



KPMG Island Group Tax Webinar Series

Offshore Trustees - *The what, why and when of UK and US reporting.*

12 January 2023

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Introduction



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Agenda

- 01** Introduction
- 02** US Overview
- 03** Residence and Domicile
- 04** Taxation of Trustees – Income and Gains
- 05** Taxation of Trustees – UK Inheritance Tax
- 06** UK Trust Registration Service
- 07** The UK Register of Overseas Entities

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US Overview



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Background to US tax and trusts

What?

- **Filing requirements:**
- US persons must file income tax returns - Form 1040
- Certain foreign trusts may need to file trust form 3520-A
- US grantors/beneficiaries may need to file trust form 3520
- Trustees may be called upon to provide necessary info

Why?

- **USA has a worldwide taxation system**
- US persons file tax return reporting worldwide income
- Worldwide income can include income from within trusts, and distributions from trusts

When?

- **Timing for filings – Initial and Extended:**
- Individual taxpayers : 15 April/October 15
- 3520-A : 15 March/September 15
- 3520 : 15 April/October 15
- For individuals : must make final payment of tax on 15 April

Definition of "U.S. person"

The term "United States person" means:

- A **citizen** of the United States.
- A **resident** of the United States.
- A domestic partnership, corporation, estate other than a foreign estate, certain trusts (covered next), or any other person that is not a foreign person.



U.S. Citizen:

- U.S. citizenship is usually acquired by birth when a child is born in the territory of the United States.
- There are two ways to become a U.S. citizen: by birth/citizenship of a parent, or by naturalization.



U.S. Resident:

- A person who meets the Substantial Presence Test (day-count test), or
- A green card holder ("given the privilege... of residing permanently in the US as an immigrant"). Green card status until voluntarily renounce and abandon it (or it is terminated by US immigration or federal court). Does not lapse when green card lapses

US tax issues on trusts

1. Grantor or nongrantor trust?

2. Grantor trust taxation

3. Nongrantor trust taxation

4. Reporting obligations

Grantor or Non Grantor Trusts

Tax treatment of Grantor and Nongrantor trusts is very different

Grantors taxed on income/gains of a **Grantor** Trust on an annual basis

Beneficiaries taxed on distributions from a **Nongrantor** Trust. Tax liability can vary significantly. Planning is essential!

Grantor trust taxation



Grantor pays tax via their 1040 individual income tax return



Income from within the trust **maintains its character** in the hands of the grantor



Tax generally due by **April 15** following the calendar year in which it is earned

Nongrantor trust taxation

Beneficiary pays tax via their 1040 individual income tax return

Distributions must be analysed to determine tax treatment in the hands of the beneficiary

Distributions must be analysed to determine tax treatment in the hands of the beneficiary

Punitive tax charges can apply on certain types of distribution

Tax generally due by April 15 following the calendar year in which it is earned

Taxation of FNGTs: Three layers

First taxable on **Distributable Net Income (DNI)**. Modest tax.

Next, taxable on **Undistributed Net Income (UNI)**. Adverse tax.

If no DNI or UNI, distribution is **corpus**. Not Taxable

Taxation of FNGTs: Three layers

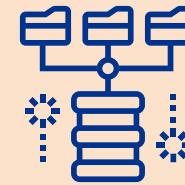
First taxable on **Distributable Net Income (DNI)**. Modest tax.



DNI means the **income for the taxable year** of the trust determined under the terms of the governing instrument and applicable local law. There is no standard Federal definition



Begin with book income, make certain adjustments, e.g. add back investment management fees, bank fees, book amortization of property etc. Deduct depreciation as calculated under U.S. tax principles



DNI is deemed to be **distributed first**. Beneficiaries report their share of DNI on a pro-rata basis

Taxation of FNGTs: Three layers

First taxable on **Distributable Net Income (DNI)**. Modest tax.



DNI maintains character in the hands of the beneficiary.

Federal rates:

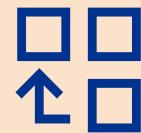
- Certain Dividends and Gains: 0 to 23.8%
- Other Dividends and Gains: Up to 40.8%
- Other income: Up to 40.8%
- State, City and other Country taxes may apply depending on beneficiary's residence
- Relief from Double Taxation may be available if multi-jurisdiction taxation applies

Taxation of FNGTs: Three layers

First taxable on **Distributable Net Income (DNI)**. Modest tax.



Non-cash distribution: Distribution is **lower of** Trust basis or FMV.



