EU Updates and
Regulatory Risk Management Issues
For Trusts

Law Society of Ireland
and
Society of Trust and Estate Practitioners (STEP)

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The purpose of this lecture is to consider

- EU developments on succession and tax pertaining to estates and
- Regulatory and risk management issues pertaining to trusts.

1 Succession Legal Considerations – Cross border issues

What are 'cross border issues'? Examples include a deceased holding property in France/Spain/the UK, having a connection abroad such as being an English national yet also having lived in Ireland for many years, having beneficiaries living in Germany. What jurisdiction should apply to the succession of the assets of the Deceased from the perspective of rights of spouses and children, testamentary freedom etc.?

The EU Regulation on Succession Law (No. 650/2012), also known as "**Brussels IV**" seeks to resolve the concern that to date different member states of the European Union apply different private international conflict of law ("PIL") rules for succession purposes.

Most of the Regulation will apply from next year in respect of deaths on or after 17 August 2015. Notwithstanding this, the Regulation is relevant for practitioners now as clients have the opportunity now to make Wills that could come into effect on a death after 2015.

Ireland, the UK and Denmark have opted out of the Regulation. Nevertheless the Regulation is still very relevant for Irish practitioners because an Irish national can elect to apply Irish law for the succession of his assets which will be binding on the EU signatory members of the Regulation.

When it comes to ascertaining what law should apply to the estate of a deceased, different jurisdictions look to different connecting factors and apply their PIL rules accordingly.

The connecting factor for Ireland is the domicile of the deceased. Irish law provides that

- the *lex domicilii* determines the succession of moveable property; and
- the law of the country where the property is situate (the *lex situs*) determines the succession of immoveable property.
- The *rule of renvoi* applies so that, if jurisdiction is referred from another country to Ireland on its PIL rules and then the Irish court determines that Irish PIL rules provide that the other country should have jurisdiction, Ireland will send that jurisdiction back to that country. If however it is sent back again to Ireland, Ireland will generally accept jurisdiction.

In contrast Brussels IV provides that, between the participating member states, generally the *habitual residence* of the deceased will determine the forum that applies the succession law of that deceased. The Regulation also removes the rule of renvoi when dealing with member states (or possibly only participating member states[1]).

Brussels IV however recognises that a person may wish the *law of nationality* to apply even if the person has acquired a habitual residence in another state. The effect of a choice of law is that the internal law of the person's nationality applies and not its PIL and so the national court should accept jurisdiction. Irish practitioners should therefore consider with Irish national clients who have cross border issues whether to elect to apply Irish law to the entire estate to

[1] This is a weakness in the Regulation as it is not clear if the reference to member states in the Regulation is to all member states as they affect participating member states or only to participating member states between themselves.

avoid foreign forced heirship provisions to apply in contrast (or possibly in addition) to Irish forced heirship provisions[2].

See also my article in the Law Society Gazette December 2013 on this subject.

[2] All commentary indicates that this election would be recognised by the participating member state and it is then most likely that the Irish court, although non participating, would accept this based on the renvoi to it of jurisdiction.

2 Succession Taxation Considerations – Cross border issues

The EU Regulation of Succession above does not deal with taxation issues. There is currently no regulation on this issue leading to difficulties of double taxation and indeed multiple taxation!

Ireland has two double taxation treaties – with the UK and the US. Both relate only to inheritance tax. The tax code also permits a unilateral credit in the case of double taxation of a property where the property is located in one country and taxed on the basis of location and taxed also in another jurisdiction. For instance if the property is located in France and therefore taxed there and the property is owned by an Irish resident and therefore taxed in Ireland also. The difficulty arises if another country also seeks to tax based on another principle (e.g. habitual residence of the deceased or residence of the beneficiary) then there is no credit for the tax paid on an asset not located in that other country[3].

The OECD model for such treaties was updated in 1982[4] to address double taxation on both gifts and inheritances and marginally addressing trusts in that context. Prior to that many treaties were based on a 1966 model which only covered double taxation of inheritances (as is the case with the Irish/UK one and indeed the US one, albeit that is pre 1966.

As a general rule the 1982 model adopted the principle of the deceased's domicile but made exceptions for real property and for mobile assets belonging to a permanent establishment or with a fixed base of activities. In this model the country would have the right to tax all the successions of those domiciled in its territory, no matter where the assets were located, whether the domicile was that of the deceased or of the beneficiary. However in the EU itself there are only 33 bilateral double taxation treaties between member states dealing with inheritance tax out of a possible total of 351. The unilateral relief offered by many member states including Ireland are recognised as incomplete[5] and in some cases these are discretionary.

