INFORMATION REPORTING ON FOREIGN TRUSTS AND GIFTS – NEW REGULATIONS PROPOSED

Authors
Wooyoung Lee
Stanley C. Ruchelman

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BACKGROUND

Due to concerns about the potential use of foreign trusts and gifts as a means to access the proceeds of unreported income, the Internal Revenue Code (the "Code") and related regulations issued by the Treasury Department ("Treas. Reg.") impose extensive reporting obligations for U.S. persons who have an interest in or transactions with foreign trusts. New regulations have been proposed to provide clarity on the application of the rules and relief to taxpayers in some cases.

Many of the rules in the proposed regulations are not new, but they describe and consolidate rules gleaned from statutes, I.R.S. notices, I.R.S. rulings, and instructions for I.R.S. forms.

LOANS TO AND USES OF FOREIGN TRUST PROPERTY

Basic Rule

Code §643(i) focuses on foreign trusts lending money to U.S. persons or allowing U.S. persons to use property without adequate compensation. An example of the latter is the free use of a condominium apartment in New York City or a vacation home in Palm Beach. If a foreign trust allows for the uncompensated use of its property by (i) its U.S. grantor or beneficiary or (ii) a U.S. person who is related to the grantor or beneficiary, the trust is deemed to have made a distribution equal to the value of the property to the grantor or the beneficiary. If the user of the property is a related U.S. person, the distribution is deemed to have been made to the U.S. grantor or beneficiary, not the related U.S. person. The U.S. person must report this transaction on Line 25 of Part III of Form 3520 (Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts).

Exceptions

This rule does not apply if the trust is compensated for the use of its property. The proposed regulations[1] detail the type of compensation that will create an exception. Loans of cash will not create a §643(i) distribution if the trust is compensated through a "qualified obligation." An obligation must meet the following criteria to be a qualified obligation:

- The obligation must be in writing.
- The term of the obligation must not exceed five years.

[1] 89 FR 39440; Prop. Reg. §1.643-2.

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- All payments must be made in cash in U.S. dollars.
- The obligation must be issued at par and provide for stated interest at a fixed rate or a “qualified floating rate” (broadly, a rate where variations in the rate reasonably track the cost of borrowing U.S. dollars).
- The yield to maturity must be at least 100% of and not greater than 130% of the applicable federal rate as of the date of the obligation’s issuance.
- All stated interest must be qualified stated interest (stated interest that is unconditionally payable in cash or property (other than debt instruments of the issuer) at least annually over the term of the debt instrument at a single fixed rate).[2]

Additionally, the obligation must meet the following requirements throughout the obligation’s existence:

- The U.S. grantor or beneficiary must extend the statute of limitations for the I.R.S. to assess the tax on the deemed distribution to three years after the obligation’s maturity date.
- The U.S. grantor or beneficiary must report the status of the obligation (including any payments made) on Part III of Form 3520.
- The obligor must pay principal and interest according to the terms of the obligation.[3]

The I.R.S. has requested comment on whether a similar exception should be made available for loans of marketable securities. Such an exception was left out because the I.R.S. does not believe that this fact pattern is not common.

For loans of property other than cash or marketable property, distribution treatment will not apply if the trust receives compensation equal to the fair market value of the use within reasonable time (defined as 60 days or less) after the U.S. person starts using the property.[4] The proposed regulations also provide a *de minimis* exception under which Code §643(i) will not apply if the loan is for a period of 14 days or less.[5]Lastly, cash loans made by foreign corporations to a U.S. beneficiary are not treated as distributions to the extent they are attributable to the corporation’s undistributed earnings that have been included in the U.S. beneficiary’s income under either the controlled foreign corporation or qualified electing fund. This exception presumably only applies to an indirect loan where a foreign corporation is a C.F.C. or a P.F.I.C. and the beneficiary is deemed to own the shares of the foreign corporation by attribution from a foreign trust.[6]

The reporting requirement also does not apply to the extent that the foreign trust is a grantor trust. A foreign trust can become a grantor trust to the extent that a U.S. person transfers property to the trust and Code §679 consequently applies to make at least a portion of the trust a foreign grantor trust. The preamble explains that this

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[2] Prop. Reg. §1.643-2(b)(2)(iii)(A).

[3] Prop. Reg. §1.643-2(b)(2)(iii)(B).

