COMMENTS OF THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL ON PROPOSED FBAR REGULATIONS

May 3, 2010

This report comments on those provisions of the proposed regulations under 31 CFR Part 103 (RIN 1506-AB08) that deal with the requirements imposed on trusts and estates and their fiduciaries and beneficiaries to file annually the Report of Foreign Bank and Financial Accounts, Form TD F 90-22.1 (hereinafter referred to as "FBAR").

The proposed regulations, which were published by the Financial Crimes Enforcement Network (FinCEN) on February 26, 2010, reflect several of the suggestions contained in comments submitted to the Internal Revenue Service and to FinCEN by the Real Property Trust and Estate Law section of the American Bar Association on October 9, 2009. These comments were submitted in response to the Internal Revenue Service's request for comments in Notice 2009-62.[1] We believe that the proposed amendments will be helpful to trusts and estates and their fiduciaries and beneficiaries who are attempting to comply with the FBAR requirements, but would like to suggest further issues that should be clarified. These issues are discussed below.

Definition of United States person

Disregarded entities and grantor trusts.

Section 103.24(b) of the proposed regulations defines a "United States person" to include a trust "created, organized, or formed under the laws of the United States, any state, the District of Columbia, the Territories and Insular Possessions of the United States or the Indian Tribes." This definition applies to an entity regardless of whether an election has been made under 26 CFR §301.7701-2 or §301.7701-3 to disregard the entity for federal income tax purposes.

The proposed regulations are not clear whether a trust that is treated as wholly owned by another person under §§ 671-679 of the Code[2] is required to file an FBAR. The deemed ownership does not result from an election under the §7701 regulations. Rather, under Revenue Ruling 85-13[3], a person who is treated as the owner of a trust under the grantor trust rules is treated as actually owning the assets held by the trust. Under such circumstances, if the grantor or other owner is a United States person, it is the grantor or other owner who should have the obligation to file the FBAR rather than the trust itself. If the grantor is obligated to file an FBAR, filing by the trust would be duplicative.

If the grantor or other owner is not a United States person, then it is unclear why an FBAR should be required at all. Certainly reports are not necessary to enforce the United States tax laws because the nonresident alien is generally not taxable on income from foreign financial accounts. Requiring an FBAR in such cases discourages nonresident aliens from using United States trust law and United States trust companies. Although the use of a United States trust company also would require an FBAR by the trustee, the level of reporting is lessened, because most United States trust companies that attract the business of nonresident aliens will have signature authority over or financial interests in more than 25 foreign accounts.

Definition of United States trust.

The proposed regulations define an individual as a United States person if she is a citizen or a resident alien under the rules of §7701(b), but defining "United States" as provided in 31 CFR 103.11(nn) rather than as in 26 CFR 301.7701(b)-1(c)(2)(ii). The determination of whether an entity, including a trust, is a United States person does not rely on the definitions provided in the Internal Revenue Code. Instead, an entity "created, organized or formed" under the laws of the United States or any state, the District of Columbia, or any territory is treated as a United States person.

The determination of whether a trust or estate is a United States person should be made by applying the rules of the Internal Revenue Code. Section 7701(a)(30) defines a trust as a United States person if (i) a court within the United States is able to exercise primary supervision over the administration of the trust; and (ii) one or more United States persons have the authority to control all substantial decisions of the trust. We do not believe that different definitions should be used for tax and FBAR purposes. Using different definitions to determine whether a trust is a United States person creates confusion. In addition, unless the United States has jurisdiction over the trustee, the filing requirement will be difficult to enforce. When the trustee is a United States person, so that jurisdiction is not a problem, requiring the trust to file FBARs is duplicative, as discussed below.

Trustee vs. trust filing.

If the trustee is a United States person, the trustee would be required to file an FBAR if the trust has a foreign account because the trustee would have signature authority over the foreign account and, under the proposed regulations, would also have a financial interest in the foreign account if the account is titled in the name of the trustee. It is unnecessary for the trust itself to have another FBAR filing responsibility. If there is no United States trustee, then the FBAR filing responsibility will be

unenforceable because the United States has no jurisdiction over a foreign trustee. Therefore, there should be no separate mandatory FBAR filing required for a trust (elective filings that are made in order to eliminate the need for beneficiaries to file FBARs, as discussed below, should be available). FBARs should be required only when the trustee is a United States person because, as a practical matter, that is the only circumstance in which filing requirements may be enforceable.

Defining when a person has a "financial interest" in an account owned by a trust

Section 103.24(e)(2)(iii) of the proposed regulations provides that a United States person has a financial interest in an account for which the owner of record or holder of legal title is a trust if–

"[T]he United States person is the trust settlor and has an ownership interest in the account for United States federal tax purposes. See 26 U.S.C. 671-679 and the regulations thereunder to determine if a settlor has an ownership interest in a trust's financial account for a year."

The proposed regulations fail to define "settlor." To avoid evasion of the FBAR filing obligation, we suggest that the term be changed to "grantor or other owner" and that the FBAR regulations make reference to Treasury regulation §1.671-2(e) for the definition of grantor. This definition includes a person who creates a trust (a settlor) as well as a person who makes a gratuitous contribution to a trust (a grantor). Under 26 U.S.C. 678, a person who is not the grantor of a trust may be treated as the owner of a trust.