EU Commission has been reviewing this again in an attempt to address cross border obstacles in the EU. In 2011 recommendations were made but not made binding on member states. One such recommendation was that where a deceased and an heir have personal links with different member states, a member state with which the heir has links should give relief for inheritance tax paid in the member state with which the deceased had links[6].

Unfortunately there has been little or no impact of these recommendations on the ground[7].

The EU Commission has since issued two further consultations on cross border tax issues in early Summer 2014, principally covering income tax and inheritance tax, seeking examples of inconsistent rules in different member states leading to double taxation and discrimination against taxpayers based on their nationality or residence or discrimination against the free movement of capital across the EU.

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[3] For instance Irish resident deceased owns property in France leaving it to a beneficiary resident in Germany. Irish tax arises as the deceased died resident there, French tax arises as the property is located there, and German tax arises as the beneficiary is resident there. The German tax on the French property will not be available as a credit against the Irish tax on the French property.

[4] Model Convention on Estate, Inheritance and Gift Tax 1982 OECD MC

[5] See footnote 3 above.

[6] Thus dealing with the situation in footnote 3 above where the Irish tax would be credited against the German tax on the French property.

[7] CFE, the umbrella group representing tax professionals in Europe, has detailed how there have been no amendments to any EU inheritance tax laws in response to the European Commission's consultation in 2011 which sought to stop the unfair taxation of foreign estates.

These consultations are a follow up to the recommendations made in 2011. They recognise the right of Member States' individual taxing rights and do not require harmonisation of rules within the EU but suggest small changes to legislation or administrative measures to allow a more flexible interpretation of existing rules.

There is more information on the issues outlined in the Commission website ec.europa.eu in the section on Taxation and Customs Union - taxation - personal direct tax - inheritance tax.

3 AML, KYC, CDD, FATF and other 3 or 4 letter abbreviations (as related to trusts)

3.1 Glossary:

AML – anti money laundering – for which Irish practitioners are regulated under the EU 3rd AML Directive and the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (the "2010 Act"), Criminal Justice Act 203 and Guidelines on the Prevention of the Use of the Financial System for the purpose of Money Laundering and Terrorist Financing[8]. The latest Directive "4th AML Directive" is currently in the process of passing through the EU legislative system and is discussed below.

KYC /CDD – Know Your Client / Customer Due Diligence in the financial industry – the procedures that practitioners should adopt to verify and identify the client/customer.

FATF – Financial Action Task Force - a specialist body concentrating on the international fight against money laundering, established in 1989 by the G7 and now comprising 34 member jurisdictions including Ireland. This body has issued 'Recommendations' to take account of changing threats to the international financial system which Recommendations are intended to serve as internationally endorsed global standards against money laundering and terrorist financing and the aims of which are to increase transparency and enable countries successfully to take action against illicit use of their financial systems. FATF has established typologies essentially to study methods and trends in money laundering to aid in better understanding the threats. It also evaluates its member countries and imposes sanctions on members; Ireland was last reported on in June 2013[9]. The 4th AML Directive was drafted in response to FATF's updated Recommendations.

3.2 Current legislation – 3rd AML Directive and 2010 Act

The principles of customer identification, verification and monitoring are at the heart of KYC. General guidelines issued under the 2010 Act and specific guidelines for professionals including solicitors have also issued[10]. These guidelines seek to establish an industry standard and may be taken into account by a court in assessing whether a designated person has fulfilled his statutory obligations[11]. Indeed practitioners are aware that these procedures are also checked by professional indemnity insurers in assessing risk management for a solicitor's practice.

The legislation and guidelines adopt a risk based approach whereby the process of customer checking is meant to be more than a document collection exercise at the outset of a business relationship but rather a process spanning the duration of business dealings. This requires practitioners to discriminate between different customers and activities and to use their own 'good judgement'. In effect this expects practitioners to apply formal procedures but also step back and assess a situation giving them room to 'smell a rat'! 'Warning bells' in the mind of the practitioner are not expected to be ignored – further inquiries should be made and reasonable suspicions reported. Typically this will result in a high, medium or low profile categorisation of the client based on the assessment made, however the importance is to ensure the assessment is reviewed regularly throughout the business relationship[12].

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[8] Department of Finance publication.

[9] As Ireland has been moved to the level of 'largely compliant' it is no longer on the regular follow up process list.

[10] S.107 Act 2010 power of Minister for justice and Equality to issue guidelines.

[11] S107(2) Act 2010 provides a defence to an offence under the Act for the defendant to prove that s/he took all reasonable steps and exercised all due diligence to avoid committing the offence. S 107(3) provides that the court may have regard to any guidelines applying in determining such steps and diligence.

[12] At least annually. See para 4.23 Guidance notes for Solicitors in AML Obligations 2010, where it is noted that for some clients the risk profile can become more evident once the business relationship has begun.