[4] Prop. Reg. §1.643-2(a)(2)(ii).

[5] Prop. Reg. §1.643-2(a)(3).

[6] Prop. Reg. §1.643-2(a)(4).

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means §643(i) will rarely apply to a U.S. grantor of a foreign grantor trust. This is also confirmed by proposed regulations under Code §679.[7]

Other Information

Indirect loans fall under the purview of this reporting requirement. The proposed regulations provide three examples of indirect loans:

- A loan made by anyone to the U.S. grantor or beneficiary where the trust guarantees the loan.
- A loan made by a person related to the trust to the U.S. grantor or beneficiary.
- A loan made by the trust to a foreign person related to the U.S. grantor or beneficiary (unless the foreign related person is a grantor or beneficiary of the trust).[8]

However, under the latter two examples, the U.S. grantor or beneficiary can avoid the Code §643(i) distribution treatment if a statement is attached to his or her tax return demonstrating that the loan would have been made even if the U.S. grantor or beneficiary were not related to the trust.[9]

The proposed regulations also contain an anti-abuse provision. A foreign individual who receives a loan from a foreign trust and becomes a U.S. person within two years will be subject to Code §643(i) to the extent of the outstanding amount of the loan as of the date the borrower becomes a U.S. person.[10]

Tax Consequences

If a loan is recharacterized as a distribution, there are tax consequences to both the trust and the U.S. grantor or beneficiary. The trust is given a deduction for making a distribution.[11] If the deemed distribution involves marketable securities, the trust is further deemed to have elected under Code §643(e)(3) to recognize gain on the distribution.[12] Consequently, any capital gain recognized on the securities is included in the trust's distributable net income.

The trust may provide a Foreign Nongrantor Trust Beneficiary Statement to the U.S. grantor or beneficiary, although the proposed regulations imply that this is not necessary.[13] The issuance of the statement determines how the U.S. person will treat the deemed distribution. If a U.S. person receives the statement from the trust, the U.S. person can opt for the actual calculation method, under which the U.S. grantor or beneficiary treats the deemed distribution as an amount that is required to be distributed under Code §662(a)(2).

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[7] Prop. Reg. §1.679-2(a)(v)(5).

[8] Prop. Reg. §1.643-1(b)(2).

[9] Prop. Reg. §1.643-1(b)(2)(ii).

[10] Prop. Reg. §1.643-1(b)(3).

[11] Prop Reg §1.643(i)-3(a).

[12] Prop Reg §1.643(i)-3(c)(2)(ii).

[13] Prop Reg §1.643(i)-3(c)(2)(iii).

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If the U.S. person does not receive a statement, he or she must use the "default calculation method," including for all subsequent distributions from the same trust (even if later distributions are not Code §643(i) distributions). Under the default calculation method, the distribution is treated as current income to the extent of 125% of the average amount of distributions received by the U.S. person in the prior three years. Any amount of the distribution in excess of that is treated as an accumulation distribution, which is generally considered a less taxpayer-friendly form of a distribution.

FOREIGN TRUSTS TREATED AS HAVING A U.S. BENEFICIARY

Under Code §679, if a U.S. person transfers property to a foreign trust, the U.S. person is treated as the owner of portion of foreign trust attributable to the transferred property to the extent that the terms of the trust allow for income or corpus to be paid to or accumulated for the benefit of a U.S. person.[14] An exception exists if the trust transfers fair market value consideration in exchange.[15] However, if the trust issues obligations in exchange, the exchange will only qualify for this fair market value exception if the obligation is a "qualified obligation." This information is all reported on Schedule A of Part I of Form 3520.

In determining whether the trust is allowed to make payments to or accumulate income on behalf of a U.S. person, the statute allows the I.R.S. to make presumptions. First, a foreign trust is treated as having a U.S. beneficiary unless none of the trust's principal and income can be paid to or accumulated for the benefit of the U.S. person.[16] Second, a foreign trust that receives a transfer of property from a U.S. person is presumed to have a U.S. beneficiary unless otherwise demonstrated to the I.R.S.[17] Third, a trust that loans cash or marketable securities to any U.S. person (whether or not that person is a beneficiary under the trust's terms) is treated as having a U.S. beneficiary, except to the extent that the United States person repays the loan at a market rate of interest (or pays the fair market value of the use of such property) within a reasonable period of time.[18]

The proposed regulations make several amendments. First, the proposed regulations remove language that explicitly states that a foreign individual who elects to be treated as a U.S. taxpayer under Code §6013(g)[19] or (h)[20] is considered a U.S.

