

*Excerpt from eBook*

# Offshore Tax Evasion: The IRS and Swiss Banks

Foreign Grantor Trusts: U.S. Tax Compliance

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# THE WOLFE LAW GROUP

Gary S. Wolfe has over 34 years of experience, specializing in IRS Tax Audits and International Tax Matters including: International Tax Planning/Tax Compliance, and International Asset Protection.

As of July 2016, Gary Wolfe has internationally published 15 books and 28 articles. Gary has received 14 international tax awards from five different Global expert societies in LONDON/UK including being voted one of the 100 leading world's law firms with votes from over 150,000 voters in over 160 countries with the following award: Global 100 (2016) (KMH Media Group) - CA/US International Tax Planning Law Firm of the Year.

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### Chapter 30 - Foreign Grantor Trusts: U.S. Tax Compliance

A U.S. taxpayer who establishes a foreign trust is classified as the trust owner, under IRC Sec. 679, for those assets transferred to the trust, and must annually report foreign trust income (IRS Forms 3520-A/Form 1040), and asset transfers to the trust (Form 3520). U.S. beneficiaries must annually report distributions received from the foreign trust (Form 3520).

The U.S. grantor of the foreign trust must annually file Form TDF-90.22-1("FBAR") to report the trust foreign financial accounts over \$10,000 (which accounts they either own or control (i.e. signatory authority) and IRS Form 8938, to report ownership of foreign assets over \$50,000.

The U.S. grantor of the foreign trust's failure to file FBAR, Form 8938, report annual income on Forms 3520-A/Form/Form 1040, report trust transfers (Form 3520) and U.S. beneficiaries' failure to report trust distributions (Form 3520) have civil and criminal tax issues, including:

1. Money Laundering: (Disguise of the nature or the origin of funds (18 U.S.C. Sec. 1956 and 1957));
2. FBAR Issues: (See below);
3. Unreported Income Issues: (See below);
4. FATCA Issues: (See below);
5. Perjury: (See below).

#### Foreign Bank and Financial Account Report (FBAR) (TD F 90-22.1), Civil & Criminal Penalties

Each U.S. Person who has a financial interest in, or signature or other authority over, one or more foreign financial accounts (value over \$10,000, at any time during a calendar year) is required to report the account on Schedule B/Form 1040, and TD F 90-22.1 (Report of Foreign Bank and Financial Accounts (FBAR)), due by June 30 of the succeeding year (I.R.M. 5.21.6.1. (2/17/09)).

Failure to file the required report or maintain adequate records (for 5 years) is a violation of Title 31 with civil and criminal penalties (or both). For each violation a separate penalty may be asserted.

		Civil Penalties	Criminal Penalties	Legal Authority
(I)	<u>Non-Willful Violation</u>	Up to \$10,000 for each violation.	N/A	31 U.S.C. § 5321(a)(5)(A)

(II)	<b><u>Negligent Violation</u></b>	Up to the greater of \$100,000, or 35 percent of the greatest amount in the account.	N/A	31 U.S.C. §5321(a)(5)(C)
(III) (1)	<b><u>Intentional Violations</u></b>  <b>Willful - Failure to File FBAR or retain records of account</b>	Up to the greater of \$100,000, or 50 percent of the greatest amount in the account.	Up to \$250,000 or 5 years or both	31 U.S.C. § 5322(a) and 31 C.F.R. §103.59(b) for criminal
(2)	<b>Knowingly and Willfully Filing False FBAR</b>	Up to the greater of \$100,000, or 50 percent of the greatest amount in the account.	\$10,000 or 5 years or both	18 U.S.C. § 1001, 31 C.F.R. § 103.59(d) for criminal
(3)	<b>Willful - Failure to File FBAR or retain records of account while violating certain other laws</b>	Up to the greater of \$100,000, or 50 percent of the greatest amount in the account.	Up to \$500,000 or 10 years or both	31 U.S.C. § 5322(b) and 31 C.F.R. §103.59(c) for criminal

