

SWISS TRUSTEES AND BOARD MEMBERS OF FOUNDATIONS HAVE TO PREPARE FOR F.A.T.C.A.

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Tags

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BACKGROUND

Trusts are unknown under Swiss law and family foundations are not commonly used because their purpose is very limited by law. Consequently, many Swiss trust companies, family offices or lawyers act as trustees of non-Swiss trusts or as members of family foundations. It is not uncommon for trustees, trusts or foundations, and underlying companies to be established under the laws of different jurisdictions, and typically Liechtenstein is used.

Foreign trusts and foundations, foreign trustees and underlying holding companies that invest in the U.S. must determine their classification under the Foreign Account Tax Compliance Act ("F.A.T.C.A.") and possibly a relevant intergovernmental agreement ("I.G.A."). In the case of Switzerland, a Model 2 I.G.A. exists.

The determination must be made prior to the end of June 2014, even if no U.S. owners or beneficiaries are involved. The reason is that, by 1 July 2014, a foreign entity that is a Foreign Financial Institution ("F.F.I.") must register on the I.R.S. F.A.T.C.A. portal and receive a G.I.I.N. The I.R.S. has announced that the last date to register and receive a G.I.I.N. prior to 1 July 2014 is 5 May. Registration is required unless the F.F.I. is a certified deemed-compliant F.F.I. or a Non-Financial Foreign Entity ("N.F.F.E."). An exempt F.F.I. could be a sponsored investment entity, a sponsored closely held investment vehicle, or an owner-documented F.F.I. In each of those fact patterns, another entity is engaged to carry out the F.A.T.C.A. reporting. An N.F.F.E. is an entity that is formed outside the U.S. that is not an F.F.I.

RELEVANT JURISDICTION

On 14 February 2013, Switzerland and the U.S. signed an I.G.A. It was amended on 30 September 2013 in line with the new timetable for F.A.T.C.A. implementation. Swiss financial institutions now have to implement F.A.T.C.A. to be fully compliant as of 1 July 2014 rather than from 1 January 2014 as initially stated.

Unlike most other countries, Switzerland signed a Model 2 I.G.A., which provides for direct reporting by the Swiss financial institution to the I.R.S. For F.F.I.'s covered by a Model 1 I.G.A., reporting is to be made to the local country's competent authority, which will automatically report the information to the I.R.S. The Swiss parliament approved the Swiss Model 2 I.G.A. and also passed the

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corresponding law for the implementation of the I.G.A., which should be effective before 1 July 2014.

As a result, Swiss reporting F.F.I.'s must comply with the Swiss F.A.T.C.A. law, the Swiss Model 2 I.G.A., and F.A.T.C.A. They will be required to register as participating F.F.I.'s with the U.S., unless exempted or certified deemed-compliant.

Liechtenstein and the U.S. have in substance reached a Model 1 I.G.A. The text has not yet been released, but the U.S. Treasury treats the Model 1 I.G.A. as if it were in effect as of 2 April 2014. Thus, financial institutions in Liechtenstein are allowed to register on the F.A.T.C.A. registration website, but the last date for registration in order to timely receive a G.I.I.N. is deferred until the end of the year.

ARE TRUSTS AND FOUNDATIONS FINANCIAL INSTITUTIONS?

The definition of "financial institution" is very broad. It includes all entities that hold funds on a fiduciary basis on behalf of other persons. Passive investment companies are typically included since their only purpose is to hold funds of the shareholder and ultimate beneficial owner.

Many professional organizations, such as the American College of Trusts and Estates Counsel, have argued that foreign trusts should be treated as N.F.F.E.'s and not as F.F.I.'s. The F.A.T.C.A. regulations accept this view if the trust, foundation, or holding company does not retain managers that are entities engaged in the business of giving investment advice to customers. On the other hand, a trust, foundation, or holding company will be an F.F.I. if it retains an entity engaged in the business of giving investment advice to customers and more than 50% of the gross income of the trust, foundation, or holding company is derived from investing in stocks, bonds, partnership interests and similar assets. Charitable trusts or foundations are classified as Non-Reporting F.F.I.'s under an I.G.A.

