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Via Electronic Submission
(Notice.Comments@irscounsel.treas.gov (NOT-112379-10)

Honorable Douglas Shulman
Commissioner
Internal Revenue Service
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Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: Comments on Foreign Account Tax Compliance under the HIRE Act Relating to Trusts and Trust Beneficiaries

Dear Messrs. Shulman and Wilkins:

Pursuant to Announcement 2010-22, as modified by Announcement 2010-34, the Treasury Department and the Internal Revenue Service requested comments from the public regarding the Foreign Account Tax Compliance ("FATCA") provisions of the Hiring Incentives to Restore Employment ("HIRE") Act of 2010, P.L. 111-147, enacted March 18, 2010.

Enclosed are comments of the Committee on Estate and Gift Taxation of The Association of the Bar of the City of New York on certain FATCA provisions as they relate to trusts and beneficiaries of trusts. In particular, our comments address the following provisions of FATCA:

- Disclosure of Information with respect to Foreign Financial Assets under new Section 6038D of the Internal Revenue Code (the "Code");
- Annual Reporting with respect to Passive Foreign Investment Companies under Section 1298 of the Code;
- The Presumption that a Foreign Trust has a United States Beneficiary under Section 679(d) of the Code; and
- Uncompensated Use of Property of a Foreign Trust under Section 643(i) of the Code.

The principal contact for questions or additional information relating to the enclosed comments is Evelyn Capassakis (646-471-2363 or evelyn.capassakis@us.pwc.com).

Very truly yours,

Brit L. Geiger
Chair, Committee on Estate and Gift Taxation

COMMENTS

Disclosure of Information with respect to Foreign Financial Assets under new Section 6038D of the Code

Background

Under the law in effect prior to (and continuing in effect after) the enactment of the HIRE Act, certain grantors and beneficiaries of a trust are required to file Foreign Bank and Financial Account Reports ("FBARs") on Form TD F 90-22.1 to report foreign financial accounts exceeding $10,000 held by the trust, and to report on Form 3520 and Form 3520A certain transactions with foreign trusts, ownership of foreign trusts under the grantor trust rules, and distributions from foreign trusts.

New reporting requirement under the HIRE Act

The purpose of FATCA is to "detect, deter and discourage offshore tax abuses" by Americans and to close certain loopholes in reporting requirements that permitted U.S. persons to avoid disclosure of offshore assets and income.[1]

In addition to the FBAR reporting discussed above, FATCA added a new reporting requirement under section 6038D of the Code.

Section 6038D(a) provides that:

> Any individual who, during the taxable year, holds any interest in a specified foreign financial asset shall attach to such person's return of tax imposed by subtitle A for such taxable year the information described in subsection (c) with respect to each such asset if the aggregate value of all such assets exceeds $50,000 (or such higher dollar amount as the Secretary may prescribe).

A foreign trust is treated as a "specified foreign financial asset" ("SFFA"). The term SFFA includes any interest in a foreign entity (as defined in section 1473 of the Code). Section 1473(5) of the Code provides that the term "foreign entity" means any entity that is not a U.S. person. The Technical Explanation to the HIRE Act contemplates that a foreign trust is an SFFA:

> For example, a beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50% may nonetheless be required to disclose the interest in the trust with his tax return under this provision if the value of his interest in the trust, together with the value of other specified foreign financial assets, exceeds the aggregate value threshold.[2]

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1 Baucus, Rangel, Kerry, Neal Press Release on FATCA, October 27, 2009.

2 Joint Committee Staff, Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the HIRE Act (JCX-4-10) February 23, 2010, p. 60.

Under section 6038D(c), the information that is required in respect of a foreign trust includes such information as is necessary to identify the trust, and the maximum value of the trust during the taxable year.