## IRS/Offshore Accounts

### Criminal Penalties

#### 6-Year Statute of Limitations

1. Tax Evasion (Willful Evasion of Tax)  
(IRC Sec. 7201) up to five years in prison  
Fine: \$100,000 (individual)  
\$500,000 (corporation)
2. Obstruct (Impede Tax Collection)  
(IRC Sec. 7212) up to three years in prison  
Fine: \$5,000
3. Conspiracy to Impede Tax Collection  
(18 USC 371) separate charge of impeding  
Up to five years in prison
4. Failure to File Tax Return  
(IRC Sec. 7203) up to one year in prison  
Fine: \$25,000 (individual)

\$100,000 (corporation)

5. File False Tax Return  
(IRC Sec. 7206(1)), up to three years in prison  
Fine: \$250,000
6. "FBAR Violation"  
(31 USC Sec. 5322(b), 31 CFR 103.59(c))  
Willful violation: up to ten years in jail and  
\$500,000 fine

#### Additional Criminal Penalties:

1. Perjury (U.S. taxpayers who fail to disclose foreign accounts under Form 1040/Schedule B, Part III, question 7(a))
2. FATCA Filings (i.e. Failure to disclose foreign financial assets on \$50,000/IRS Form 8938)
3. Money Laundering: Disguise of the nature or the origin of funds (18 USC Sec. 1956 and 1957)

#### **U.S. Tax Compliance Issues**

U.S. taxpayers who establish a foreign trust (i.e. a trust which either a U.S. court does not supervise trust administration, or a U.S. person does not control substantial trust decisions. See: IRC Sec. 7701(a)(30)(E) (31)(B), and funds the trust (i.e. transfers property to the trust), if the trust has a U.S. beneficiary, the trust will be treated as foreign "grantor trust" and the U.S. taxpayer will be treated as the owner "of that portion of the trust attributable to the property transferred" (IRC Sec. 678(b), 679).

Trust tax items of income, deduction or credit are for tax purposes treated as belonging to the trust grantor, and these tax items are reflected on the income tax return of the trust grantor; i.e. Form 1040 (originally declared on the Trust Tax Return, Form 3520-A: Annual Information Return of Foreign Trust with a U.S. Owner).

Based on a U.S. person funding the foreign trust, the IRS can presume that the trust has a U.S. beneficiary unless the U.S. person (i.e. transferor of trust assets) submits to the IRS any information that the IRS requires regarding the transfer and demonstrates to the IRS's satisfaction that:

- Under the trust terms, no part of the trust's income or corpus may be paid or accumulated during the tax year, to or for the benefit of a U.S. person, even if that person's interest is contingent on a future event; and

- No part of the trust's income or corpus could be paid to or for the benefit of a U.S. person if the trust were terminated at any time during the tax year.

Generally:

1. The U.S. taxpayer who transfers assets to the trust must ensure that the trust satisfies tax reporting requirements, and submit any information the IRS may require regarding the foreign trust (IRC Sec. 6048(b), 6677(a);

2. The U.S. grantor trust rules will not apply to any portion of a trust that would otherwise be deemed to be owned by a foreign person (IRC Sec. 672(f).

Under Treas. Reg. Sec. 1.671-2(e) a trust grantor is a person (either an individual or a non-natural person) who either creates a trust, or indirectly makes a "gratuitous transfer" of property to a trust

A gratuitous transfer means a transfer made, other than a transfer for fair market value.

A U.S. taxpayer who creates a foreign trust faces a myriad of U.S. tax-reporting compliance issues.

1. If the foreign trust is irrevocable, the U.S. taxpayer faces a U.S. gift tax on funding. The U.S. taxpayer must file Form 709 to report the gift, subject to the 2013: \$5,250,000 gift tax exclusion. If the trust is revocable, the U.S. taxpayer must report any gifts (by filing Form 709) over \$14,000 per donee;
2. File Form 3520 ("Annual Return to Report Transactions with Foreign Trusts) to report transfers to the trust and trust ownership (IRC Sec. 671-679).

Penalties for non-compliance:

a. Thirty-five percent (35%) of the gross value of any property transferred to a foreign trust for failure by a U.S. transferor to report the creation of or transfer to a foreign trust, or

b. On an annual basis, 5% of the gross value of the portion of the trust's assets treated as owned by a U.S. person for failure by the U.S. person to report the U.S. owner information.