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14 Code §679(a)(1).

15 Code §679(a)(2)(B).

16 Code §679(c)(1).

17 Code §679(d).

18 Code §679(c)(6).

19 Code §6013(g) allows a nonresident alien individual who is married to a U.S. citizen to be treated as a U.S. resident, thereby allowing the married couple to file a joint income tax return.

20 Code §6013(g) allows an individual who was a nonresident alien at the beginning of a calendar year but a U.S. resident at the close of the year to be treated as a resident for the full year in order for the married couple to file a joint income tax return.

person for this reporting purpose.[21] This should not be interpreted as changing the substantive law; rather, the I.R.S. simply felt the language was unnecessary.

However, dual-resident taxpayers (those who are residents of the U.S. and another country) who are treated solely as foreign taxpayers under the residence tiebreaker rule of an income tax treaty are not considered U.S. persons for purposes of Code §679. According to the preamble that accompanied the issuance of the proposed regulations, the Treasury Department and the I.R.S. are of the view that it is not necessary to treat a dual resident taxpayer in these circumstances as a U.S. person for purposes of Code §679. This approach departs from the general rule that appears in Treas. Reg. §301.7701(b)-7(a)(3) that a dual resident individual is treated as a U.S. resident for tax purposes other than the computation of that individual's income tax. Nonetheless, it is consistent with a recent case in which a court held that a green card holder residing in a treaty jurisdiction and treated solely as a resident of that jurisdiction under a treaty tiebreaker provision was not a U.S. resident required to file FinCEN Form 114 (*Report Foreign Bank and Financial Accounts*).[22]

With respect to the presumption of the existence of a U.S. beneficiary for purposes of Code §679, the proposed regulations contain several exceptions that mirror those under Code §643(i). A loan of cash will qualify for an exception if the U.S. person provides a qualified obligation. The definition of qualified obligation is amended for consistency with the proposed regulations under §643(i) (see above). A loan of trust property other than cash or marketable securities is also excepted from the general rule if the U.S. person provides fair market value consideration.

If either exception applies, the trust will not automatically be treated as having a U.S. beneficiary.

FOREIGN GIFTS

Code §6039F requires U.S. persons to report the receipt of a foreign gift in excess of $10,000 from a foreign donor. For administrative purposes, the I.R.S. increased the reporting threshold to $100,000 from a foreign donor.[23] Once the $100,000 threshold is met, the donee must report each gift in excess of $5,000 but is not required to identify the donor on the form. To determine if a U.S. person received gifts in excess $100,000 from a particular foreign individual, the U.S. person must aggregate gifts from foreign persons that the U.S. person knows or has reason to know are related to each other, such as husband and wife or father and grandfather. The report is made on Part IV of Form 3520.

Filing Deadlines

The proposed regulations describe filing deadlines for Form 3520. By default, Form 3520 must be filed by the 15th day of the fourth month after the close of the taxpayer's tax year. Extensions that are applicable to income tax returns also apply to Form 3520. For example, U.S. persons residing abroad are given automatic extension to the 15th day of the sixth month after the tax year in question.[24] This extension

[21] Prop. Reg. §1.679-1(c)(2)(ii)A).

[22] *Aroeste v. U.S.,* 655 F. Supp. 3d 1053 (S.D. Cal. 2023).

[23] Notice 97-34, Section VI.B.1.

[24] Prop. Reg. §1.6039F-1(a)(2).

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also applies to reporting foreign gifts on Form 3520. Likewise, Form 3520's filing deadline is extended to the 15th day of the 10th month after the tax year if the taxpayer has been granted the same extension for his or her income tax return. If a discretionary extension is granted for filing a tax return beyond the 15th day of the 10th month, the due date for filing Form 3520 is not extended.

If the taxpayer died during the taxable year, the executor of the taxpayer's estate must report the foreign gift by the 15th day of the fourth month after the taxpayer's final tax year or by the 15th day of the 10th month if the executor has been granted an extension.

