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GMS Flash Alert

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United States - IRS Announces Relief for Reporting of Certain Foreign Trusts

On March 2, 2020, the U.S. Internal Revenue Service (IRS) released an advance version of Rev. Proc. 2020-17 (the Revenue Procedure) to provide selected U.S. citizens and residents an exemption from the information reporting requirements for certain tax-favored foreign retirement trusts and tax-favored foreign non-retirement savings trusts. The trusts that qualify for this relief will not need to be reported on Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*, or Form 3520-A, *Annual Information Return of Foreign Trust With a U.S Owner*.

The Revenue Procedure also includes procedures for requesting an abatement or refund of penalties imposed for failures to comply with reporting requirements concerning an applicable tax-favored foreign trust.

The Revenue Procedure will be effective as from March 16, 2020 (when it will be published in the *Internal Revenue Bulletin*) and it will generally apply to all prior open tax years.

WHY THIS MATTERS

Taxpayers who would otherwise be required to file Form 3520, due by April 15, 2020, and/or Form 3520-A due by March 16, 2020 for the 2019 tax year, will **not** now be required to file these forms if they qualify for the relief set out in the Revenue Procedure. Providing the taxpayer is eligible for the relief, this should alleviate the administrative burdens and related costs tied to filing these forms.

Relief: Exemption from Reporting Requirements

The Revenue Procedure provides an exemption from the information reporting requirements[1] for certain U.S. citizens and resident individuals with respect to their transactions with, and ownership of, certain tax-favored foreign trusts – specifically, tax-favored retirement trusts and tax-favored foreign non-retirement savings trusts that are established and operated exclusively or almost exclusively to provide pension or retirement benefits, or to provide medical, disability, or educational benefits. Absent this exemption, affected taxpayers would be required to file Form 3520 and/or Form 3520-A.

Applicable tax-favored foreign trusts generally are subject to written restrictions – such as contribution limitations, conditions for withdrawal, and information reporting, all of which are imposed under the laws of the country in which the trust is established. The IRS has determined that because U.S. individuals with an interest in these trusts may be required to separately report information about their interests in accounts held by, or through, these trusts on Form 8938, *Statement of Specified Foreign Financial Assets*, it would be appropriate to exempt U.S. individuals from the requirement to provide information about these trusts on Form 3520 and Form 3520-A.

Reporting Requirements the Relief Does Not Affect

The relief does not affect the Form 8938 filing requirement or any reporting obligations under any other provision of U.S. law, including the requirement to file FinCEN Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*. Moreover, the Revenue Procedure does not affect previously-issued guidance providing an exception from reporting with respect to distributions from certain foreign compensatory trusts[2] and an exception from all information reporting requirements with respect to certain Canadian retirement plans.[3]

Who Qualifies for Relief?

The relief provided by the Revenue Procedure is available to individuals who meet the definition of an 'eligible individual.' An eligible individual is a person who is or was a U.S. citizen or resident and who is compliant (or comes into compliance) with all requirements for filing U.S. federal income tax returns and has reported any contributions to, earnings of, or distributions from, an applicable tax-favored foreign trust.[4]

Which Foreign Trusts Are Affected?

The foreign trusts to which the relief provided by the Revenue Procedure apply fall into two categories: (a) tax-favored foreign retirement trusts, and (b) tax-favored foreign non-retirement savings trusts.

a. Tax-Favored Foreign Retirement Trusts

A foreign trust will qualify for the reporting exemption if it is a trust, plan, fund, scheme, or other arrangement set up in a foreign jurisdiction to operate exclusively or almost exclusively to provide, or to earn income for the provision of, pension or retirement benefits, and it meets the following requirements:[5]

(1) The trust is generally exempt from income tax or is otherwise tax-favored under the laws of the trust's jurisdiction. A trust is tax-favored if it meets any one of the following conditions:

a. Contributions to the trust that would be subject to tax are deductible or excluded from income, are taxed at a reduced rate, give rise to a tax credit, or are eligible for another tax benefit; and

b. Investment income earned by the trust is tax-deferred until distribution or is taxed at a reduced rate.

