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April 30, 2014

Internal Revenue Service  
CC:PA:LPD:PR (Notice 2014-18)  
Room 5203  
Post Office Box 7604  
Ben Franklin Station  
Washington, DC 20044

Via Electronic Mail: [Notice.Comments@irsounsel.treas.gov](mailto:Notice.Comments@irsounsel.treas.gov)

Re: Recommendations for 2014-2015 Guidance Priority Plan (Notice 2014-18)

Dear Ladies and Gentlemen,

The American College of Trust and Estate Counsel (the "College") is pleased to submit recommendations pursuant to Notice 2014-18, I.R.B. 2014-15, released March 21, 2014, which invites recommendations for items that should be included in the 2014-2015 Guidance Priority Plan.

The College is a professional organization of approximately 2,600 lawyers from throughout the United States. Fellows of the College are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of the College have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift, and GST tax planning, fiduciary income tax planning, and compliance. The College offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

The recommendations include items in the following categories and, as encouraged by the Notice, we have placed the items under each category in what we believe to be the order of their priority. The recommendations we are making are the same as the ones we submitted last year. We note that one of those recommendations was included in the Guidance Priority Plan last year – clarification that QTIP elections in estate tax returns required only to elect portability are valid. This matter should remain on the Priority Guidance Plan.

#### EMPLOYEE BENEFITS

1. Guidance identifying the “successor beneficiaries” of a trust who may be disregarded in determining a decedent’s designated beneficiary when a non-conduit “see-through” trust is named beneficiary of qualified plan or IRA benefits.
2. Guidance concerning spousal rollovers of qualified plan and IRA benefits when an estate or trust is named beneficiary of a decedent's interest.

#### GIFTS AND ESTATES AND TRUSTS

1. Clarification that QTIP elections in estate tax returns required only to elect portability are valid.
2. Regulations or other guidance defining “GST Trust” under section 2632(c), particularly relating to trusts that give beneficiaries continuing withdrawal rights attributable to prior year gifts to a trust and trusts that make distributions to a nonskip beneficiary dependent upon both the death of a person more than ten years older and the beneficiary attaining a specified age.
3. Guidance regarding the completion of gifts and includibility in the gross estate in the context of self-settled asset protection trusts.
4. Safe Harbor Guidance concerning the application of the Reciprocal Trust Doctrine.

#### INTERNATIONAL ISSUES

1. Guidance concerning the tax consequences under Section 643(i) of the undercompensated use by a U.S. person of property owned by a foreign trust.
2. Guidance under Section 6048 changing the due date for filing Form 3520-A from March 15 to April 15.
3. Guidance concerning the application of the Foreign Account Tax Compliance Act (“FATCA”) provisions of the Hiring Incentives to Restore Employment (“HIRE”) Act (P.L. No. 111-147, 124 Stat. 71 (2010) on reporting and withholding with respect to trusts and their beneficiaries.
4. Guidance concerning the coordination of the foreign corporation anti-deferral rules and Subchapter J.

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If you or your staff would like to discuss the recommendations, please contact Ellen Harrison, Chair of the ACTEC Washington Affairs Committee, at (202) 663-8316, or [ellen.harrison@pillsburylaw.com](mailto:ellen.harrison@pillsburylaw.com); or Leah Weatherspoon, ACTEC Communications Director, at (202) 688-0271, or [lweatherspoon@actec.org](mailto:lweatherspoon@actec.org).

Respectfully submitted,

A handwritten signature in black ink that reads "Kathleen R. Sherby". The signature is written in a cursive style with a large, looping initial 'K'.

Kathleen R. Sherby  
President

Enclosure

The American College of Trust and Estate Counsel (ACTEC)  
Recommendations for the  
2014-2015 Guidance Priority Plan (Notice 2014-18)  
April 30, 2014

**EMPLOYEE BENEFITS**

- 1. Guidance identifying the “successor beneficiaries” of a trust who may be disregarded in determining a decedent’s designated beneficiary when a non-conduit “see-through” trust is named beneficiary of qualified plan or IRA benefits.**
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- 4. Safe Harbor Guidance concerning the application of the Reciprocal Trust Doctrine.**

**INTERNATIONAL ISSUES**

- 1. Guidance concerning the tax consequences under Section 643(i) of the undercompensated use by a U.S. person of property owned by a foreign trust.**
- 2. Regulation changing the due date for filing Form 3520-A from March 15 to April 15.**
- 3. Guidance concerning the application of the Foreign Account Tax Compliance Act (“FATCA”) provisions of the Hiring Incentives to Restore Employment (“HIRE”) Act (P.L. No. 111-147, 124 Stat. 71 (2010) on reporting and withholding with respect to trusts and their beneficiaries.**
- 4. Guidance concerning the coordination of the foreign corporation anti-deferral rules and Subchapter J.**

## EMPLOYEE BENEFITS

### **1. Guidance identifying the “successor beneficiaries” of a trust who may be disregarded in determining a decedent’s designated beneficiary when a non-conduit “see-through” trust is named beneficiary of qualified plan or IRA benefits.**

Reg. §1.401(a)(9)-4, A-5 provides that if a trust is named as beneficiary and certain threshold requirements for a “see-through trust” are satisfied, the beneficiaries of the trust (and not the trust itself) will be treated as having been designated for purposes of determining the minimum required distribution period under Section 401(a)(9). Reg. §1.401(a)(9)-5, A-7 provides that “contingent beneficiaries” of such a trust must be counted among the trust’s beneficiaries for purposes of determining the distribution period, but “successor beneficiaries” will be disregarded. The distinction between the two is not articulated in the regulations apart from two examples. From one example (Reg. §1.401(a)(9)-5, A-7, Ex. 2), one may extrapolate that remaindermen of a conduit trust (a trust under which all plan or IRA distributions are required to be paid out currently as opposed to accumulated in the trust) that lasts for the lifetime of the conduit beneficiary will be treated as successor beneficiaries. The second example (Reg. §1.401(a)(9)-5, A-7, Ex. 1) deals with a non-conduit trust, but is of limited utility since it describes a trust which in the real world would not exist.