Recommendations

1. Guidance Regarding What Constitutes an Interest in a Foreign Trust

Although the information required by section 6038D may not be within the scope of the FBAR, the final rule (the "Final Rule") issued by the Financial Crimes Enforcement Network ("FinCEN") on February 24, 2011 on Foreign Bank Account Reporting ("FBAR") could be used as guidance regarding what constitutes an interest in a foreign trust for the purposes of section 6038D. The Final Rule provides that only a U.S. settlor who is treated as the owner of the trust under the grantor trust rules, and a U.S. person who has either a present beneficial interest in more than 50% of the trust assets or who receives more than 50% of the trust's current income, have a financial interest in foreign financial accounts held by a trust. Most notably, the Final Rule clarified that a remainder interest in a trust is not within the scope of the term "present beneficial interest" for the purposes of filing an FBAR, and it is not intended for a beneficiary of a discretionary trust to be treated as having a financial interest in a foreign account simply because of his status as a discretionary beneficiary. Moreover, a beneficiary with more than a 50% present beneficial interest in the trust assets or who receives more than 50% of the trust's current income is not required to report the trust's foreign financial accounts on an FBAR if the trust, trustee of the trust, or agent of the trust is a U.S. person and files an FBAR as required. At least until such time as a discretionary beneficiary receives a distribution from the trust or the interest of a remainder beneficiary becomes vested, the beneficiary may never realize any direct or indirect benefit in respect of the value or the income of the trust. Moreover, the existence of the trust may be unknown to discretionary or remainder beneficiaries until they receive a distribution from the trust. The Service or the Treasury should clarify that section 6038D does not apply to a person who has a remainder interest in a foreign trust. Similarly, a discretionary beneficiary who did not receive any trust distributions in a given year should not have filing requirements under the section.

Presumably, the filing requirements should apply to a settlor of the foreign trust who is treated as the owner under the grantor trust rules (or an individual treated as the owner of the foreign trust under section 678 of the Code), a beneficiary who has a present fixed, rather than a contingent interest, in the foreign trust, and a discretionary beneficiary who receives distributions from a foreign trust in the year in question. This should be clarified so it is clear that this is the case.

2. Valuation of an Interest in the Foreign Trust

If a U.S. person is the owner of a foreign trust under sections 671 through 679 of the Code, the aggregate value of his or her interest in the trust under section 6038D should be calculated by reference to the portion of the foreign trust of which he or she is treated as an owner.

A U.S. person who has a fixed present interest in a foreign trust could calculate his or her interest in the trust by reference to the IRS valuation tables, or, alternatively, the valuation of his or her interest could be based on the value of the distributions made to him or her during the year.

A discretionary beneficiary's interest in a foreign trust should be determined on a year-by-year basis, on the basis of the value of the distributions received in such year.

3. Section 6038D should apply only to interests in the foreign trust itself

It should be clarified that section 6038D applies to an individual's interest in the foreign trust itself, but not to any SFFAs owned by the foreign trust.

4. Disclosure Requirements

Regarding identification of the trust, it should be clarified whether a copy of the trust agreement needs to be provided. A beneficiary may not have a copy of the trust agreement, and may not have the power under applicable law to compel the trustee to provide him with such a copy. There is no requirement for a U.S. beneficiary who receives a distribution from a foreign trust to furnish a copy of the trust agreement with Form 3520. Even in the case of an owner of a foreign trust, a copy of the trust agreement is not required if a U.S. agent is appointed. We recommend that the Service and Treasury require only the disclosure of the name or identifying information of the trust and the name and address of the trustee.

In determining an individual's maximum interest in the trust, if a discretionary beneficiary's interest in a trust is measured by the amount of distributions received in a given year, such distributions should be his maximum interest in the trust. The requirement to disclose the maximum interest in the trust makes more sense for an individual who is treated as the owner of the trust.

5. Application of section 6038D to foreign individuals

The section applies to individuals without reference to whether they are U.S. or foreign. Section 6038D should be clarified to exclude foreign individuals.

6. Duplicative filings

Section 6038D(h) provides that the Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of the section, including regulations or other guidance providing appropriate exceptions for classes of assets the disclosure of which the Secretary determines to be duplicative.