Identification of beneficial owner should be the issue most prevalent in the mind of the practitioner dealing with trusts. Beneficial owner means any individual who ultimately controls or owns a customer or on whose behalf a transaction is conducted[13]. Broadly this is anyone who has an interest in any relevant property of 25 per cent or more. The control may be exercised by means of a chain of natural or legal persons. However the difficulty arising from identifying the ultimate beneficial ownership has resulted in the changes being brought through under the 4th AML Directive in the context of public registers.

More specifically at present practitioners should, prior to starting a business relationship concerning a trust, seek to comply with the obligations set out in the legislation[14] in respect of customers and the beneficial owners of its customers. Practitioners should

- assess the source of the funds;
- assess the type of customer and business relationship involved; and
- assess the purpose and intended nature of the business relationship.

Each relevant individual should then be identified and verified[15]. In the case of trusts it is recommended that where the practitioner assesses the risk to be standard, he should identify all

- trustees,
- protectors and
- other persons who hold powers of appointment over the trust fund or have power to give instructions to operate accounts of the trust funds.

If the matter relates to 'politically exposed persons' (as defined), further special procedures will need to be adopted.

There is a further obligation to identify the beneficial owner connected with the customer or service concerned and to understand the ownership and control structure of the entity or arrangement concerned[16]. A beneficial owner of a trust is any of the following

i. Any individual who is entitled to a vested interest in possession, remainder or reversion, whether or not the interest is defeasible, in at least 25% of the capital of the trust property;
ii. In the case of a trust other than one that is set up or operates entirely for the benefit of individuals referred to in paragraph (a), the class of individuals in whose main interest the trust is set up or operates;
iii. Any individual who has control over the trust[17].

Practitioners should identify beneficial owners of a trust but need only verify their identity where reasonably warranted under the risk assessment procedure[18]. Where a beneficiary is entitled to less than 25% of the trust, provided they do not have control over the trust, then they only need to be identified by reference to the class of individuals entitled under the trust and therefore no verification of such identity should be required at least until payment from the trust to a particular beneficiary. Thus beneficiaries in the class of a 'pure' discretionary trusts should be identified but that identity should not need to be verified.

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[13] Ss. 26-30 Act 2010
[14] S. 33 Act 2010
[15] By means of documentary evidence giving photographic proof and proof of current addresses by seeing original (or certified copies of) documents from a prescribed class of documents and keeping copies of these (the typical passport and utility bill requirement).
[16] S.33(2)(b) Act 2010
[17] Control is defined in s. 28(4) and (5) Act 2010
[18] Ss. 28(2) Act 2010 and 33

3.3 Proposed legislation – 4th AML Directive

The 4th AML Directive continues the risk focused approach and was initiated to take on board the revised standards set by FATF in February 2012. The directive as initially drafted by the European Commission closely followed the FATF revised Recommendations[19]. However the European Parliament agreed a report in March 2014 whereby the Commission's draft was substantially amended putting greater onus on practitioners dealing with trusts by the introduction of a public register. The EU Council agreed a general approach in June 2014[20] attempting to meet some of the points raised at Parliamentary level but also recognising the difficulties presented by the more onerous amendments suggested. The matter is now back with the Commission to produce a compromise text.

The 4th AML Directive introduces the requirement to oblige trustees to keep and maintain accurate and current information on beneficial ownership of the trust. This information would include the identity of the settlor, trustees, protector, beneficiaries or class of beneficiaries and of any other natural person exercising effective control over the trust.

Now the number of persons to be identified appears to have increased from the 3rd AML Directive. Again each relevant individual should then be identified and verified[21]. In the case of trusts it is recommended that, where the practitioner assesses the risk to be standard, he should identify all individuals who are directly or indirectly

- settlors,
- trustees,
- protectors,
- identifiable beneficiaries, and
- other persons who exercise effective control over a trust such as by holding powers of appointment over the trust fund or power to give instructions to operate accounts of the trust funds.

Furthermore trustees will now be obliged to disclose their status as trustee to obliged entities with which they form a business relationship.

There has been substantial lobbying carried out by STEP and the Law Society in Ireland[22] and STEP UK on the 4th AML Directive from a trust practitioner's perspective to the extent the amendments suggested by Parliament would result in great difficulties for the use of trusts in both jurisdictions. The above additional checks are welcomed for AML protection purposes but concern rests principally on the matter of beneficial ownership registers for both trusts and companies.

The 4th AML Directive in its current form proposes two forms of registers, that for companies and that for trusts. There is a separate debate in relation to the question of a register for companies. The purpose of this lecture is to address the issue of a register for trusts.

