July 5, 2024

CC:PA:01:PR (IRS REG-124850-08)
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RE: Transactions With Foreign Trusts and Information Reporting on Transactions With Foreign Trusts and Large Foreign Gifts Proposed Regulations (REG-124850-08, Docket IRS-2024-0022, RIN 1545-B104)

Dear Ms. Banjanin and Ms. Wolf:

The American Institute of CPAs (AICPA) is providing comments on the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS or "Service") proposed regulations regarding transactions with foreign trusts and information reporting on transactions with foreign trusts and large foreign gifts (REG-124850-08, Docket IRS-2024-0022, RIN 1545-B104) (dated 5/8/24) as well as the related statement[1] that IRS posted on its website on 5/8/24.

We are providing our comments and suggestions to improve these proposed regulations. The IRS should consider these comments and suggestions when contemplating and drafting the applicable final regulations and improving the penalty process. Our recommendations will simplify filing for

[1] IRS website statement, "IRS statement on proposed regs that address foreign trust information reporting," 5/8/24, https://www.irs.gov/newsroom/irs-statement-on-proposed-regs-that-address-foreign-trust-information-reporting. It states: "This week, the Treasury Department and the IRS released proposed regulations for transactions with foreign trusts and information reporting on transactions with foreign trusts and large foreign gifts that are reported using Forms 3520 and 3520-A. Recent feedback from stakeholders has highlighted potential opportunities for improvement with respect to the IRS' penalty processes related to Forms 3520 and 3520-A. As such, the IRS has assembled a working group to further evaluate its penalty processes associated with Forms 3520 and 3520-A to identify opportunities for improvement, reduce burden and incentivize voluntary compliance. We plan to have further details on the group's recommendations in the near future."

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taxpayers and practitioners while also reducing the administrative burden on the IRS. These comments are in addition to our prior comments on foreign trust and foreign gift reporting issues.[2]

Our attached comments cover the following issues and recommendations:

1. Inbound Foreign Trust Migration

   A. Treat the inbound migration of a foreign trust as a "distribution" solely for purposes of the mandatory reporting and disclosure requirements of section 6048 and not for any other purpose. The final regulations should confirm that there is no intention to change the income tax consequences when a foreign trust changes its situs to the U.S.

   B. Clarify that Prop. Reg. § 1.6048-4(b)(4) does not control whether an actual distribution of trust corpus or income has occurred for income tax purposes.

   C. Clarify that, in the absence of an actual distribution or decanting of the foreign trust's assets to a domestic trust, where a foreign trust merely changes its situs to the U.S., there should not be any immediate income tax consequences to the domestic trust, the U.S. grantor, and/or the U.S. beneficiary.

   D. Update Part III of Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, to contemplate trust migrations, such as by adding a simple checkbox or by creating a new section of Form 3520 so that the migration is not reported on Part III.

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[2] AICPA comments, "Recommendations for the 2024-2025 Guidance Priority Plan (Notice 2024-28)," May 17, 2024; "Sharing Appeals Form 3520 and Form 3520-A Reasonable Cause Determinations with the Campus," August 14, 2023; "Improvements to Form 3520 and Form 3520-A and Instructions," August 14, 2023; "Response to Request for Public Comments on Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, and Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner (OMB Number: 1545–0159)," February 13, 2023; "2023 AICPA Compendium of Tax Legislative Proposals – Simplification and Technical Proposals," February 7, 2023; "IRS Proposed Regulations on Guidance under Section 2801 Regarding the Imposition of Tax on Certain Gifts and Bequests from Covered Expatriates (REG-112997-10)," May 17, 2016; "Request for Guidance on Foreign Trusts as Part of the HIRE Act," March 28, 2011; "Additional Comments on Notice of Proposed Rulemaking (RIN-1506-AB08) regarding Amendment to the Bank Secrecy Act Regulations – Pertaining to Foreign Trusts," November 19, 2010; "AICPA Draft Form 1041NR, U.S. Income Tax Return for Foreign Estates and Trusts, and Relevant Schedules, for Consideration by the IRS (including AICPA letter and AICPA proposed: Draft Form 1041NR (pages 1-5), Draft Form 1041NR- page 6, Draft Form 1041NR- page 7, Draft From 1041NR-T, Draft Schedule D, Draft Schedule K-1, Draft Schedule K-1 – page 9, Draft Form 4970FT, and Draft Schedule J)," September 22, 2008; "AICPA response to May 12, 2008 IRS follow-up oral comments regarding March 3, 2008, AICPA follow-up submission to IRS on foreign trust reporting," June 12, 2008; "AICPA Comments on Foreign Gift Reporting Threshold – AICPA requests that the IRS further consider the issue of indexing for inflation the $100,000 threshold for gifts to be reported on the Form 3520," March 3, 2008; "AICPA response to May 25, 2007 IRS follow-up oral comments regarding Jan. 31, 2007, AICPA submission to IRS on foreign trust reporting," March 3, 2008; AICPA Foreign Trust Task Force Comments Regarding Foreign Trust Reporting," January 31, 2007; and "Comments on Form 3520-A and Form 3520," June 17, 2003.