Alternative: Elect for Trust to recognise gain, distribution equals FMV, beneficiary's base cost is FMV.



No gain recognition by Trust, beneficiary inherits Trust's base cost in asset.



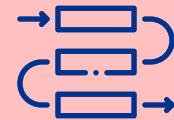
Uncompensated use of trust property (e.g. rent-free use of home): Deemed distribution of Fair market value of rent.

Taxation of FNGTs: Three layers

Next, taxable on **Undistributed Net Income (UNI)**. Adverse tax.



UNI is effectively a pool of undistributed income from prior years held within the trust.



“Throwback Tax” is charged. Complex process, but is essentially interest on the tax that would have been paid, if the income had been distributed (and taxed) to a U.S. beneficiary in the year it arose.



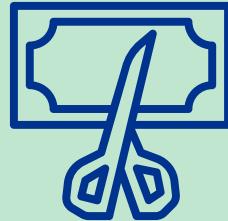
Accumulation Distributions (AD) are taxed punitively to the extent they are made from UNI.



Careful planning is required. Well-managed trust ensures UNI kept low, or \$0, at all times.

Taxation of FNGTs: Three layers

If no DNI or UNI, distribution is **corpus**. Not Taxable



No income tax due on distribution of corpus.

Reporting obligations - grantor trust

Foreign Grantor Trust must file Form **3520-A** "Annual Information Return of Foreign Trust With a U.S. Owner"

Due annually on **March 15**, extension available to September 15

Penalty for failure to timely file or furnish all info, or include incorrect information: **5%** of value of trust assets

Form 3520 "Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"

Due annually on **April 15**, if distributions or contributions made. Extension available to October 15

Penalty of **35%** of the amount transferred or distribution received

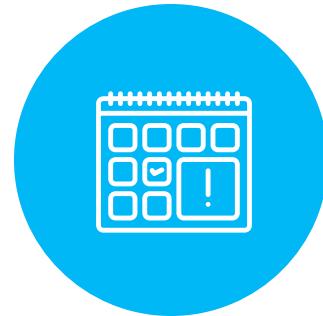
Reporting obligations- nongrantor trust

Beneficiary must file Form **3520** Annual
Return To Report Transactions
With Foreign Trusts and Receipt of
Certain Foreign Gifts



Reports distributions from the trust

Penalty of **35%** of the amount
distributed, for failure to timely report
distribution



Due annually on **April 15**, extension
available to October 15

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Residence and Domicile

Trust Residence

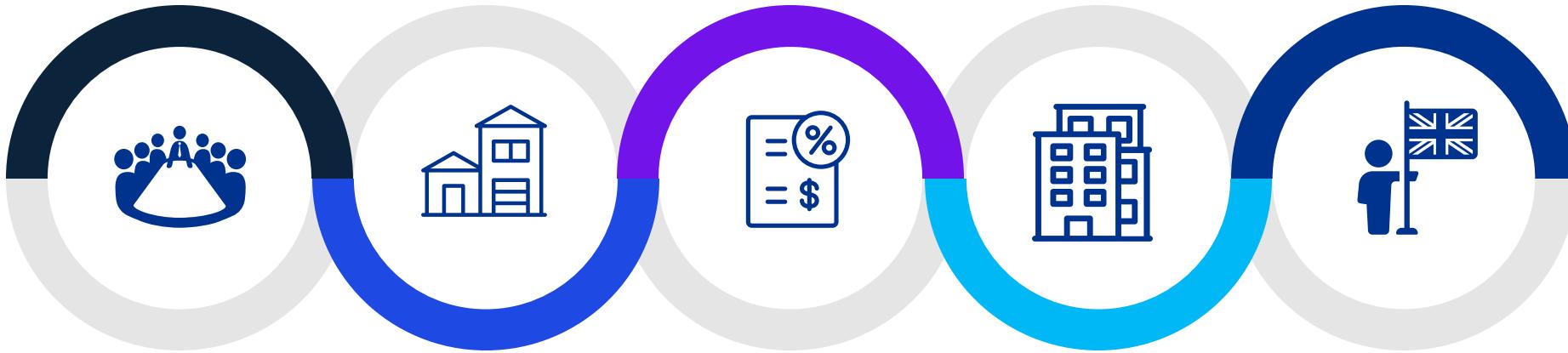
- Trusts are not legal entities so the position for UK tax purposes relies on the residence of trustees.
- Residence is defined in accordance with the type of entity in which the trustee falls is classed.
- Different criteria apply for individual trustees and corporate trustees.
- The residence of individual trustees is assessed in line with the Statutory Residence Test ("SRT").
- For corporate entities, residence for non-UK persons will be the location of management and control.
- The focus of this webinar is on trustees who are non-UK resident.