Section 103.24(e)(2)(iv) of the proposed regulations provides that a person has a financial interest in an account for which the owner of record or the holder of legal title is a trust if a United States person either has a beneficial interest in more than 50 percent of the assets or receives more than 50 percent of the income. We appreciate the addition of §103.24(g)(5), which waives the filing requirement if the trust, the trustee or agent of the trust is a United States person that files an FBAR. However, guidance is needed for determining when a person has a more than 50 percent beneficial interest in a trust, because a beneficiary may be required to file an FBAR if the trust, the trustee, or agent does not file an FBAR. The determination of beneficial interest in a discretionary trust is particularly difficult.

Section 103.24(e)(v) of the proposed regulations provides that a person has a financial interest in an account for which the owner of record or the holder of legal title is a trust if a United States person "established" the trust and appointed a trust protector that is subject to such person's direct or indirect instruction. Citing the 2006 report of the Senate Permanent Subcommittee on Investigations (PSI), Committee on Homeland Security and Governmental Affairs, "Tax Haven Abuses: the Enablers, the Tools and Secrecy," Senate Hearing 109-797, 109th Cong., 2d. Sess. (August 1, 2006), footnote 14 of

the preamble says that arrangements such as trust protectors have been employed by United States taxpayers to achieve substantial control over assets held in offshore trusts:

"In some cases trust protectors serve to safeguard trust assets from misappropriation. However, many offshore trusts are established with the intention of maintaining client control. In such cases trust protectors can serve as conduits of the client's instructions to the trustees, with the trustees merely rubber stamping the protectors' directions. Such an arrangement permits greater client control while maintaining the appearance of trustee independence."

The focus on the role of a "protector" is unfortunate. Whether a trust has a protector or not, or whether another individual with a different denomination is used to oversee the administration of a trust, are beside the point. We think that the objective of the FBAR regulations is to require an FBAR report where a grantor has retained control over the trust. Such control may exist regardless of whether there is a protector. For example, the trustee may be unreasonably compliant with the grantor's instructions.

It is insufficient under the proposed regulations to require filing an FBAR simply because the trust has a protector, and we agree that the proposed regulations are correct in this respect. The proposed regulations say that reports are required only if the protector "is subject to such [United States] person's direct or indirect instruction." However, no guidance is offered to determine when a person is considered to be "subject to" another's "instruction." After many decades of trying to determine when a grantor has retained sufficient control over a trust to be treated as the owner of trust assets for income tax purposes, Congress enacted §671 to employ a bright line test. Section 671 provides "No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart." We suggest that the same bright line standards that are used for income tax purposes be used for FBAR purposes.

Under Revenue Ruling 95-58[4], a grantor is not treated as having the powers held by a trustee except where the grantor retains the right to remove and replace the trustee with a person who is a related or subordinate party as defined in §672(c) of the Code. The same rule should be used for FBAR reporting.

Trust as the Owner of Record or Holder of Legal Title

The predicate for applying any of proposed §§103.24(e)(2)(iii) through (v) is an account the ownership of legal record of which or the legal title to which is held by a trust. Because trusts created under the common law are not separate entities for most legal purposes, title to or record ownership of assets that

are held under a trust instrument are not generally held in the name of the trust. Instead the trustees of the trust hold title or record ownership. To avoid confusion, we suggest, therefore, that the words "or trustee or trustees of a trust" be inserted after the first two words of each of§§103.24(e)(2)(iii) through (v).

Anti avoidance rule.

Section 103.24(e)(3) of the proposed regulations provides that a United States person that causes an entity to be created for a purpose of evading the reporting requirement shall have a financial interest in any account for which the entity is an owner of record. The preamble mentions the use of "transfer companies." Transfer companies were sometimes used to create trusts to disguise the fact that a trust had a United States grantor who would be treated as the owner of the trust under 26 U.S.C. 679. The amendment of Treasury regulations in 1999 and 2000 to adopt a definition of "grantor" prevents this abuse. Treasury regulation §1.671-2(e)(4) now provides that a corporation or partnership (a "transfer company") will not be treated as the grantor of a trust unless the trust is created for a business purpose. Where the trust is created for the personal purposes of one or more of its shareholders or partners, the shareholder or partner will be treated as the grantor. We recommend that the FBAR regulations incorporate the rules adopted in Treasury regulation §1.671-2(e)(4).

Holders of Powers of Appointment Over Property Held in Trust as Holding Signature or Other Authority.

Many trust instruments confer powers of appointment over portions of the property held under the instrument to persons who are neither trustees nor beneficiaries. The holders of powers of appointment generally have the power, exercisable in a non-fiduciary capacity, to direct the trustees to distribute some portion or all of the trust property to one or more beneficiaries. These power holders often will not have the power to make any specific direction with respect to any particular accounts. We suggest that the regulations provide guidance as to whether the holders of such powers who are U.S. persons have FBAR reporting obligations with respect to foreign financial accounts held by the trustees if they do not have powers exercisable with respect to the accounts.

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. [1] 2009-35 I.R.B. 260

. [2] References to "Code" refer to the Internal Revenue code of 1986, as amended.

. [3] Rev. Rul. 85-13, 1985-1 C.B. 184.

. [4] Rev. Rul. 95-58, 1995-2 C.B. 191.