beneficiaries at the rate they would have been taxed at if they had received the distribution in the same year the trust received the income
  - In addition to tax, distributions of UNI are subject to an interest charge (calculated at the applicable §6621 rate for underpayments of tax, compounded daily)
Foreign Trust Reporting

Forms 3520 and 3520-A

• Required by Sections 6039F and 6048

• Forms 3520 must be filed by US persons who
  – Receive distributions from or transfer property to non-US trust
    • Notice to IRS for creation of trust by US person or for receipt of trust property by a US person
  – Are classified as “owners” of any portion of a non-US trust
  – Receive large non-US gifts during the calendar year

• Form 3520-A must be filed annually by a non-U.S. trust treated as owned in whole or in party by a U.S. person under the grantor trust rules
  – Taxpayers are frequently tripped by the March 15 filing date
  – U.S. person (“owner”) penalized if trustee fails to file Form 3520-A
Foreign Trust Reporting

Penalties for failing to file Forms 3520/3520-A (Section 6677)

• Failure to report transfers to or distributions from a foreign trust incurs a penalty of the greater of 35% of value of property transferred/distributed or $10,000

• Failure to report ownership of grantor trust carries penalty of 5% of the gross value of the trust’s assets at the close of the year at issue

• These are stackable and assessable penalties
  - Collection procedures are frequent in 3520/3520-A cases
  - No right to petition tax court for penalty determination. What about a back door approach?

• Additional penalties ($10k per each 30 days) if failure to file continues more than 90 days after IRS notifies of failure. Capped at gross reportable amount
Foreign Trust Reporting

Reasonable Cause Exceptions

• Available as a defense against penalties
  - Reasonable man standard (yet to be successful in a 3520 context)
  - Reliance on professional (*U.S. v. Boyle dicta* frequently cited by Taxpayers)
    • Requirement of qualified expert
    • Taxpayer must provide tax advisor with all pertinent information
    • Taxpayer must have sought out and reasonable relied on the advice of the tax advisor

• Appeals has been reluctant to find reasonable cause in a myriad foreign trust penalty cases
Foreign Trust Reporting

Form 8938 and the FBAR

• Due date of both forms now tied to due date of individual return

• Owners of FGT must report value of trust on FBAR and Form 8938, if reporting threshold met

• Reporting for FNGT depends on status of beneficiary
  - One must have a present beneficial interest in order to require FBAR filing
  - Form 8938 reporting less clear. Does a discretionary beneficiary who has never received a distribution have an “interest” in a trust? May even be required to report $0 value on Form 8938 if no distributions received during the year

• Penalty for nonfiling Form 8938 a mere $10,000 per year. However, the FBAR penalty, if willfulness is found, can easily equal the value of the trust assets

• Reasonable cause exceptions exist
Is it even a Trust?
Is it even a Trust?

There are arrangements which are known as trusts because the legal title to property is conveyed to trustees for the benefit of beneficiaries, but which are not classified as trusts for purposes of the Internal Revenue Code because they are not simply arrangements to protect or conserve the property for the beneficiaries.

If not considered “trusts,” must apply default entity classification rules under I.R.C § 301.7701-2 to determine how to treat the entity for U.S. tax purposes.
Types of “Trusts”

Treas. Reg. § 301.7701-4 – Trusts
a) Ordinary Trusts
b) Business Trusts
c) Investment Trusts
d) Liquidating Trusts
e) Environmental Remediation Trusts
Types of “Trusts” – Ordinary Trusts

Treas. Reg. § 301.7701-4(a)

“Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.”

Beneficiaries simply accept benefits and are not planners or creators of the arrangement
Types of “Trusts” – Business Trusts

Treas. Reg. § 301.7701-4(b)

These trusts, which are often known as business or commercial trusts, generally are created by the beneficiaries simply as a device to carry on a profit-making business which normally would have been carried on through business organizations that are classified as corporations or partnerships under the Internal Revenue Code.