To date it is sufficient for a practitioner to keep details of the relevant trust and notify any suspicious transaction to the authorities. Now there is a move to report interests on returns for the purposes of a register which may become a public register. This is concerning for private family trusts.
Given that information on Irish trusts will already be available to the Irish governmental authorities via

[19] February 2013 http://bit/ly/1e7wOGI
[20] June 2014 http://bit/ly/1polL9b
[21] By means of documentary evidence giving photographic proof and proof of current addresses by seeing original (or certified copies of) documents from a prescribed class of documents and keeping copies of these (the typical passport and utility bill requirement).
[22] See joint submission dated January 2014 http://www.step.ie/law-society-and-step-joint-submission-on-the-4th-anti-money-laundering-directive

- the 2010 Act in relation to any identified suspicious transactions carried out using the AML risk assessment procedures
- the registration of the trust if it holds assets under form TR1,
- the registration of discretionary trusts under section 46(15) Capital Acquisitions Tax Consolidation Act 2003,
- the obligations of practitioners to report under section 896A Taxes Consolidation Act 1997,
- the information provided under from CA24 (Inland Revenue Affidavit) at Part 6 Question 10 in the case of Will trusts,
- the expected regulation of charitable trusts under the Charities Act 2009 and the registration of these anyhow with Revenue to obtain charitable tax status,
- the extensive regulation of pension trusts and reporting obligations to the Irish Pensions Board, Central Bank for UCITS and Unit Trusts,

it is frustrating that there may be a need for a further register in relation to trusts and it is very concerning if that register is to be made public. All of this appears disproportionate and indeed limited in its effectiveness quite apart from being an unnecessary cost on trusts.

There is a perception that trusts are not transparent and so must be elusive and abusive. This perception seems to stem from the fact that the public nature of the register is being promoted by European parliamentarians from the civil law jurisdictions of the EU and it goes far beyond what FATF had ever suggested in their Recommendations. There appears to be a shift in focus in the 4th AML Directive from purely protecting the financial system from the infiltration of illicit funds (including the proceeds of tax evasion) to a new tool for the collection of publically available data.

Already there has been mention that in certain risk assessed circumstances the trust deed and letters of wishes might have to be registered. Compromise suggestions are that trusts would only be registered on a risk assessed basis.

Watch this space!

4 Exchange of Information - FATCA Ireland and Trusts

The Foreign Account Tax Compliance Act (FATCA) was signed into US law in March 2010, effective from January 2013 as part of the US Hiring Incentives to Restore Employment (HIRE) Act 2010. Its purpose is to increase revenue to the US Internal Revenue Service (IRS) by identifying offshore US accounts that could be used for tax evasion by US residents. It requires institutions outside the US to pass information to the US tax authorities.

While the legislation is controversial, it is being accepted by many countries[23]. The threat of withholding of 30% tax on institutions with investments in the US[24] and penalties for the institutions appears to have spurred its implementation outside the US.

Ireland concluded an inter-governmental agreement (IGA) with the US to better facilitate the implementation of FATCA and to provide a reciprocal exchange of information regarding US Financial Accounts held by Irish residents. This IGA was imported into Irish law under Finance Act 2013[25]. The Irish US IGA is based on a model[26] whereby institutions are required to report information directly to the Irish Revenue Commissioners rather than to the IRS and where Ireland then annually automatically exchanges information with the US in respect of reportable accounts. However Financial Institutions (FFIs) as defined must still register with the IRS being directly to obtain a Global Intermediaries Identification Number (GIIN)[27] before the IRS list is published on 31 December 2014. To ensure the FFI is on this list, registration should be completed ***before 24 October 2014***. This is the last practical date to meet that deadline.

In May 2013 Irish Revenue Commissioners circulated draft guidance notes on the implementation of FATCA in Ireland and draft Financial Accounts Reporting Regulations 2013. These were updated in January 2014 again in draft form inviting observations and comments however no formal Guidance notes are yet available[28]. Reporting Regulations were published in June 2014 to implement FATCA in Ireland with effect from 1 July 2014.[29]

4.1 Summary for trusts

FATCA has implications for trusts and estates whether operating in the US or outside. In the case of trusts, they will likely be either a Financial Institution (FFI also known as an FI) for the purposes of the legislation or an NFFE. The category a trust falls into depends on both the nature of the trust assets and the nature of the trustees. Which category a trust falls into

