

Excerpt from eBook

The IRS and Offshore Tax Evasion - U.S. Foreign Grantor Trusts

Foreign Trusts with U.S. Beneficiaries (Outbound Trusts) - IRC Sec. 679

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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 11 - Foreign Trusts with U.S. Beneficiaries (“Outbound Trusts”) - IRC Sec. 679

If a U.S. person transfers property to a foreign trust that has one or more U.S. beneficiaries, IRC Sec. 679 treats the transferor as owner of the portion of the trust attributable to the property transferred (IRC Sec. 679(a)(1)).

There are exceptions:

1. A transfer by reason of the death of the transferor (IRC Sec. 679 (a)(2)(A));
2. A transfer “in exchange for consideration of at least the fair market value of the transferred property” (IRC Sec. 679(a)(2)(B)).

If a foreign trust accumulates income during a year in which it has no U.S. beneficiary, if the trust acquires a U.S. beneficiary in a later year, a U.S. transferor (who would have been treated as owner of a portion of the trust during the prior year, but for the fact that it had no U.S. beneficiary) is taxable in the first year IRC Sec. 679 applies, on additional income equal to the trust’s undistributed net income for all prior taxable years (to the extent such undistributed net income remains in the trust at the end of the taxable year immediately prior to applicability of IRC Sec. 679) attributable to the portion to which IRC Sec. 679 applies (IRC Sec. 679(b)).

Direct/Indirect Transfers

Under the IRC Sec. 679(a)(1) a U.S. person’s transfer to a foreign trust includes both indirect and direct transfers, either of which classifies the U.S. person as the owner of the trust attributable to the property transferred if the foreign trust has one or more U.S. beneficiaries.

Indirect transfers include:

1. A transfer by either a foreign or domestic entity in which a U.S. person has an interest “may be regarded as an indirect transfer to the foreign trust by the U.S. person if the entity merely serves as a conduit for the transfer by the U.S. person or if the U.S. person has sufficient control over the entity to direct the transfer by the entity rather than himself.” (S. Rep. 938, 94th Cong., 2d Sess. 219 (1976)).
2. If a foreign trust borrows money or property and a U.S. person guarantees the loan, the U.S. person is making an indirect transfer to the trust.
3. An intermediate transfer to either another person or an entity that makes the actual transfer to the foreign trust is to be disregarded “unless it can be shown that the ultimate transfer of property to the trust was unrelated to the intermediate transfer. In such a case, the person making the intermediate transfer would be treated as having made the ultimate transfer directly.” See: Haeri v. Commr., 56 TCM 1061 (1989) (transfer by agent). Treas. Reg. Sec. 1.679-3 provides elaborate guidance with respect to indirect transfers.

IRC Sec. 679: U.S. Persons

IRC Sec. 679 applies only to a “U.S. person” which IRC Sec. 7701 (a) (30) defines as “a citizen or resident of the U.S.”, including a resident alien (See: Treas. Reg. Sec. 1.679-1(d); Haeri v. Commr., 56 TCM 1061 (1989); Rev. Rul. 90-106, 1990-2 (B162)). A “U.S. person” includes: a U.S. partnership or corporation, any estate other than a foreign estate (defined in IRC Sec. 7701(a)(31)(A). A U.S. person includes a “U.S. Trust” (i.e. a domestic trust) which is a trust if “a court within the U.S. is able to exercise primary supervision over the administration of the trust”, and “one or more U.S. persons have the authority to control all substantial decisions of the trust”. (Treas. Reg. Sec. 301.7701-7(a)(1).

IRC Sec. 679 only applies to transfer to a “foreign trust” (i.e. not a domestic trust) only if a trust has a U.S. beneficiary. (IRC Sec. 7701(a) (31)(B) defines a foreign trust as any trust that does not qualify as a U.S. person.

U.S. Beneficiary

Under IRC Sec. 679(c), a foreign trust always has a U.S. beneficiary unless “under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a U.S. person (IRC Sec. 679(c)(1)(A). Under Treas. Reg. Sec. 1.679-2(a)(2)(i), this determination is independent of whether there is an actual distribution of income or corpus to a U.S. person during the year. If the trust authorizes accumulations for possible distributions to any U.S. person in the future, the trust has a U.S. beneficiary throughout the intervening period. Treas. Reg. Sec. 1.679-2(a)(2)(iii), (Ex 2). Even if the only interest a U.S. person has a right to receive is corpus upon termination, the trust has a U.S. beneficiary. Treas. Reg. 1.679-2 (a)(2)(iii), Ex (3).