3. Form 3520-A is the annual information return of a foreign trust with at least one U.S. owner, which provides annual information about trust income/expense, its U.S. beneficiaries and any

person treated as an owner of any portion of the trust. Each U.S. person treated as an owner of any portion of a foreign trust is responsible for ensuring that the foreign trust files Form 3520-A and furnishes the required annual statements to its U.S. owners and U.S. beneficiaries.

**Penalties for non-compliance:**

The U.S. owner is subject to an initial penalty equal to the greater of \$10,000 or 5% of the gross value of the portion of the trust's assets treated as owned by the U.S. person at the close of that tax year, if the foreign trust either fails to timely file Form 3520-A or does not furnish all of the information required by IRC Sec. 6048(b) or includes incorrect information.

Criminal penalties may be imposed under IRC Sections 7203, 7206 and 7207 for failure to file on time and for filing a false or fraudulent tax return.

For both Forms 3520 and 3520-A:

1. Additional penalties will be imposed if the non-compliance continues after the IRS mails a notice of failure to comply with the required reporting.
2. Effective for taxable years beginning after 3/18/10, the IRC Sec. 6662 negligence penalty is increased from 20% to 40% if the deficiency is attributable to an unreported financial asset (See Sec. 512 of the 2010 HIRE Act).

**U.S. Tax Reporting Foreign Financial Assets and Foreign Accounts ("FBAR")**

USC Sec. 5314 of Title 31 (the Bank Secrecy Act) requires a U.S. person to file Form TDF 90-22.1- Report of Foreign Bank Account ("FBAR") to report all foreign bank and financial accounts in which they have a financial interest, or signatory authority, if the aggregate value of the accounts exceeded \$10,000 at any time during the year (31 USC Sec. 5314). A financial account includes a bank or financial account, a securities account, mutual fund or pooled investment fund.

A U.S. person has an indirect financial interest in an account owned by the trust and is required to file an FBAR report for foreign accounts held by the trust if they are the trust grantor (IRC Sec. 671-679) or they have a present beneficial interest in more than 50% of the trust assets or receive more than 50% of the trust income.

The U.S. Treasury Dept., division "Financial Crimes Enforcement Network" ("FINCEN") issued regulations providing that trust beneficiaries (other than those treated as owners under the grantor trust rules) do not have to file an FBAR report for financial assets held by trusts of which they are the trust beneficiary if the trust, trustee of the trust or trust agent is a U.S. person and files an FBAR report disclosing the trust's foreign financial accounts (31 CFR part 103, Sec. 103.24(g)(5), Federal Register Vol. 76, No. 37 at 10234 (Feb. 16, 2011). FINCEN delegates the

authority to enforce the FBAR reporting requirement of the Bank Secrecy Act to the IRS (by a memorandum of agreement).

A trust discretionary or remainder beneficiary are not required to file FBARs (Fed. Register Vol. 76, No. 37 at 10234 (Feb. 16, 2011)).

### **IRC Reporting Requirements for Foreign Financial Assets**

Section 511 of the 2010 HIRE Act added new Sec. 6038D to the Code, effective for taxable years beginning after 12/31/10.

Section 6038 D(a) requires any individual who holds any interest in a specified foreign financial asset during any taxable year to attach to his or her income tax return for that year the information described in Section 6038 D(c); i.e. Form 8938, if the aggregate value of all such assets exceeds \$50,000.

Specified foreign financial assets include: financial accounts, stock or security issued by a non-U.S. person, financial instruments or contracts held for investment that has an issuer or counter-party other than a U.S. person, and any interest in a foreign entity (which includes foreign trusts).

A person who is treated as the owner of a trust under the grantor trust rules is treated as having an interest in any foreign financial assets held by the trust (Treas. Reg. Sec. 1.6038(D)-2T(b)(3).

The value of a beneficiary's interest in a trust equals the sum of the amounts actually received in the taxable year plus the present value of a mandatory right to receive a distribution (Treas. Reg. 1.6038D-5J(f)(3). This valuation rule applies even if the trust is deemed to be owned by another person under the grantor trust rules. A foreign financial asset is subject to reporting even if the asset does not have a positive value (Treas. Reg. Sec. 1.6038D-2T(a)(5).

