

## IRS Adds Foreign Trust Information Reporting to Compliance Campaign Program

June 1, 2018

On May 21, 2018, the IRS Large Business and International (LB&I) division added [foreign trust information reporting](#) to its “compliance campaigns,” signaling that the IRS sees a “compliance risk” in this area that requires a targeted response to achieve compliance objectives. LB&I specifically indicated that it will take a “multifaceted approach” to improving compliance, including through the use of “examinations and penalties assessed by the campus when forms are late or incomplete.” ***With this latest announcement, individuals who may have foreign trust reporting requirements now face an increased IRS audit risk and should be sure to consult with their legal advisors to avoid potential penalties.***

[Form 3520-A](#), *Annual Information Return of Foreign Trust with a U.S. Owner*, is an annual information return required of a foreign trust with a U.S. owner. Whether a U.S. person that is a settlor or beneficiary of a foreign trust is an “owner” generally depends on the types of powers held by that person with respect to the trust assets. A U.S. person may also be treated as an owner if he or she creates a trust with current or future U.S. beneficiaries. The IRS may look not only to the terms of the trust but also to the conduct of the parties and even foreign law to determine whether a U.S. person has sufficient powers over a trust to be treated as its owner.

The Form 3520-A reports information about the trust, including its income statement, distributions made during the year (whether to U.S. or foreign beneficiaries), its balance sheet, as well as information about its U.S. beneficiaries and U.S. owners on Foreign Grantor Trust Beneficiary Statements and Foreign Grantor Trust Owner Statements (which must be provided to the U.S. beneficiaries and owners in turn). The foreign trustee must sign and file the Form 3520-A. However, because the penalties for failing to file the form are imposed on the U.S. owners, each U.S. owner is effectively responsible for ensuring that the foreign trust files Form 3520-A and furnishes annual statements to its U.S. owners and beneficiaries. If the trustee is unwilling to sign the Form 3520-A, the U.S. owner may do so instead.

[Form 3520](#), *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*, must be filed by any U.S. person who creates or transfers property to a foreign trust, receives a distribution from a foreign trust, or who is deemed an owner of all or any part of a foreign trust, to report such transactions or ownership. In addition, beneficiaries who receive distributions from foreign trusts must ensure they receive either a Foreign Grantor Trust Beneficiary Statement (if there is a U.S. or foreign owner) or a Foreign Nongrantor Trust Beneficiary Statement (if there is no U.S. or foreign owner), that shows the appropriate taxation (if any) of the distribution in order to avoid application of a “default” regime that taxes the entire distribution at ordinary rates and includes a punitive interest charge.

The Form 3520-A is due on March 15<sup>th</sup>, with an extension available until September 15<sup>th</sup>, of each year, and Form 3520 is due on April 15<sup>th</sup> of each year, with an extension available until October 15<sup>th</sup>. Both forms must be filed with the IRS service center in Ogden, Utah. The failure to timely file or accurately complete either the Form 3520 or

Form 3520-A can come at a steep cost. With respect to a failure to file Form 3520, the IRS can impose a penalty equal to 35% of the gross value of the property transferred to or received from a foreign trust if the transfer is not reported. With respect to the failure to file Form 3520-A, the penalty is imposed on the U.S. owner and is equal to 5% of the value of the trust assets treated as owned by the U.S. owner at the close of each taxable year. The failure to timely file a complete and correct Form 3520 or Form 3520-A may result in an additional penalty of \$10,000 per 30-day period for failing to comply within 90 days of notification by the IRS that the information return has not been filed. The total penalty for failure to report a trust transfer, however, cannot exceed the amount of the property transferred.

Individuals may argue against the imposition of penalties by demonstrating that their failure to comply with their reporting obligations was due to reasonable cause and not willful neglect. In addition, if an individual discovers any foreign trust information reporting noncompliance (but no unreported income) prior to the initiation of an IRS examination, he or she may file Forms 3520-A or 3520, with a reasonable cause statement, through the [Delinquent International Information Return Submission Procedures](#) to potentially avoid the imposition of penalties. The Delinquent International Information Return Submission Procedures require Forms 3520-A and/or 3520 to be filed at the same IRS campus as timely filed returns.

Individuals who have, or believe they may have, foreign trust reporting requirements should consult legal advisors to determine their obligations and the appropriate compliance options. Attorneys in [Caplin & Drysdale's Private Client](#) and [Tax Controversy](#) practice groups are experienced in analyzing foreign trust documents, communicating with foreign trustees, preparing annual owner and beneficiary statements, analyzing your compliance and reporting obligations, remedying any prior noncompliance, and defending against IRS challenges to reporting positions. For more information please contact:

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