Non-conduit trusts are widely used as estate planning vehicles for time-honored reasons having nothing to do with income tax planning. The lack of guidance on the contingent beneficiary and successor beneficiary concepts since 2002, when the regulations were issued, has complicated standard planning for millions of plan participants and IRA owners and has introduced unnecessary uncertainty. These issues continue after the death of the participant or IRA owner who has named a trust as beneficiary, when a decision needs to be made as to the applicable payout period. The ad hoc process of private letter rulings is an expensive and, for most taxpayers, unfeasible way of obtaining certainty.

Please see the attached March 27, 2003 ACTEC letter addressed to Marjorie Hoffman, Esq., Senior Technician Reviewer, Employee Benefits & Exempt Organizations, Internal Revenue Service (also transmitted to George Bostick, Esq., Benefits Tax Counsel, Office of Tax Policy at the Department of Treasury by the attached July 1, 2010 ACTEC letter). The 2003 letter provides examples of six non-conduit trusts named as beneficiaries of qualified plan or IRA benefits, suggests which beneficiaries should be identified as successor beneficiaries in each case, discusses the rationale for the results, and emphasizes the need for clear rules to make these determinations. The 2003 letter reviews the “snapshot rule” that has been applied in many private letter rulings and compares that rule to a suggested “life expectancy rule” that might instead be applied to a greater number of non-conduit trust provisions.

The 2003 letter also proposes for consideration a rule to apply to trusts that defer distributions to a younger beneficiary until a specified age is attained. The proposed rule is contrary to the result reached in certain private letter rulings, but it is supported by strong policy considerations [recognized in the generation-skipping transfer (GST) tax law] and produces a simpler, more understandable method of determining successor beneficiaries in this common form of non-conduit trust. Finally, the 2003 letter discusses instances where a trust beneficiary’s estate is the recipient or potential recipient of trust benefits upon the beneficiary’s death and the

reasons such a circumstance should not prevent the trust beneficiary from being treated as a designated beneficiary.

**2. Guidance concerning spousal rollovers of qualified plan and IRA benefits when an estate or trust is named beneficiary of a decedent's interest.**

Spousal rollovers of qualified retirement plans and IRAs are allowed under Sections 402(c) and 408(d). More than a hundred private letter rulings have been issued since the late 1980s allowing a spousal rollover when an estate or trust (not the surviving spouse) is named as beneficiary. In the vast majority of these rulings, the spouse as executor, trustee and/or beneficiary may unilaterally effect the rollover, and this appears to be key to the result reached. The preamble to the final Section 401(a)(9) regulations, however, suggests a broader approach, which would permit a surviving spouse who does not unilaterally control distributions from an IRA but who does actually receive a distribution from a decedent's IRA to complete a spousal rollover.

The basic fact pattern found in the private letter rulings arises frequently. Therefore, we believe that a published ruling is needed. Currently, after the death of a plan participant or IRA owner, the spouse may be obliged to obtain his or her own ruling at considerable cost and inconvenience, either because the plan administrator or IRA sponsor insists on a ruling or simply because the spouse knows that even numerous private letter rulings issued to others may not be relied on. A Revenue Ruling would provide assurance to plan sponsors and guidance to taxpayers as to the circumstances (whether a spouse's unilateral control over the decision to distribute the decedent's interest in the plan or account, the spouse's actual receipt of a distribution, or both) under which a spousal rollover is valid if an estate or trust is named as the beneficiary.

Please see the attached April 15, 2009 ACTEC letter addressed to Henry S. Schneidermann, Assistant Chief Counsel, Internal Revenue Service (also transmitted to George Bostick, Esq., Benefits Tax Counsel, Office of Tax Policy at the Department of Treasury by the attached July 1, 2010 ACTEC letter). The 2009 letter provides more detail of the issues, requests clarifying guidance, underscores the need for that guidance, and presents a proposed resolution that would avoid the current need for private letter rulings.

## **GIFTS AND ESTATES AND TRUSTS**

**1. Clarification that QTIP elections in estate tax returns required only to elect portability are valid.**

This issue is on the Priority Guidance Plan for 2013-2014. We suggest that it remain on the Priority Guidance Plan for 2014-2015. A discussion of this topic was included in ACTEC's submission last year.

**2. Regulations or other guidance defining "GST Trust" under section 2632(c), particularly relating to trusts that give beneficiaries continuing withdrawal rights attributable to prior year gifts to a trust and trusts that make distributions to a**

**nonskip beneficiary dependent upon both the death of a person more than ten years older and the beneficiary attaining a specified age.**

Section 2632(c)(3)(B) defines the type of trust to which GST exemption will be automatically allocated in the absence of an election to the contrary (a “GST Trust”). The definition is in the form of a very broad general rule (“a trust that could have a generation-skipping transfer with respect to the transferor”), followed by six exceptions. The six exceptions are designed to exclude trusts to which donors are unlikely to want GST exemption to be allocated, most often because, although a generation-skipping transfer is possible under the terms of the trust, it is unlikely that a generation-skipping transfer will occur with respect to more than 75% of the trust property.<sup>1</sup> The exceptions are in turn followed by “flush language” excepting certain situations from their reach (the exception to the exception).<sup>2</sup>

In the more than a decade since the subsection 2632(c) was enacted, it has become increasingly apparent that this goal of conforming the automatic rules to a transferor’s likely intent based on the terms of the trust has been frustrated in certain common types of trusts by a literal reading of two parts of the definition – the second exception to the general rule and a portion of the flush language exception to the exception. We believe that it is possible to interpret both of these provision by regulation in a manner that will cause them to be applied as necessary to better accomplish the goals of the provision. However, because many taxpayers have relied on the literal language of these provisions, any such regulations should apply prospectively and allow a period for taxpayers to elect into their retroactive allocation.