The fact that any organization is technically cast in the trust form, by conveying title to property to trustees for the benefit of persons designated as beneficiaries, will not change the real character of the organization if the organization is more properly classified as a business entity under § 301.7701-2.
Similar to a Business Trust, the arrangement could be considered an Investment Trust, i.e., a business entity under § 301.7701-2, if there is a power under the trust agreement to vary the investment of the certificate holders.

Regulations provide a few examples; generally will be classified as a business entity, either with a single class of ownership or multiple classes of ownership, unless no power under trust to vary the investment of the certificate holders, where the trust is formed to facilitate direct investment in the assets of the trust and the existence of multiple classes of ownership interests is incidental to that purpose.
Types of “Trusts” – Liquidating Trusts

Treas. Reg. § 301.7701-4(d)

This is in fact considered to be a “trust” for income tax purposes.

- An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing the assets transferred to it, and if its activities are all reasonably necessary to, and consistent with, the accomplishment of that purpose.

- A liquidating trust is treated as a trust for purposes of the IRC because it is formed with the objective of liquidating particular assets and not as an organization having as its purpose the carrying on of a profit-making business which normally would be conducted through business organizations classified as corporations or partnerships.

- However, if the liquidation is unreasonably prolonged or if the liquidation purpose becomes so obscured by business activities that the declared purpose of liquidation can be said to be lost or abandoned, the status of the organization will no longer be that of a liquidating trust.
Types of “Trusts” – Environmental Remediation

Trusts

Treas. Reg. § 301.7701-4(e)

This is in fact considered to be a “trust” for income tax purposes.

• If the organization is organized under state law as a trust;
  - the primary purpose of the trust is collecting and disbursing amounts for environmental remediation of an existing waste site to resolve, satisfy, mitigate, address, or prevent the liability or potential liability of persons imposed by federal, state, or local environmental laws;
  - all contributors to the trust have (at the time of contribution and thereafter) actual or potential liability or a reasonable expectation of liability under federal, state, or local environmental laws for environmental remediation of the waste site; and
  - the trust is not a qualified settlement fund within the meaning of § 1.468B-1(a) of this chapter.
Foreign vs. Domestic Trust
Foreign or Domestic Trust? Not always clear

- U.S. law controls the classification of a foreign entity for U.S. tax purposes
- Trust formed outside the U.S. could still be a U.S. trust
- Trust formed inside the U.S. could still be a foreign trust
  - Even if its creator, trustees, beneficiaries, governing law, and assets are all located in the U.S.
- Control, residency/citizenship of grantors, beneficiaries, trustees, could all affect whether a trust is domestic or foreign
- U.S. applies two-part test to determine whether foreign or domestic
  - Default rule is that a trust is a foreign trust (defined as a U.S. person) unless BOTH:
    - A court within the U.S. is able to exercise primary supervision over the administration of the trust (the “court test”), and
    - One or more U.S. persons have the authority to control all substantial decisions of the trust (the “control test”). I.R.C. § 7701(a)(30)(E)
Court Test

A court within the U.S. is able to exercise primary supervision over the administration of the trust (the “court test”).

- Consideration must be given to all the terms of the trust instrument
- Stating that trust is to be administered outside the U.S., fails this test
- If silent on jurisdiction, may be U.S., unless subject to an automatic migration/flee clause

Will satisfy the Court Test if it each of the following are met:

1. The court with primary supervision over the trust must be within the 50 States or the District of Columbia
2. The U.S. court must be “able to exercise” its authority over the trust (i.e. render judgments, orders, or resolve issues related to the administration)
3. The U.S. court must have “primary supervision” over the trust (i.e. must have authority regarding substantially all of the issues related to administration. Treas. Reg. § 301.7701-7(c)(3)
   1. U.S. and Foreign country could both have primary and be okay
Court Test (Con’t)

If desire is to establish a foreign trust, doing so through this test is more difficult than planning through the Control Test.

