

LB&I International Practice Service Process Unit – Audit

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Unit Name	Foreign Grantor Trust Determinations – Part I – Section 679
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Process Overview

Foreign Grantor Trust Determination – Part I – Section 679

Process Description

- Once it is determined that a foreign trust exists, (refer to International Practice Service (IPS) Unit “Defining the Entity – Foreign Trusts”) a determination must be made on whether the foreign trust will be treated as a foreign grantor trust or a foreign non-grantor trust for United States (U.S.) tax purposes. Making this determination is important because it affects who is taxed on the income of the trust and when they are taxed.
- Any foreign trust not determined to be a grantor trust will be treated as a foreign non-grantor trust for U.S. tax purposes. The taxation of foreign non-grantor trusts is covered in the “Taxation of Foreign Non-Grantor Trusts” IPS Unit.
- The Foreign Grantor Trust determination is divided into two IPS Units. The “Foreign Grantor Trust Determination – Part I – Section 679,” will discuss the rules of Internal Revenue Code (IRC) § 679. This section provides that a foreign trust that has, or is deemed to have, U.S. beneficiaries will generally be treated as a grantor trust to the extent a U.S. person has transferred property to it. Consequently, a U.S. transferor will generally be treated as the trust’s owner in proportion to the value of the transferred property.
- “Foreign Grantor Trust Determination – Part II – Sections 671-678” is an IPS Unit on the grantor trust rules under IRC §§ 673-678 which apply to all trusts whether foreign or domestic.
- IRC § 679 rules apply without regard to the grantor or transferor's retained powers over the trust, and the section specifically applies only to foreign trusts, a determination under IRC § 679 takes precedence over the rules found in IRC §§ 673-678.
- ***This unit should always be examined first in determining whether a foreign trust will be treated as a foreign grantor trust.***
- IRC § 679 is specifically designed to prevent U.S. taxpayers from achieving tax-free deferral by transferring property to foreign trusts.

Process Overview (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Example Circumstances Under Which Process Applies

- U.S. Person (USP) transfers, directly or indirectly, property to a foreign trust and the foreign trust has, or is deemed to have, one or more U.S. beneficiaries.
 - USP gratuitously transfers funds to a financial account held in the name of a foreign trust that has, or is deemed to have, one or more U.S. beneficiaries or
 - USP is treated as the owner of a portion of a domestic trust under the grantor trust rules of IRC §§ 673-678, and there is a transfer of property from that portion of the domestic trust to a foreign trust that has, or is deemed to have, one or more U.S. beneficiaries. Under these circumstances, the transfer is treated as a transfer from the USP to the foreign trust. (Refer to IPS Unit Foreign Grantor Trust Determination – Part II – Sections 671-678.)

- Note : A USP can be an individual or an entity.

- For purposes of IRC § 679, the term “U.S. person” is defined under Treas. Reg. § 1.679-1(c)(2) as:
- A U.S. person as defined under IRC § 7701(a)(30), which includes:
 - citizen or resident of the U.S. See IRC § 7701(a)(30)(A)
 - A domestic partnership See IRC § 7701(a)(30)(B)
 - A domestic corporation See IRC § 7701(a)(30)(C)
 - Any estate (other than a foreign estate within the meaning of IRC § 7701(a)(31))
 - A domestic trust (as defined in IRC § 7701(a)(30)(E) and regulations)

- A nonresident alien individual who elects under IRC § 6013(g) to be treated as a resident of the U.S.
- An individual who is a dual resident taxpayer within the meaning of Treasury Regulation (Treas. Reg.) § 301.7701(b)-7(a).

Determination of Process Applicability

Foreign Grantor Trust Determination – Part I – Section 679

A foreign trust that has, or is deemed to have, U.S. beneficiaries will generally be treated as a foreign grantor trust under IRC § 679 to the extent a USP has gratuitously transferred property to it. If a foreign trust is characterized as a grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property. In general, any person treated as the owner of the trust is taxed directly on the income earned by the property placed in the trust. A USP treated as an owner of a trust is required to report his or her share of trust income, deductions, and credits as if those items were received or paid directly by the USP.