The filing requirements of section 6038D seem to be duplicative for a U.S. person who is treated as the owner of a trust under the grantor trust rules. A U.S. person who is treated as the owner of a trust under the grantor trust rules is required to file an FBAR to report any foreign financial accounts held by a trust, and if the trust is foreign, the U.S. owner is required to file Form 3520 and Form 3520A to disclose information about the trust. As the disclosure required by Form 3520 and Form 3520A pertains to the trust itself rather than to the identification of accounts held by the trust, the filing of Form 3520 or Form 3520A (rather than the FBAR) should satisfy the requirements of section 6038D. Such Forms could be modified to require the disclosure of the maximum amount of the owner's interest and other information required by section 6038D that is not addressed by the forms.

A U.S. person who receives a distribution from a foreign trust, no matter what the amount is, is required to report the distribution on Form 3520 (although such person is not required to file an FBAR if he or she is not deemed to have a financial interest in the trust's foreign financial accounts under the FBAR rules). Form 3520 can be modified to include any section 6038D disclosure that is not included in the current form.

A U.S. person who is not the owner of a foreign trust and who did not receive distributions from the trust in a given year is not required to file Form 3520. Such person is also not required to report any foreign financial accounts held by the trust on an FBAR if he or she

does not have a present beneficial interest in more than 50% of the trust assets. Again, as the disclosure required by section 6038D pertains to the trust interest itself rather than to the accounts held by the trust, Form 3520 (rather than the FBAR) should be modified to incorporate the filing requirements of such persons.

The Service has issued a proposed Form 8938 for reporting under section 6038D. Instructions have not been issued. The form does not address the concerns hereinbefore expressed, and is not designed to report interests in a trust. Accordingly, it should be modified to take into account these considerations prior to being finalized.

Annual Reporting by U.S. Shareholders of a Passive Foreign Investment Company ("PFIC") – Application to Trust Beneficiaries under Section 1298(f) of the Internal Revenue Code

Background

A PFIC is any foreign corporation if (a) 75% or more if its income is passive income or (b) 50% or more of its assets produce or could produce passive income.[3] In the absence of certain elections, a U.S. person who receives an "excess distribution" from a PFIC or that disposes of stock in a PFIC pays tax at ordinary income rates on the distribution or gain and is subject to an interest charge measured by reference to the U.S. person's holding period.[4] If the U.S. shareholder makes an election to treat the PFIC as a "qualified electing fund" ("QEF") the shareholder is essentially taxed on a pass-through basis and must include his share of the PFIC's earnings and gains in his income on a current basis.[5] Alternatively, if the stock of a PFIC is publicly traded, the U.S. shareholder may make a mark to market election in respect of the stock, *i.e.*, on an annual basis, the U.S. shareholder takes into account as income or loss (subject to certain limitations) the difference between the fair market value of the stock at the close of the taxable year and the shareholder's adjusted basis in the stock.[6]

Prior to amendment by the HIRE Act, section 1291(e) of the Code (by reference to section 1246) included a general reporting requirement for certain U.S. shareholders of PFICs which was contingent upon the issuance of regulations. Although regulations requiring annual reporting by U.S. shareholders of PFICs were proposed in 1992, such regulations have not been finalized.[7] Instead, U.S. shareholders of PFICs were required to file Form 8621, Return by a Shareholder of Passive Foreign Investment Company or Qualified Electing Fund, only to report an excess distribution from or the disposition of stock of the PFIC, to report income in respect of the QEF or mark to market elections, or to make certain elections in respect of the PFIC.[8]

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3 Code Section 1297.

4 Code section 1291.

5 Code section 1293.

6 Code section 1296.

7 Prop. Reg. §1.1291-1(i).

8 Instructions to Form 8621.

U.S. beneficiaries of a trust that owns PFIC shares may be treated as indirect shareholders of such PFIC subject to the tax rules applicable to direct U.S. holders of shares of a PFIC.[9] Proposed regulations provide that beneficiaries are considered to own a proportionate amount of the stock of the PFIC held by the trust and that this determination is to be made on the basis of all the facts and circumstances in each case.[10] The application of these rules is unclear in a number of situations, including those involving discretionary or remainder beneficiaries, grantor trusts and even U.S. trusts with U.S. beneficiaries.

