



GOLENBOCK
EISEMAN
ASSOR
BELL &
PESKOE LLP

CLIENT ALERT

The HIRE Act Makes Important Changes to Taxation and Reporting for U.S. Persons with Interests in Foreign Trusts.

To pay for the hiring incentives in the recently enacted “Hiring Incentives to Restore Employment Act” (the “HIRE Act”), Congress passed several offsetting revenue raisers, including a number of provisions that target U.S. individuals who are or might become U.S. beneficiaries of foreign trusts.

Use by Beneficiaries of Property Owned by a Foreign Trust.

Up to now it has been possible for U.S. individuals to use property owned by a foreign trust rent free and tax free. The HIRE Act, effective March 18, 2010, changes this rule. If a foreign non-grantor trust has current or accumulated income, any rent-free use of property (including real estate, art, etc.) will become taxable to the U.S. beneficiary. Under this provision of the new law, such use by a U.S. grantor, U.S. beneficiary or any U.S. person related to such grantor or beneficiary is deemed to be a distribution of an amount equal to the fair market value of the use of the property to the U.S. person. The deemed distribution will not apply if the U.S. person using the property pays fair market rent for such use within a reasonable period of time. Although this new deemed distribution provision most obviously catches rent free accommodation provided to a U.S. grantor or beneficiary, this provision also applies to the uncompensated use of artwork or other items of tangible personal property. The new provisions give no assistance on determining the value of the use of such property.

Presumption that Foreign Trust has U.S. Beneficiary.

When a U.S. person transfers property to a foreign trust after March 18, 2010, the HIRE Act causes a rebuttable presumption to arise which deems the trust to have a U.S. beneficiary. This presumption applies unless the U.S. transferor submits information to the IRS that no portion of the income or corpus of the trust may be accumulated or paid to or for the benefit of a U.S. person.

Who is a U.S. Beneficiary of a Foreign Trust?

The HIRE Act contains a broad interpretation of who is deemed to be a U.S. beneficiary of a foreign trust, which may result in a very wide class of U.S. individuals being treated as U.S. beneficiaries of foreign trusts. Under the Act, a foreign trust will be treated as having a U.S. beneficiary if a current, future or contingent beneficiary of the trust is a U.S. person.

Additionally, when any trustee or other person has the discretion to make distributions of trust property to or for the benefit of any person, the trust is deemed to have a U.S. beneficiary unless (1) the terms of the trust specifically identify a class of persons who may receive distributions and (2) none of the permissible distributees are U.S. persons during the applicable tax year.

Reporting Requirements for U.S. Beneficiaries.

Under the Act, a U.S. person who is treated as the 'owner' of all or any portion of a foreign trust has an obligation to provide information to the IRS regarding the foreign trust and to ensure that the trust complies with the reporting requirements for foreign trusts as set out in the Treasury Regulations. This provision of the new law applies to taxable years beginning after 2010.

Penalty for Failure to Report Foreign Trust

Under pre-HIRE Act law, a taxpayer who failed to file an information return regarding the creation of a foreign trust, the transfer of money or property to a foreign trust, or the death of a U.S. owner of a foreign trust, was subject to a penalty of 35% of the amount required to be disclosed on such return. However, if the IRS uncovered an undisclosed foreign trust but was unable to determine the amount required to be disclosed on the required information return, it was unable to impose a penalty. The HIRE Act leaves the current 35% penalty in place but adds a minimum penalty of \$10,000 on any such failure to file. This provision applies to notices and returns required to be filed after Dec. 31, 2009.

If you would like more information about the HIRE Act or to discuss a particular set of facts please contact:

Ian Shane
212-907-7331
ishane@golenbock.com

Donald A. Hamburg
212-907-7380
dhamburg@golenbock.com

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