Safe Harbor Regulations exist, however, to satisfy the Court Test if:

- The trust is registered with a State court under provisions similar to Article VII of the Uniform Probate Code, or
- The trust is created pursuant to a will probated in the U.S. and all fiduciaries have been qualified, or
- The trustee or fiduciary of the trust takes affirmative steps with a U.S. court to cause the administration of the trust to be subject to the primary supervision of that U.S. court.

Treas. Reg. § 301.7701-7(c)(4)(i)
Control Test

One or more U.S. persons have the authority to control all substantial decisions of the trust (the “Control Test”)

Substantial decisions means “a decision that personas are authorized or required to make under the terms of the trust instrument and applicable law that are not ministerial. These include, but are not limited to:

A. Whether and when to distribute income or corpus;
B. The amount of any distributions;
C. The selection of a beneficiary;
D. Whether a receipt is allocable to income or principal;
E. Whether to terminate the trust;
F. Whether to compromise, arbitrate, or abandon claims of the trust;
G. Whether to sue on behalf of the trust or to defend suits against the trust;
Control Test (Con’t)

H. Whether to remove, add, or replace a trustee;
I. Whether to appoint a successor trustee to succeed a trustee who has died, resigned, or otherwise ceased to act as a trustee, even if the power to make such a decision is not accompanied by an unrestricted power to remove a trustee, unless the power to make such a decision is limited such that it cannot be exercised in a manner that would change the trust’s residency from foreign to domestic, or vice versa; and
J. Investment decisions; however, if a U.S. person under § 7701(a)(30) hires an investment advisor for the trust, investment decisions made by the investment advisor will be considered substantial decisions controlled by the U.S. person if the U.S. person can terminate the investment advisor’s power to make investment decisions at will.

Treas. Reg. § 301.7701-7(d)(ii).
Control Test (Con’t)

“Control” also means:

Having the power, by vote or otherwise, to make all of the substantial decisions of the trust, with no other person having the power to veto any of the substantial decisions. To determine whether U.S. persons have control, it is necessary to consider all persons who have authority to make a substantial decision of the trust, not only the trust fiduciaries. Treas. Reg. § 301.7701-7(d)(iii).
Grantor Trust vs. Non-Grantor Trust
Grantor Trust vs. Non-Grantor Trust

There are two types of trusts:

Grantor Trust – Considered wholly owned by the grantor and is treated as an extension of the grantor. Thus all items of income, deduction and credit of the trust are includable in the grantor’s income as if the assets were owned by the grantor personally. (I.R.C. § 671)

Non-Grantor Trust – Considered a separate taxpayer

Generally speaking, the trust will be a non-grantor trust unless the grantor or another person is treated as the owner of that trust’s assets because the grantor, trustee, or beneficiary has certain powers over the trust’s income or corpus.

So need to answer the following questions:

1. Who is the “Grantor?”
2. Does the “Grantor” have sufficient powers over the trust to make it a grantor trust?
First Question: Who is the Grantor?

Who is the “Grantor?”

Any person (individual or entity) who “creates a trust, or directly or indirectly makes a gratuitous transfer . . . of property to a trust. Entity grantors require business purpose.” Treas. Reg. § 1.671-2(e).

Caution: Many complex rules exist to shift the deemed owner of the trust and potentially alter the “grantor.”