2. Exception for Treaty Protected Foreign Pensions and Similar Accounts

   A. Supplement the Prop. Reg. § 1.6048-5(b) provisions in the regulations for "tax-favored foreign retirement trusts" with an additional category that covers retirement plans located in certain treaty countries.

   B. Include in Prop. Reg. § 1.6048–5(b)(5) definitions of "rollover" and "transfer" and provide guidance as to the scenarios that may satisfy the requirements for a rollover of assets or transfer of funds.

   C. Modify the regulations to provide additional analysis and guidance related to treaty-protected foreign pensions and similar accounts, including:

      i. Promulgate additional analysis and guidance under the proposed regulations to expand on the distinction between a foreign trust covered by the proposed regulations and foreign compensatory trusts under Treas. Reg. § 1.672(f)–3(c)(1), given that both types of trusts may be utilized in a primary or incidental manner in the administration and delivery of compensatory payments, benefits, and property to employees and other service providers, and it is recommended, to the extent possible, provide examples of each.

      ii. With respect to trust arrangements not subject to Prop. Reg. § 1.6048-5(a) and (b), which pertain to tax-favored foreign retirement trusts and non-retirement savings trusts (including those used to provide medical, dental, disability or education benefits), include in the regulations a definition of a foreign trust that is subject to section 6048 and not exempt under Treas. Reg. § 1.672(f)–3(c)(1), and include in the regulations the factors and characteristics that must be assessed in order to determine the tax treatment of such an arrangement.

   D. Clarify the application of the "value threshold" to make clear that the focus is on the value of a foreign retirement trust(s) during the tax year and that it is not a requirement that local law prescribe such a limit.

   E. Increase the $600,000 value threshold in Prop. Reg. § 1.6048-5(b)(2)(iv)(1) to at least $1,000,000 and index for inflation.

   F. Eliminate the requirement in Prop. Reg. § 1.6048-5(b)(2)(iii) that, "Generally, only contributions with respect to income earned from the performance of personal services are permitted." If it is not eliminated, we recommend in the alternative that it be substantially changed so that if contributions are allowed to a foreign retirement trust other than with respect to income earned from the performance of personal services ("earned income"), those contributions in the aggregate may not exceed a certain percentage of all contributions to the specific individual's trust(s).

G. Limit the need for participants in a tax favored foreign retirement trust to monitor changes in foreign law related to the requirements in Prop. Reg. § 1.6048-5(b)(2) only to tax years when contributions are made to the trust.

H. Revise Prop. Reg. § 1.6048-5(b)(1) to expressly provide a filing exception for "tax-favored foreign de minimis savings trusts" described in Prop. Reg. § 1.6048-5(b)(4). Similarly, Prop. Reg. § 1.6048-5(b)(5) should be revised so as to provide that tax-favored foreign de minimis savings trusts will also benefit from the rollover provisions in that paragraph.

I. Amend the regulations to state that Canadian retirement plans are not subject to the tax-favored retirement trust reporting requirements set forth under the regulations and, instead, are subject to the provisions of Notice 97-34 and Rev. Proc 2014-55, which provide an exception to the section 6048 reporting requirements.

3. Clarify that the section 6048 reporting exception for tax-favored foreign retirement trusts, nonretirement savings trusts, and de minimis savings trusts, shall apply retroactively to all years in the taxpayer's holding period of that investment.

4. Actual Calculation Method and Default Calculation Method

   A. Update Prop. Reg. § 1.6048-4 to permit the use of the default method by U.S. beneficiaries who receive accumulation distributions from domestic trusts that were formerly foreign trusts.

   B. Modify Prop. Reg. § 1.6048-4(d)(1) to permit the use of the actual method on an amended Form 3520 and amended income tax return if the statement is received by the time the U.S. person files their amended income tax return.

   C. Modify Prop. Reg. § 1.6048-4(d)(3)(iii) to require the character of a terminating distribution to be substantiated either by a Foreign Nongrantor Trust Beneficiary Statement provided by the trustee or the recalculation of amounts by the beneficiary using information provided by the trustee.