Annual Reporting Under the HIRE Act

Section 521 of the HIRE Act added section 1298(f) to the Code which provides as follows:

> Except as otherwise provided by the Secretary, each United States person who is a shareholder of a passive foreign investment company shall file an annual report containing such information as the Secretary may require.

Section 1298(f) is effective on March 18, 2010. However, the IRS issued Notice 2010-34 on April 26, 2010 which provided that shareholders of a PFIC that were not otherwise required to file Form 8621 prior to March 18, 2010, will not be required to file an annual report under section 1298(f) for taxable years beginning before March 18, 2010. Those persons required to file Form 8621 prior to the enactment of section 1298(f), must continue to file Form 8621 in accordance with the instructions thereto.

The HIRE Act added section 1298(f) to the list of information reports that, if not filed when required, tolls the running of the statute of limitations on the assessment of tax with respect to any tax return, event or period to which the information relates.[11]

Recommendations

1. The application and scope of the indirect ownership rules with respect to a U.S. person who is a discretionary beneficiary or a remainder beneficiary of a foreign nongrantor trust which owns shares of a PFIC is unclear. At least until such time as a discretionary beneficiary receives a distribution from the trust or the interest of a remainder beneficiary becomes vested, the beneficiary may never realize any direct or indirect benefit in respect of the value or income of the PFIC. Moreover, the existence of the trust may be unknown to discretionary or remainder beneficiaries until they first receive a distribution from the trust. As such, a discretionary or remainder beneficiary of a foreign nongrantor trust who has never received distributions from the trust should not be required to file an information return under section 1298(f) in respect of shares of a PFIC held by the trust.

2. U.S. persons who are current income beneficiaries or discretionary beneficiaries of a foreign nongrantor trust and who receive de minimis distributions from the trust should not be required to file an information return under section 1298(f) solely in respect of the ownership of shares of a PFIC by the trust. We recommend that this exemption apply to any such beneficiary who receives distributions during a year, or has received an average annual distribution over a defined number of years, of less than a specified amount (for example, the

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9 Code section 1298.

10 Prop. Reg. §1.1291-1(b)(8).

11 Code section 6501(c)(8)

amount of the gift tax annual exclusion under Code section 2503(b)). U.S. beneficiaries (indirect shareholders) who would otherwise be required to file Form 8621 to report a taxable PFIC event or income or loss under the QEF or mark to market elections would not be exempt under this rule.

3. A U.S. person who is treated as the owner of any portion of a trust under the grantor trust rules,[12] and not the U.S. beneficiaries of such portion of the trust, should be required to report the information required under section 1298(f) in respect of his attributable portions of PFIC shares held by the trust.

4. Except to the extent provided in regulations, there is no attribution of ownership of PFIC shares held by a U.S. person or entity to another person. Therefore, in the absence of final regulations which would treat PFIC shares held by a U.S. trust as being owned by trust beneficiaries, the trustee, and not the beneficiaries, of a U.S. nongrantor trust should be obligated to make the filing required under section 1298(f). If the current proposed regulations attributing ownership of PFIC shares from a U.S. trust to its U.S. beneficiaries are finalized, or similar regulations are otherwise adopted, a U.S. beneficiary of the trust should not be obligated to make the filing required under section 1298(f) if the trustee of the trust makes the filing and the beneficiary is not otherwise required to included any amount in income in respect of the PFIC (*i.e.*, as a result of a triggering event or election).[13]

5. In the case of a foreign nongrantor trust, if the trustee or its U.S. agent, files the information required under section 1298(f), a U.S. beneficiary of such trust should not be required to make such filing unless such beneficiary is required to include in income any amount in respect of an excess distribution by or disposition of the PFIC, or under the QEF or mark to market elections.

6. Other than instances in which a trust beneficiary has a fixed interest in trust income or capital, it may be extremely difficult to quantify a U.S. beneficiary's indirect interest in PFIC shares held by a trust. This difficulty should be taken into account in determining the manner in which the ownership of PFIC shares (as opposed to a taxable event or an income inclusion election in respect of the PFIC) must be reported. Rather than providing for reporting strictly in terms of the number of shares or percentage ownership of a PFIC, the applicable form should include or accommodate a description of the interest with respect to which indirect ownerships results (*e.g.*, discretionary beneficial trust interest).