Examples:

- Where a foreign person would be treated as the owner of any portion of a trust with a U.S. beneficiary, if such U.S. beneficiary transfers (directly or indirectly) property (other than in a sale for FMV) to such foreign person, then that U.S. beneficiary shall be treated as the grantor of such portion transferred. I.R.C. § 672(f)(5)

- If a U.S. person transfers (directly or indirectly) property to a foreign trust, such person shall be treated as the owner for his taxable year of that property if for such year there is a U.S. person beneficiary (i.e. a distinct U.S. person). I.R.C. § 679(a) (with certain exceptions)
  - [NRA deemed to be U.S. Person] - If NRA transfers property to a foreign trust and becomes a U.S. income tax resident within 5 years following the transfer, such person will be deemed to have made the transfer on such person’s U.S. residency starting date; i.e. deemed to have been a transfer of property into a trust by a U.S. person. I.R.C. § 679(a)(4)

- [Deemed to have U.S. Beneficiary] – Deemed to have U.S. beneficiary unless trust explicitly excludes any benefit to U.S. persons, and no part of trust income or corpus would go to or for the benefit of a U.S. person upon termination of the trust at any time during the taxable year. I.R.C. § 679(c)
Second Question: Does the Grantor Have Sufficient Powers?

Does the “Grantor” have sufficient powers over the trust to make it a grantor trust?

If the “grantor” is a *U.S. income tax resident*, the trust is a grantor trust if the grantor (or spouse) satisfies the criteria under §§ 671 through 679; namely,

- Grantor retains a reversionary interest in the income or principal (I.R.C. § 673)
- Grantor or non-adverse party has power over beneficial enjoyment with some exceptions (I.R.C. § 674)
- Grantor or non-adverse party has power to purchase, exchange or deal with or to permit another person to deal with the trust without adequate and full consideration (I.R.C. § 675)
- Grantor or non-adverse party can borrow from trust without adequate interest or without adequate security (I.R.C. § 675)
- Any person who is not a fiduciary can acquire trust assets by substituting assets of equivalent value (I.R.C. § 675)
Second Question: Does the Grantor Have Sufficient Powers? (Con’t)

- Grantor or non-adverse party has power to revoke and revest in grantor (I.R.C. § 676)
- Grantor or non-adverse party has power to distribute income to grantor or spouse (I.R.C. § 677)
- Distribution from a foreign trust may be made to or accumulated for a U.S. beneficiary during taxable year (I.R.C. § 679)
Second Question: Does the Grantor Have Sufficient Powers? (Con’t)

Does the “Grantor” have sufficient powers over the trust to make it a grantor trust?

If the “grantor” is **NOT** a *U.S. income tax resident*, the trust is a grantor trust if the grantor satisfies the criteria under I.R.C. § 672(f); namely,

- The trust deed must provide that all payments of income or corpus are payable only to the grantor or his spouse during the grantor’s lifetime, **or**

- The grantor is able to revest himself of all trust property at any time.

Note different rules if grantor is not a U.S. income tax resident. This addresses concerns that trusts would be structured as foreign owned, thus avoiding U.S. income tax unless ECI or U.S. Source. Thus, limitations were made in 1996 as to whether a foreign person would be deemed to own the trust.
Considerations

Grantor Trusts:
- Potential migration from foreign to domestic or reverse (filings etc.)
- Change from grantor to non-grantor upon death (Throwback rules, CFCs, PFICs, etc.)

Non-Grantor Trusts:
- Domestic Non-Grantor Trusts ("DNGT"):
  - Filings done on Form 1041
  - Distributions (gains allocated to principle rather than distributable net income)
  - Transfers to DNGT potentially subject to U.S. gift tax or income tax (i.e. FIRPTA)
- Foreign Non-Grantor Trusts ("FNGT")
  - Filings done on Form 1040NR (if earning ECI or U.S. Source) and may also include Form 3520 or Form 3520A
  - Distributions (gains allocated to distributable net income)
    - Later distributions from undistributed net income subject to draconian "throwback tax" rules; i.e., loss of capital gain treatment and subject to prior year interest charges.
  - Transfers to a FNGT by a U.S. person are treated as a sale and taxable to the transferor. I.R.C. § 685
  - Transfers to FNGT potentially subject to U.S. gift tax or income tax (i.e. FIRPTA)
Case Study – Grantor Trust vs. Non-grantor Trust