Definitions

The definition of "U.S. person" is consistent with the use of the term elsewhere in the Code. Consequently, a dual resident taxpayer who is treated as a nonresident, non-citizen taxpayer for purposes of U.S. tax liability is not treated as a U.S. person for purposes of these reporting provisions.[25] In comparison, a dual status taxpayer will not be treated as a U.S. person for purposes of Code §6039F with respect to the portion of the taxable year during which the taxpayer is treated as a nonresident, noncitizen individual for purposes of computing U.S. income tax liability.[26] A dual-status taxpayer is one who is a U.S. person for only part of a tax year because, for example, U.S. citizenship or residence was acquired or abandoned during the year.

". . . a dual resident taxpayer who is treated as a nonresident, non-citizen taxpayer for purposes of U.S. tax liability is not treated as a U.S. person for purposes of these reporting provisions."

A "foreign gift" is defined as any amount received from a non-U.S. person that the recipient treats as a gift, bequest, devise, or inheritance for income tax purposes.[27] Qualified transfers for educational or medical expenses within the meaning of Code §2503(e)(2), related to transfers excluded from being characterized as gifts for gift tax purposes, are excluded.[28] An anti-avoidance rule provides that the I.R.S. can re-characterize a transfer (such as a loan) as a gift that is exempt from gross income,[29] if facts and circumstances indicate that the transfer is in substance a gift.[30]

Reporting Threshold Amounts

The proposed regulations also restate and expand upon exceptions to this reporting requirement. First, as mentioned above, gifts received by a U.S. donee from foreign individuals or estates are not reportable unless the aggregate amount of foreign gifts from any one transferor (including persons related to the transferor) exceeds $100,000, modified by cost-of-living adjustments.[31] If this threshold is met, each foreign gift in excess of $5,000 must be separately identified. In a change from the current Form 3520 instructions, the U.S. recipient of the gift must also provide identifying information about the transferor.

A separate reporting threshold applies to covered gifts and bequests from covered expatriates (U.S. persons who expatriated from the U.S. and are subject to the exit

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[25] Prop. Reg. §1.6039F-1(f)(1).

[26] Prop. Reg. §1.6039F-1(f)(2).

[27] Prop. Reg. §1.6039F-1(b)(1).

[28] *Id.*

[29] Code §102.

[30] Prop. Reg. §1.6039F-1(b)(2).

[31] Prop. Reg. §1.6039F-1(c)(2)(i).

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tax by reason of high income, high net worth, or a failure to certify U.S. tax-compliant status).[32] The threshold is $18,000 for 2024.[33]

Foreign gifts from a foreign corporation or partnership do not have to be reported by a U.S. donee if the aggregate amount of transfers received from a particular entity does not exceed $10,000, adjusted for cost of living.[34]

For spouses who file a joint tax return, these reporting thresholds apply separately to each spouse.[35]

Valuation

A foreign gift is valued as of the time of the transfer. The value is defined at the price at which the property would changes between a willing buyer and seller, and it is determined in accordance with principles under the gift tax.[36]

Penalties

A U.S. donee who fails to report a reportable foreign gift will pay a penalty equal to 5% of the amount of the foreign gift for every month that the taxpayer is noncompliant, up to a maximum of 25% of the amount of the gift.[37]

Tax Treatment

The tax consequences of noncompliance by a U.S. donee are determined based on facts and circumstances.[38] The I.R.S. may take into account the purported-gift rules of Treas. Reg. §1.672(f)-4. These rules generally require purported gifts from a partnership or foreign corporation, generally defined as transfers to a U.S. individual who is not a partner or shareholder of the transferor, to be included in the recipient's gross income. In general, those rules provide as follows:

- If the transferor is a foreign partnership, the amount included is treated as ordinary income, and if the transferor is a foreign corporation, the amount included is treated as a distribution.
- If the foreign corporation is a P.F.I.C., the rules of Code §1291 apply.
- For purposes of Code §1012, relating to basis in property, the U.S. donee is not treated as having any basis in the stock of the foreign corporation.
- For purposes of Code §1223, the United States donee is treated as having a holding period in the stock of the foreign corporation on the date of the deemed distribution equal to the weighted average of the holding periods of the actual interest holders.[39]

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[32] Prop. Reg. §1.6039F-1(c)(2)(ii).