An FBAR and Form 8938 both have to be filed in full, and filed with different agencies. The penalty for failing to file Form 8938 is \$10,000 with additional penalties after notice is given to the taxpayer of \$10,000 per 30 day period, after expiration of the 90 day notice period (after notice given to the taxpayer, the penalty cannot exceed \$50,000).

The FATCA Form 8938 filing applies only to interests held directly by U.S. individuals (or indirectly through disregarded entities), but does not apply to U.S. entities.

For tax years beginning 1/1/11, the negligence penalty, if imposed by IRC Sec. 6662, is increased from 20% to 40% if the deficiency is attributable to an unreported foreign financial asset. (Sec. 512 of the 2010 HIRE Act.)

The statute of limitations will not commence to run until the return required (Form 8938) is filed, and is extended from three to six years if the taxpayer omitted more than \$5,000 from gross income and the omission is attributable to assets with respect to which a return was required by IRC Sec. 6038 D (IRC Sec. 650(c)(8)), as amended by Sec. 513 of the 2010 HIRE Act).

### **Offshore Tax Evasion: U.S. Taxpayer/Foreign Grantor Trust: U.S. Beneficiaries (U.S. Tax Compliance)**

A U.S. person who receives directly, or indirectly, a distribution from a foreign trust must report the gross amount of distributions received from a foreign trust on Form 3520 the information to the IRS regarding the trust name, date of distribution, description of property received, fair market value of property received, fair market value/description of property transferred, if any. (See Form 3520, Part III, line 24).

Under IRC Sec. 6677 (as amended by Sec. 535 of the 2010 HIRE Act) a penalty generally applies if Form 3520 is not timely filed or if the information is incomplete or incorrect. Generally, the initial penalty is equal to the greater of \$10,000 or 35% of the gross value of the distributions received from a foreign trust for failure by a U.S. person to report receipt of the distribution (on Form 3520).

Additional penalties can be imposed by the IRS for continuing non-compliance. Although the total penalties may not exceed the reportable amount, the IRS may assess the penalties before the reportable amount is determined. When the reportable amount is determined, the excess must be refunded. The IRS is authorized to assess and collect those penalties without prior judicial review.

### **FBAR Filing (Foreign Financial Accounts)**

31 U.S.C. Sec. 5314 requires a U.S. taxpayer to file Form TDF 90-22.1- Report of Foreign Bank Account ("FBAR") to report all foreign bank and financial accounts in which they have a financial interest or signature authority if the aggregate value of the accounts exceeded \$10,000 at any time during the year.

A U.S. taxpayer has a financial interest in an account owned by the foreign trust, and is required to file an FBAR report for foreign accounts held by the trust if they have a present beneficial interest in more than 50% of the trust assets, or receives more than 50% of the trust income. Discretionary beneficiaries and remainder beneficiaries are not required to file FBAR. Trust beneficiaries do not have to file an FBAR report for foreign financial assets held by the trust, if the trust, trustee or agent of the trust is a U.S. person and files an FBAR disclosing the trust's foreign financial accounts (Sec. 103.24(g)(5) of 31 CFR Part 103, Federal Register Vol. 76, No. 37 at 10234 (2/16/11)).

### **Form 3520: Trust Distributions**

A distribution to a U.S. beneficiary is any gratuitous transfer of money or other property from a trust, whether or not the trust is treated as owned by another person under IRC Sec. 671-679, and

without regard to whether the recipient is designated as a beneficiary by the terms of the trust. A distribution includes the receipt of trust corpus and the receipt of a gift or bequest described under IRC Sec. 663(a).

A distribution includes constructive transfers from a trust:

1. Personal charges made on a credit card paid by a foreign trust;
2. Personal charges (e.g. credit card) guaranteed or secured by the assets of a foreign trust;
3. Personal checks written on a foreign trust's bank account, the amount will be treated as a distribution.

In addition, a U.S. taxpayer who receives a payment from a foreign trust in exchange for property transferred to the trust, or services rendered to the trust, and the fair market value of the payment received exceeds the fair market value of the property transferred or services rendered, the excess will be treated as a distribution.