In addition, a foreign trust always has a U.S. beneficiary if “no part of the income or corpus” of the trust could be paid to or for the benefit of a U.S. person “if the trust were terminated at any time during the taxable year”. (IRC Sec. 679(c)(1)(B).

If any person has the authority to distribute trust income or corpus to unnamed persons generally or to any class of persons which include “U.S. persons”, the trust has U.S. beneficiaries (Treas. Reg. 1.679-2(a)(2)(i), this determination is independent of whether a U.S. person’s trust interest is contingent).

If any person has a power of appointment pursuant to which income or corpus may pass to a U.S. person, the trust has U.S. beneficiaries (Treas. Reg. Sec. 1.679-2(a)(2)(iii), (Ex 11).

If any person has the power to amend the trust so as to include U.S. persons as beneficiaries, the trust has U.S. beneficiaries (S. Rep 938, 94th Cong., 2d Sess. 219 (1976)).

Under Treas. Reg. 1.679-2(a)(4), the determination of whether income or corpus may be paid to or for the benefit of a U.S. person, the IRC consults “writings, oral agreements between the trustee and persons transferring property to the trust, local law, and the trust instrument”.

IRC Sec. 679(c)(2) provides attribution rules that can cause income paid to or accumulated for a foreign corporation, partnership, trust or estate to be treated as though it were paid to or accumulated for the benefit of a U.S. beneficiary: these attribution rules apply if a corporation is a controlled foreign corporation, as defined in IRC Sec. 957(a) (See: IRC Sec. 679(c) (2)(A)).

If a U.S. person is a partner of a foreign partnership (IRC Sec. 679(c) (2) (B)), or if a U.S. person is a beneficiary of a foreign estate or trust (IRC Sec. 679(c)(2)(C)). See: Treas. Reg. Sec. 1.679-2(b)(2) and (3), (Ex. 4 & 5).

A foreign trust has U.S. beneficiaries the day after the trust beneficiaries move to the U.S. (Treas. Reg. Sec. 1.679-2(a)(3)(ii), (Ex 1)). Under IRC Sec. 679(c)(3), a beneficiary who first becomes a U.S. person more than 5 years after the date of a transfer to a foreign trust is not a U.S. person with respect to that transfer (See: Treas. Reg. Sec. 1.675-2(d)(3)(ii), (Ex 2)).

The determination whether a trust has a U.S. beneficiary for purposes of IRC Sec. 679 occurs on an annual basis (Treas. Reg. 1.679-2(a)(1)).

If a foreign beneficiary becomes a U.S. person, IRC Sec. 679 begins to apply with the transferor’s first taxable year in which the foreign beneficiary is a U.S. person. The U.S. transferor has “additional income” pursuant to IRC Sec. 679(b) in the taxable year in which the trust acquires a U.S. beneficiary. Treas. Reg. 1.679-2(c)(1)(3), (Ex 1).

When a trust ceases to have any U.S. beneficiaries, the U.S. transferor continues to be treated as owner until the beginning of the following taxable year (Treas. Reg. Sec. 1.679-2(c)(2)(3), (Ex 2)).

Under IRC Sec. 679, with respect to a foreign trust, to which no U.S. resident has ever transferred anything, if a non-resident alien becomes a U.S. resident within 5 years of an actual transfer (Treas. Reg. 1.679-5), it is a U.S. grantor trust.

If a non-resident alien transfers property to a foreign trust and during the succeeding 5 years becomes a U.S. resident, IRC Sec. 679 applies as though the transferor had, on that later date, transferred “an amount equal to the portion of such trust attributable to the property actually transferred”. (IRC Sec. 679(a)(4)(A), which includes undistributed

net income of the trust for periods before the transferor became a U.S. resident (IRC Sec. 679(a)(4)(B)).

If a U.S. trust becomes a foreign trust, under IRC Sec. 679 the trust becomes a foreign grantor trust (Treas. Reg. 1.679-6) and IRC Sec. 679 applies as though the grantor had on that date transferred “an amount equal to the portion of such trust attributable to the property previously transferred (IRC Sec. 679(a)(5), including undistributed net income of the trust for periods before the trust became a foreign trust.” (IRC Sec. 679(a)(5)).