[33] Rev. Proc. 2023-34, Section 3.43.

[34] Prop. Reg. §1.6039F-1(c)(2)(iii) and (v).

[35] Prop. Reg. §1.6039F-1(c)(2)(iv).

[36] Prop. Reg. §1.6039F-1(d).

[37] Prop. Reg. §1.6039F-1(e)(1)(ii).

[38] Prop. Reg. §1.6039F-1(e)(1)(i).

[39] Treas. Reg. §1.672(f)-4(a)(2).

Exceptions

The foregoing tax treatment does not apply to the extent the U.S. donee can demonstrate to the satisfaction of the I.R.S. that either of the following two fact patterns are applicable in the circumstances in the circumstances of the U.S. donee and the person owning the foreign corporation or partnership.

- The foreign corporation or partnership is directly or indirectly owned by a U.S. citizen, or by a resident individual who is not a citizen. The owner reported the purported gift or bequest for U.S. tax purposes as a two-step transaction involving the receipt of a distribution by the owner followed by the subsequent gift or bequest to the U.S. donee.[40]

- The foreign corporation or partnership is directly or indirectly owned by a nonresident, noncitizen individual with regard to the U.S. The foreign individual treated and reported the purported gift or bequest for purposes of the tax laws of the owner's country of residence as the receipt of a distribution and a subsequent gift or bequest to the U.S. donee. The U.S. donee timely complied with the U.S. reporting requirements regarding foreign gifts.[41]

FOREIGN TRUSTS

Code §6048 creates three reporting obligations in transactions involving a U.S. persons and foreign trusts. First, U.S. persons must report the occurrence of "reportable events." Second, U.S. persons who own foreign trusts within the meaning of the grantor trust rules must ensure the trust files and issues certain statements. Third, U.S. persons must report the receipt of distributions from foreign trusts.

Reportable Events

Code § 6048(a) requires a "responsible party" to file information returns when certain "reportable events" occur. A responsible party is any person who is

- a U.S. grantor of an *inter vivos* foreign trust,
- a U.S. person who transfers property to a foreign trust, or
- the executor of a U.S. decedent's estate.

Reportable events include

- the creation of a foreign trust by a U.S. person,
- the direct or indirect transfer of any money or property to a foreign trust by a U.S. person (including a transfer by reason of death), and
- the death of a U.S. person who either was the owner of any portion of a foreign trust or had any portion of a foreign trust included in the estate.[42]

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40 Treas. Reg. §1.672(f)-4(b)(1)(i).

41 Treas. Reg. §1.672(f)-4(b)(1)(ii).

42 Prop Reg §1.6048-2(b).

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> ***"This effectively means that a foreign grantor trust without a U.S. agent is subject to the I.R.S. estimating its tax liability."***

The proposed regulations add that a reportable event includes a transfer to a domestic trust that becomes a foreign trust.[43] The fact that the transferor might receive a qualified obligation in exchange for the transferred property (which would create an exception to certain other types of reporting, as described earlier) does not affect whether the transfer is a reportable event. But transfers to certain trusts, such as foreign charitable trusts or retirement trusts, are not reportable events.

A reportable event is reported on Part I of Form 3520.

U.S. Owners of Foreign Trusts

Code §6048(b)(1) applies to a U.S. person who is treated for purposes of the grantor trust rules as the owner of any portion of a foreign trust. The grantor is required to ensure that the foreign grantor trust files an annual information return (Form 3520-A (*Annual Information Return of Foreign Trust With a U.S. Owner*))[44] and furnishes an annual information statement to each U.S. owner and to any U.S. person who receives a distribution from the trust during the tax year (the Foreign Grantor Trust Owner Statement and Foreign Grantor Trust Beneficiary Statement, respectively).[45] Form 3520-A is due by the 15th day of the third month after the close of the tax year (unlike Form 3520), and the maximum extension available is six months. A failure by the trust to file Form 3520-A means the U.S. owner must file it with his or her own Form 3520.[46]

The provision also states that unless a foreign trust with a U.S. owner appoints a U.S. agent whom the I.R.S. can contact for the provision of records or production of testimony related to the trust and upon whom a summons may be served in relation to the trust,[47] the I.R.S. has discretion to determine the amounts that must be taken into account under the grantor-trust rules.[48] This effectively means that a foreign grantor trust without a U.S. agent is subject to the I.R.S. estimating its tax liability.