**a. The second exception.<sup>3</sup>**

Under the second of the six exceptions, a trust is not a GST trust if the trust instrument provides that more than 25% of the trust corpus must be distributed to or may be withdrawn by one or more non-skip persons who are living on the date of death of another person identified in the instrument (by name or by class) who is more than ten years older than such individuals. For example, a trust that will terminate in favor of a child of the transferor on the death of the transferor or the transferor’s spouse (if more than ten years older than the child) would fit within this exception and as a result GST exemption would not be automatically allocated to it.

Unfortunately, in the absence of a regulation to the contrary, this exception may be read to not apply to the following common types of trusts to which we believe the

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<sup>1</sup> According to the House Report to H.R. 8 as passed by the House on April 4, 2001, the “Committee recognizes that there are situations where a taxpayer would desire allocation of generation-skipping transfer tax exemption, yet the taxpayer had missed allocating generation-skipping transfer tax exemption to an indirect skip, *e.g.*, because the taxpayer or the taxpayer’s advisor inadvertently omitted making the election on a timely-filed gift tax return or the taxpayer submitted a defective election. Thus, the Committee believes that automatic allocation is appropriate for transfers to a trust from which generation-skipping transfers are likely to occur.” House Report, p. 35.

<sup>2</sup> I.R.C. § 2632(c)(3)(B)(flush language).

<sup>3</sup> I.R.C. § 2632(c)(3)(B)(ii).

exception was intended to apply: (1) a trust that provides for a parent and his or her child or children until the parent's death and then holds the trust property in further trust until the child reaches a specified age, with an outright distribution of the property thereafter, or (2) an insurance trust that provides for distribution of the trust property on the last to occur of the insured's death, the insured spouse's death or when the insured's child reaches a specified age (often younger than age 46, the age specified in the first exception)<sup>4</sup> because no portion of the trust property would be distributed to the child at the death of a person unless the child had already reached the specified age. Therefore, assuming that none of the other exceptions apply,<sup>5</sup> the trusts would be GST trusts and GST exemption would be allocated automatically in the absence of an election to the contrary and except in the case of an addition to the trust after the child has attained the specified age. **However, in both types of trusts at least 25% of the trust principal is likely to pass to a non-skip person (the child) because most individuals outlive their parents and reach age 46 (if the specified age is younger than age 46).** As a result, it is likely that most transferors would not want to allocate GST exemption to the trust.

We believe regulations could and should make it clear that the second exception to the general rule applies (1) even if in addition to surviving a person who is at least 10 years older than the non-skip person, the non-skip person has to reach an age younger than age 46, the age specified in the first exception and (2) even if the non-skip person needs to survive more than one person, as long as each is at least 10 years older than the non-skip person. A narrower approach to the second suggested clarification would be to provide that for purposes of this exception a married couple is treated as a single person.

#### **b. The flush language exception to the exceptions.<sup>6</sup>**

Several of the exceptions,<sup>7</sup> without more, would apply to trusts in which one or more non-skip persons are granted a temporary right to withdraw trust property whenever property is contributed to the trust. Such lapsing withdrawal rights are often limited to the amount of the annual exclusion and lapse during or at the end of the year of the contribution, at least to the extent the lapse will not cause the power holder to be treated as having made a taxable gift by reason of the so called 5 x 5 rule of Code section 2514(e). Because many trusts that grant these powers are likely to give rise to generation-skipping transfers, an exception to this deemed allocation exceptions provides that the value of transferred property is not considered to be includible in the gross estate

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<sup>4</sup> I.R.C. § 2632(c)(3)(B)(i), which provides that a trust is not a GST trust if the trust instrument provides that more than 25% of the trust corpus must be distributed to or may be withdrawn by one or more non-skip persons before that individual reaches 46 years of age, on or before one or more dates specified in the trust instrument that will occur before such individual attains 46 years of age, or upon the occurrence of an event that in accordance with Treasury regulations may reasonably be expected to occur before the date that such individual attains age 46. I.R.C. § 2632(c)(3)(B)(i) That exception applies, for example, to a trust that will terminate in favor of its beneficiary when the beneficiary reaches age 45.

<sup>5</sup> Note that these type of trusts do not fit within the first exception because the death of an individual's parent or parents, in most instances, may not reasonably be expected to occur before the child reaches age 46.

<sup>6</sup> I.R.C. § 2632(c)(3)(B)(flush language).

<sup>7</sup> The fourth exception, for example, provides that a trust is not a GST trust if any portion of it would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer. I.R.C. § 2632(c)(3)(B)(iv).

of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the annual exclusion amount referred to in I.R.C. § 2503(b) with respect to any transferor. Thus, a trust with such a withdrawal right that does not fall within any of the other exceptions will be a GST trust and the deemed allocation will occur.

Unfortunately, in the absence of a clarifying regulation, this special rule for withdrawal rights tied to the annual exclusion may not always apply to trusts with powers that lapse each year only to the extent of the 5 x 5 rule. Put differently, it may not apply to transfers made at a time when the total amount that may be withdrawn (the sum of the withdrawal right arising by reason of the transfer in the current year and all prior year withdrawal rights that have not lapsed as of the date of the transfer) exceeds the current year's annual exclusion with respect to any transferor. Without this exception to the exceptions, such a trust will meet the fourth exception (and perhaps the first exception if the withdrawal amount exceeds 25% of the value of the trust property, which would not be unusual in the early years of an insurance trust) and thus will not be a GST trust for those transfers. Thus, in the first year that transfers are made to such a trust, if the amounts that could be withdrawn are within annual exclusion amount, the trust will be a GST trust and the deemed allocation will apply. In future years, the continuation of a portion of a power from one year to the next may cause the trust to no longer be a GST trust such that no deemed allocation will apply.