Presumption that a Foreign Trust has a United States Beneficiary under Section 679(d) of the Code

Background

Subject to certain exceptions, under Code section 679(a), a U.S. person who directly or indirectly transfers property to a foreign trust is treated as the owner of the portion of the trust attributable to the transferred property for any year in which there is a United States beneficiary of any portion of the trust. Under section 679(c)(1) of the Code, a trust is treated as having a U.S. beneficiary for this purpose unless "(A) under the terms of the trust, no part of the income or

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12 *See* Subpart E, Subchapter J, Chapter 1 of the Code.

13 *See* Prop. Reg. §1.1291-1(b)(8)(iii)(C).

corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a U.S. person, and (B) if the trust were terminated at any time during the taxable year, no part of the income or corpus of such trust could be paid to or for the benefit of a United States person.

Code section 6048 imposes information reporting requirements with respect to, among other items, the transfer by a U.S. person of property to a foreign trust and the ownership by a U.S. person of any portion of a foreign trust.

Presumption of U.S. Beneficiaries

Section 532 of the HIRE Act added a new section 679(d) to the Code which provides as follows:

> If a United States person directly or indirectly transfers property to a foreign trust (other than a trust described in section 6048(a)(3)(B)(ii)), the Secretary may treat such trust as having a United States beneficiary for purposes of applying this section to such transfer unless such person – (1) submits such information to the Secretary as the Secretary may require with respect to such transfer, and (2) demonstrates to the satisfaction of the Secretary that such trust satisfies the requirements of subparagraphs (A) and (B) of (c)(1).

Section 512 of the HIRE Act added section 6662(j) to the Code which provides for a 40% penalty on an understatement of tax attributable to a transaction involving an "undisclosed foreign financial asset" which term includes any information required to be reported under section 6048 of the Code that was not provided.

Recommendation

To provide certainty to those U.S. persons wishing to transfer property to a foreign trust without the intent that the trust should benefit other U.S. persons, Treasury should issue safe-harbor guidance under section 679(d) upon which such person could rely to meet the second prong of the exception to the U.S. beneficiary presumption. A simple form of such guidance could be the provision of language, which if fully incorporated in the governing trust instrument, would be deemed adequate for purposes of demonstrating to the satisfaction of the Secretary that (A) no part of the income or corpus of the trust may be paid or accumulated during the year to or for the benefit of a U.S. person and (B) if the trust were terminated, no part of the income or corpus of such trust could be paid to or for the benefit of a U.S. person.

Uncompensated Use of Trust Property Under Section 643(i) of the Code

Background

Prior to the amendments by the HIRE Act, Code section 643(i) provided that if a foreign trust makes a loan of cash or marketable securities to a US grantor or beneficiary of the foreign trust, or a person related to such grantor or beneficiary, then the amount of the loan is treated as a distribution by the trust to the grantor or beneficiary.

Under the HIRE Act

Effective with the date of enactment, section 533 of the HIRE Act amended Code section 643(i) to add new provisions treating uncompensated use of trust property by a US grantor or beneficiary of the foreign trust, or a person related to such grantor or beneficiary as a distribution to the grantor or beneficiary. Specifically, section 643(i)(1) now reads as follows:

(1) General Rule - Except as provided in regulations, if a foreign trust makes a loan of cash or marketable securities (or permits the use of any other trust property) directly or indirectly to or by --

(A) any grantor or beneficiary of such trust who is a United States person, or

(B) any United States person not described in subparagraph (A) who is related to such grantor or beneficiary,

the amount of such loan (or the fair market value of the use of such property) shall be treated as a distribution by such trust to such grantor or beneficiary (as the case may be).

Section 533 also amended Code section 643(i)(2) to add the following exception:

(E) Exception for Compensated Use of Property - In the case of the use of any trust property other than a loan of cash or marketable securities, paragraph (1) shall not apply to the extent that the trust is paid the fair market value of such use within a reasonable period of time of such use.