Criteria	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ In order for the grantor trust rule of IRC § 679 to apply, all four elements must be present: <ol style="list-style-type: none"> 1. The foreign trust must have, or be deemed to have, one or more U.S. beneficiaries. This determination is made on an annual basis. 	<ul style="list-style-type: none"> ▪ IRC 679(a)(1) ▪ Treas. Reg. 1.679-1(a) & (b) ▪ Treas. Reg. 1.679-2(a) & (b) 	
<ol style="list-style-type: none"> 2. There must be a direct or indirect transfer of property to the foreign trust. <ul style="list-style-type: none"> - The term “property” means any property including cash. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3 ▪ Treas. Reg. 1.679-1(c)(4) 	
<ol style="list-style-type: none"> 3. The direct or indirect transfer must be made by a USP. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-1(a) ▪ Treas. Reg. 1.679-1(c)(1) & (c)(2) 	

Determination of Process Applicability (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

A foreign trust that has, or is deemed to have, U.S. beneficiaries will generally be treated as a foreign grantor trust under IRC § 679 to the extent a USP has gratuitously transferred property to it. If a foreign trust is characterized as a grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property. In general, any person treated as the owner of the trust is taxed directly on the income earned by the property placed in the trust. A USP treated as an owner of a trust is required to report his or her share of trust income, deductions, and credits as if those items were received or paid directly by the USP.

Criteria	Resources	6103 Protected Resources
4. The trust to which the transfer is made must be a foreign trust.	<ul style="list-style-type: none"> ▪ IRC 679 ▪ Treas. Reg. 1.679-1(a) ▪ Treas. Reg. 1.679-1(c)(3) ▪ Treas. Reg. 301.7701-7 ▪ IPS Unit Defining the Entity – Foreign Trusts provides specific details for the process of determining if a trust is a domestic or foreign trust. 	

Summary of Process Steps

Foreign Grantor Trust Determination – Part I – Section 679


Step 1	Determine if the trust is domestic or foreign.
Step 2	Determine if there was a direct or indirect transfer of property to the foreign trust.
Step 3	Determine if the transfer of property to the foreign trust was made by a U.S. person.
Step 4	Determine if the foreign trust has, or is treated as having, one or more U.S. beneficiaries.

Step 1

Foreign Grantor Trust Determination – Part I – Section 679

Step 1: Determine if the trust is domestic or foreign.

The first step is to determine whether the trust is a domestic trust or a foreign grantor trust by operation of IRC § 679. IRC § 679 only applies to foreign trusts without regard to the grantor or transferor's retained powers over the trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ IRC § 679 only applies when property is transferred to a foreign trust. The existence of a foreign trust is the most fundamental requirement for IRC § 679 to apply, and should be considered before examining the other elements. <p> DECISION POINT: If both the court and control test (described at Treas. Reg. § 301.7701-7) are met, the trust is a domestic trust and IRC § 679 will not apply to treat the trust as a foreign grantor trust. However, the grantor trust rules of IRC §§ 673 - 678 may apply to treat the domestic trust as a grantor trust. See IPS Unit Foreign Grantor Trust - Determination - Part II - Sections 671-678</p>	<ul style="list-style-type: none"> ▪ IPS Unit Defining the Entity - Foreign Trusts provides specific details for the process of determining if a trust is a domestic or foreign trust. ▪ IRC 679 ▪ Treas. Reg. 1.679-1(a) ▪ Treas. Reg. 1.679-1(c)(3) ▪ Treas. Reg. 301.7701-7 ▪ <u>Trust Instrument</u> – refer to the Trust Instrument to determine where the trust is administered, whether there is an automatic migration clause and who makes all substantial decisions. 	

Step 2

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ A transfer means a direct, indirect, or constructive transfer. Consideration must be given to whether any transfer has been made, including, indirect or constructive transfers which may be more difficult to detect. ▪ Direct Transfers: A direct transfer to a foreign trust is generally straightforward. Example: Title to property or cash is transferred directly from the transferor to the foreign trust. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3(a) ▪ Trust Instrument - Request and Review it to determine initial property transferred to trust. ▪ Request information on property subsequently held in the trust and how trust obtained that property. ▪ IPS Unit Foreign Grantor Trust - Determination - Part II - Sections 671-678 	

Step 2 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ A direct transfer may include a transfer of property to a foreign trust from another trust (domestic or foreign) of which a USP is treated as the owner. If any portion of a trust is treated as owned by a USP, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the U.S. owner to the foreign trust. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3(b) ▪ Treas. Reg. 1.679-3(b)(2) 	