We believe regulations could and should rectify this confusing and complicated situation by providing that the exception to the exceptions for annual exclusion withdrawal rights applies if at the time of any transfer that gives rise to a withdrawal right, the amount subject to the withdrawal right "does not exceed the amount referred to in section 2503(b) with respect to any transferor" without regard to whether in future years all or a portion of the withdrawal right from a prior year remains outstanding. Put differently, we believe regulations could provide that once it is determined pursuant to the flush language that a withdrawal amount is not to be taken into account in applying the exceptions to the broad definition of a GST trust, such withdrawal amount is not to be taken into account in any year even if unlapsed.

### **3. Guidance regarding the completion of gifts and includibility in the gross estate in the context of self-settled asset protection trusts.**

In an environment of increasing concern that wealth can attract claims and create risks, it is becoming more common for grantors to create trusts in which, for their lives, they themselves (and sometimes others too) have an interest, often in a trustee's discretion. The trust is designed to protect the trust assets from both opportunistic claims and the unwise decisions of grantors themselves. Because the amount of wealth involved in such self-settled trusts is often substantial, it is important for those grantors to know the gift and estate tax consequences – that is, whether and to what extent the transfer will be complete enough to be a taxable gift for federal gift tax purposes and whether and to what extent the value of the trust property will be included in the grantor's gross estate for federal estate tax purposes. Of those two issues, the completed gift issue is the most important, because it has immediate impact.

The principle typically applied to determine whether a transfer is a completed gift is in Reg. §25.2511-2(b):

As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

The completed gift issue was spotlighted by the disclosure of an Office of Chief Counsel Internal Revenue Service Memorandum dated September 28, 2011 (opened to public inspection on February 24, 2012, as CCA 201208026). Quoting the above regulation, CCA 201208026 concludes that Donors had made completed gifts to a Trust (albeit not a “self-settled” trust from which the Donors themselves could receive distributions). CCA 201208026 has attracted attention among practitioners because it finds a completed gift despite the Donors’ testamentary powers over the disposition of the trust property upon their deaths, powers that estate planners have frequently used specifically to prevent a transfer from being a completed gift. This in turn has raised questions about the continued application of the published guidance on which those practitioners have relied, including in the context of self-settled trusts.

As an example, Rev. Rul. 62-13, 1962 C.B. 180, ruled a transfer in trust incomplete because trustees had discretion to pay income and/or principal to the grantor and others during the grantor’s life and there was therefore “no assurance that anything of value would ever pass to the remaindermen,” even though the grantor retained no power to direct the disposition of the remainder. Thus, CCA 201208026 presents the anomaly that its Donors with a power of appointment over the trust property at death were left with “no power to change [the trust property’s] disposition,” while the grantor in Rev. Rul. 62-13 who retained no power had not “parted with dominion and control.” But CCA 201208026 does not cite Rev. Rul. 62-13 (or Rev. Rul. 77-378, 1977-2 C.B. 347, which “clarified” it).

As another example, CCA 201208026 rests its holding on the fact that the Donors’ “limited power to appoint so much of [the trust property] as would still be in the Trust at his or her death” would be reduced or eliminated – in effect terminated – by the trustee’s discretionary distributions during the Donors’ lives. Reg. §25.2511-2(f) specifically addresses the “termination” of such a power, including termination by the “receipt of income or of other enjoyment of the transferred property by the transferee or by the beneficiary (other than by the donor himself),” which “operates to free such income or other enjoyment from the power.” But CCA 201208026 does not cite Reg. §25.2511-2(f).

We appreciate that CCA 201208026 is necessarily a part of a larger file, that it is addressed to Area Counsel and thus possibly written in contemplation of litigation (or at least serious pursuit of issues in audit), and that it recites that it “may contain privileged information” (although no redaction other than identifying details, including identification of the jurisdiction, is apparent), and for all those reasons it may not tell the whole story. We also appreciate that CCA 201208026 may not be used or cited as precedent (and it so recites). Nevertheless, such documents, when made available for public inspection, are used by practitioners to guide their own best practices and assist them in advising clients. Thus, balanced (and citable) guidance that seeks to resolve questions rather than to pursue a litigation position would be desirable and would foster uniform treatment and compliance. As we have seen in other contexts (such as Rev. Rul. 81-51, 1981-1 C.B. 458, and Rev. Rul. 2004-64, 2004-2 C.B. 7), such guidance could and perhaps should address the extent to which it will be applied prospectively under Section 7805(b)(8).

#### **4. Safe Harbor Guidance concerning the application of the Reciprocal Trust Doctrine.**

Since 1940, the courts have recognized there were circumstances when trusts can be so interrelated that the economic positions of the persons who created the trusts have not changed enough to honor the separate trusts for certain tax purposes. As a result, it is possible that trusts created at about the same time may be “uncrossed” and one or more of the retained power provisions (Sections 2036-2038) applied to cause a portion or all of the value of a trust to be included in the settlor’s gross estate. This result can obtain even though the settlor was not a beneficiary of that included trust and did not retain a power with respect to that trust which would cause such inclusion absent the existence of the so-called reciprocal trust. This has come to be known as the “Reciprocal Trust Doctrine.”