- Taxpayer, Dr. X, is a U.S. citizen residing in Chicago.
- Taxpayer’s father ("Father"), a non-U.S. person, accumulated significant wealth during his lifetime, with which he engaged in extensive estate planning.
- Among other things, Father created and funded a foreign trust – the M Trust– for the benefit of Taxpayer and Taxpayer’s two children. The Trust was funded solely with Father’s own assets; Taxpayer never, at any point in time, contributed funds to the Trust.
- Taxpayer was never told about the creation or existence of the Trust until just before Father died.
- Father left a letter to Taxpayer that contained a list of trusts that Father had created during his lifetime, including this foreign trust, and the contact information for the Trustee/ Foundation Board of the Trusts.
- Upon Taxpayer’s contact, both the Trustee and the Foundation Board invited Taxpayer to an in-person meeting at the bank at which the Trusts’ assets were held.
- In November of 2000, Taxpayer traveled to Switzerland and Germany for the in-person meetings.
Case Study – Grantor Trust vs. Non-grantor Trust

• Taxpayer was informed that the trust held roughly $15 million in assets.
• The trust was a discretionary trust, and Taxpayer must seek Trustee’s approval for any action with respect to the Trust.
• From time to time, the Trustee would ask Taxpayer’s opinion on investments.
• At the Trustee’s direction, Taxpayer was told to contact the bank directly to discuss investments and portfolio performance.
• Taxpayer was directed (without an option to decline) to:
  – Provide personal information for record keeping and ID verification.
  – Sign various pre-filled documents, with minimal explanation.
  – Obtain a credit card from bank, which was to be used solely for the purpose of covering Taxpayer’s travel expenses incurred for the periodic in-person meetings with the bank.
  – Open a personal bank account purely for the administrative purpose of transferring funds from the M Trust to settle Taxpayer’s personal bank credit card bills incurred for the in-person meetings.
Case Study – Grantor Trust vs. Nongrantor Trust

• The Credit Card
  – 30,000 a month limit
  – Intended for trust-related expenses
  – Tied to a personal account
  – There was a “directive” attached to the credit card, from the Foundation Board, ordering the bank to pay expenses each month from M Trust assets
  – No formal review by Trustee before paying charges.

• Taxpayer received distributions from M Trust solely in the form of the Trustee providing funds for the settlement of Taxpayer’s bank credit card bills—the vast majority of which related to travel expenses incurred in connection with meetings regarding the Trust.

• Taxpayer never communicated with bank or the Foundation Board to seek payment of the credit card bills.

• Taxpayer did not receive any other distributions from M Trust in any other form.

• The total amount of distributions that Taxpayer received over the 13-year period at issue, as compared to the total asset value of Trust, is miniscule (0.14% - 0.20%).

• Taxpayer believed in good faith that his use of the credit card did not constitute distributions.
Case Study – Grantor Trust vs. Non-grantor Trust

Is Dr. X the owner?

• An individual who is *not* a grantor of a trust may be treated as an owner of that trust only if either (i) the person has a power *exercisable solely by himself* to vest the corpus or the income therefrom in himself, or (ii) the person partially released or modified such a power, and thereafter retains such control as would, within the principles of §§ 671-679, subject a grantor of a trust to treatment as the owner thereof. I.R.C. § 678.

• A person must hold an *ascertainable and legally enforceable power expressly reserved in the trust instrument* to unilaterally vest the corpus or income therefrom in himself, in order to deem him a U.S. owner under § 678, regardless of the degree of de facto control that the person exercises over the trust. *See Estate of Goodwyn v. Comm’r*, 35 T.C.M. (CCH) 1026 (1976).
Case Study – Grantor Trust vs. Non-grantor Trust

• Is Dr. X the owner?

• What place does foreign law have in this US law determination?

• Is the credit card determinative?
  − Is it a power over corpus or income?

