COUNTDOWN TO JULY

Paul Foster Millen and Peter Cotorceanu ask: are US corporate trustees about to be ambushed by FATCA?

KEY POINTS

WHAT IS THE ISSUE?
Quite a few US corporate trustees do not realise that many trusts they administer on behalf of foreign persons qualify as foreign financial institutions (FFIs) under the US *Foreign Account Tax Compliance Act* (FATCA). Further, FATCA imposes periodic Internal Revenue Service (IRS) certification obligations on certain FFIs.

WHAT DOES IT MEAN FOR ME?
Responsible officers (ROs), the designated FATCA representatives of those US corporate trustees, will need to submit certifications under their own name to the IRS on or before 1 July 2018, affirming their FATCA compliance based on FATCA policies and procedures in place and reviewed by them.

WHAT CAN I TAKE AWAY?
US trust companies must act promptly to ensure their FFI trusts have been complying with FATCA and that they can meet the RO certification requirements.

In absolute terms, US financial institutions (FIs) have been let off rather lightly by the *Foreign Account Tax Compliance Act* (FATCA). In comparative terms, it has arguably been a boon for global US banks, as their non-US rivals have been compelled to divert multiple personnel and a significant amount of money in order to satisfy their far more onerous compliance duties. However, one group of US FIs has been affected by FATCA, and many of them don't even know it yet. US corporate trustees: you may have FATCA responsible officer (RO) certification obligations.

Under FATCA, almost all trusts with US corporate trustees that are set up for non-US persons are foreign financial institutions (FFIs). That's right: trusts with US trustees can be FFIs; it doesn't matter which law they are governed by.

Why are we first learning of such a significant point only now? Essentially, this particular quirk of FATCA sits in an enforcement vacuum because:

- Few of these trusts have reportable US person account holders (and there is no nil-reporting requirement).
- Many hold accounts with US banks that did not conduct the blanket FATCA documentation exercise required of non-US banks.
- Even where the trust holds a financial account offshore, non-US banks and other types of FFIs tend to lack the information about the trust's setup needed to challenge a claim of US person status.

Nonetheless, US trust companies serving non-US clients have an ever-increasing number of FFIs in their portfolios, given the growing popularity of the US as a trust jurisdiction for non-US persons. Accordingly, most will need to submit RO certifications to the Internal Revenue Service (IRS), both on behalf of trusts they administer and for themselves as sponsors.

HOW AND WHY TRUSTS WITH US TRUSTEES CAN BE FFIs

As many readers will know, almost all trusts with corporate trustees are FIs for FATCA purposes.[1] An FFI is simply an FI that is a 'foreign entity'.[2] Under FATCA's binary approach, any entity that is not a US person is a foreign entity.[3] But if a trust with a US trustee governed by US law is a non-US trust for US tax (and, therefore, FATCA) purposes, in which non-US country is it resident and by which FATCA intergovernmental agreement (IGA), if any, is it governed? The answer is simple: none.[4] But this doesn't mean it eludes FATCA. Quite the contrary: FFIs not governed by an IGA are governed by the US FATCA regulations by default.

IMPLICATIONS FOR THE US TRUST INDUSTRY

Once this revelation is digested, the next inquiry must be: what consequences

> 'The first RO certification deadline looms on 1 July 2018'

emerge from it? The compliance obligations attaching to an FFI trust.

For an FFI trust, the trustee must assess the trust's eligibility for available compliance categories, adopt one and fulfil the obligations of the category. Overwhelmingly, trustees select the trustee-documented trust (TDT) classification, but that deemed-compliant category is not available to trusts subject to the US FATCA regulations. In the absence of the TDT category, trustees of FFI trusts tend to select one of the sponsored categories – a sponsored investment entity (SIE) or a sponsored closely held investment vehicle (SCHIV) – as the nearest substitute available.

This selection imposes duties directly on the trustees as well. Trustees adopting a sponsored FFI category for their FFI trusts need to register themselves[5] and act as the sponsoring entity for those sponsored FFI trusts.[6] In this sponsoring role, the trustees essentially agree to perform the compliance activities of an FFI trust on behalf of the trust.[7] Under the sponsoring concept, the conduct of the compliance activities is reallocated to the sponsoring trustee, but the overall compliance burden for each sponsored FFI trust is not lessened.[8]

As such, trustees serving as sponsors will need to initiate promptly an appropriate compliance programme, specifically by registering as sponsors (including nominating a sponsor RO) and re-documenting their trusts as sponsored entities towards any FFI where they hold financial accounts (and to which they may have originally submitted a Form W-9). Unfortunately, the new responsibilities do not end with the paper shuffling.