Step 2 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ <i>Example:</i> In 2001, A, a U.S. citizen, creates and funds DT, a domestic trust. A is treated as the owner of DT under the grantor trust rules of IRC §§ 671 - 678 (Refer to IPS Unit Foreign Grantor Trust Determination – Part II – Sections 671-678). In 2004, DT transfers property to FT, a foreign trust. A is treated as having transferred the property to FT in 2004 for purposes of this section. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3(a) ▪ Trust Instrument - Request and Review it to determine initial property transferred to trust. ▪ Request information on property subsequently held in the trust and how trust obtained that property. ▪ IPS Unit Foreign Grantor Trust - Determination - Part II - Sections 671-678 ▪ Treas. Reg. 1.679-3(b) ▪ Treas. Reg. 1.679-3(b)(2) 	

Step 2 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Indirect Transfers: ▪ Indirect transfers to foreign trusts may take many forms, including using other persons or entities as intermediaries to conduct the actual transfer to the foreign trust. ▪ A transfer to a foreign trust by any person (intermediary) to whom a USP transfers property is treated as an indirect transfer by a USP to the foreign trust if, such transfer is made pursuant to a plan, one of the principal purposes of which is the avoidance of U.S. tax. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3(c)(1) ▪ Treas. Reg. 1.679-3(c)(5), Example 1 	

Step 2 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ <i>Example:</i> A, a U.S. citizen, creates and funds FT, a foreign trust, for the benefit of A's children, who are U.S. citizens. In 2004, A decides to transfer an additional \$1,000 to the foreign trust. Pursuant to a plan with a principal purpose of avoiding the application of IRC §679, A transfers \$1,000 to I, a foreign person. I subsequently transfers \$1,000 to FT. A is treated as having made a transfer of \$1,000 to FT.		

Step 2 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ An indirect transfer to a foreign trust will be deemed to exist if <u>both</u> of the following factors are met: <ol style="list-style-type: none"> 1. The USP is related to a beneficiary of the foreign trust, or has another relationship with a beneficiary that establishes a reasonable basis for concluding the U.S. transferor would make a transfer to the foreign trust, <p>AND...</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3(c)(2)(i) ▪ Treas. Reg. 1.679-3(c)(4) ▪ IRC 643(i)(2)(B), with a couple of modifications, defines related parties. 	

Step 2 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<p>2. The USP <i>cannot</i> demonstrate that:</p> <ul style="list-style-type: none"> ▪ The intermediary has a relationship with a beneficiary of the foreign trust that establishes a reasonable basis for concluding the intermediary would make a transfer to the foreign trust; ▪ The intermediary acted independently of the USP; ▪ The intermediary is not an agent of the USP under generally applicable United States agency principles; and ▪ The intermediary timely complied with the reporting requirements of IRC § 6048, if applicable. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3(c)(2)(ii) ▪ IPS Unit Failure to File the Form 3520/3520-A - Penalties 	

Step 2 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Constructive Transfers: ▪ A constructive transfer to a foreign trust should also be considered in determining if there has been a transfer to a foreign trust. ▪ A constructive transfer includes any assumption or satisfaction of a foreign trust's obligation to a third party. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3(d)(1) 	

Step 2 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ <i>Example:</i> A foreign trust owes \$100,000 to an unrelated foreign corporation because the foreign corporation performed services for the foreign trust. Your individual taxpayer, who is a USP, transfers \$100,000 to the foreign corporation on behalf of the foreign trust and in satisfaction of the foreign trust's liability to the foreign trust. Given these facts, your individual taxpayer is treated as having made a constructive transfer of property to a foreign trust.		

Step 2 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 2: Determine if there was a direct or indirect transfer of property to the foreign trust.

The second step in determining whether IRC § 679 applies to treat a foreign trust as a foreign grantor trust is to determine if there was either a direct or indirect transfer of property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust. If a foreign trust is characterized as a foreign grantor trust under IRC § 679, the trust is ignored for income tax purposes and the grantor is treated as owner of the trust in proportion to the value of the transferred property.