Other considerations

- Mixed residence trustees can create conflicts.
- Protectors and other persons with control can also have an impact on the residence of a trust.
- The local jurisdiction of the trust must also be considered.

Residence for Settlors & Beneficiaries



Trusts/trustees are independent of the settlor(s) and any beneficiaries so whilst the residence of these other parties is often not critical to determining the residence of a trust, they can still have an impact.

For mixed residence trusts, the residence and domicile of the settlor is used as a tiebreaker.

The residence of individual is again assessed under the Statutory Residence Test.

- Automatic UK tests
- Automatic overseas tests
- Sufficient ties test

The residence of settlors and beneficiaries can affect how distributions are taxed on beneficiaries.

Specific (and rather complex) anti-avoidance provisions can apply where there are UK resident settlors and/or beneficiaries.

Domicile

- Often confused with tax residence.
- Impacts income tax, capital gains tax and inheritance tax in different ways.



Common law domicile

- Domicile of choice
- Domicile of origin
- Domicile of dependency



Deemed domicile

- Long term residents
- Formerly domiciled residents
- Domiciled at some point in the last 3 years (only applies to IHT)

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Taxation of Trustees - Income & Gains

Trust Income



Trust Gains



Non-UK resident trustees are not subject to UK capital gains tax on disposal of UK assets.



Taxpayers must determine the situs of the assets in their possession for tax purposes.



The primary exception is the disposal of direct or indirect interests in UK real estate.



File a capital gains tax return within 60 days of completion of the disposal.



Penalties for late filing are raised in the same manner as income tax returns.



A CGT return must be filed regardless of whether there is any tax to pay.



Corporate trustees must file on paper so it is important that the trustees are efficient in appointing an agent as the return must be requested directly from HMRC.

Non-Compliance

- Penalties for non-compliance vary depending on the type of offence and behaviour of the taxpayer.
- Types of non-compliance can be broken down into four main categories:
 - Failure to notify
 - Failure to file on time
 - Inaccuracies
 - Failure to pay on time
- Notification is the first step in the compliance process and this must be undertaken within 6 months following the end of the tax year (i.e. 5 October). Failing to notify on time may result in a tax-geared penalty.

Behaviour	Max. penalty	Min. penalty(unprompted)		Min. penalty(prompted)	
Deliberate and concealed	100%	30%		50%	
Deliberate but not concealed	70%	20%		35%	
Non-deliberate	30%	< 12m	≥ 12m	< 12m	≥ 12m
		0%	10%	10%	20%

- The percentages above are a baseline and can differ depending on whether the non-compliance relates to an “offshore matter”. For some territories the percentages will be higher.

Non-Compliance

- Failure to file on time arises when a return is submitted late (i.e. after the statutory filing deadline).
- When filing online the deadline for filing income tax returns is 31 January following the end of the tax year; for paper returns the deadline is 31 October following the end of the tax year.
- As mentioned on the previous slide, CGT returns and payments of tax (if any) are due 60 days from the date of completion.
- The penalty regime which applies to inheritance tax is different.

Timeline	Penalty	
Day 1 after the filing deadline	£100	
3 months after “Day 1”	£10 per day (max. 90 days)	
6 months after “Day 1”	Greater of: £300; or 5% of tax liability	
12 months after “Day 1”	Deliberate and concealed	Greater of: £300; or 100% of tax liability
	Deliberate but not concealed	Greater of: £300; or 70% of tax liability
	Non-deliberate	Greater of: £300; or 5% of tax liability

05

Taxation of Trustees - UK Inheritance Tax

Liability to IHT - General

- For UK IHT purposes, trusts broadly fall into two categories:
 - Relevant property trusts; and
 - Trusts with a qualifying interest in possession.
- Special IHT rules apply to relevant property trusts and all trusts established on or after 22 March 2006
- The importance of settlor's domicile:
 - on creation of the trust; and
 - when additions made
- The importance of where trust assets are located (ie UK or foreign):
 - NB loans, UKRPI
- Chargeable events:
 - Ten-Year Anniversaries; and
 - Transfers of assets out of trust / Exit charges
- If settlor non-UK domiciled on creation, UK assets only within scope to IHT
- If settlor UK domiciled or deemed domiciled on creation, all assets within scope to IHT



Liability to IHT - Additions

- Finance Act 2020 changes:



Transfers of assets between settlements



Additions to excluded property trusts

Example 1 – Adding property to an excluded property trust

Sabina, when domiciled in Spain, transfers a house in Spain into a new settlement. Later she acquires a UK domicile and then adds some Australian property to the settlement.