Even though the Doctrine was recognized and applied by the United States Supreme Court in *United States v. Grace* (395 U.S. 316 (1969)) the federal courts and the Internal Revenue Service have been required to define and apply the doctrine in a variety of settings with varying results. See, for example, *Estate of Bischoff* (69 T.C. 32 (1977)), *Estate of Herbert Levy* (T.C. Memo 1983-453 (1983)), *Estate of Green v. United States* (68 F. 3d 151 (6<sup>th</sup> Cir. 1995)), and Private Letter Rulings 199643013 and 200426008. Taxpayers and their advisors frequently are faced with a planning situation where both spouses are planning to engage in an arrangement concerning the wealth of the spouses and their family that is best structured using two trusts, which ideally might be identical in terms but for the identity of the settlors. This is most common when spouses are designing mirror image arrangements for themselves and younger family members. Skilled practitioners are able to create degrees of difference which should decrease the possibility of uncrossing such trusts. However, in the absence of a definitive set of rules addressing this issue, taxpayers and their advisors are left to speculate, which can lead to extreme variations in plans solely to assure that one does not run afoul of the Doctrine.

While it may not be necessary to address the full range of variations that should result in trusts that need not be uncrossed, it should be possible to create greater clarity by acknowledging a set of safe harbors such as the existence of separate trustees (or co-

trustees when the settlors have been named as fiduciaries) or differences in the powers granted to the spouses, both of which would make it possible to have trusts with a common purpose without requiring some of the differentiation and distortion commonly applied currently to avoid the application of the Doctrine.

## **INTERNATIONAL ISSUES**

### **1. Guidance concerning the tax consequences under Section 643(i) of the undercompensated use by a U.S. person of property owned by a foreign trust.**

Section 643(i) was amended by the Foreign Account Tax Compliance Act (“FATCA”) provisions of the Hiring Incentives to Restore Employment (“HIRE”) Act (P.L. No. 111-147, 124 Stat. 71 (2010) to provide that the use by certain U.S. persons of property owned by a foreign trust would be deemed to be a distribution by the trust equal to the fair market value of the use of such property except to the extent adequate consideration for such use was timely paid. The amendment was effective on date of enactment, March 18, 2010. Prior to this amendment, the statute applied only to loans of cash or marketable securities and not to “loans” of other property, such as residences or works of art.

The statute applies to use by a U.S. person who is a grantor, a beneficiary or any other person who is related to a grantor or beneficiary. A person is related to a grantor or beneficiary by application of the rules in section 267 or section 707(b) applied as if family members included spouses of members of the family.<sup>8</sup> If the person using the trust property is not a grantor or beneficiary, the deemed distribution is treated as made to the grantor or beneficiary to whom such person is related rather than to the person who is or was actually using the trust property. If the person using the property is related to more than one grantor and/or beneficiary, the deemed distribution to the grantor and/or beneficiaries is to be allocated among them in accordance with regulations. No regulations or other guidance has been issued.

If compensation is paid for the use of property other than cash or marketable securities, the deemed distribution is reduced by the amount of such compensation if it is paid within a reasonable period of time of such use.

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<sup>8</sup> Thus, related persons include members of the family (sibling, brother or sister-in-law, spouse, ancestors and their spouses, and descendants and their spouses), an individual and a corporation more than 50% owned by such individual, two corporations which are members of the same controlled group, a grantor and a fiduciary of a trust created by such grantor, fiduciaries of separate trusts created by the same grantor, a fiduciary and a beneficiary, a fiduciary and a beneficiary of another trust if the same person is the grantor of both trusts, a fiduciary of a trust and a corporation more than 50% owned by the trust or by the grantor of the trust, a person and an exempt organization if the organization is controlled by the person or a member of such person’s family, a corporation and a partnership if more than 50% of the stock or more than 50% of the capital or profits interest in the partnership interests are owned by the same persons, S corporations if the same persons own more than 50% of the stock of both, an executor of an estate and a beneficiary of an estate, a partner and a partnership if the partner owns more than 50% of the capital or profits interest and two partnerships in which the same persons own more than 50% of the capital or profits interest. In applying the related party rules, a person is treated as indirectly owning stock held through a corporation, partnership, estate or trust in which such person has an interest, and is treated as constructively owning stock owned by a family member.

If the statute applies to deem a distribution to have been made, any subsequent transaction, such as the return of such property to the trust, shall be disregarded.

Guidance is needed concerning the following issues:

- How should the trustee and the taxpayer determine the fair market value of the use of property where there is inadequate data for determining the fair market value of the use of such property? An example would be the fair rental value of fine art. To make compliance easier, a rule of convenience would be helpful. A similar rule of convenience exists, for example, for determining fair market interest rates and the present value of life estates, annuities and remainders. A similar rule could be used for determining the fair rental value of property for which no market data is readily available.
- How should the trustee and the taxpayers allocate the deemed distribution where more than one person uses the property owned by the trust or the person using such property is related to more than one beneficiary and/or the grantor?
- What are the tax consequences of the receipt by the trust of compensation for the use of trust property paid by a grantor, beneficiary or related person? For example, will a beneficiary realize gross income from payments such beneficiary herself made to the trust which are distributed or required to be distributed back to her? If the rental is for the use of U.S. property, is tax withholding required? Will compensation for the use of property include expenses of use (such as utilities and condominium fees) paid by the person who uses the property and, if so, will the foreign trust be deemed to have received gross income where such person pays such expenses?
- It would be helpful to confirm that the deemed distribution carries out trust income and accumulated income but does not create income.
- It would be helpful to confirm that the statute does not apply to grantor trusts covered by Subpart E of Subchapter J.
- It would be helpful to clarify the provisions of section 643(i)(3) providing that subsequent transactions, such as the return of property to the trust, will be disregarded.

## **2. Guidance under Section 6048 changing the due date for filing Form 3520-A from March 15 to April 15.**

Under section 6048(b), U.S. persons treated as “owners” of a foreign trust (“U.S. Owners”) must annually file a return confirming such status and must also ensure that the

trust files a return providing a full and complete accounting of all trust activities and operations. The trust's return is filed on Form 3520-A. The Form 3520-A instructions and Notice 97-34, 1997-1 C.B. 422, indicate that Form 3520-A is due by the 15th day of the third month following the close of the trust's tax year.<sup>9</sup> Because section 644 provides that all trusts other than tax exempt and charitable trusts must adopt a calendar year as their taxable year for U.S. tax purposes, as a practical matter most Forms 3520-A are due on March 15<sup>th</sup>.