   D. Modify Prop. Reg. § 1.6048-4(d)(3) to allow taxpayers, in the absence of a trust beneficiary statement, to determine the number of years a foreign trust has existed by providing other information or documentation establishing years of existence with their Form 3520, as currently permitted in the instructions to Line 32 of the Form 3520.

5. Original and Extended Due Dates for Form 3520

   A. Modify the regulations to clarify that the June 15 due date also applies for Forms 3520 filed by U.S. citizens and residents who are on military or naval duty outside the U.S. and Puerto Rico, consistent with the June 15 due date provided for these individuals' U.S. federal income tax returns under Treas. Reg. § 1.6081-5(a)(6).

B. Modify the regulations to clarify that U.S. citizens and residents who live, or are on military or naval duty, outside the U.S. and Puerto Rico may extend the due date of their Form 3520 to December 15, synchronizing it with the extended due date of their U.S. federal income tax return.

6. Provide that the deadline for Foreign Nongrantor Trust Beneficiary Statements and Foreign-Owned Grantor Trust Beneficiary Statements is the due date of the beneficiary's income tax return.

7. Incorporate into the regulations or administrative procedures, administrative relief including mandating (i) review of reasonable cause prior to penalty assessment, and (ii) First Time Abate (FTA) for sections 6677 and 6039F penalties.

8. Provide guidance regarding the classification of certain foreign trusts and entities organized under the laws of a foreign or civil law jurisdiction.

9. Clarify how the spousal attribution rule in section 672(e) applies in the content of section 672(f).

10. Distributions, Deemed Distributions, and Related Party Loan Transactions

    A. Modify the requirements included in Prop. Reg. § 1.643(i)-2(b)(2)(iii) as follows:

        i. Modify the requirement that "all payments on the obligation must be made in cash in U.S. dollars" to permit loans denominated in foreign currency to be considered qualified obligations.

        ii. Modify the requirement that a qualified obligation must have a yield to maturity based upon the applicable Federal rate (AFR) for cases where such a rate is not viable in the marketplace and a trustee therefore may not be willing to issue such a loan.

    B. Clarify Prop. Reg. § 1.643(i)-1(b)(2)(i), as follows:

        i. Clarify whether in the example in Prop. Reg. § 1.643(i)-1(b)(2)(i)(B), the lender is acting as an intermediary, agent, or nominee of the trust.

        ii. Clarify whether in the example in Prop. Reg. § 1.643(i)-1(b)(2)(i)(C) the foreign person who receives the loan is acting as an intermediary, agent, or nominee of the U.S. grantor or beneficiary.

        iii. Consider adopting intermediary rules similar to the existing provisions of Treas. Reg. § 1.643(h)-1(a) and Treas. Reg. § 1.679-3(c) to better establish a connection between loan transactions and foreign trusts.

C. Update Prop. Reg. § 1.643(i)-4 to incorporate related party rules similar to those that have long been included as part of Treas. Reg. § 1.643(h)-1(a) and Treas. Reg. § 1.679-3(c).

D. Eliminate Prop. Reg. § 1.643(i)-1(b)(3), or if that is not possible, revise it in one or more of the following ways:

    i. Treat the existing obligation as a distribution from the foreign trust as of the loan origination date.

    ii. Narrow the applicability of this provision to apply only if the loan was made to an individual who was previously a resident alien for at least a three-year period, and if the loan was made within two years before the individual resumed his or her resident alien status.

    iii. Clarify the tax treatment for taxpayers with nonqualified loans originated within this two-year period which are fully repaid by the taxpayer.

    iv. Implement this provision in a prospective manner with a specific time horizon for implementation.

E. Revise Prop. Regs. §§ 1.643(i)-3(a)(2) and 1.643(i)-3(c)(2)(ii) to establish that indirect distributions due to nonqualified loans, in the form marketable securities, will not be subject to mark-to-market (MTM) treatment, unless an affirmative election is made in accordance with section 643(e).

