Court Deems a Foundation a Foreign Trust, Greenlighting Tax Penalties

By Alicea Castellanos, CPA

Foreign assets are always tricky for U.S. tax reporting. A recent court decision also shows that differentiating a foundation from a trust is pivotal.

The levying of tax penalties stood in a recent federal appeals court decision on whether a private foundation was a foreign trust subject to such penalties.

In *Rost v. U.S.*, the U.S. Court of Appeals for the Fifth Circuit upheld tax penalties against U.S. citizen John Rebold, who failed to report his personal-use Liechtenstein "Stiftung" (a non-charitable private foundation) as a foreign trust.

The decedent Rebold formed the Enelre Foundation in 2005 for the general support and education of him and his children. He transferred $2 million to the foundation in 2005 and $1 million in 2007, but did not disclose the transactions to the IRS.

Rebold later learned that the IRS would consider his foundation a foreign trust with the associated reporting requirements. He filed the reports belatedly, in 2013, and the IRS assessed penalties.

Under IRC Sec. 6048, a U.S. person must report creation of a foreign trust, transfers to a foreign trust and distributions received by a foreign trust; ownership of the trust must also be disclosed. Annual filing forms are 3520 and 3520-A, with penalty for failing to file as the greater of $10,000 or 35% of the gross value of property contributed to a foreign trust.

Rebold paid the penalties and then filed a refund action, arguing that the penalties were improper because the reporting requirements for the private foundation were unclear, even though he'd been told as early as 2010 (one year before the IRS announced a new Offshore Voluntary Disclosure Initiative, a.k.a. OVDI) that his tax-reporting position was obvious.

After he was assessed $1,380,252.35 in penalties, Rebold negotiated to reduce these penalties by half. He paid the reduced penalties and filed for an administrative refund claim, which was ultimately taken over by his estate after his death. The estate argued that the foundation wasn't a foreign trust, claiming that the rules defining trusts are vague and that the IRS never designated that a Stiftung was a foreign trust.

The district court granted summary judgment for the government; the Fifth Circuit has agreed, opining that Enelre's organizing documents explain its purpose is to support its

beneficiaries and limit its transactions to pursuing and realizing its purpose–characteristic of an ordinary trust. Proving Enelre was “foreign” meant simply applying the tests of whether a U.S. court processed supervision over the trust administration and if a U.S. person controlled all substantial decisions of the trust. The beneficiaries also didn’t know about the trust for years.

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