Recommendations

1. Valuation

Unlike cash or marketable securities, other trust property that is used by a beneficiary may or may not have a readily ascertainable fair market value. Guidance and specific examples are therefore needed as to how to determine the fair market value of the use of the property for purposes of complying with this section.

For example, suppose a trust purchases real property and allows the beneficiary to use the property. The beneficiary in fact uses the property as his or her principal residence. In that case, if a real estate market exists for the use value of the property, then the fair rental value could constitute the amount of the deemed distribution.

What if, in the example above, the trust also purchases furniture and furnishings for the house, and allows the beneficiary to use them, together with the house? In that case if there is a market in the location for rental of furnished real property, then the value of the beneficiary's use might be quantifiable, and, once again, the market rental could constitute the use value.

In both of the above cases, guidance should contain a safe harbor that fair rental value, as determined in the community, would suffice for purposes of determining use value in these examples.

Extending the above example, what if the trust purchases tangible personal property for use by the beneficiary and the tangibles are of a type for which there may not be a ready rental market? For example, what if the trust purchases horses or dogs or other animals for use by the beneficiary in an area where there is no ready market for use of these animals? What about extremely valuable artwork? Presumably the value of the property is capable of valuation but how is the use value of that property to be determined? Would something as arbitrary as an interest charge on the value as determined be appropriate? Presumably it would not, and guidance should so state.

Suppose that instead of the above example, the property is used as a vacation home, and then only occasionally. How is the use to be quantified? Is it based on the number of days actually used, as compared to the total number of days in the year? Or is the calculation based on the number of days that the property is actually available to the beneficiary (e.g., is a summer home that has no heating considered unavailable in the winter?) It might be considered inappropriate to treat a beneficiary as using the property when the beneficiary is not actually there. On the other hand, if the beneficiary retains his or her furnishings in the property year-round, even if the beneficiary only uses the property in the summer, does this constitute a "use"

by the beneficiary of the property year-round? Guidance should clarify whether use requires physical presence by the beneficiary.

2. Apportionment Among Beneficiaries

Suppose a parent and child are named beneficiaries of the trust. Suppose further that four family members -- parent and spouse and child and child's spouse -- use the property as their principal residence or as a vacation home. Taking a literal reading of the language of Code section 643(i), then each of the beneficiaries is related to the other beneficiaries, and since a related party's use is attributed to a beneficiary, then each of the beneficiaries (parent and child) is attributed with the other non-beneficiary-family-member's use, so that each beneficiary is technically treated as receiving the uncompensated use of the 75% of the trust property - the 25% share of the beneficiary and the 25% share of the two non-beneficiaries. Does this mean that the use value is deemed distributed one and one-half times, or 150%?

Guidance should contain a mechanism to avoid such double-counting where there is simultaneous use of the property by more than one beneficiary and other persons related to both.

The above example assumes that each beneficiary's share is determined in proportion to the number of beneficiaries. Is this a valid assumption? Should the proportion be determined based on the amount of time each person stays in the house? For example, would a working spouse be attributed less use than a stay-at-home spouse?

In a related question, how is the portion used by the beneficiary determined? For example, if the beneficiary is only using one bedroom of a four-bedroom house, and no one else is using the house, how do you apportion the use value? In that case, it would seem that something less than the entire use value of the property might be appropriate. If there is apportionment among family members who all use the house, how is it accomplished? Is it based on square-footage used, with common areas divided among the beneficiaries? Guidance should clarify how this is to be accomplished.

3. *De Minimis* Exception

Guidance should contain a de minimis exception. At what level does it become impractical for the beneficiary, the trustee, or the government to concern itself about the application of the rule? Should this be measured by the number of days of use? For example, if the use is less than three days, would the beneficiary be exempt from the rule?

4. Reasonable Period

For purposes of the exception to the rule providing that use value is not deemed distributed where the trust is paid fair market value for use of the property within a "reasonable period of time" of the use, what constitutes a "reasonable period of time?" It is recommended that a safe harbor might be adopted. A safe harbor might allow fair market value to be paid, for example, up until the time for filing the trust's US federal income tax return, including extensions, or, if no return is required, then the date which would have been the due date for the trust's return if one had been required.