

PwC US Tax Services: US Trust Filing Essentials



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In general, a trust is a relationship in which one person holds title to property, subject to an obligation to keep or use the property for the benefit of another. While these are created under individual state law in the U.S., many countries around the world allow for similar types of vehicles to pass assets from one person to another. From a U.S. tax perspective, reporting is necessary when U.S. beneficiaries begin to receive benefits from a foreign trust.



Trusts created in the U.S.

Trusts created in the U.S. are subject to U.S. taxes based on their worldwide income, as with any other entity or individual domiciled in the U.S. or citizens of the U.S., and are able to offset this income through certain deductions. Most notably, income distributed to beneficiaries is considered a deduction for the trust (but taxable for the beneficiary), unless the distribution is from the original principal. U.S. trusts must file Form 1041, U.S. Income Tax Return for Estates and Trusts, every calendar or fiscal year, and issue Schedule K-1s to their beneficiaries so they may report their taxable income and deductions.

Foreign trusts and Form 3520

Foreign trusts, while often structured similarly to U.S. trusts, are not subjected to the same U.S. tax reporting obligations; specifically, there is no requirement for these trusts to file Form 1041, U.S. Income Tax Return for Estates and Trusts, with the Internal Revenue Service (IRS). While U.S. taxpayers with dealings in foreign trusts or who receive certain foreign gifts are not required to file Form 1041, they do have other tax-related responsibilities. For instance, individuals may need to file Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. This form is critical for reporting transactions with foreign trusts and the receipt of large gifts or bequests from foreign persons, underscoring the importance

of understanding your obligations as a U.S. taxpayer.

Additionally, if a foreign trust generates U.S. effectively connected income (ECI) or fixed, determinable, annual, or periodical (FDAP) income that is taxable in the United States, the tax reporting and withholding requirements become more nuanced. For ECI, the relevant parties might need to file Form 1040-NR, U.S. Nonresident Alien Income Tax Return, to ensure compliance with U.S. tax laws. This form is also pertinent for nonresident aliens or foreign entities generating income from U.S. sources, including FDAP income, which encompasses a wide range of income types such as interest, dividends, rents, and royalties. FDAP income is taxed on a gross basis at a flat rate of 30% or at a lower treaty rate, without deductions, emphasizing the necessity for proper tax withholding and reporting by the payer and compliance by the recipient.

Understanding these obligations is crucial for U.S. taxpayers involved with foreign trusts to navigate the complexities of U.S. tax law and accurately fulfill their reporting and tax obligations.

U.S. owners of foreign trusts

Just because you are a U.S. citizen or tax resident does not mean your trust will be considered a U.S. trust. The designation of a trust as a U.S. or foreign trust is determined by specific criteria, including the court test and the control test, which assess the court's ability to exercise primary supervision



over the trust's administration and the control U.S. persons have over substantial decisions of the trust, respectively. If you own assets in a foreign trust, you will be required to file Form 3520, regardless of the activity in the trust for the year.

Recipients of substantial gifts

As a U.S. taxpayer, you are mandated to file Form 3520 if you receive a gift exceeding \$100,000 from a foreign trust or a nonresident alien. This requirement is designed to ensure transparency and compliance with U.S. tax laws regarding significant foreign gifts. Additionally, for the tax year 2024, the threshold under U.S. Code Section 6039F for reporting gifts from foreign corporations, partnerships, or related foreign persons has been updated. If you receive more than \$19,570 from such entities, you will be obligated to file Form 3520. This adjustment reflects the IRS's annual inflationary updates, aiming to maintain the relevance and efficacy of these reporting requirements in line with current economic conditions. Understanding and adhering to these thresholds is crucial for U.S. taxpayers to ensure proper reporting and compliance with the tax obligations related to receiving gifts from foreign sources.

Certain transactions

Additionally, you are required to file Form 3520 if certain transactions between you and a foreign trust occur

during the year. These transactions include transfers of property (including cash) to a related foreign trust or person related to the foreign trust in exchange for an obligation, or if you hold a qualified obligation from a foreign trust that is currently outstanding, receiving a distribution from a foreign trust, a loan of cash or marketable securities (including an extension of credit), the uncompensated use of trust property, or if a foreign trust holds an outstanding qualified obligation of yours (and you are a beneficiary of that foreign trust).

Regarding filing Form 3520, the IRS assesses hefty penalties for failing to make disclosures, including a monthly penalty of 5% (up to a total of 25%) for foreign gifts, as well as a penalty of the greater of \$10,000 or 35% of the gross value of the distribution for failing to report transfers between the U.S. taxpayer and the foreign trust.

Form 3520-A

A foreign trust with at least one U.S. owner files Form 3520-A to provide information about the trust, its U.S. beneficiaries, and any U.S. person who is treated as an owner of any portion of the foreign trust. This form is similar to most entity reporting in the U.S. and requires the filer to report the foreign trust's year-to-year balance sheet and current year income statement, as well as distributions and information about the U.S. owners and beneficiaries.

Our services

PwC's adept U.S. Tax team in Zurich specializes in U.S. and foreign trust reporting and consulting services, delivering tailored solutions to individuals across the globe. Our in-depth understanding of the regulatory landscape for trusts, coupled with a client-centric approach, ensures precise compliance and optimal tax positioning for our clients navigating the complexities of trust taxation and reporting.

We invite you to reach out to our team for an initial call. This is your opportunity to learn how our tailored approach can address your specific needs and help you optimise your tax position. Contact us today to start a conversation about how we can assist you.



More information on
www.pwc.ch/us-tax-service



Get in touch

Connect with the PwC US Tax team in Zurich for assistance with your tax compliance queries. We are here to guide you through the complexities of this regulatory environment and offer support in managing your obligations effectively.



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