F. Regarding Prop. Reg. § 1.643(i)-2(a)(4):

    i. Give amounts previously taxed at the beneficiary level the same type of prioritization as section 965 previously taxed earnings & profits (PTEP) received in Notice 2019-1 such that these amounts are deemed distributed first before other amounts.

    ii. Create an additional PTEP relief provision to address the potential double taxation of distributions (in addition to loans) from foreign corporations owned by foreign non-grantor trusts that can reasonably be traced to amounts that have already been included in the U.S. beneficiary's gross income as a subpart F income inclusion, a global intangible low-taxed income inclusion, an inclusion by reason of a controlled foreign corporation's investment of earnings in U.S. property, or a qualified electing fund inclusion.

    iii. Create a separate relief provision for loans that do not meet the exceptions in Prop. Reg. § 1.643(i)-2 (and are thus treated as section 643(i) distributions) but are repaid by the obligor/beneficiary consistent with the loan terms using the currency from a subsequent distribution from the trust to the obligor/beneficiary.

G. Create exceptions in the regulations under section 643(i) for loans made by or guaranteed by a foreign trust to a related person.

i. Create an exception in the regulations under section 643(i) for loans made by foreign trusts to persons who are related to a U.S. grantor or beneficiary but who are not themselves beneficiaries if the loan is bona fide (there is a reasonable expectation of repayment), the loan is made on commercially reasonable terms, and the loan was not made for the principal purpose of tax avoidance, using the standards adopted in section 643(h) for determining when a distribution to a beneficiary is deemed to have been made indirectly through an intermediary.

ii. Provide that no reporting requirement is imposed on a U.S. grantor or beneficiary with respect to a loan made by a foreign trust to a related person unless the U.S. grantor or beneficiary knew or had reason to know that the loan had been made.

iii. Provide that a trust's guarantee of a loan to a related person should not cause section 643(i) to apply if the terms of the guarantee are commercially reasonable.

11. Valuing Foreign Gifts for Purposes of International Information Reporting

A. Regarding the requirement under Prop. Reg. § 1.6039F-1(c)(2)(ii) and Prop. Reg. § 1.6039F-1(h)(2) for the lower reporting threshold for covered gifts or bequests from a covered expatriate, reserve for public comment until after the final regulations under section 2801 have been promulgated.

B. Expand reporting exceptions for large foreign gifts and inheritances, including:

i. Increase reporting thresholds for large foreign gifts and inheritances from individuals to $1,000,000 and index for inflation, and

ii. Provide an exception for all reporting of large foreign gifts and inheritances between spouses.

C. Create a standalone form with instructions for reporting large foreign gifts and inheritances.

D. Clarify in the regulations the reporting of partial or incomplete foreign gifts under section 6039F.

E. Revise Prop. Reg. § 1.6039F-1(d) to remove the reference therein to chapter 14 of the Code for the purpose of valuing foreign gifts, with such gifts instead being valued using the principles of section 2512 and the regulations thereunder.

F. Modify Prop. Reg. § 1.6677-1(c)(2) to remove the statement therein that would disregard the effect of taxes, expenses, liabilities or restrictions on the sale or use of property for valuation purposes. The gross value or gross amount of property would thus be determined

in accordance with the valuation principles of sections 2512 and 2031 and the regulations thereunder.

12. Add an example to Prop. Reg. § 1.6048-6(a)(1) that reminds taxpayers that although reporting requirements are waived for the dual resident taxpayer, they are not waived for other taxpayers who have transactions with the same foreign trust.

13. Modify the regulations to exclude foreign trusts electing to be treated as an estate under section 645 from the filing requirements of section 6048.

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The AICPA is the world's largest member association representing the CPA profession, with more than 400,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of our recommendations and welcome the opportunity to discuss our comments. If you have any questions, please contact Henry P. Alden, II, Chair, AICPA Form 3520 Penalties Task Force, at (410) 571-0388 or Halden@eigtax.com; Eileen Sherr, AICPA Director – Tax Policy & Advocacy, at (202) 434-9256 or Eileen.Sherr@aicpa-cima.com; or me at (830) 372-9692 or bvickers@alamo-group.com.

Sincerely,

Blake Vickers, CPA, CGMA
Chair, AICPA Tax Executive Committee

cc: Ms. Catherine Hughes, Estate and Gift Tax Attorney-Advisor, Office of Tax Legislative Counsel, Office of Tax Policy, Department of the Treasury
Ms. Holly Porter, Associate Chief Counsel, Passthrough & Special Industries, Internal Revenue Service
Ms. Karlene Lesho, Senior Technician Reviewer, Office of Associate Chief Counsel, Passthroughs & Special Industries (Estate & Gift), Internal Revenue Service
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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Comments on Transactions With Foreign Trusts and Information Reporting on Transactions With Foreign Trusts and Large Foreign Gifts Proposed Regulations (REG-124850-08, Docket IRS-2024-0022, RIN 1545-B104)