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[23] All G7 countries, 42 countries hold IGAs and 59 jurisdictions have reached agreements in substance. Model 1, which Ireland has adopted, is reciprocal whereby the US will also share information to the partner country. However Latin America, the Middle East and China have not yet complied and may resist. A fall out is that many institutions are refusing to do business with known Americans because of the compliance costs and enhanced risks. There is also the huge administrative costs associated with compliance. More recently there has been a constitutional challenge taken against the IGA between Canada and the US based on the Charter of Rights and Freedom (privacy, search and seizure) and sovereignty issues including the division of federal and provincial powers in Canada.
[24] FATCA obliges all US paying agents to withhold tax of 30% from payments of US source income that are made to any non-US Financial Institution unless that institution has entered into an agreement with the US IRS to directly report certain information on Account Holders who are US persons. Under the IGA Irish Financial Institutions will not be subject to the 30% withholding tax on US source income provided they comply with the requirements of the Irish legislation.
[25] S. 104 FA 2013
[26] Model IGA published 26 July 2012, Model I similar to the model adopted by the UK, Denmark and Mexico.
[27] Using Form 8957 see Appendix
[28] See www.revenue.ie/en/business/international-tax
[29] S.I. 292/2014

defines the level of reporting, who needs to report for the trust and whether registration is required for either the trust or the trustee.

The status of a trust depends on various factors but ***NOT*** on whether the trust has ***US connections to the settlor, beneficiaries or the ownership of US assets.***

As a trust will need to declare its status to any Financial Institution with which it has dealings (banks, stockbrokers etc.), the trust will need to determine its own status and either claim exemption, register as a Financial Institution (and then report itself) or self-certify that it is an NFFE.

If it is a Financial Institution the trust must be registered and obtain a GIIN and use this number as evidence for other Financial Institutions that it is FATCA compliant. It must then complete a due diligence on the composition of its trust and file a return detailing information about US residents/citizens who are beneficiaries or control the trust or file a nil return annually if there are no US connections as beneficiaries or controllers.

If it is not a Financial Institution it must determine if it is a passive NFFE as defined and self-certify this on a form W-8[30] for giving to Financial Institutions with which they hold accounts to avoid those institutions withholding 30% tax.

If the trust does not hold a Financial Account however this should be noted on the trust file to explain why the trust has not either registered as a Financial Institution or self-certified as a passive NFFE.

Once the trust has determined its status, a note of this should be kept with the trust deed. The status can change if circumstances change.

4.2 The Formal Details

Various questions must be asked of the trust/estate entity to know if it requires registration, reporting, self-certification or need do nothing at all other than note its position on the file.

4.2.1 Is the entity Irish resident?

The IGA applies to trusts resident in Ireland.

Revenue have confirmed that 'normal residence rules for trusts apply for the purposes of FATCA'. However different criteria apply in determining the residence of a trust under various tax heads. It had been assumed that the CGT test of residence under Section 54 Taxes Consolidation Act 1997 would be the relevant criteria to use in the context of the IGA and Revenue have indicated in correspondence that in the case of some trustees being resident outside Ireland in effect some of the CGT tests apply. However unusually the residence of the settlor appears to apply in the case of professional trustees[31].

If the trust is not Irish resident, it is not subject to Irish IGA reporting but may still need to report under the US FATCA regulations or under another IGA.

4.2.2 Is it a Financial Institution (also known as an FFI – Foreign Financial Institution)?

A ***Financial Institution*** is defined as a Custodial Institution, Depository Institution, Investment Entity and a Specified Insurance Company. In the case of trusts and estates it is likely that the

[30] Form W-8 See Appendix

[31] Per Revenue correspondence with STEP Ireland: If all trustees are Irish resident – trust is Irish resident. If some trustees are non-Irish resident – trust is Irish resident if effective administration of trust in Ireland. Professional trustees – residence of the settlor at the time the trust is established is attributed to the trust.

category ***Investment Entity*** will apply to these entities. This category includes an entity that is managed by an entity that conducts as a business one or more of various activities on behalf of a customer (Account Holder) including individual and collective portfolio management and investing, administering or managing funds or money on behalf of other persons. If the entity's gross income from such activities equals or exceeds 50% of the entity's gross income during the shorter of two periods[32] then it is deemed to be an Investment Entity.

Therefore the trust will be an Investment Entity if it engages another Financial Institution such as a stockbroker to manage the trust or financial assets on its behalf on a discretionary basis. This is not however entirely clear and the Irish Revenue guidance notes do not clarify what is meant by these professionally managed trusts. Perhaps the latest update to UK guidance notes on their similar position is therefore helpful which indicates that 'a trust is professionally managed

- Where trustees have appointed a Financial Institution to carry out the day to day functions of the trust beyond just the managing of investments; or
- Where the Financial Institution manages the financial assets and manages the investment strategy.'

Therefore if the trust merely holds a Financial Account and there is no participation by the Financial Institution holding that account, this does not make the trust itself a Financial Institution. Thus trusts placing trust funds on advisory accounts with investment managers would not seem to make the trust itself a Financial Institution.

