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## HIRE Act Affects Foreign Trusts and Imposes Additional Requirements on U.S. Persons with Foreign Accounts

On March 18, President Obama signed the Hiring Incentives to Restore Employment Act (H.R. 2847) (the “Act”), which includes several unrelated revenue raising provisions affecting foreign entities and individuals with certain foreign assets that were originally proposed as part of the Foreign Account Tax Compliance Act of 2009.

These provisions create significant changes in the rules governing foreign trusts and their trustees, resulting in a new category of deemed distributions of foreign trust property and a broader application of the rules that treat contributors to foreign trusts as the owner of the trust for income tax purposes. In addition, there are a number of provisions that increase withholding obligations on foreign banks, trusts and other entities and impose additional reporting requirements on US persons with certain foreign assets .

**1. Use of Foreign Trust Property.** U.S. individuals who have been enjoying rent-free use of real estate owned by a foreign non-grantor trust may no longer be able to use such property free from rent without tax consequences. If the foreign non-grantor trust has current or accumulated income, the rent-free use of the property will be taxable to the U.S. person. Under this provision of the new law, which applies to uses of property after the date of enactment, such use by the U.S. grantor, U.S. beneficiary or any U.S. person related to such grantor or beneficiary after the enactment date of the Act is deemed to be a distribution of the fair market value of the use of the property to the U.S. person, unless the U.S. person using the property pays fair market rent for such use. This law also applies to the uncompensated use of artwork or other items of tangible personal property. Determining the value of the use of such tangible property will likely be problematic.

**2. Expanded Reporting Requirements in Addition to FBARs.** Under existing law, every U.S. person who has a financial interest in, or signature authority over, bank, securities or financial accounts in a foreign country must file an FBAR for each calendar year in which the aggregate value of the accounts exceeds \$10,000. For taxable years after 2010, in addition to the existing FBAR reporting requirements, U.S. individuals must now also disclose “an interest in a ‘specified foreign financial asset’” by attaching a disclosure statement to their individual income tax returns reporting any interest in the following assets if the aggregate value of such assets exceeds \$50,000: (i) depository or custodial accounts at foreign financial institutions; (ii) to the extent not held in an account at a financial institution, foreign issued stock or securities, interests in a foreign investment fund or derivatives with a foreign counterparty; and (iii) any interest in a foreign entity. Individuals who fail to make the required disclosures are subject to a penalty of \$10,000 for the tax year, which may increase to \$50,000 if the failure continues after notification by the IRS.

**3. When Foreign Trust Has a U.S. Beneficiary.** The Act contains a broad interpretation of who is deemed to be a U.S. beneficiary of a foreign trust, which may result in more individuals being treated as the “grantors” (i.e., owners for income tax purposes) of foreign trusts. Generally, 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 comprising the transferred property for any taxable year in which there is a U.S. beneficiary of that portion of a trust. Under the Act, a foreign trust will be treated as having a U.S. beneficiary if a current, future or contingent beneficiary of the trust is a U.S. person. Additionally, when any trustee or other person has

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the discretion to make distributions of trust property to or for the benefit of any person, the trust is deemed to have a U.S. beneficiary unless (1) the terms of the trust specifically identify a class of persons who may receive distributions and (2) none of the permissible distributees are U.S. persons during the applicable tax year. In determining whether a foreign trust has a U.S. beneficiary, the trust instrument will be considered along with all written and oral agreements related to the trust. This provision of the new law is effective as of the date of enactment.

4. **Presumption of U.S. Beneficiary.** When a U.S. person transfers property to a foreign trust after the effective date of the Act, the Act imposes a rebuttable presumption that the trust is deemed to have a U.S. beneficiary unless the U.S. transferor submits information to the IRS providing that no portion of the income or corpus of the trust may be accumulated or paid to or for the benefit of a U.S. person during the tax year or if the trust were terminated during the tax year.

5. **Reporting Requirements for U.S. Owners.** Under the Act, a U.S. person who is treated as the owner of all or any portion of a foreign trust has the obligation to provide such information as the IRS may require regarding the trust and ensure that the foreign trust complies with the reporting requirements for the trust set forth by the IRS. This provision of the new law applies to taxable years beginning after 2010.

6. **Penalty for Failure to Satisfy Reporting Obligation.** The Act increases the minimum and maximum penalties for the failure to satisfy the reporting obligations for foreign trusts under Section 6048 of the Internal Revenue Code. This provision of the new law applies to notices and returns required to be filed after December 31, 2009.

7. **Withholding on Payments to Foreign Financial Institutions.** For payments made after December 31, 2012, the Act provides for withholding taxes to enforce reporting requirements on certain foreign accounts owned by specified U.S. persons or U.S.-owned foreign entities. Generally, a tax equal to 30% must be withheld by a U.S. withholding agent on any withholdable payment made to a foreign financial institution if the institution does not have an agreement with the IRS under which the institution agrees to obtain certain information on each U.S. account holder and comply with various reporting and withholding requirements. This provision will result in increased disclosure of U.S. account holders by foreign financial institutions.

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## We Can Help

For more information about the new tax provisions of the HIRE Act that affect foreign entities, please contact your Katten Muchin Rosenman LLP attorney, or any member of Katten's Trusts and Estates Practice.

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