July 5, 2024

Our comments address numerous foreign trust reporting issues. These comments specifically respond to and address issues related to the proposed regulations (REG-124850-08) on transactions with foreign trusts and information reporting on transactions with foreign trusts and large foreign gifts as well as the related statement[1] that IRS posted on its website on 5/8/24.[2]

These comments are in addition to our prior comments on foreign trust and foreign gift reporting issues.[3]

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[1] IRS website statement, "IRS statement on proposed regs that address foreign trust information reporting," 5/8/24, https://www.irs.gov/newsroom/irs-statement-on-proposed-regs-that-address-foreign-trust-information-reporting. It states: "This week, the Treasury Department and the IRS released proposed regulations for transactions with foreign trusts and information reporting on transactions with foreign trusts and large foreign gifts that are reported using Forms 3520 and 3520-A. Recent feedback from stakeholders has highlighted potential opportunities for improvement with respect to the IRS' penalty processes related to Forms 3520 and 3520-A. As such, the IRS has assembled a working group to further evaluate its penalty processes associated with Forms 3520 and 3520-A to identify opportunities for improvement, reduce burden and incentivize voluntary compliance. We plan to have further details on the group's recommendations in the near future."

[2] Unless otherwise indicated, references to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), and references to a "Treas. Reg. §" are to the Treasury regulations promulgated under the Code.

[3] AICPA comments, "Recommendations for the 2024-2025 Guidance Priority Plan (Notice 2024-28)," May 17, 2024; "Sharing Appeals Form 3520 and Form 3520-A Reasonable Cause Determinations with the Campus," August 14, 2023; "Improvements to Form 3520 and Form 3520-A and Instructions," August 14, 2023; "Response to Request for Public Comments on Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, and Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner (OMB Number: 1545–0159)," February 13, 2023; "2023 AICPA Compendium of Tax Legislative Proposals – Simplification and Technical Proposals," February 7, 2023; "IRS Proposed Regulations on Guidance under Section 2801 Regarding the Imposition of Tax on Certain Gifts and Bequests from Covered Expatriates (REG-112997-10)," May 17, 2016; "Request for Guidance on Foreign Trusts as Part of the HIRE Act," March 28, 2011; "Additional Comments on Notice of Proposed Rulemaking (RIN-1506-AB08) regarding Amendment to the Bank Secrecy Act Regulations – Pertaining to Foreign Trusts," November 19, 2010; "AICPA Draft Form 1041NR, U.S. Income Tax Return for Foreign Estates and Trusts, and Relevant Schedules, for Consideration by the IRS (including AICPA letter and AICPA proposed: Draft Form 1041NR (pages 1-5), Draft Form 1041NR- page 6, Draft Form 1041NR- page 7, Draft From 1041NR-T, Draft Schedule D, Draft Schedule K-1, Draft Schedule K-1 – page 9, Draft Form 4970FT, and Draft Schedule J)," September 22, 2008; "AICPA response to May 12, 2008 IRS follow-up oral comments regarding March 3, 2008, AICPA follow-up submission to IRS on foreign trust reporting," June 12, 2008; "AICPA Comments on Foreign Gift Reporting Threshold – AICPA requests that the IRS further consider the issue of indexing for inflation the $100,000 threshold for gifts to be reported on the Form 3520," March 3, 2008; "AICPA response to May 25, 2007 IRS follow-up oral comments regarding Jan. 31, 2007, AICPA submission to IRS on foreign trust reporting," March 3, 2008; AICPA Foreign Trust Task Force Comments Regarding Foreign Trust Reporting," January 31, 2007; and "Comments on Form 3520-A and Form 3520," June 17, 2003.

Our below comments cover the following issues.

1. Inbound Foreign Trust Migration

2. Exception for Treaty Protected Foreign Pensions and Similar Accounts

3. Clarify that the section 6048 reporting exception for tax-favored foreign retirement trusts, nonretirement savings trusts, and de minimis savings trusts, shall apply retroactively to all years in the taxpayer's holding period of that investment.

4. Actual Calculation Method and Default Calculation Method

5. Original and Extended Due Dates for Form 3520

6. Provide that the deadline for Foreign Nongrantor Trust Beneficiary Statements and Foreign-Owned Grantor Trust Beneficiary Statements is the due date of the beneficiary's income tax return.

7. Incorporate into the regulations or administrative procedures, administrative relief including mandating (i) review of reasonable cause prior to penalty assessment, and (ii) First Time Abate (FTA) for sections 6677 and 6039F penalties.

8. Provide guidance regarding the classification of certain foreign trusts and entities organized under the laws of a foreign or civil law jurisdiction.