4.2.3 <u>Is it a Reporting Financial Institution or Exempt/Deemed Compliant?</u>

The Financial Institution then must decide if it is a Reporting Irish Financial Institution or a Non Reporting Irish Financial Institution. A ***Reporting Irish Financial Institution*** is any Irish resident Financial Institutions unless it is exempt from FATCA reporting or deemed compliant for FATCA purposes under Annex II of the IGA or under US Regulations.

Exemption from reporting is categorised under Annex II Part I and includes NTMA, NAMA, Central Bank, and Irish offices of EU institutions or the European Investment Bank and certain retirement funds.

Deemed Compliant Entities are those entities such as sporting and charitable bodies, pension trusts, financial institutions with a local client base, certain collective investment vehicles all listed in Part II of Annex II of the IGA where they are categorised as ***Self Certified Deemed Compliant Financial Institutions*** which, in general need not register with the IRS, nor will such an entity have any reporting obligations in relation to any Financial Accounts it may have claim the exemption in the first place[33].

Charitable trusts would therefore fall into this category and not require registration or reporting.

Other trusts that are already established under the above criteria as Investment Entities and therefore as Financial Institutions are then treated as Reporting Financial Institutions.

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[32] The three year period ending on 31 Dec of the year preceding the year in which the determination is made or the period during which the entity has been in existence.

[33]See Revenue Guidance Notes issue dated January 2014 at Chap 2 para 3B. Self-Certified Deemed Compliant Financial Institutions. Clarification has been sought by STEP Ireland with the Irish Revenue on whether these bodies need concern themselves at all with FATCA. The Guide currently provides that 'unless specifically stated' the body will not have to register or submit returns or carry out due diligence under FATCA and are deemed self-certified Deemed Compliant Financial Institutions. If the body has US source income it should supply the US payor with self-certification in a particular form to avoid US FATCA withholding tax on that income.

If the trust is a Reporting Financial Institution because it is managed by a Financial Institution, but that Financial Institution is not the trustee, the trust will be required to register as an Investment Entity unless the trust is able to take advantage of the ***Sponsored Investment Entity*** or the ***Owner Documented Financial Institution*** category.

4.2.4 Does the Financial Institution hold a Financial Account?

A ***Financial Account*** is an account maintained by a Financial Institution including equity/debt interests in an Investment Entity. A Financial Institution does not however automatically have Financial Accounts.

Therefore if the trust is a Financial Institution, it needs to assess if it holds any Financial Accounts. Likewise if the trust is not a Financial Institution but holds an account with a Financial Institution, that Financial Institution must assess if the trust account is a Financial Account. For example if the Financial Institution is acting as an executing broker (e.g. not acting on a discretionary basis but only on an advisory basis) then this facility will not be treated as a Financial Account.

The accounts of deceased persons are not treated as Financial Accounts on the condition that the death is noted by the Financial Institution (e.g. the death certificate is noted on the account) the account will not be treated as a Financial Account and so it is not reportable by the estate in the year of death or subsequently.

There may still be a need to identify the controlling person of the trust or estate (if the entity is a Passive NFFE) by virtue of the self-certification route, see below.

An account held by a Financial Institution for a non-financial intermediary (e.g. a solicitor or estate agent) established for the purposes of

- a court order, judgement or other legal matter where the solicitor/estate agent is acting on behalf of their client or
- a sale, lease, exchange of real or personal property with various conditions applying for compliance purposes

is not a Financial Account. It is an ***Intermediary Account (Escrow Account).*** A person holding a Financial Account for another person who himself is not a Financial Institution is not treated as an Account Holder. This applies for nominees, agents, signatories, intermediaries, custodians. Where a parent opens an account for a child, the child (not the parent) is the Account Holder unless it is an Intermediary Account (Escrow Account).

Exempt accounts are listed in Annex II of the IGA and generally relate to pension type accounts, profit sharing schemes and ESOTs. If the account is an exempt account, it is not a Financial Account.

Where the account is not a Financial Account it would appear that it is not reportable nor is there a requirement for registration or a ‘nil return’ in respect of this.

4.2.5 Does the Financial Institution hold a Reportable Financial Account?

A Reportable Financial Account is a Financial Account that is not exempt, is held by one or more ***Specified US persons*** or by a passive NFFR with one or more controlling persons that are Specified US persons and is maintained by a Reporting Financial Institution.

Where the Financial Account is not a Reportable Financial Account, as the Account Holder is not a Specified US person, the Reporting Financial Institution must make a *nil return*.

4.3 What should be reported and how?

The reportable information for Financial Institutions that maintain Financial Accounts covers:

- Name, address and US tax identification number (TIN) of each Account Holder who is a Specified US Person;
- Account number;
- Name and identifying number of the reporting Irish institution;
- Account balance or value; and
- Amounts paid gross to the Account Holder and received gross by the account holder.