Reporting of Distributions

Code §6048(c)(1) requires a U.S. person who receives a distribution from a foreign trust to file an information return (Part III of Form 3520).[49] Additionally, the proposed regulations treat all loans that might potentially be recharacterized as §643(i) distributions as distributions under Code §6048(c)(1), regardless of whether they are actually and simultaneously distributions under Code §643(i).[50]

For reporting purposes, Code §6048(d) explains that even if the foreign trust is a grantor trust, the distribution is treated as a transfer from the trust and not from the grantor.

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[43] Prop Reg §1.6048-2(b)(2).

[44] Prop Reg §1.6048-3(a)(1)(i).

[45] Prop Reg §1.6048-3(a)(1)(ii) and (iii).

[46] Prop Reg §1.6048-3(a)(2)(i) and (ii).

[47] Prop Reg §1.6048-3(d).

[48] Prop Reg §1.6048-3(c).

[49] Prop Reg §1.6048-4(a).

[50] Prop Reg §1.6048-4(b)(5).

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Distribution Defined

The proposed regulations define a distribution as any transfer of property from a trust to a U.S. person related to the trust to extent that the value of the transfer exceeds the value of property or services received by the trust in exchange.[51] Distributions include those received through an intermediary, nominee, or agent.[52] This also includes transfers made directly from an entity owned by the trust.[53] In the latter case, the transfer is considered to be part of a step transaction. The first step is a distribution from the entity to the trust and the second step is from the trust to the U.S. person, unless it is demonstrated to the satisfaction of the I.R.S. that the first distribution is attributable to the U.S. person's direct ownership interest in the entity.[54]

A domestication of a foreign trust is considered to be a distribution from the foreign trust to the new domestic trust.[55] Finally, as mentioned above, loans of property from a foreign trust as described in Code §643(i)) are treated as reportable distributions for purposes of Code §6048. Both the actual recipient of the loan and the grantor or beneficiary of the trust must report the loan.[56]

Tax Consequences

The tax consequences are determined by the type of beneficiary statement that is timely received by the distributee from the foreign trust (if any). If the statement is a Foreign Grantor Trust Beneficiary Statement or Foreign-Owned Grantor Trust Beneficiary Statement, the beneficiary can treat the distribution as that from a grantor trust, which typically is tax-free to a beneficiary that is not the grantor.[57] If the statement is a Foreign Nongrantor Trust Beneficiary Statement that is issued on a timely basis, the beneficiary calculates tax liability under the rules for foreign nongrantor trusts.[58] When a statement is issued, either of two methods can be chosen. These are the default calculation method and the actual calculation method.. Beneficiaries who do not receive statements on a timely basis must use the default calculation method to determine U.S. tax.[59] This is the method that is described under the Code §643(i) regulations and the Form 3520 instructions, where a portion of the distribution is deemed current income based on previous distributions, and the balance is treated as an accumulation distribution. The method is adopted in the proposed regulations as well.[60]

If a U.S. person fails to provide adequate records to the I.R.S. for purposes of determining the tax consequences of a distribution from a foreign trust other than a loan of trust property that is not treated as a Code §643(i) distribution, the I.R.S. will

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51 Prop Reg §1.6048-4(b)(1).

52 Prop Reg §1.6048-4(b)(2).

53 Prop Reg §1.6048-4(b)(3).

54 *Id.*

55 Prop Reg §1.6048-4(b)(4).

56 Prop. Reg. §1.6048-4(b)(5)(iii).

57 Prop. Reg. §1.6048-4(d)(1)(i).

58 Prop. Reg. §1.6048-4(d)(1)(ii).

59 Prop. Reg. §1.6048-4(d)(1)(iii).

60 Prop. Reg. §1.6048-4(d)(3).

characterize the entire distribution as an accumulation distribution, which generally has much harsher consequences for a taxpayer.[61] But if the trust appoints a U.S. agent, the I.R.S. can examine records through the U.S. agent and more precisely determine the tax consequences of the distribution.