Below discusses the rules considered in determining whether there were direct or indirect transfers of property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ In addition, consider any transfers to entities owned by a foreign trust in determining if a transfer of property was made to a foreign trust. ▪ If a USP, who is a related person to a foreign trust, transfers property to an entity in which the foreign trust holds an ownership interest, it will be deemed to be a transfer of property by the USP to the foreign trust, followed by a transfer of the property from the foreign trust to the entity owned by the foreign trust, unless, the USP demonstrates the transfer to the entity is properly attributable to the USP's ownership interest in the entity. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3(f)(1) 	

Step 3

Foreign Grantor Trust Determination – Part I – Section 679

Step 3: Determine if the transfer of property to the foreign trust was made by a U.S. person

The third step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if there was a USP who has transferred property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ IRC § 679 applies in recognizing a <u>USP</u> as the owner of a foreign trust, only if the USP directly or indirectly, gratuitously transferred property to the foreign trust. IRC § 679 does not apply to treat a <u>foreign</u> person as the owner of any portion of a foreign trust. ▪ It is important to determine who transferred property to the foreign trust and whether the transferor is a USP, because the USP will be treated as the owner of any assets that person transferred to the foreign trust. A USP treated as the owner of the portion of the foreign grantor trust will be taxed on the trust's income attributable to the transferred property. 	<ul style="list-style-type: none"> ▪ IRC 679 ▪ IRC 672(f)(1) and (f)(5) ▪ IPS Unit Foreign Grantor Trust Determination – Part II – Sections 671-678 Issue #4 for a detailed discussion. 	

Step 3 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 3: Determine if the transfer of property to the foreign trust was made by a U.S. person

The third step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if there was a USP who has transferred property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust.


Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ In addition, the outbound migration of a domestic trust may be treated as a transfer by a USP to a foreign trust. ▪ IRC § 679(a)(5) prevents U.S. individuals from circumventing IRC § 679 by transferring property to a domestic trust and then causing the domestic trust to become a foreign trust ("migrating" from the U.S. to a foreign jurisdiction). 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-1(c)(2) ▪ IRC 679(a)(5) 	

Step 3 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 3: Determine if the transfer of property to the foreign trust was made by a U.S. person

The third step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if there was a USP who has transferred property to the foreign trust. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if a USP gratuitously transfers, either directly or indirectly, property to a foreign trust.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Outbound Migration of a Domestic Trust ▪ If an individual who is a U.S. person transfers property to a domestic trust, and that trust becomes a foreign trust while the USP is still alive, the USP is treated as a U.S. transferor and is deemed to have transferred the property to a foreign trust on the date the domestic trust becomes a foreign trust. ▪ The property deemed transferred includes both the original transferred property and any undistributed net income attributable to such property. <p> DECISION POINT: If it is clear that a USP has transferred property to a foreign trust then continue on to step 4 in determining whether IRC § 679 applies (step 4 requires determining whether the foreign trust has a U.S. beneficiary).</p>	<ul style="list-style-type: none"> ▪ IRC 679(a)(5) ▪ Treas. Reg. 1.679-6(a) ▪ Treas. Reg. 1.679-6(b) ▪ Treas. Reg. 1.679-1(c)(2) 	

Step 4

Foreign Grantor Trust Determination – Part I – Section 679

Step 4: Determine if the foreign trust has, or is treated as having, one or more U.S. beneficiaries.

The fourth and final step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if the foreign trust has, or is deemed to have, at least one U.S. beneficiary for a taxable year. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if the trust has a U.S. beneficiary, or is deemed to have, a U.S. beneficiary.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The determination of whether a foreign trust has a U.S. beneficiary is made on an annual basis. ▪ <u>All foreign trusts will be treated as having a U.S. beneficiary during the taxable year of the U.S. transferor, unless:</u> <ol style="list-style-type: none"> 1. Under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of, directly or indirectly, a USP; <p>And</p> <ol style="list-style-type: none"> 2. If the trust were to be terminated at any time during the taxable year, no part of the income or corpus of such trust could be paid to or for the benefit of, directly or indirectly, a USP. 	<ul style="list-style-type: none"> ▪ IRC 679(c)(1) ▪ Treas. Reg. 1.679-2(a)(1) ▪ Treas. Reg. 1.679-2(a)(1)(i) ▪ IRC 679(c)(1)(A) ▪ Treas. Reg. 1.679-2(a)(1)(ii) ▪ IRC 679(c)(1)(B) ▪ Treas. Reg. 1.679-2(a)(2) 	

Step 4 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 4: Determine if the foreign trust has, or is treated as having, one or more U.S. beneficiaries.

