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**MEMORANDUM**

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**RE:     INTERNATIONAL TAX COMPLIANCE**  
**FOREIGN ASSETS (U.S. TAXPAYERS)**  
**#4: FOREIGN TRUST (U.S. TAX REPORTING)**

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1. Form 3520 is filed upon initial Trust formation (within ninety (90) days of formation).

Annually, this form is used to report transactions with foreign Trusts and to report receipts of foreign gifts.

The Form 3520 return is due on the 15<sup>th</sup> day of the third month after the end of the year of the Trust. For calendar year Trusts, the return is due March 15<sup>th</sup>. A separate return is required for each offshore Trust;

2. Form 3520-A tax return includes a full and complete accounting of all annual Trust activities, Trust operations, and other relevant information. This information is furnished to U.S. owners and U.S. beneficiaries. The return is due at the same time as Form 3520 (above).

A copy of the both Form 3520 and Form 3520-A is to be attached to the U.S. person's tax return and a separate copy sent directly the Internal Revenue Service ("IRS") in Philadelphia. (These forms replaced Form 926 previously used to report transfers to foreign Trusts and corporations. Form 926 is now only used for transfers to corporations.)

Form 3520-A includes:

- a. The Foreign Grantor Trust Beneficiary Statement;
- b. The Foreign Grantor Trust Owner Statement; and
- c. The Foreign Grantor Trust Information Statement (see attached).

In regard to the Annual Filing (Form 3520-A) for offshore Trusts, the annual Trust tax return (i.e., the information return) is jointly required from the Trustee and Settlor (who is responsible

under U.S. law to file the tax return for the Settlor's offshore Trust). The Settlor, not the Trustee, is responsible to pay the U.S. tax (the Trustee's tax filing requirement is the information filing, only), since the Trustee does not pay U.S. tax with the tax return.

The Settlor may, at his election:

1. File the U.S. tax return Form 3520-A (signed as the Grantor of the Trust), which is attached to and filed with Settlor's Federal Tax Return (Form 1040), and assume the responsibility of the U.S. tax filing (from the offshore Trustee);
2. The IRS's concern is that the Form 3520-A Tax Return is filed. Once filed, both the Settlor and the Trustee are in tax compliance for the Trust tax year.

In regard to Form 3520-A, a U.S. person who is treated as the owner of all, or a portion of, a foreign trust is:

**"Responsible" to ensure that the Trustee:**

1. Files a return with the IRS for each year, setting forth a full and complete accounting of all Trust activities and operations;
2. Furnishes the name of the U.S. agent for the Trust and such other information as the IRS describes; and
3. Furnishes such information to each U.S. grantor and beneficiary of the Trust as the IRS subscribes (see attached).

A U.S. owner of a foreign trust must ensure that the Trustee of a foreign trust, annually:

1. Properly completes, executes and files current Form 3520-A;
2. Attaches a Foreign Grantor Trust Owner Statement to the form (see attached);
3. Sends a Foreign Grantor Trust Owner Statement to each U.S. owner of a portion of the Trust and a Foreign Grantor Trust Beneficiary Statement to each U.S. beneficiary who receives a distribution (see attached).

The Foreign Grantor Trust Information Statement must contain the following background information:

1. The name, address and taxpayer identification number, if

any, of the Trust, its U.S. agent, and the Trustee filing Form 3520-A;

2. The Trust's method of accounting;
3. The taxable year for which the statement applies; and
4. A Balance Sheet and Income Statement (applying U.S. tax principles to the Trust).

Moreover, the following documents must be filed with the Foreign Grantor Trust Information Statement:

1. Foreign Grantor Trust Owner Statement;
2. Foreign Grantor Trust Beneficiary Statement.

In the U.S., a Grantor's personal tax return (Form 1040) includes all the Trust income on Form 3520-A (Annual Return of Foreign Trust with United States Beneficiary). Additionally, annual contributions to, or distributions from, the Trust are reportable on Form 3520.

The United States has made the United States Settlor responsible to ensure that the Trustee files the offshore tax return, by making the Settlor and the Trustee jointly responsible to file the tax returns. However, the income is reportable to the U.S. person (not reportable to the Trustee who is merely filing an information return).

### **Form 3520, Part IV (Foreign Gifts):**

Taxpayers required to file a Form 3520 are U.S. persons who, during the particular tax year, received certain gifts or bequests from a foreign person. Failure to report these gifts that should be reported could result in the imposition of penalties. A gift to a U.S. donee does not include any amounts paid for qualified tuition or medical payments made on behalf of the U.S. donee.