The Form 3520-A filing was conceived as the filing obligation of a foreign trust. However, because it is the U.S. Owner, not the trust itself, who is responsible for ensuring the form is filed, in practice the preparation and filing of the form falls to the U.S. Owner. As a result, the March 15<sup>th</sup> due date for the Form 3520-A acts as a trap for the unwary. In most cases, the U.S. Owner has an April 15<sup>th</sup> deadline for his own income tax return and therefore may not consider the filing obligations with respect to the trust until after the March 15<sup>th</sup> deadline has passed.

The likely rationale for the March 15<sup>th</sup> deadline is to ensure that the U.S. Owner has time to review the Form 3520-A information and include it on his own return and Form 3520. Because the U.S. Owner is responsible for ensuring that the Form 3520-A is filed, however, in most cases the U.S. Owner's tax preparer is charged with completing the Form 3520-A, making this lead time unnecessary. Thus, we would suggest that the IRS issue guidance adopting an April 15th due date the Form 3520-A to avoid confusion and simplify administration. In addition, the IRS should consider issuing guidance that the filing of a Form 4868 by the U.S. Owner to extend his own return is effective to extend the due date for the Form 3520-A.

### **3. Guidance concerning the application of the Foreign Account Tax Compliance Act ("FATCA") provisions of the Hiring Incentives to Restore Employment ("HIRE") Act (P.L. No. 111-147, 124 Stat. 71 (2010)) on reporting and withholding with respect to trusts and their beneficiaries.**

FATCA imposes new withholding requirements on certain payments to foreign entities, including foreign trusts, that are not FATCA compliant,<sup>10</sup> new information reporting requirements for U.S. beneficiaries who are treated as indirect owners of passive foreign investment company ("PFIC") stock owned through estates and trusts<sup>11</sup> and new reporting rules for beneficial interests in foreign estates and trusts.<sup>12</sup> Foreign trusts located in jurisdictions with which the U.S. has an Intergovernmental Agreement ("IGA") are FATCA compliant if the trusts comply with the applicable IGA.

To avoid withholding, a trust must become compliant with FATCA. The requirements for trusts to become FATCA compliant are different depending upon

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<sup>9</sup> Confusingly, regulations under section 6048 applicable solely to foreign grantor trusts described in section 679 specify an April 15<sup>th</sup> deadline for filing the Form 3520-A. Treas. Reg. § 401.6048-1(c)(1). These regulations pre-date the current version of section 6048.

<sup>10</sup> Sections 1471 and 1472.

<sup>11</sup> Section 1298(f).

<sup>12</sup> Section 6038D.

whether a trust is classified as a foreign financial institution (“FFI”) or non-financial foreign entity (“NFFE”) and whether the trust is subject to an IGA.

ACTEC previously submitted comments suggesting that trusts be classified as NFFEs because the compliance rules for them are feasible for trusts. An NFFE merely has to certify that it has no U.S. beneficiaries or identify the U.S. beneficiaries to the IRS.

However, regulations issued under Section 1471 classify most foreign trusts as FFIs. To avoid withholding, a trust classified as an FFI (and not subject to an IGA) must register with the IRS to become a participating FFI and agree to perform filing and withholding obligations. A participating FFI must annually file FATCA Reports on Form 8966 that require it to report the “accounts” of U.S. beneficiaries. Beneficiaries do not have “accounts.” We recommend that trustees of nongrantor trusts not be required to report “accounts” but only to provide information about distributions required to be made to U.S. beneficiaries or, in the case of discretionary beneficiaries, distributions in fact made to U.S. beneficiaries during the year. There is no tax reporting obligation for nongrantor trusts under Subchapter J unless distributions are either required to be made or in fact are made.

The regulations under Sections 6038D and Sections 1471-1474 were extremely helpful in providing bright line tests for determining when a beneficiary has a beneficial interest that must be reported and quantifying the value of such interest. In particular, the regulations are helpful in stating that a person whose interest is mandatory is deemed to own a portion of the trust based on his or her mandatory distribution rights valued using the rules under Section 7520, a beneficiary whose interest is wholly discretionary is considered to own only the value of what he or she actually received from the trust in the relevant year, the interest of a beneficiary in a trust that is deemed owned by another U.S. person under the grantor trust rules may be disregarded (so that only the U.S. person who is deemed to be the owner under Sections 671-679 is considered to own the trust) and certain de minimis interests may be disregarded. This rule acknowledges the difficulty of allocating beneficial interests to discretionary beneficiaries. However, certain questions remain such as whether mandatory distribution rights include remainder and contingent interests, whether the de minimis rules apply to trusts classified as FFIs as well as to trusts classified as NFFEs, whether the rules for determining beneficial interests are applicable to owner reports filed by owner-documented FFIs, and whether Treas. Reg. §1.1473-1(b)(2)(v) (attributing ownership among related parties) applies to related parties who are foreign persons and to trusts that are FFIs. For example, if a foreign person is treated as owning all or a portion of a trust, will a U.S. relative of that foreign person be attributed ownership even though the U.S. relative received no distribution?

In addition, the regulations under Sections 1471-1474 do not allow the bright line test described above for determining beneficial ownership of a trust to be applied for purposes of determining indirect ownership of shares of a holding company owned by a trust. Instead, the regulations require that a “facts and circumstances” test be used.<sup>13</sup> The same bright line rule described above is necessary to determine indirect ownership of the holding company in order to make administration of the withholding rules practicable.

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<sup>13</sup> Treas. Reg. §1.1473-1(b)(2).