The fourth and final step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if the foreign trust has, or is deemed to have, at least one U.S. beneficiary for a taxable year. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if the trust has a U.S. beneficiary, or is deemed to have, a U.S. beneficiary.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ This determination is made without regard to whether income or corpus is actually distributed to a USP during the year. The determination is also made without regard to whether a USP's interest in the trust income or corpus is contingent on a future event.		

Step 4 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 4: Determine if the foreign trust has, or is treated as having, one or more U.S. beneficiaries.

The fourth and final step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if the foreign trust has, or is deemed to have, at least one U.S. beneficiary for a taxable year. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if the trust has a U.S. beneficiary, or is deemed to have, a U.S. beneficiary.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ <u>Records and documents:</u> To determine whether there is a U.S. beneficiary request and review the terms of the trust instrument based on the following: <ul style="list-style-type: none"> ▪ All written and oral agreements and understandings related to the trust including Memoranda or letters of wishes; ▪ All records that relate to the actual distribution of income and corpus; and ▪ All other documents that relate to the trust, whether or not of any purported legal effect (including codicils, amendments, modifications, etc.). Additionally, records that pertain to the use of trust assets may need to be considered. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-2(a)(4)(i) 	

Step 4 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 4: Determine if the foreign trust has, or is treated as having, one or more U.S. beneficiaries.

The fourth and final step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if the foreign trust has, or is deemed to have, at least one U.S. beneficiary for a taxable year. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if the trust has a U.S. beneficiary, or is deemed to have, a U.S. beneficiary.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ <u>Additional factors to consider in determining whether there is a U.S. beneficiary:</u> Take into account whether the trust agreement includes all written and oral changes, modifications, codicils, etc., whether there are other written or oral agreements or understandings relating to the trust, and: <ul style="list-style-type: none"> ▪ The trust can be amended to benefit a USP; ▪ Even if the trust terms do not provide benefits for a USP, may the law applicable to the foreign trust require distributions or accumulations to or for the benefit of any USP; and ▪ The parties to the trust ignored or can reasonably be expected to ignore the terms of the trust, thus providing benefits to a USP. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-2(a)(4)(ii) 	

Step 4 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 4: Determine if the foreign trust has, or is treated as having, one or more U.S. beneficiaries.

The fourth and final step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if the foreign trust has, or is deemed to have, at least one U.S. beneficiary for a taxable year. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if the trust has a U.S. beneficiary, or is deemed to have, a U.S. beneficiary.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Presumption of US Beneficiary: ▪ The IRC presumes every foreign trust has a U.S. beneficiary unless the transferor can demonstrate otherwise. To establish the trust does not have a U.S. beneficiary, the transferor must submit information regarding the transfer(s) and must demonstrate, to the satisfaction of the Secretary of the Treasury, the transfer(s) satisfies the requirements of IRC § 679(c)(1)(A) and (B). This statutory presumption is effective for transfer(s) of property after 3/18/2010. 	<ul style="list-style-type: none"> ▪ IRC 679(d) ▪ IRC 679(c)(1)(A) and (B). 	

Step 4 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 4: Determine if the foreign trust has, or is treated as having, one or more U.S. beneficiaries.

The fourth and final step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if the foreign trust has, or is deemed to have, at least one U.S. beneficiary for a taxable year. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if the trust has a U.S. beneficiary, or is deemed to have, a U.S. beneficiary.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ When considering whether a foreign trust has, or is treated as having, a U.S. beneficiary, you need to take into account any indirect beneficiaries. ▪ Indirect U.S. Beneficiary: ▪ An amount is treated as paid or accumulated by a foreign trust for the benefit of a USP if the amount is paid or accumulated for the benefit of: <ul style="list-style-type: none"> ▪ A controlled foreign corporation, as defined in IRC § 957(a); ▪ A foreign partnership, if a USP is a partner of such partnership; or ▪ A foreign trust or estate, if such trust or estate has a U.S. beneficiary. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-2(b)(1) ▪ IRC 957(a) 	

Step 4 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 4: Determine if the foreign trust has, or is treated as having, one or more U.S. beneficiaries.

The fourth and final step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if the foreign trust has, or is deemed to have, at least one U.S. beneficiary for a taxable year. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if the trust has a U.S. beneficiary, or is deemed to have, a U.S. beneficiary.


Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ In addition, an amount is treated as paid or accumulated by a foreign trust to, or for the benefit of, a USP, if the amount is paid to or accumulated for the benefit of a USP through an intermediary, such as an agent or nominee, or by any other means that may confer an actual or constructive benefit on a USP. ▪ <i>Example:</i> A, a resident alien, transfers property to FT, a foreign trust. B is a A's son and is also a resident alien. The trust instrument provides that no USP can benefit either as to income or corpus. However, FT maintains an account with FB, a foreign bank, and FB issues a debit card to B, against the account maintained by FT and B is allowed to make withdrawals. FT is treated as having a U.S. beneficiary. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-2(b)(2) ▪ Treas. Reg. 1.679-2(b)(3), Example 4. 	

Step 4 (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Step 4: Determine if the foreign trust has, or is treated as having, one or more U.S. beneficiaries.

The fourth and final step in determining whether IRC § 679 applies to treat the foreign trust as a foreign grantor trust is to determine if the foreign trust has, or is deemed to have, at least one U.S. beneficiary for a taxable year. IRC § 679 will only apply to treat a foreign trust as a foreign grantor trust if the trust has a U.S. beneficiary, or is deemed to have, a U.S. beneficiary.

Considerations	Resources	6103 Protected Resources
<p> DECISION POINT: At this point you have determined if all four elements have been established:</p> <ol style="list-style-type: none"> 1. The trust is a foreign trust; 2. There was a transfer of property to the foreign trust; 3. The transfer of property to the foreign trust was from a USP; and 4. The foreign trust has or is treated as having at least one U.S. beneficiary. <ul style="list-style-type: none"> ▪ If all four elements are present then IRC § 679 applies, and the foreign trust is treated as a grantor trust. Any USP who transferred property to the foreign trust is treated as the owner of the portion of the foreign trust attributable to the transferred property. The USP treated as the owner of the foreign trust must report on their U.S. income tax return the income, deductions and credits of the foreign trust (or portion of the foreign trust) they are treated as owning. 	<ul style="list-style-type: none"> ▪ IPS Unit Foreign Grantor Trust Determination – Part II – Sections 671-678, Issue #4 for a detailed discussion. 	

Other Considerations / Impact to Audit

Foreign Grantor Trust Determination – Part I – Section 679

Considerations	Resources
<ul style="list-style-type: none"> ▪ Step Transaction Doctrine. When considering if there was an indirect transfer of property to a foreign trust, the step-transaction doctrine should be considered since the ultimate transfer could have taken a number of years to accomplish and could have gone through a number of persons or entities. ▪ Intermediary – Effective date of Transfer. Once it is determined a USP transferred property to a foreign trust through an intermediary, the question becomes “When was the property transferred?” Determining when the property was transferred will determine if, and when, IRC § 679 first applied. <ul style="list-style-type: none"> ▪ If it is determined that the intermediary is an agent of the foreign trust, then the property is treated as being transferred to the foreign trust in the year the USP transferred the property to the intermediary. The fair market value of the property transferred is determined on the date of the transfer by the USP to the intermediary. ▪ Otherwise, the intermediary is treated as being an agent of the original transferor and the transfer of the property to the foreign trust is treated as made in the year the intermediary transferred the property, or made the property available to the foreign trust. The fair market value of the property transferred is determined on the date the property is transferred to the foreign trust by the intermediary. ▪ If a transfer of property is treated as an indirect transfer, the intermediary is not treated as having transferred the property to the foreign trust. 	<ul style="list-style-type: none"> ▪ Judicial Doctrines-Step Transaction ▪ Commissioner v. Court Holding Co. - 324 U.S. 331 ▪ Kimbell-Diamond Milling Co. v. Commissioner - 14 TC 74 ▪ Commissioner v. Clark - 489 U.S. 726, 738 ▪ Treas. Reg. 1.679-3(c)(3)(ii) ▪ Treas. Reg. 1.679-3(c)(3)(i) ▪ Treas. Reg. 1.679-3(c)(3)(iii)