• What place does de facto control over a Trust have in 678 analysis?
Common Foreign Trust-Like Entities
Common Foreign Trust or Trust-Like Entities

Common foreign entities or trusts that are similar to U.S. trusts, but raise significant issues:

• Anstalts
• Australian Unit Trusts
• Fideicomisos
• Stiftungs
• Usufructs
Common Foreign Trust or Trust-Like Entities

Lichtenstein Anstalts

• Separate legal entity may be treated as a trust or corporation

• Created by transferring assets to a board of directors, which manage the assets as directed by the articles of incorporation

• Anstalts are made up of the founder, board of directors, and potentially an audit authority, legal representative and beneficiaries
  - Board of directors is only mandatory body
  - Board of directors conducts and manages the company’s business

• If the establishment does not carry on economic activities, a member of the board of directors must have a professional trustee’s license

• Audit authority only required if the establishment conducts a business

• See Rev. Rul 79-116; IRS Advice Memorandum 2009-012
Common Foreign Trust or Trust-Like Entities

Australian Unit Trusts

- Can be both private and publicly traded:
  - Separate legal entity
  - Generally fixed trusts in which the beneficiaries and respective interests are identified by their holding “units”
  - Beneficiaries can transfer their units
  - No limit on number of units, but tax treatment can vary depending on size and activities of the trust

- Reporting Obligations
  - Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

- Generally not considered a trust, but consider:
  - Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts
  - Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner
Common Foreign Trust or Trust-Like Entities

Fideicomisos

• Background
  – Under the Mexican Federal Constitution, non-Mexican persons cannot directly own real property located in “restricted zones” in Mexico. The restricted zones include real property located within 100 kilometers (63 miles) of Mexico’s inland borders and 50 kilometers (32 miles) of its coastline
  – Thus, non-Mexican persons must use a Mexican Land Trust – e.g. “fideicomisos” – to purchase property

• Essentially a bank trust
  – Property transferred to a fiduciary (often domestic bank), which distributes income or allows use of property by the beneficiaries for a term or years or measuring life

• Rev. Rul. 2013-14
  – States that a Mexican fideicomiso is not a foreign trust for U.S. tax purposes where the fideicomiso does not engage in activity other than holding title to land
  – Thus, no Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, or Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner filing obligation
Common Foreign Trust or Trust-Like Entities

Stiftung (or foundation)

• Statutory entity with separate legal entity from owner
• Assets irrevocably transferred to the foundation and managed by a council for a specific purpose
• Can be charitable or not
• IRS looks at purpose to determine whether it should be treated as a foreign private foundation, trust, or business entity.
• See Estate of O.T. Swan, 24 T.C. 829 (1955), aff’d, 247 F.2d 144 (2d Cir. 1957); PLR 200302005; and IRS Advice Memorandum 2009-012
Common Foreign Trust or Trust-Like Entities

Usufruct

- Instrument used to divide the “usufructuary” and “bare” interests – frequently used estate planning tool in civil law countries
  - **Usufruct** – This attribute gives the holder the right to the enjoyment of the underlying asset and the right to the income generated by the underlying asset, typically for the balance of the holder’s lifetime.
  - **Bare ownership** – This attribute gives the holder the right to transfer the underlying asset during the period of the usufruct interest.

- Generally, a usufruct right lasts for a lifetime. Upon death of the holder of the usufruct interest (or at the end of its term), usufruct rights automatically transferred to bare owner.

- Tax Consequences
  - **Civil Law**: a beneficiary may receive a stepped-up basis as a result of (i) an inter vivos gift of bare ownership or (ii) a transfer at death of the usufruct.
  - **U.S. Tax Law**: no step-up in basis upon a gift of bare ownership or the receipt of the usufruct interest upon death of its holder. Capital gains from sale of the property generally taxable in the United States. Savings clause in most U.S. tax treaties allows the U.S. to tax its citizens and residents on capital gains realized on the sale of foreign assets.
Common Foreign Trust or Trust-Like Entities

Usufruct – Potential Filing Requirements

- **PFICs** – Form 8621, *Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*
  - If only own the bare interest, there is not likely a filing requirement as the bare interest holder is not deemed to own any underlying PFICs
  - No regulations or rulings on point, but see IRS Field Service Advisory Memos (PLR 8748043; FSA 199952014) that review this concept in light of the CFC rules.
  - Bare interest owners would likely have a PFIC filing obligation in any year they actually receive proceeds from the sale of PFIC shares.