(2) Annual information reporting with respect to the trust (or of its participants or beneficiaries) is provided, or is otherwise available, to the relevant tax authorities in the trust's jurisdiction.

(3) Only contributions with respect to income earned from the performance of personal services are permitted.

(4) Contributions to the trust are limited by a percentage of earned income of the participant, are subject to an annual limit of $50,000 or less to the trust, or are subject to a lifetime limit of $1,000,000 or less to the trust.[6]

(5) Withdrawals, distributions, or payments from the trust are conditioned upon reaching a specified retirement age, disability, or death, or penalties apply to withdrawals, distributions, or payments made before such conditions are met (note provisions that allow for withdrawals, distributions, or payments for in-service loans or for reasons such as hardship, education purposes, or the purchase of a principal residence will not cause a trust to fail this condition).

(6) In the case of an employer-maintained trust, the trust is nondiscriminatory as regards the employees eligible to participate in it and the benefits provided.

A trust that satisfies the above conditions and is allowed to receive a rollover of assets or funds from another qualified tax-favored foreign retirement trust established and operated under the laws of the same jurisdiction will be treated as a tax-favored trust.

Additional details on the applicable requirements are set out in section 5.03 of the Revenue Procedure.

b. Tax-Favored Foreign Non-Retirement Savings Trusts

A foreign trust will qualify for the reporting exemption if it is a trust, plan, fund, scheme, or other arrangement set up in a foreign jurisdiction exclusively or almost exclusively to provide, or to earn income for the provision of, medical, disability, or educational benefits, and it meets the following requirements:[7]

(1) The trust is generally exempt from income tax or is otherwise tax-favored under the laws of the trust's jurisdiction.

(2) Annual information reporting with respect to the trust (or about the beneficiary or participant) is provided, or is otherwise available, to the relevant tax authorities in the trust's jurisdiction.

(3) Contributions to the trust are limited to $10,000 or less annually or $200,000 or less on a lifetime basis.[8]

(4) Withdrawals, distributions, or payments from the trust are conditioned upon the provision of medical, disability, or educational benefits, or apply penalties to withdrawals, distributions, or payments made before such conditions are met.

A trust that meets these conditions will be treated as a tax-favored trust even if it may receive a rollover of assets or funds from another qualifying tax-favored non-retirement savings trust established and operated under the laws of the same jurisdiction.

Additional details on the applicable requirements are set out in section 5.04 of the Revenue Procedure.

Penalty Relief

The Revenue Procedure sets out steps whereby eligible individuals who have been assessed a penalty for failing to comply with the Form 3520 or Form 3520-A filing requirements with respect to an applicable tax-favored foreign trust (without regard to whether such failure was due to reasonable cause) and who wish to obtain relief, may request an abatement of the penalty assessed, or a refund of the penalty paid, by filing Form 843, *Claim for Refund and Request for Abatement*.

KPMG NOTE

Prior to the issuance of this Revenue Procedure, there has been very little guidance from the IRS on the filing requirements for most foreign retirement and education trusts. Today's guidance appears to provide relief by removing

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the information return filing requirements for some taxpayers in the United States who hold assets in foreign pensions and other retirement plan foreign trusts. However, taxpayers will have to review each account or arrangement to determine whether it meets the requirements to be classified as a "tax-favored foreign trust."

FOOTNOTES:

1 I.R.C. sec. 6048.

2 Notice 97-34, 1997-1 C.B. 422, Sec. V.

3 Rev. Proc. 2014-55, 2014-44 I.R.B 753.

4 Rev. Proc. 2020-17, Sec. 5.02.

5 Rev. Proc. 2020-17, Sec. 5.03.

6 Contribution limits are determined using the U.S. Treasury Bureau of Fiscal Service foreign currency conversion rate on the last day of the tax year (available by clicking here).

7 Rev. Proc. 2020-17, Sec. 5.04.

8 Determined using the U.S. Treasury Bureau of Fiscal Service foreign currency conversion rate on the last day of the tax year (available by clicking here).

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The above information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 as the content of this document is issued for general informational purposes only.

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