The Spanish property is excluded property because of Sabina's non-UK domicile when she settled that property. However, the Australian property is not excluded property as Sabina had a UK domicile when she added that property to the settlement.

- Separate settlement fiction (same settlor or different settlor)
- NB Finance Act 2020 received Royal Assent on 22 July 2020 so may be different rules before and after

Liability to IHT - Settlor is Formerly Domiciled Resident

Definition of FDR:



Example 2 – Settlor is FDR

Brenda is born in Manchester, England in 1955. She has a UK domicile of origin. In 1980, at the age of 25 she moves to Singapore for work and remains there until her retirement at age 65. She acquires a domicile of choice of Singapore. She settles non-UK assets into trust in June 2012 at the age of 57.

In 2020/21 she returns to the UK and is UK resident from 2020/21 onwards. A ten-year anniversary charge on the trust potentially arises in June 2022. Brenda is UK resident in 2022/23 and was UK resident in 2021/22 (and 2020/21). Although the settled property was excluded property at the time of settlement, a ten-year anniversary charge arises in 2022. However, because the property remained excluded property until Brenda became a FDR on 6 April 2021 relief will be available for nine years of the ten.

NB this is so even if Brenda had re-acquired a common law UK domicile; she is still within the definition of an FDR and so the new rule applies.

IHT Compliance - Form IHT100

 HM Revenue & Customs

Inheritance Tax Account

Fill in this account to tell us about any of the events listed below. You should read the guidance notes before filling in any box on this or the accompanying forms. Complete all names and addresses in capital letters.

A About the chargeable event

Tick one of the following boxes.

Event	Tick box	Event form
A1 Gifts and other transfers of value including failed potentially exempt transfers.	<input type="checkbox"/>	IHT100a
A2 Ending of an interest in possession in settled property.	<input type="checkbox"/>	IHT100b
A3 Assets in a discretionary trust ceasing to be relevant property (proportionate charge), or a charge to tax arising on an age 18 to 25 trust.	<input type="checkbox"/>	IHT100c
A4 Discretionary trust 10-year anniversary (principal charge).	<input type="checkbox"/>	IHT100d
A5 Assets ceasing to be held on special trusts (flat rate charge). See form IHT110 'How to fill in form IHT100'.	<input type="checkbox"/>	IHT100e
A6 Cessation of conditional exemption and disposal of trees or underwood (recapture charge).	<input type="checkbox"/>	IHT100f
A7 Chargeable event in respect of an alternatively secured pension fund on death of scheme member, death of a dependant or relevant dependant, or relevant dependant ceasing to be a relevant dependant.	<input type="checkbox"/>	IHT100g

This account must be accompanied by the event form shown against the box you've ticked.

B About the transferor or settlor

Title of transferor or settlor
B1 _____

Surname of the transferor or settlor
B2 _____

Forename(s) of the transferor or settlor
B3 _____

Address, or last usual address of the transferor or settlor
B4 _____
Postcode _____

Date of birth of the transferor or settlor
B5 _____

Date of death of the transferor or settlor (where appropriate)
B6 _____

IHT reference for the transferor or settlor (where appropriate)
B7 _____

If you're a Trustee, you may have to register the trust using the Trust Registration Service to make sure the details are up to date. For more information, go to www.gov.uk/trusts-taxes/registering-a-trust

IHT100 www.gov.uk/inheritance-tax **Helpline 0300 123 1072** **HMRC 08/20**

- Offshore trustees generally have duty to submit IHT forms (whether or not an exemption applies and/or IHT is due)
- Deadline for submission and payment is 6 months from end of month in which chargeable event occurred (although for certain assets, can pay in 10 equal annual instalments)
- Different submission and payment dates applied to chargeable events occurring before 5 April 2014
- Interest levied on late payments of IHT
- Penalties charged on late submission of IHT forms:
 - £100 initial penalty
 - Further £100 penalty where forms filed > 6 months late
 - Up to £3k where forms are > 12 months late
- Penalties restricted to IHT liability due