- **Form 3520**, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*
  - U.S. citizen or resident children that receive a bare interest in foreign property will likely have a Form 3520 reporting obligation to report the gift from an NRA.

- **Form 8938**, *Statement of Specified Foreign Financial Assets*
  - There may be a Form 8938 filing requirement, the guidance is not clear regarding bare interests.
  - There is no case law or regulation, but there is a Private Letter Ruling and a few IRS Field Service Advisory Memos (PLR 8748043; FSA 199952014), in which the Service indicates the bare/naked interest owners do not have full ownership rights over various types property.
  - Conservative approach is file in order to avoid additional tax equal to 5% of the highest aggregate value of assets that should have been reported on Form 8938.
Alexander Lewis is a Senior Associate in the International Private Client Services practice, where he helps provide advice to institutional and private clients, both domestic and international, in individual and business tax planning matters. Since joining RSM US, his focus has been on cross-border transactions, tax efficient restructurings, and foreign pensions. He also helps advise clients with regard to their pre-immigration, expatriation, cross-border estate, and offshore compliance planning.

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Dianne Mehany's practice focuses on international tax planning and controversies, including inbound and outbound tax planning, foreign tax credits, tax treaties, tax audits, and FATCA planning and compliance. She also has experience in tax compliance of individuals, companies and financial institutions in the cross-border context, including FATCA reporting, reporting of interests in foreign trusts, and offshore financial accounts and assets. Her practice also encompasses income and succession planning for wealthy individuals and families, including pre-immigration planning and expatriations, and foreign trusts.
Richard S. LeVine, J.D., LL.M., LL.B

Richard is special counsel in the private client and tax team. He is familiar with the taxation of partnerships, LLCs, corporations and trusts from both an income and an estate tax perspective, along with knowing how to incorporate them into international structures, he is one of our renaissance lawyers who ties together many aspects of our tax practice for individuals and wealthy families. Richard recently helped a real estate developer transfer minority interests in closely-held entities to trusts to minimize both state income tax and federal estate taxes; a hedge fund manager form a private trust company to administer both personal and charitable assets; a wealthy entrepreneur to create an insurance dedicated fund as part of US pre-immigration planning; and an investment professional to expatriate while minimizing his exit tax. He is one of the few lawyers at Withers who has read every page of the US FATCA regulations (both the Chapter 3 and 4 portions), as well as the OECD CRS Standards, Commentary and Implementation Handbook, and stands ready to explain all the new international transparency and automatic exchange of information regimes without putting the audience to sleep.

Practice

- Offshore Tax Compliance (FATCA)
- Tax Controversy
- Inbound and Outbound Tax Planning
- Estate Planning

Education

- New York University School of Law, LL.M. in Taxation
- Harvard Law School, J.D.
- Northwestern University, B.A.

Bar Admission

- New Jersey
- New York
- Florida
- Illinois
- Connecticut
Severiano Ortiz advises institutional and private clients, both domestic and international, in individual and business tax planning matters. He focuses on cross-border transactions and tax efficient restructurings. He advises clients regarding tax developments affecting their business, both globally and locally. He also advises clients with regard to their pre-immigration, expatriation, cross-border estate, and offshore compliance planning.

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Practice
- Int'l Private Client Services
- International Tax Services

Education
- Northwestern University School of Law, LL.M., Taxation
- Northwestern University School of Law, J.D.
- Jacksonville University, B.S. / B.A.

Bar Admission
- Illinois
- Washington, D.C.