Exceptions

There are several exceptions derived from statutory language. The following transfers to foreign trusts are not reportable events:

- A transfer made in return for fair market value, with limitations if the transfer is made by a person related to the trust and the trust or a person related to it issues an obligation
- A transfer to certain compensatory foreign trusts
- A transfer to a trust that is a Code §501(c)(3) organization[62]

The proposed regulations add several more exceptions[63] from reporting:

- Transactions with tax-favored foreign retirement trusts, non-retirement savings trusts, and *de minimis* savings trusts
- Distributions from certain foreign compensatory trusts
- Distributions received by certain domestic charitable organizations
- Certain trusts in mirror code possessions (broadly jurisdictions where tax liability is calculated as though the jurisdiction were the U.S.)[64]

Tax-favored foreign retirement trusts are foreign trusts to provide or earn income for retirees. Certain additional requirements must be met, including those related to contribution limits, withdrawal conditions, and information reporting.[65]

Non-retirement savings trusts are those meant to provide medical, disability, or educational benefits. They must meet similar additional requirements as retirement trusts described above.[66]

Finally, a tax-favored foreign *de minimis* savings trust is a foreign trust that is meant to operate as a savings vehicle and whose value is under a *de minimis* threshold.[67]

Other Rules

As with Code §6039F, dual-resident and dual-status taxpayers are not treated as U.S. persons for these reporting purposes.[68] Married taxpayers filing jointly who

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[61] Prop. Reg. §1.6048-4(e).

[62] Prop. Reg. §1.6048-5(a).

[63] Prop. Reg. §1.6048-5(b).

[64] Prop. Reg. §1.6048-5(e).

[65] Prop. Reg. §1.6048-5(b)(1).

[66] Prop. Reg. §1.6048-5(b)(3).

[67] Prop. Reg. §1.6048-5(b)(4).

[68] Prop. Reg. §1.6048-6(a).

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each have reporting obligations can combine their information on a single Form 3520.[69]

Trusts can be either grantor trusts or nongrantor trusts. In many contexts, a grantor trust is ignored for tax purposes, and the assets and income of a grantor trust are attributed directly to the grantor. The proposed regulations restate the rule in the statute that for purposes of §6048, a trust's status as a grantor trust is ignored, and transfers to or distributions from foreign grantor trusts are viewed as transactions with the trust, and not the grantor.[70]

Finally, the proposed regulations reserve space for the statutory rule that a domestic trust is treated as a foreign trust under Code §§6048 and 6677 if it has substantial activities or property outside the U.S.[71]

Penalties

Code §6677 creates a penalty for failure to comply with §6048(a) or (c). The penalty is equal to the greater of $10,000 or 35% of the reportable amount (generally the value of the property transferred or received). Additionally, a failure to comply with Code §6048(b) will lead to a penalty equal to the greater of $10,000 or 5% of the reportable amount (in this case, the value of the trust corpus). For both penalties, continued noncompliance for more than 90 days after the date on which the I.R.S. notifies the taxpayer will lead to an additional $10,000 penalty. However, if the I.R.S. has sufficient information to determine the reportable amount, the aggregate amount of the penalties cannot exceed the reportable amount.

As with many penalties in the Code, the §6677 penalty can be abated if the taxpayer shows that noncompliance was due to reasonable cause and not willful neglect. The statute states that the threat of penalties from a foreign jurisdiction does not constitute reasonable cause. The proposed regulations mirror the statute and expressly state that a trustee's refusal to provide the taxpayer with information is not considered reasonable cause.[72]

As to other matters, the proposed regulations provide that deficiency procedures do not apply in respect of the assessment or collection of any penalty that may be imposed.[73]

The proposed regulations also specify that married taxpayers filing jointly are considered a single taxpayer for purposes of the penalty. Joint filers are subject to joint-and-several liability for the penalties.[74]

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[69] Prop. Reg. §1.6048-6(d).

[70] Prop. Reg. §1.6048-6(b).

[71] Prop. Reg. §1.6048-6(c).

[72] Prop. Reg. § 1.6677-1(d)(2).

[73] Prop. Reg. § 1.6677-1(e).

[74] Prop. Reg. § 1.6677-1(f).

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CONCLUSION

The proposed regulations add some exceptions to reporting and expand reporting obligations in some cases. They also provide the convenience of compiling rules from several sources of authority into one location. As these are only proposed regulations, comments and possible revisions are to be expected. Comments are requested by this July. A public hearing is also planned for August.

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