9. Clarify how the spousal attribution rule in section 672(e) applies in the content of section 672(f).

10. Distributions, Deemed Distributions, and Related Party Loan Transactions

11. Valuing Foreign Gifts for Purposes of International Information Reporting

12. Add an example to Prop. Reg. § 1.6048-6(a)(1) that reminds taxpayers that although reporting requirements are waived for the dual resident taxpayer, they are not waived for other taxpayers who have transactions with the same foreign trust.

13. Modify the regulations to exclude foreign trusts electing to be treated as an estate under section 645 from the filing requirements of section 6048.

BACKGROUND

The AICPA is providing comments on the proposed Treasury Regulations (REG-124850-08) published in the Federal Register on May 8, 2024. The proposed regulation package provides guidance regarding information reporting of transactions with foreign trusts, receipt of large foreign gifts and regarding loans from, and uses of property of, foreign trusts.[4] This proposed

[4] 89 Federal Register 39440 (May 8, 2024).

regulation package specifically contains proposed amendments to 26 CFR part 1 under sections 643(i), 679, 6039F, 6048, and 6677 of the Internal Revenue Code ("the proposed regulations").[5]

Prior guidance related to foreign trust reporting and transactions originated from multiple sources and was incomplete. The proposed regulations released on May 8, 2024, were, therefore, helpful and welcome. The proposed regulations consolidate much of the prior guidance that was previously extrapolated from sections 643(i), 679, 6039F, 6048, 6677, related Treasury Regulations released to date, Notice 97-34 and Revenue Procedure 2020-17.

Section 643(i) (added to the Code by the Small Business Job Protection Act of 1996 "1996 Act") and section 679 (amended by the 1996 Act) provide rules intended to prevent taxpayers from avoiding U.S. income tax consequences through the use of foreign trusts.[6] Section 6039F requires U.S. persons to report the receipt of large gifts or bequests from foreign persons and imposes penalties on taxpayers that do not disclose in accordance with the section.[7] Similarly, section 6048 generally requires U.S. persons to report transactions that involve foreign trusts.[8] Finally, section 6677 imposes penalties on U.S. persons for failing to comply with the information reporting obligations established in section 6048.[9]

In addition to the statutory guidance mentioned above, Treasury and the IRS issued Notice 97-34, 1997-1 CB 422, on June 2, 1997, to provide guidance on sections 643(i), 679, 6039F, 6048 and 6677 as enacted or modified by the 1996 Act.[10] On August 7, 2000, Treasury and the IRS also published proposed Treasury Regulations under section 679. Final regulations under section 679 were released on July 20, 2001.[11]

To comply with information reporting requirements under the guidance discussed above, taxpayers report via Forms 3520-A, *Annual Information Return of Foreign Trust with a U.S. Owner,* and 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*. Form 3520-A is a trust-level filing completed by the foreign grantor trust considered to be owned all or in part by a U.S. person. Form 3520 is filed by any U.S. person that contributes to, owns an interest in, or receives a distribution from a foreign trust. Form 3520 is also used to report the receipt of large foreign gifts by U.S. persons.

SPECIFIC COMMENTS

1. Inbound Foreign Trust Migration

Overview

Proposed Reg. § 1.6048-4(b)(4) provides that a distribution from a foreign trust includes an inbound migration of a foreign trust, without any clarification as to whether this treatment is solely

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[5] *Id.*
[6] Section 643(i); section 679; 89 Federal Register 39440 (May 8, 2024).
[7] Section 6039F; 89 Federal Register 39442 (May 8, 2024).
[8] Section 6048; 89 Federal Register 39440 (May 8, 2024).
[9] Section 6677; 89 Federal Register 39440 (May 8, 2024).
[10] Notice 97-34, 1997-1 CB 422; 89 Federal Register 39440 (May 8, 2024).
[11] Section 679; 89 Federal Register 39440 (May 8, 2024).

for information reporting purposes (as opposed to the substantive taxation of the inbound migration).

Recommendations

A. We recommend that the inbound migration of a foreign trust be treated as a "distribution" solely for purposes of the mandatory reporting and disclosure requirements of section 6048 and not for any other purpose. Our understanding is that the proposed regulations did not intend to change the income tax consequences when a foreign trust changes its situs to the U.S., but it would be helpful if the final regulations could confirm this treatment.

B. Specifically, the regulations should clarify that Prop. Reg. § 1.6048-4(b)(4) does not control whether an actual distribution of trust corpus or income has occurred for income tax purposes.