In comparison to F.F.I.'s, N.F.F.E.'s are generally subject to less stringent F.A.T.C.A. compliance obligations. Consequently, foreign trusts or foundations that are not managed by entities engaged in the business of giving investment advice to customers may avoid F.F.I. classification. Nonetheless, they will be required to provide withholding agents (including U.S. banks and Reporting F.F.I.'s with information about U.S. beneficiaries having substantial interests in the trust). Trustees can pass the reporting obligation down to a wholly owned holding company if reporting is problematic for the trustee. If they hold all investments through a holding company that is categorized as a corporation for U.S. tax purposes, the holding company will be subject to F.A.T.C.A. compliance obligations as an F.F.I. in its own right, but not the trust. If disclosure of information on beneficiaries is problematic, a foreign trust or foundation that is an N.F.F.E. can avoid F.A.T.C.A. disclosure to third parties by forming its holding company in the U.S., thereby taking steps to be compliant but limiting the dissemination of confidential information so that the U.S. party receiving information is within the group. This may have suboptimal U.S. tax consequences if the investment portfolio is structured to generate items of tax-free portfolio debt for foreign investors and capital gains from publicly traded equity securities.

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SWISS FINANCIAL INSTITUTIONS

Specific I.G.A.'s generally apply to entities that are resident in the foreign country or that are organized under the laws of that country. While most I.G.A.'s define a financial institution as one that is "resident" in the country signing the I.G.A., Switzerland chose the definition based on organization in Switzerland. Some advisers suggest that "organized under the laws of Switzerland" means managed and controlled in Switzerland. This substance-over-form approach could lead to a result where a Liechtenstein foundation could be viewed as a Swiss F.F.I. if it is managed and controlled by Swiss board members. Merely receiving bank statements or carrying on an accounting function for the trust or foundation is likely not sufficient for the management and control of a trust or foundation to exist in Switzerland.

It is the view of the authors that this interpretation is not supported by the Swiss Model 2 I.G.A. The German translation interprets the term "organized" as "established or settled under the laws of Switzerland." Accordingly, any trust or foundation settled outside Switzerland could never be considered a Swiss Financial Institution as form of organization controls over the substance of management. Thus, the Swiss Model 2 I.G.A. would not be applicable to determine the classification of the trust or foundation. The Swiss trustee on the other hand or an underlying holding company incorporated under the laws of Switzerland would fall under the Swiss Model 2 I.G.A.

Custodial or depository institutions, investment entities or specified insurance companies having their place of organization in Switzerland will be characterized as Swiss F.F.I.'s. For purposes of the Swiss Model 2 I.G.A., an investment entity is any entity that conducts as a business (or is managed by an entity that conducts as a business) one or more of the following activities or operations for or on behalf of a customer:

- Trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures;
- Individual and collective portfolio management; or
- Otherwise investing, administering, or managing funds or money on behalf of other persons.

In comparison to the F.A.T.C.A. rules, the Swiss Model 2 I.G.A. provides that the term "investment entity" should be interpreted in a manner consistent with similar language set forth in the definition of "financial institution" in the Financial Action Task Force Recommendations. Although this definition is very broad, it is limited to financial services subject to the Swiss Anti-Money Laundering Law. Thus, an entity managed directly by its beneficial owners (not to exceed the number of 20) is not covered by the anti-money laundering law and therefore not subject to the Swiss Model 2 I.G.A. or F.A.T.C.A. The result, however, is similar to the F.A.T.C.A. rule

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described above under which a trust, foundation or holding company will not be considered to be an F.F.I. if its assets are not managed by an entity engaged in the business of giving investment advice to customers.¹

U.K. OR LIECHTENSTEIN FINANCIAL INSTITUTIONS

The U.K. and Liechtenstein have entered into Model 1 I.G.A.'s. Each Model 1 I.G.A. defines a financial institution as one that is "resident" in the respective country.

The updated U.K. guidance notes of 28 February 2014 regarding the Implementation of The International Tax Compliance (United States of America) Regulations 2013 make clear that in cases where the residence of an F.F.I. is less obvious, H.M.R.C. will determine the entity's status from the tax residence of the entity. If the F.F.I. is resident for tax purposes in the U.K., H.M.R.C. will regard the F.F.I. as within the scope of the U.K. Model 1 I.G.A.