Other Considerations / Impact to Audit (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679	
Considerations	Resources
<ul style="list-style-type: none"> ▪ Guarantee of Foreign Trust's Obligations. ▪ When determining whether a USP has transferred property to a foreign trust, also consider any guarantees of the foreign trust's obligations by a USP. <ul style="list-style-type: none"> ▪ If a USP, who is related to a foreign trust (i.e., grantor, beneficiary or person related to any grantor, owner or beneficiary) guarantees an obligation of the foreign trust (i.e., loan) to a person unrelated to the foreign trust, the USP (as guarantor) is deemed to have made a transfer to the foreign trust on the date of the guarantee. ▪ If a USP is treated as having made a transfer by reason of the guarantee of an obligation, payments of principal to the lender by the foreign trust with respect to the obligation are taken into account on and after the date of the payment in determining the portion of the trust attributable to the property deemed transferred by the U.S. guarantor. ▪ If the U.S. guarantor is treated as having made a transfer to the trust using this rule, a lender that is a USP shall not be treated as having transferred that amount to the foreign trust. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.679-3(e)(1) ▪ Treas. Reg. 1.679-3(e)(3) ▪ Treas. Reg. 1.679-3(e)(1)

Other Considerations / Impact to Audit (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Considerations	Resources
<ul style="list-style-type: none"> ▪ When determining whether a foreign trust has a U.S. beneficiary, develop a clear understanding of the terms of the trust, and keep in mind that specific items will cause the foreign trust to be treated as having a U.S. beneficiary. ▪ Elements that cause the Foreign Trust to be treated as having a U.S. Beneficiary: <ul style="list-style-type: none"> ▪ A trust is treated as accumulating income for the benefit of a U.S. beneficiary even if the beneficiary's interest in the trust is contingent on a future event. ▪ A trust is treated as having a U.S. beneficiary if any person has the discretion to make a distribution to or for any person, unless the trust terms specifically identify the entire class of beneficiaries and none are in fact USPs. ▪ Any agreement that may result in trust income or corpus being paid or accumulated to or for a U.S. beneficiary is treated as a term of the trust if a U.S. transferor of property to the trust is involved in such agreement. ▪ A trust is treated as having a U.S. beneficiary if a loan of cash or marketable securities is directly or indirectly made to, or trust property is directly or indirectly used by, any USP unless the USP repays the loan at a market rate of interest or pays the fair market value of the use of such trust property within a reasonable time. Note that this provision is effective only with respect to transfer of property after 3/18/2010. 	<ul style="list-style-type: none"> ▪ IRC 679(c)(1) ▪ IRC 679(c)(4) ▪ IRC 679(c)(5) ▪ IRC 679(c)(6)

Other Considerations / Impact to Audit (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679	
Considerations	Resources
<ul style="list-style-type: none"> ▪ Owner with Respect to a Portion of the Trust ▪ The grantor trust treatment may not apply to a foreign trust in its entirety. If a USP transfers property to a foreign trust with a U.S. beneficiary, only the portion attributable to property transferred by the USP person will be treated as owned by the U.S. transferor. ▪ For example, if both USPs and foreign persons transfer property to a foreign trust with a U.S. beneficiary, only the portion attributable to property transfers by USPs will be treated as owned by them. Thus, the taxation of the trust by the U.S. is “split” between two dramatically different treatments. ▪ ▪ IRC § 679 applies without regard to whether the U.S. transferor retains any power or interest described in IRC §§ 673 through 677. IRC § 679 supersedes the other grantor trust rules with respect to any portion of a trust to which it applies. If a U.S. transferor would be treated as the owner of a portion of a foreign trust pursuant to the rules of IRC § 679 and another person would be treated as the owner of the same portion of the trust pursuant to IRC § 678, then the U.S. transferor is treated as the owner and the other person is not treated as the owner. 	<ul style="list-style-type: none"> ▪ IRC 679(a)(1) ▪ Treas. Reg. 1.679-1(a) ▪ Treas. Reg. 1.679-1(b)

Other Considerations / Impact to Audit (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Considerations	Resources
<ul style="list-style-type: none">▪ Even if a non-resident alien transferred property to a foreign trust, IRC § 679 may apply if the non-resident alien becomes a USP within 5 years of transferring the property. If a non-resident alien individual becomes a USP within 5 years after a direct or indirect transfer of property to a foreign trust (the original transfer), the individual is treated as having made the transfer on the day they became a USP.▪ 5-Year Rule (i.e. “pre-immigration trusts”): A non-resident alien individual could transfer property to a foreign trust in anticipation of becoming a USP. So, if a non-resident alien individual becomes a USP within 5 years after directly or indirectly transferring property to a foreign trust, the individual is treated as having made the transfer of an amount equal to the portion of the trust attributable to the original property transfer (including the undistributed accumulated income of the trust) on the date that the individual became a USP.	<ul style="list-style-type: none">▪ IRC 679(a)(4) ▪ Treas. Reg. 1.679-5(a)▪ Treas. Reg. 1.679-5(c), Example #1