Key Takeaways



IHT ten-year anniversary and exit charges are both reportable events to HMRC with the trustees bearing responsibility for completion of the relevant IHT forms

IHT liabilities payable by the trustees (although a beneficiary may pay the liability on an exit charge)

The liabilities are between 0% and 6% of the value of relevant property at the date of the IHT charge (so potentially not small numbers)

Most common scenarios under which IHT may be due:

- i. The trust was created by a non-domiciled individual but holds UK situs assets or a UKRPI on a TYA or distributes these assets to a beneficiary
- ii. The trust was created by a non-domiciled individual but additions were subsequently made to the trust when that same individual was UK domiciled or deemed domiciled
- i. The trust was created by a non-domiciled individual but additions were subsequently made to the trust by someone else who was either UK domiciled or deemed domiciled at that time thereby creating a separate settlement for IHT purposes
- ii. The trust was created by an FDR and that FDR subsequently becomes UK resident bringing all assets held by the trust within the scope of IHT on a TYA or exit charge
- iii. The trust was created by a UK domiciled or deemed domiciled individual (bearing in mind the complexity of the dd rules) thus bringing all assets held by the trust within the scope of IHT on a TYA or exit charge

06

UK Trust Registration Service

UK Trust Registration Service ("TRS")

Non-UK resident trusts with a UK tax liability are required to register on the TRS. Taxes covered: IT, CGT, IHT, SDLT, SDRT, LBTT (Scotland).



The EU's 5th AMLD

- All UK express trusts required to register unless specifically out of scope
- Non-UK express trusts:
 - **Acquire UK real estate after 6 October 2020**
 - **Form a business relationship in the UK after 6 October 2020 (e.g. financial or credit institution, accountant, tax adviser, estate agent, legal professional) and has at least one UK resident trustee**



Deadlines

- Existing trusts taxable before 6 April 2021: 5 October/31 January
- Trust becomes taxable from 6 April 2021: 90 days after becoming taxable
- Non-taxable trusts: 90 days after becoming registrable
- NB interaction between the CGT reporting service and TRS – may need to register sooner!

UK Trust Registration Service ("TRS")

Updating the TRS – must be done using HMRC online service within 90 days of any changes and when trust ceases

If liable to tax: annual declaration that the details on the TRS are accurate and up to date by 31 January following the end of the tax year

No annual declaration required for non-taxable trusts

Still need to register trust if trust terminated

No penalties if first offence (subject to deliberate behaviour) otherwise failure to register or keep up to date = financial penalties

07

The UK Register of Overseas Entities

UK Register of Overseas Entities ("ROE")

- Applies to overseas entities owning or acquiring a "qualifying estate" (being any freehold interest and any leasehold interest where the lease is for a term of seven years or more)
- Applies retrospectively to UK land and property acquired by overseas entities from 1 January 1999
- Requirement to register on the ROE at UK Companies House and disclose certain information regarding beneficial ownership and/or managing officers
- "Overseas entities" covers any body corporate, partnership, or other entity (but not individuals) governed by the law of a country or territory outside the UK.
- **31 January 2023** – End of the six-month transitional period during which overseas entities with existing "qualifying estates" must apply to be registered on the ROE. Entities that disposed of UK land or property after 28 February 2022 still need to register.
- Annual updates required to confirm information held on ROE is correct
- Failure to register = restrictions on the ability for overseas entities to sell or lease land interests or create a charge over it AND civil or criminal penalties.
- Members of public can access without charge



UK Register of Overseas Entities ("ROE")

Non-UK corporate trustees fall within the definition of an “overseas entity”

A beneficial owner is a person (e.g. individual, legal entity, trustee of a trust) that:

- directly or indirectly holds more than 25% of the shares in the overseas entity; or
- directly or indirectly holds more than 25% of the voting rights in the overseas entity; or
- directly or indirectly holds the right to appoint or remove a majority of the board of directors of the overseas entity; or
- exercises or has the right to exercise significant influence or control over the overseas entity, or
- has the right to exercise, or exercises, significant influence or control over a trust which meets any of the above conditions.

Registrable beneficial owners

- An individual
- A legal entity if subject to its own disclosure requirements
- A government or public authority

Subject to its own disclosure requirements means that an entity:

- is required to keep a register of persons with significant control (i.e. the UK's PSC register); or
- its voting shares are traded in a UK or EU regulated market, or
- it is itself registered on the ROE; or
- it provides trust services and is regulated in an overseas territory.

Managing officers

Verification checks

Questions?



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Thank You



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