If it has been established that an Account Holder is a US person, the Financial Institution must obtain a US TIN number for that person. There are various provisions in relation to pre-existing and new accounts in this respect. The accounts are reportable if not exempt for all subsequent years unless the Account Holder ceases to be a US person. There are certain de minimis amounts exempting reporting (e.g.USD50,000 or less for deposits)

Where a trust or an estate is listed as the holder of a Financial Account, the trust is to be treated as the Account Holder rather than any owner or beneficiary.

In the case of a trust which is a Financial Institution, unless it avails of the Sponsored Investment Entity or the Owner Documented Financial Institution category, the trust will need to report in respect of persons who are the beneficial owner of all or a portion of the trust, persons who are beneficiaries entitled to mandatory distributions from the trust (directly or indirectly) and the persons who are beneficiaries who receive discretionary distributions from the trust in the reporting period.

This information must be exchanged by Ireland within 9 months after the year end to which the information relates, although 2013 information will be reported with 2014 information ***by 30 September 2015***. Otherwise the Financial Institution is not FATCA compliant and categorised as a Non-Participating Financial Institution. In the case of Irish Financial Institutions, this will apply to those who do not comply with the guidelines and legislation.

It is possible for a trust which is a Financial Institution to provide a Designated Withholding Agent[34] with all relevant information and arrange that this agent reports to the IRS/Irish Revenue on behalf of the trustee.

The identification of the Account Holder may become an issue as the Financial Institution is expected to apply due diligence procedures to identify the Account Holder to ascertain if s/he/it is a Specified US Person[35].

A person is a US person if s/he/it is resident in the US or a US tax citizen. A trust is a US person if

- a court within the US would have authority under applicable law to render orders or judgments concerning substantially all issues regarding the administration of the trust; and
- one or more US persons have the authority to control all substantial decisions of the trust or an estate of a decedent that is a citizen or resident of the US.

[34] Such as a participating Financial Institution who agrees to undertake the additional due diligence and reposting required under the US Regulations to treat the Financial Institution as an Owner Documented Financial Institution and so the entity itself need not register with the IRS. If a Financial Institution relies on a third party service provider to fulfil its obligations under FATCA the obligations remain that of the Financial Institution which remains accountable.

[35] As set out in Chapters 7 – 10 of the Guidelines

The due diligence process requires that

- the Financial Institution identifies certain defined US indicia linked to an Account Holder[36] or
- the Account Holder self-certifies their status to the Financial Institution.

Financial Institutions can rely on self-certification in the following circumstances. Typically this is done on a US form known as an IRS Form W-8 or W-9[37].

For Individual Account Holders

This allows a person to confirm that s/he is not resident in the US and not a US tax citizen for new accounts and if, by using the Financial Institution's existing KYC procedures for anti-money laundering purposes, the confirmation is seen to be reasonable, provided the confirmation is checked against other records of that person, then this is acceptable. For existing accounts, if indicia suggest the Account Holder is a US person further inquiries are required to establish the veracity of the self-certification and this also depends on the level of funds in the Account (ref. low value and high value accounts).

For Entity Account Holders

If the entity is identified as a Specified US Person then the account is reportable unless self-certification determines it is not such a person. Generally there is no de minimis amount for this.

If the Financial Institution is not an Irish Financial Institution (or one of another recognised state) then the Financial Institution needs to establish if the entity is a Certified Deemed Compliant Financial Institution (as mentioned above), an Exempt Beneficial Owner or an excepted FFI. If the entity is a Passive NFFE the Financial Institution must obtain a self-certification from the Account Holder to establish its status unless information is publically available or already in its possession whereby it can be reasonably determined to be an active NFFE. If the trust is identified as a passive NFFE the Financial Institution must consider if any of the controlling persons of that entity are a US citizen or tax resident in the US and in this regard can rely on KYC information already gathered for those accounts holding less than USD1 million or in the case of accounts balances exceeding that, the Account Holder or the controlling person can self-certify.

4.4 Non-Financial Foreign Entity (NFFE)

Where a trust is not a Financial Institution and holds a Financial Account with a Financial Institution, it will be a Non-Financial Foreign Entity (NFFE).

In such cases the trust is required to prove a self-certification to the Financial Institution in relation to its status as a Passive or Active NFFE as applicable so that the Financial Institution with which the trust holds a Financial Account can carry out due diligence for that NFFE.

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[36] Indicia include –
- Identification of the account holder as a US resident or citizen,
- unambiguous indication of a US place of birth,
- current US mailing or residence address,
- current US telephone number,
- standing instruction to transfer funds to an account maintained in the US,
- current effective power of attorney or signatory authority to a person with a US address,
- a 'care of' or' hold mail' address (where the review of paper records will then need to be carried out).