Other Considerations / Impact to Audit (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679	
Considerations	Resources
<ul style="list-style-type: none">▪ Exceptions – IRC § 679 will not apply for:<ul style="list-style-type: none">▪ Any transfer of property to a foreign trust by reason of the death of the transferor.▪ Any transfer of property to a foreign trust described in IRC § 402(b), § 404(a)((4) (i.e., stock, bonus, pension or profit-sharing trust) or IRC section § 404A (e.g., established to fund a foreign deferred compensation plan) or a foreign trust exempt from tax under IRC § 501(c)(3).▪ Any transfer of property to a foreign trust to the extent the transfer is for fair market value.	<ul style="list-style-type: none">▪ IRC 679(a)(2)▪ Treas. Reg. 1.679-4(a)

Other Considerations / Impact to Audit (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679	
Considerations	Resources
<ul style="list-style-type: none"> ▪ Exception – Transfer at Fair Market Value: ▪ IRC § 679 will not apply to a transfer of property to a foreign trust for fair market value. A transfer is for fair market value only to the extent that the value of property received from the trust, services rendered by the trust, or the right to use property of the trust is at least the fair market value of the transferred property. ▪ For example, rents, royalties, interest, and compensation paid to a trust are transfers for fair market value only to the extent that the payments reflect an arm's length price for the use of the property, or for the services rendered by, the trust. ▪ For purposes of this determination, an interest in the trust is not property received from the trust. ▪ Special Rule – Transfer for Partial Consideration: ▪ If a person transfers property to a foreign trust in exchange for property having a fair market value that is less than the fair market value of the property transferred, the exception to the application of IRC § 679 applies only to the extent of the fair market value of the property received. 	<ul style="list-style-type: none"> ▪ IRC 679(a)(2)(B) ▪ Treas. Reg. 1.679-4(b)(1) ▪ Treas. Reg. 1.679-4(b)(2)

Other Considerations / Impact to Audit (cont'd)

Foreign Grantor Trust Determination – Part I – Section 679

Considerations	Resources
<ul style="list-style-type: none">▪ For example, a U.S. citizen transfers property that has a fair market value of \$1,000 to a foreign trust in exchange for \$ 600 of cash. Assuming there is a U.S. beneficiary, IRC § 679 applies with respect to the transfer of \$400 (\$1,000 less \$600) to the foreign trust. ▪ Exception – Transfer at Fair Market Value: ▪ In determining whether a transfer by a U.S. transferor, that is a related person with respect to the foreign trust, is for fair market value, any obligation of the trust or a related person that is not a qualified obligation shall not be taken into account.	<ul style="list-style-type: none">▪ IRC 679(a)(3)▪ Treas. Reg. 1.679-4(c)▪ Treas. Reg. 1.679-4(d) defines a Qualified Obligation.

Training and Additional Resources

Chapter 12.2.1 Taxability of Income from Grantor Trusts

Type of Resource	Description(s) and/or Instructions for Accessing	References
Podcasts / Videos	<ul style="list-style-type: none">▪ CPE 2011-Day 1-Pass Through Entities and Foreign Corporations.	
Other Training Materials	<ul style="list-style-type: none">▪ Revenue Agent Foreign Trust and Other Offshore Entity Training (Catalog Number 20347E) – <i>WARNING this text was last updated in April 2009. Some information may be outdated</i>	

Glossary of Terms and Acronyms

Term/Acronym	Definition
FE	Foreign Entities
IPS	International Practice Service
IRC	Internal Revenue Code
Treas. Reg.	Treasury Regulations
U.S.	United States

Index of Related Issues

Issue	Associated UIL(s)	References
Defining the Entity - Foreign Trusts		▪ FEN/9434.02_01
Foreign Grantor Trust Determination – Part II – Sections 671-678		▪ FEN/9434.02_07
Failure to File Form 3520/3520-A – Penalties		▪ FEN/9434.02_05
Taxation of Foreign Non-Grantor Trusts		
Taxation of Beneficiary of a Foreign Non-Grantor Trust		
Check-The-Box Rules for Foreign Entities		