For these purposes, residence in the U.K. means the following:

- For a company – the company is incorporated in the U.K. or centrally managed and controlled in the U.K.
- For a company not resident in the U.K. – it is within the charge to corporation tax because it carries on a trade in the U.K. through a permanent establishment in the U.K.
- For a trust – all the trustees are resident in the U.K. Where some of the trustees are U.K. tax resident, the trust is treated as U.K. resident if the settlor is both resident and domiciled in the U.K. for tax purposes.

Liechtenstein has not issued any guidance at this time.

SWISS TRUSTEES OR BOARD MEMBERS OF LIECHTENSTEIN TRUSTS OR FOUNDATIONS

Swiss trustees or board members of a Liechtenstein foundation have an initial obligation to determine their own classification under F.A.T.C.A. and the applicable I.G.A. If they meet the criteria of an investment entity, they must undertake due diligence and prepare to register with the I.R.S. If the applicable I.G.A. is the Swiss Model 2 I.G.A., they must do this by the end of June 2014. If the applicable I.G.A. is the Liechtenstein Model 1 I.G.A., the target date for registration is the end of the year.

Even professional trust companies acting as trustees must register in order to comply with the respective I.G.A. In this way, they can avoid the withholding taxes

¹ See Treas. Reg. §1.1471-5(e)(4)(v) Example 5 and 6.

that will be imposed under F.A.T.C.A. on an F.F.I. that fails to have a system in place that documents U.S. owners or account holders, if any.

Private trustee companies may be classified as N.F.F.E.'s. These trustee companies remain obligated to certify their F.A.T.C.A. status to withholding agents, but they are not subject to F.A.T.C.A. due diligence. In order to be classified as an N.F.F.E., a private trust company must not meet any of the broad criteria that defines an investment entity. Consequently, they must limit their activity to fiduciary activity for the trusts and foundations they serve.

The classification of the trustee or manager as an N.F.F.E. does not result in the trust or foundation being categorized as an N.F.F.E. As outlined above, the trust or foundation could be classified as an F.F.I. if a financial institution is engaged to manage the trust or the financial assets for the trust. F.F.I. status for the trust or foundation can be avoided if investments are managed by an individual who is not employed by an investment entity.

SUMMARY

Regarding non-Swiss trusts and foundations, the Swiss Model 2 I.G.A. is not applicable because neither the trust nor the foundation is organized under the laws of Switzerland. Thus, the I.G.A. of the jurisdiction where the trust or foundation is resident would typically be applicable and should be analyzed.

If the trust or foundation is resident in Liechtenstein, the Liechtenstein Model 1 I.G.A. is applicable. A Liechtenstein trust or foundation that is professionally managed would be classified as an F.F.I. The Liechtenstein Model 1 I.G.A. provides for trustee-documented F.F.I. classification for trusts where the trustee is itself a reporting F.F.I. The trustee or manager will be required to identify any trust or foundation for which it provides fiduciary services if it has U.S. beneficiaries. For those trusts or foundations, it must submit an annual report to the I.R.S. containing information regarding, *inter alia*, income and distributions affecting the U.S. beneficiaries.

According to the guidance notes of H.M.R.C., a trust settled under U.K. law is not tax resident in the U.K. when all its trustees are outside the U.K. Consequently, if all trustees are resident in Switzerland, the U.K. trust will not be tax resident in the U.K. and the U.K. Model 1 I.G.A. would not be applicable. Additionally, the Swiss Model 2 I.G.A. will be applicable only if the trust is organized under Swiss law. Some have suggested that a substance-over-form interpretation should be applied to determine where the trust is "organized." If this view is correct, the Swiss Model 2 I.G.A. would be applicable. However, the German translation is clear that the Swiss Model 2 I.G.A. cannot apply. A trust must be settled under the laws of Switzerland to qualify for coverage by the Swiss Model 2 I.G.A. Consequently, the F.A.T.C.A. regulations, unmodified by any I.G.A., would be applicable to the trust in this fact pattern.

If a trust is settled under Swiss law or a foundation is formed under Swiss law, the Swiss Model 2 I.G.A. will be applicable. If it is professionally managed by an investment entity that is itself organized pursuant to the laws of Switzerland, the trust or foundation would qualify as a Swiss F.F.I. In this case, the trust must be registered with the I.R.S. directly under F.A.T.C.A.