The use of different rules for determining ownership of the trust and holding company may lead to illogical results. For example, it may be possible for a beneficiary whose interest in the trust is zero percent to be considered indirectly to own some of the shares of the underlying holding company owned by the trust.

A simplified method for determining ownership of shares of foreign corporations held indirectly through foreign trusts also is necessary to comply with the PFIC information reporting rules under Section 1298(f). FATCA requires annual reporting of PFIC interests held or deemed held by a U.S. beneficiary indirectly through an estate or nongrantor trust even if the beneficiary has not received a distribution from the trust or made any of the elections available to PFIC shareholders. The preamble to temporary regulations issued December 31, 2013 under Sections 1291 and 1298(f) requests comments on how to determine the proportionate ownership by trust beneficiaries of PFIC stock held by an estate or nongrantor trust and provide that, until further guidance is issued, beneficiaries should use a “reasonable method” to determine their ownership of PFIC stock held by the estate or nongrantor trust.<sup>14</sup> Although the temporary regulations waive the PFIC filing requirement for a beneficiary of a foreign estate or nongrantor trust who has not made a PFIC election and does not receive a distribution, the waiver does not apply if such beneficiary is treated as receiving an excess distribution with respect to the stock of a PFIC the beneficiary is deemed to indirectly own, thus leaving unaddressed the issue of whether such a beneficiary will be treated indirectly owning the PFIC stock.<sup>15</sup> Imposing tax with respect to trust income on a person who does not receive a distribution and has no right to receive a distribution is inconsistent with Subchapter J and fundamental fairness. A preferable alternative to aggressive application of indirect ownership rules would be adoption of reforms to the treatment of income from corporations owned through trusts which are discussed in paragraph 4 below.

The rules and regulations under Sections 1471-1474 are extremely complex. It would be very helpful if the IRS would issue simplified guidance as to how these rules apply specifically to trusts and estates. In addition to the specific guidance described above, clarification of the following would be helpful:

- a. Whose FATCA status is relevant to the determination of whether withholding is required when payment is made to a trust? Is the relevant person the trustee, the custodian of trust accounts, the holding company owned by the trust, the trust itself as an entity, the grantor in the case of a grantor trust, or the beneficiary in the case of a beneficiary-owned trust). Is the relevant person different depending upon whether the trust is an FFI or an NFFE, whether the payment is U.S. source fixed and determinable annual periodic income and whether the trust beneficiaries are exempt persons? In particular, the rules of Treas. Reg. §1.1471-3(a)(3)(ii), which define who is the “payee,” are confusing.
- b. Whether an estate is disregarded as a specified U.S. person for all withholding tax purposes or whether the exception to the definition of U.S. accounts to exclude

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<sup>14</sup> T. D. 9650.

<sup>15</sup> Treas. Reg. §1.1298-1T(b)(3)(iii). Thus, this regulation will only clearly waive filing if the foreign estate or trust itself has no excess distributions (or gains treated as excess distributions) during the year, so that even if ownership were attributed to a U.S. beneficiary, there would be no excess distribution for the year.

accounts held by an estate<sup>16</sup> applies only to accounts held directly by a U.S. estate. For example, is a trust that has only a U.S. estate and foreign persons as beneficiaries considered to be a U.S. owned entity?

- c. Whether a trust that is a participating FFI must report “accounts” deemed held by U.S. beneficiaries or may report account information in the aggregate in the same manner as an owner-documented FFI or NFFE may report.<sup>17</sup>
- d. Guidance for determining when and how a beneficiary of a foreign trust can claim a refund of overwithheld tax as the “beneficial owner” of the income. The beneficiary is the beneficial owner to the extent of distributions made to such beneficiary that carry out income of the trust to the beneficiary. However, the beneficiary could not be the beneficial owner of that portion of trust income that has been withheld to pay tax unless the trustee were able to assign that tax refund to the beneficiary. The trust is not itself eligible to apply for a refund if it is not exempt from FATCA withholding.
- e. Guidance for determining the “controlling persons” of foreign trusts subject to an IGA. The IGA defines controlling person to include the grantor and beneficiaries or class of beneficiaries, as well as trustees, protectors, holders of powers of appointment and any other person in control of the trust. The definition is confusing because grantors and beneficiaries would not normally have any control over the trust, so that the adjective “controlling” is misleading (as is the reference to any other person in control of the trust). Does a “controlling person” include a beneficiary whose discretionary beneficial interest is disregarded under the bright line test in the regulations?
- f. Clarification of when a trust is eligible to avoid withholding by becoming an owner-documented FFI, and in particular, those affiliations that make a trust ineligible to be an owner-documented FFI.<sup>18</sup>
- g. Guidance concerning an election by a foreign trustee to file US information returns. A foreign trustee should be permitted to elect to file those forms that a U.S. trustee would file, such as Forms K-1 (in lieu of Forms 1099 or FATCA reports).
- h. Further clarification of the distinction between an FFI and an NFFE including: whether a private trust company and/or a trust managed by a private trust company is an FFI or an NFFE, whether a trust managed by a professional individual trustee is an FFI or an NFFE, and whether a trust managed by an individual trustee who hires a financial institution to advise on investments but doesn’t delegate investment authority is an FFI or an NFFE.

#### **4. Guidance concerning the coordination of the foreign corporation anti-deferral rules and Subchapter J.**

ACTEC submitted comments to representatives of the Department of the Treasury on June 23, 2010. A copy is attached. The corporate anti-deferral rules applicable to controlled

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<sup>16</sup> Treas. Reg. §§1.1471-5(b)(2)(iii) and 1.1471-2(a)(4)(viii).

<sup>17</sup> Treas. Reg. §1.1471-4(d)(3).