C. In addition, the regulations should clarify that, in the absence of an actual distribution of the foreign trust's assets to a domestic trust, where a foreign trust merely changes its situs to the U.S., there are no immediate income tax consequences to the domestic trust, the U.S. grantor, and/or the U.S. beneficiary.

D. If our recommendation is ultimately adopted in the regulations, then we also recommend that the IRS update Part III of Form 3520 to contemplate trust migrations. Otherwise, U.S. persons may inadvertently characterize the migration of a foreign trust as a taxable distribution based on the current structure of the form. For example, foreign trust migrations could easily be incorporated into the form by adding a simple checkbox or by creating a new section of Form 3520 so that the migration is not reported on Part III.

Analysis

Section 6048 imposes mandatory reporting and disclosure requirements on certain U.S. persons with respect to their interactions with and ownership of foreign trusts. These reporting requirements may apply to any U.S. person who creates a foreign trust, owns a foreign trust, transfers any money or property (directly or indirectly) to a foreign trust, or receives a distribution from a foreign trust.

In the context of distributions, section 6048(c) requires any U.S. person who receives (directly or indirectly) any distribution from a foreign trust to report the distribution on Part III of Form 3520, along with the name of the foreign trust and the aggregate amount of distributions received. The U.S. person must also include the entire amount of the distribution received in gross income as an accumulation distribution under section 668 unless the U.S. person provides the IRS with adequate records to establish the appropriate income tax treatment. Proposed Reg. § 1.6048-4(b)(1) defines the term "distribution" as any transfer of property (including cash) from a foreign trust received directly or indirectly by a U.S. person to the extent such property exceeds the fair market value of any property or services received by the foreign trust in exchange for the property transferred, without regard to whether any portion of the foreign trust is treated as owned by the grantor or

another person under the grantor trust rules, whether the recipient is designated as a beneficiary by the terms of the foreign trust, or whether the distribution has any income tax consequences.

Pursuant to Proposed Reg. § 1.6048-4(b)(4), a "distribution" also includes "an inbound migration of a foreign trust" (which occurs when a foreign trust becomes a domestic trust); reporting is required in this case because the foreign trust "is treated as distributing the trust corpus and income to the domestic trust on the date the foreign trust becomes a domestic trust." However, the proposed regulations do not address whether this treatment is intended to apply solely for purposes of the mandatory reporting requirements of section 6048, or whether the migration is intended to be treated as a distribution for all other purposes as well. For example, if the migration of a foreign trust is to be treated as a distribution of the trust's corpus and income for Federal income tax purposes, then the migration could have income tax consequences to the domestic trust, the U.S. grantor, and/or the U.S. beneficiary – even though an actual distribution did not occur. This result appears contrary to existing guidance and legislative history, but it is not clear whether this treatment was intended.

The application of Proposed Reg. § 1.6048-4(b)(4) is illustrated by Example 11 of Prop. Reg. § 1.6048-4(g):

> FB, a foreign bank, resigns as trustee of FT, and DB, a domestic bank, becomes the new trustee of FT. Pursuant to section 7701(a)(30)(E), FT becomes a domestic trust, DT. Under paragraph (b)(4) of this section, *DT is treated as receiving a distribution of the trust corpus and income from FT*. Under paragraph (a) of this section, *DT must report the deemed distribution of the trust corpus and income on Part III of Form 3520* for the year in which the inbound migration occurs [emphasis added].

Despite this welcome guidance, the proposed regulations do not explicitly address whether the inbound migration of a foreign trust is characterized as "distribution" for all purposes of the Code, or whether this characterization applies strictly for purposes of section 6048(c). One possible interpretation of Prop. Reg. § 1.6048-4(b)(4) is that the IRS and Treasury decided to characterize the inbound migration of a foreign trust as a "distribution" solely in the section 6048(c) context to enhance their ability to obtain information on U.S. persons' transactions with foreign trusts. Otherwise, the domestication of a foreign trust would not fall within the purview of the section 6048(c) reporting requirements, as no actual distribution of property has taken place.

However, the plain language of the proposed regulations conveys a much broader interpretation. Proposed Reg. § 1.6048-4(b)(4) clearly says that a "distribution" includes the inbound migration of a foreign trust; this characterization is not in any way limited to section 6048(c). Further, Example 11 of Prop. Reg. § 1.6048-4(g) concludes that when a foreign trust becomes a domestic trust, the domestic trust must report the "deemed distribution" of the foreign trust's corpus and income on Part III of Form 3520. Ordinarily, a U.S. person who receives an actual distribution of property from a foreign trust uses Part III of Form 3520 to figure their taxable income associated with the distribution. Thus, Example 11 of Prop. Reg. § 1.6048-4(g) suggests that the inbound migration of a foreign trust would be characterized as a "distribution" both for section 6048(c) purposes and for income tax purposes.