RO CERTIFICATIONS

At the time of registration via the IRS FATCA Portal, participating FFIs (PFFIs) subject to FATCA (as well as Reporting Model-2 FIs subject to Model-2 IGAs) enter into a so-called 'FFI agreement' with the IRS.[9] One condition of this agreement is that the RO of the FFI submit initial and periodic RO certifications, confirming past and ongoing FATCA compliance.[10] This obligation applies to sponsoring entities and then doubles it. A sponsor RO submits a dual certification: both on behalf of the entities it sponsors[11] and on behalf of itself as the sponsoring entity.[12]

Such certifications must include, among other things, the following confirmations:

- The sponsoring entity has a *written sponsorship agreement* in effect with each sponsored FFI, authorising the sponsoring entity to fulfil its duties as a sponsor.[13]
- For each FFI sponsored by the sponsoring FFI, a FATCA compliance programme – including policies, procedures and processes sufficient to satisfy the due diligence, reporting and withholding requirements – is operational[14] and was reviewed by the sponsor RO or a designee.[15]
- Any material failures (as specifically defined in the regulations) identified during the RO certification review period were corrected and remedial actions were implemented in order to prevent the recurrence of such failures.[16]
- Any failures to withhold, deposit or report as required were rectified.[17]

For the initial certification only, the sponsor RO must also confirm for each sponsored FFI the following:

- the completion of the mandatory due diligence on pre-existing account holders; and
- the absence (to the best of the RO's knowledge) of any formal or informal practices or procedures in place since 6 August 2011 to aid the avoidance of FATCA reporting or withholding.[18]

The form and manner of the RO certification submissions remain as yet unspecified.[19] However, extrapolating from previous FATCA signature requirements, such as the withholding certificates (e.g. Form W-8BEN-E and Form W-8IMY), we may expect the RO certification to be subject to the penalties of perjury. To the extent that the sponsor cannot certify to the above compliance activities, it must make a qualified certification.[20]

CONCLUSION

The first RO certification deadline looms on 1 July 2018.[21] While that may appear to be a substantial way off, FATCA compliance is accretive. Prudent foreign corporate trustees devised their compliance programmes with the RO certification as a guiding principle, testing their programme and controls on a regular basis over the past few years in preparation for that end objective. Unfortunately, US corporate trustees do not have time and space for such trials and, even less, for any errors.

1 All that is required is that: (i) the trust be 'professionally managed', which is true if the trustee is a commercial trust company; and (ii) under the US FATCA regulations, the trust gets at least half its income from financial assets, which is true for the vast majority of trusts. For further information, refer to Peter Cotorceanu, 'FATCA and Offshore Trusts: A Second Bite of the Elephant', *Tax Notes* Special Report (2 September 2013), 1007, at page 1,011 **2** US *Internal Revenue Code* (IRC), s1471(d)(4) and US Treas Reg, s1.1471-5(d) **3** IRC, s1473(2)(5) and US Treas Reg, s1.1473-1(e) **4** Technically, it is not impossible for such a trust to be covered by an IGA, but it is highly improbable, because almost all IGA countries limit their IGAs' coverage to trusts with locally incorporated, registered or licensed trustees **5** Where the trustee selects the SIE category for any trust, rather than, say, the SCHIV one, the SIE trust will need to be registered in its own right as well (US Treas Reg, s1.1471-5(f)(1)(i)(F)(3)(iii) **6** US Treas Reg, ss1.1471-5(f)(1)(i)(F)(3); 1.1471-5T(f)(2)(iii)(D) **7** *Id* **8** Critically, the sponsor assumes the most demanding level of compliance duties available for the sponsored FFI. Accordingly, the sponsoring trustee must fulfil the FATCA compliance duties for the sponsored trust as if the trust were a participating FFI under the US FATCA regulations or a Reporting Model 1 or 2 FI under a Model 1 or 2 IGA, respectively (see e.g. US Treas Reg, ss1.1471-5(f)(1)(i)(F)(3)(iv); 1.1471-5T(f)(1)(i)(F)(3)(v)-(vii); 1.1471-5T(f)(2)(iii)(D)(2)-(5)) **9** The FFI agreement is set forth in IRS Revenue Procedure 2017-16, available at bit.ly/2yNQkD4 **10** US Treas Reg, ss1.1471-4(f)(3); 1.1471-4(f)(7) **11** US Treas Reg, ss1.1471-5T(f)(1)(i)(F)(3)(vi); 1.1471-5T(f)(2)(iii)(D)(4) **12** US Treas Reg, ss1.1471-5T(f)(1)(i)(F)(3)(vii); 1.1471-5T(f)(2)(iii)(D)(5) **13** Prop US Treas Reg, s1.1471-5(j)(3)(v)(B) **14** Prop US Treas Reg, s1.1471-5(j)(3)(vi)(A)(1); FFI agreement, sec 8.01 **15** Prop US Treas Reg, s1.1471-4(j)(2); FFI agreement sec 8.02 **16** Prop US Treas Reg, s1.1471-5(j)(3)(vi)(A)(2)) **17** Prop US Treas Reg, s1.1471-5(j)(3)(vi)(A)(3)) **18** Prop US Treas Reg, s1.1471-5(j)(5); FFI Agreement s8.03(a) **19** But see FFI Agreement, s8.03(C) **20** Prop US Treas Reg, s1.1471-5(j)(3)(vi)(B) **21** Prop US Treas Reg, s1.1471-5(j)(3)(i)

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