<sup>18</sup> Treas. Reg. §1.1471-3(d)(6).

foreign corporations (“CFCs”) and passive foreign investment companies (“PFICs”) and the accumulation distribution rules applicable to trusts serve the same purpose – preventing the use of foreign entities to defer payment of tax or imposing an interest charge if tax payment is deferred. Proposed regulations on the corporate anti-deferral rules for passive foreign investment companies were issued on April 1, 1992, and have not been finalized. The preamble notes the need to coordinate the accumulation distribution rules of Subchapter J and the PFIC tax regime. We agree, but there has been no further published guidance on this issue in twenty years.

On December 31, 2013, final, temporary and proposed regulations were issued that provide guidance on determining ownership of a PFIC.<sup>19</sup> The temporary regulations adopt the rule set forth in the proposed regulations by treating beneficiaries of nongrantor trusts and estates as owning stock in proportion to their beneficial interests, which are determined by applying a facts and circumstances test.<sup>20</sup> The temporary regulations provide that a beneficiary may be attributed ownership of PFIC stock owned by a nongrantor trust or estate whether the trust or estate is foreign or domestic. The temporary regulations also provide guidance on the annual filing requirement imposed by Section 1298(f) on owners of PFIC stock. Under these regulations, a beneficiary of a foreign nongrantor trust or foreign estate who is considered to be the indirect owner of PFIC shares held by the foreign nongrantor trust or foreign estate is not required to report under Section 1298(f) provided that no PFIC elections have been made for such year and no excess distribution has occurred.<sup>21</sup> This rule is significantly different from the regulations adopted under Sections 1471-1474 and 6038D which treat a discretionary beneficiary of a foreign trust who has not received a trust distribution in a particular year as not having a beneficial interest in such trust. Treas. Reg. §1.1298-1T(b)(iii) supports the conclusion that a beneficiary who is deemed to have received an excess distribution because he/she is treated as an indirect shareholder of a PFIC would have a reporting requirement, and a tax payment obligation, whether or not he/she received, or was entitled to receive, a distribution from the trust.

The preamble to the regulations issued in T.D. 9650 requests guidance on the determination of proportionate ownership by beneficiaries of PFIC shares owned by a nongrantor trust or estate. The preamble also states that the regulations are not providing guidance on the application of the PFIC tax rules when an estate or nongrantor trust, or a beneficiary thereof, receives or is treated as receiving an amount taxable under the PFIC rules as an excess distribution. Until further guidance is issued, the preamble states that the PFIC and Subchapter J rules must be applied in a reasonable manner to preserve or trigger the tax and interest charge rules on excess distributions under Section 1291. The preamble also states that it would be unreasonable for the shareholders to take the position that neither the beneficiaries of an estate or trust nor the estate or trust itself is subject to the tax and interest charge on excess distributions under Section 1291. However, it should not be unreasonable to take the position that such income was not taxable under Section 1291 if the income was attributable to a foreign person either because the foreign person was the indirect owner of the stock or because a domestic trust or estate distributed such income to a foreign beneficiary in the year it was received.

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<sup>19</sup> T.D. 9650.

<sup>20</sup> Treas. Reg. §1.1291-1T(b)(8).

<sup>21</sup> Treas. Reg. §1.1298-1T(b)(iii).

In light of the preamble, we request that Priority Guidance Plan include the issues of (1) attribution of ownership of PFIC and CFC shares to beneficiaries of nongrantor trusts and estates; and (2) treatment of income attributable to ownership of stock of a CFC or PFIC through a nongrantor trust or estate.

Comments previously submitted by ACTEC suggested a set of rules that would better coordinate the overlapping PFIC/CFC and subchapter J rules with the objective that tax would be owed at the time a beneficiary of a foreign nongrantor trust or estate received distributions (and not before) but the interest charge on delayed payment of tax would be preserved. Under such rules, it would not be necessary to attribute ownership through nongrantor trusts and estates. The prior comments did not address attribution of ownership through domestic trusts or estates, which we believe is not advisable.

The possible issues include:

- a. If ownership is allocated to beneficiaries, how such allocation will be made, whether it is fair and practical to impose tax on a person based on income he/she has not received and has no enforceable right to obtain, and what adjustments will be made to avoid double tax when income imputed and taxed to a beneficiary is later distributed to someone else or when the trust disposes of shares.
- b. Whether, instead of imputing income to beneficiaries, beneficiaries should be taxed only when they receive distributions (as under Subchapter J) but the interest charge under the accumulation distribution rules would be modified to treat the trust as having accrued income at the time the income accrued to the CFC or PFIC owned by the trust.
- c. Whether it is necessary or advisable to impute to beneficiaries ownership of PFICs held by domestic nongrantor trusts and domestic estates (ownership of CFCs by statute may not be imputed through U.S. entities).

Attribution from domestic nongrantor trusts and domestic estates is unnecessary to protect the PFIC tax regime, since the tax on excess distributions from a PFIC (and gains treated as excess distributions) could be collected from the U.S. taxpayer-trust and/or its U.S. beneficiaries to the extent such income is taxable to the domestic trust and/or its U.S. beneficiaries under the rules of Subchapter J. Moreover, this attribution rule is inconsistent with the attribution rule for CFCs and would interfere with the CFC and PFIC “overlap” rule in Section 1297(d), which generally provides that where a foreign corporation is both a CFC and a PFIC, the CFC rules “trump” the PFIC rules. Attribution from domestic trusts also is inconsistent with the regulations issued under Section 1411 addressing the tax treatment of PFIC income received by a U.S. charitable remainder trust (which is not attributed to beneficiaries of such a trust).<sup>22</sup>

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<sup>22</sup> Prop. Treas. Reg. §1.1411-3(d)(2)(ii) Provides that income treated as an excess distribution within the meaning of section 1291 or gain treated as an excess distribution is included in the tier system applicable to distributions from charitable remainder trusts, which thus could not also be imputed to the beneficiaries of the charitable remainder trust. This is the correct result because imputing the income to beneficiaries would be inconsistent with the rules of section 664.