If a foreign trust makes a distribution to a U.S. person, this should be reported on Part III of the Form 3520. A domestic trust that is not treated as owned by another person is required to report the receipt of a gift or bequest from a foreign person. Conversely, a domestic trust that is treated as owned by a foreign person is not required to report the receipt of a contribution to the trust by a foreign

person.

Line 60 of the Form 3520 (Part IV) must be answered affirmatively if, during the applicable tax year, a U.S. donee receives more than \$100,000 from a non-resident alien or a foreign estate that were treated as gifts or bequests. Line 61 must be answered affirmatively if, during the applicable tax year, a U.S. donee receives more than \$13,561 (2008) from a foreign corporation or a foreign partnership that was treated as gifts or bequests.

If the U.S. donee answers affirmatively to Line 62, then an explanation must be prepared if the ultimate donor on whose behalf the reporting donor was acting is a foreign corporation or foreign partnership. This explanation must include the ultimate foreign donor's name, address, identification number (if available), and whether the entity is a corporation or a partnership.

### **Due Dates:**

In general, Form 3520 is due on the date (for that particular taxable year) that the U.S. person's income tax return is due, including extensions. As such, Form 3520 should be attached to the U.S. person's income tax form, and additionally, a copy should be sent to the IRS Center in Philadelphia, Pennsylvania. Form 3520 must have all the required attachments to be considered a complete return.

If the Form 3520 is filed by an individual or a fiduciary, it must be signed by such individual or fiduciary. If the Form 3520 is filed by a partnership, it must be signed by a general partner of the partnership. If the Form 3520 is filed by a corporation, it must be signed by someone authorized to sign on the corporation's behalf.

### **Penalties:**

A penalty generally applies if Form 3520 is not timely filed or if the information is incomplete or incorrect. Generally, the penalty is as follows:

- Thirty-five percent (35%) of the gross value of any property transferred to a foreign trust for failure by a U.S. transferor to

report such transfer;

- Thirty-five percent (35%) of the gross value of any distributions received from the foreign trust for failure by a U.S. beneficiary to report receipt of the distribution;
- Five percent (5%) of the amount of certain foreign gifts for each month for which the failure to report continues.

Additional penalties may be imposed if noncompliance continues after the IRS mails a notice of failure to comply with required reporting. However, this penalty may not exceed the gross reportable amount. Penalties will only be imposed to the extent that the transaction is not reported.

### **Form 3520-A:**

In addition to the filing requirements of the Form 3520, there may also be requirements to file a Form 3520-A. The Form 3520-A is the annual information return of a foreign trust with at least one U.S. owner. The Form 3520A provides information about the foreign trust, its U.S. beneficiaries, and any U.S. owner who is treated as the owner of any portion of the foreign trust.

A foreign trust must file the Form 3520-A to satisfy its annual information reporting requirements if such foreign trust possesses a U.S. owner. An owner of a foreign trust is the person that is treated as owning any of the assets of the foreign trust pursuant to the grantor trust rules. If the foreign trust is treated as owned by a U.S. person, then each U.S. person treated as a U.S. owner of the foreign trust is responsible for ensuring that the foreign trust files the Form 3520-A setting forth a full and complete accounting of all trust activities, trust operations, and other relevant information. Additionally, the U.S. owner is responsible for ensuring that the foreign trust annually furnishes certain information to the other U.S. owners and U.S. beneficiaries of the foreign trust.

The completed Form 3520-A must be filed with the IRS by the 15<sup>th</sup> day of the third month after the end of the foreign trust's tax year. The Form 3520-A should be filed with the IRS Center in Philadelphia. An extension of time to file the Form 3520-A can be obtained through the filing of Form 2758 with the IRS. The U.S. beneficiary and the U.S. owner's tax returns must be consistent with

the Form 3520-A filed by the foreign trust, unless such inconsistency is reported to the IRS.

**Penalties:**

The U.S. owner of a foreign trust is subject to a penalty of 5% of the gross value of the portion of the foreign trust's assets treated as owned by that person at the close of that year if the foreign trust fails to timely file Form 3520-A or does not furnish certain required information. Additional penalties may be imposed if the failure to file or furnish information continues after the IRS mails a notice to the U.S. owner.

No penalties will be imposed if the U.S. owner can demonstrate that the failure to comply was due to reasonable cause and not willful neglect. The fact that a foreign country would impose penalties for disclosing the required information is not reasonable cause. Similarly, reluctance on the part of the foreign fiduciary or provisions in the trust instrument that prevent the disclosure of required information is to reasonable cause either.

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