withersworldwide

HIRE Act Briefing note

21 MAY 2010

CATEGORY:
ARTICLE

Effective Immediately! Uncompensated Use of Trust Property Taxable to United States Persons

Effective immediately new US legislation will tax certain US beneficiaries of non-US trusts on their use of trust property. This same provision will, in most instances, create special US information filing obligations for the affected US beneficiaries who will be required to obtain special information statements from their trustees in order to meet their US disclosure obligations.

This legislation was enacted by President Obama on 18 March 2010 as part of the Hiring Incentives to Restore Employment Act of 2010 (the "HIRE Act"), which included a number of new tax and reporting provisions intended to raise US tax revenue and curb 'offshore' noncompliance by US taxpayers. Additional information about the HIRE Act is available on our website by accessing the "Stop Press" dated 18 March 2010, including an overview of the upcoming disclosure requirements soon to be applicable to US and non-US individuals and entities investing via virtually any non-US bank, financial institution, fund or other collective investment structure.

Under the HIRE Act, the uncompensated use of trust property is treated as a distribution to the US beneficiary in an amount equal to the fair market value of the use of the trust property and is taxable under the US federal income tax rules applicable to US beneficiaries of non-US trusts. Such a deemed distribution would cause tax and possibly an interest charge if there is realised income or gains within the trust. It will likely trigger a US reporting obligation regardless of whether it draws an income tax charge. If the trustee fails to provide an affected US beneficiary with a so called "Foreign Nongrantor Trust Beneficiary Statement" in connection with his use of such trust property, then the beneficiary may find himself to be taxed even though he may not have been taxable if the proper information had been provided to him by the trustee.

There is an exception to deemed distribution treatment for the compensated use of trust property, which provides that the use will not be treated as a distribution to the extent that the US beneficiary pays fair market value for the use of the trust property "within a reasonable period of time of such use." The IRS has yet to explain what period of time is considered a "reasonable period of time", but one might speculate that the IRS will require the payment by the US beneficiary to be made within a few months following the close of the calendar year in order to qualify for the compensated use exception. While the compensated use exception avoids distribution treatment, the US beneficiary likely will still be required to report the use to the IRS.

In addition to the compensated use exception, there are other means by which to mitigate or, in many circumstances, eliminate the application of this new provision (including the reporting obligation). These might include modifying or domesticating existing trusts or establishing new trusts, for example a trust containing only the uncompensated use property that does not generate taxable income. However, trustees and beneficiaries must be proactive in this respect and should contact their advisors immediately to consider the available planning options and to allow adequate time for implementation.

Authors

Jay Krause

PARTNER | LONDON

Private client and tax

+44 20 7597 6350

jay.krause@withersworldwide.com

Jay H. Rubinstein

PARTNER | GENEVA

Private client and tax

+41 22 593 7716

jay.rubinstein@withersworldwide.com