[37] See Appendix

A passive NFFE is an NFFE that is not active. An active NFFE is any NFFE that meets one of the various criteria, including that less than 50 per cent of the NFFE's gross income for the preceding calendar year or other appropriate reporting period is passive income and less than 50 per cent of the assets held by the NFFE during the preceding calendar year or other appropriate reporting period are assets that produce or are held for the production of passive income. For FATCA purposes, income received on assets used as capital in general insurance business should be treated as active rather than passive income. It is not however entirely clear what is deemed to be passive income.

Where a passive NFFE has controlling persons or beneficiaries that are US persons then its accounts will be reportable accounts but it is the Financial Institution that holds these accounts that will be required to report on the accounts. The trust will need to provide the details to the Financial Institution.

5 Practical Approach

It is expected that most Irish family trusts would either be

- Financial Institutions (where the trust fund is managed by a Financial Institution on a discretionary basis); or
- Passive NFFEs (as the greater part of the income will be passive).

On this basis the following checklist would be useful for practitioners dealing with trusts.[38]

- Is the trust resident in Ireland? If not, this is not of concern under the Irish IGA but may be under the FATCA regulations that pertain to the place of its residence. If it is Irish resident, then continue to the next question.

- Is the trust a charity? If so, it is exempt under Annex II and does not need to register or report under the Irish IGA.

- If the trust is a Financial Institution then it should register and report directly or appoint a third party to report for it.

- How is it determined if it is a Financial Institution?

    - Is it managed by professional trustees[39]? If so, it is a Financial Institution.

    - Does the trust have financial assets where more than 50% of its income comes from investing, reinvesting or trading in such investments? If not, then it may not be a Financial Institution. If the income has reached this threshold, then the trust is a Financial Institution.

    - Does the trust engage an adviser to manage its funds on a discretionary basis? Even if the trust does not have more than 50% of its income derived from its investments, it is a Financial Institution.

    - Does the trust have a corporate trustee which is in itself therefore a Reportable Financial Institution? If so, the corporate trustee should report on behalf of the trust (where the trust itself does not register or report). The corporate trustee must also register and report as a Financial Institution itself. This trust itself is then an 'Owner Documented Trust'.

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[38] STEP UK have provided a very useful flowchart for the UK/US IGA which is very similar to the Irish/US IGA. They have also provided useful practical examples and a Guide.

[39] An entity carrying on business in Ireland where more than 50% of its gross income is attributable to trading in money market instruments, portfolio management or the investment and administration of funds.

- If the trust is not a Financial Institution then it will be a NFFE and it does not need to register or report. However it will need to self-certify on a form W8 that it is a passive NFFE or consider if it is an active NFFE.

6 Conclusion

All Irish trusts and trustees, whether or not they have any known US connections, need to consider their status under the Irish/US IGA. If they are required to register, they must do so by 25 October 2014. Otherwise there will be withholding from 1 January 2015 and potential penalties.

Financial Institutions with whom the trusts hold funds will be expecting each trust to produce a GIIN registration number that the trust is registered before 1 January 2015 or produce a certificate that confirms its status. It is likely that these procedures will arise as part of the Financial Institutions KYC procedures (either on their review of their procedures for existing accounts or on the initial set up of the accounts).

Failure to confirm the trust's status will leave Financial Institutions (including potentially the trusts themselves) open to penalties and will leave trusts vulnerable to withholding as payees.

Practitioners should identify and classify the entities comprising their practice and the client entities such as trusts with which they are connected. The terms of engagement for a practice should be amended to reflect that practitioners will need to consider FATCA and any necessary reporting on behalf of the trust as a client in respect of any dealings with that trust. If you are acting for trusts you will need to advise your clients, the trustees, of their reporting requirements including future reporting in a change of circumstances. If practitioners themselves or their partners are trustees, they need to be aware of what reporting requirements a trustee has immediately and on an ongoing basis.

- Any entities that are identified as Financial Institutions should be registered for a GIIN from the IRS before 24 October 2014.

- You should put in place adequate systems to identify and record US persons - this identification is required now even if reporting is not required until 2015. Such reporting will be made to the Irish Revenue Commissioners. There will either be a nil return filed or a return detailing the US persons who are beneficiaries or control the trust.

- Any entities that are identified as passive NFFEs will be asked by Financial Institutions in due course to confirm it is an NFFE using a form W8 so that the Financial Institution can operate the account for that entity.

- In such a case the Form W8 will allow the entity to list out the US persons relevant to the trust.

- Any changes to the status of the trust, the trustees or the beneficiaries of the trust will need to be notified.

Appendix

Form 8957

Form W-8-BEN –E

Form W-8BEN-indiv