Separately, Example 11 does not distinguish between migrations involving grantor trusts and nongrantor trusts, whereas Example 12 of Prop. Reg. § 1.6048-4(g) expressly points out this distinction. Example 12 reads as follows:

> T, as trustee of FT, has the power to decant. Exercising that power, T distributes the trust corpus and income of FT to DT, a domestic trust. *Neither FT nor DT is a grantor trust*. Under paragraph (b)(1) and (4) of this section, DT receives a distribution of the trust corpus and income from FT. Under paragraph (a) of this section, DT must report the distribution of the trust corpus and income on Part III of Form 3520 for the year in which the decanting occurs [emphasis added].

In both Example 11 and Example 12, the proposed regulations conclude that the domestic trust must report the "distribution" of the foreign trust's corpus and income on Part III of Form 3520. However, the form of each transaction is very different. In Example 11, the situs of the foreign trust is simply changing to the U.S., whereas in Example 12, the foreign trust is decanting its assets to a domestic trust. In effect, the proposed regulations characterize trust migrations and decantings in the exact same manner, despite the lack of statutory authority for this position under section 6048. In addition, because Example 12 limits its application to nongrantor trusts but Example 11 does not, the proposed regulations suggest that the trust's classification does not affect the reporting requirements or income tax treatment when a migration occurs, even though an actual distribution of property from a foreign grantor trust is generally not a taxable event to the recipient. Characterizing the inbound migration of a foreign trust as a "distribution" that potentially triggers income or gain recognition to the U.S. trust, U.S. grantor, and/or U.S. beneficiary would not only be contrary to existing guidance but would also arguably exceed the regulatory authority of the Treasury Department.

- *Revenue Ruling 91-6, 1991-1, C.B. 89*

  In Revenue Ruling 91-6, the IRS addressed the income tax treatment of accumulation distributions made by a domestic trust that was previously a foreign trust. The ruling concludes that an actual distribution received by a U.S. beneficiary from a domestic trust that was formerly a foreign trust is subject to the accumulation distribution rules of section 666 because the distribution is deemed to have been made in a year in which the trust was a foreign trust.

  Based on the fact pattern of the ruling, the foreign trust in question changed its situs to the U.S. "in a manner that did not cause a termination of the trust or a constructive distribution of trust assets" to the U.S. beneficiary. Thus, the inbound migration of the foreign trust itself was not characterized as a distribution of either income or corpus, and therefore, did not result in any immediate income tax consequences to the domestic trust or its beneficiary. Rather, the income tax consequences of the inbound migration were deferred until the domestic trust made an actual distribution to the U.S. beneficiary. This conclusion stands in stark contrast to Example 11 of Prop. Reg. § 1.6048-4(g), which says that the domestic trust "is treated as receiving a distribution of the [foreign trust's] corpus and income" when the migration occurs.

  In short, the proposed regulations suggest that the inbound migration of a foreign trust results in a deemed distribution of assets from the foreign trust to the domestic trust, whereas Revenue

Ruling 91-6 concludes that the mere migration of a foreign trust does not result in a constructive distribution of trust assets.

- *Authority to Characterize Inbound Migration as Taxable Distribution*

  Section 6048 was originally enacted as a disclosure provision that requires U.S. persons to report certain transactions involving foreign trusts. Other than section 6048(c)(2), which addresses the income tax treatment of certain distributions made from foreign trusts in the hands of a distributee, the statute does not address (and was not intended to address) the income tax consequences of a foreign trust migrating to the U.S. The inbound migration of a foreign trust is also not characterized as a distribution by either section 661 or section 662, nor is it defined as a reportable event under section 6048(a)(3).

  Based on this statutory framework, a change in the situs of a foreign trust to the U.S. should not be a taxable event without a corresponding distribution, consistent with the conclusion from Revenue Ruling 91-6. By labeling the inbound migration of a foreign trust as a deemed distribution, the proposed regulations suggest that this would now be treated as a taxable event under section 6048(c) even if no actual distribution occurred, which would arguably exceed the regulatory authority of Treasury and the IRS without Congressional action.

  If Treasury and the IRS believe that the inbound migration of a foreign trust should be characterized as either a deemed distribution or a taxable event, then Congress would arguably need to enact legislation to this effect. For example, Congress formally addressed the income tax consequences of a domestic trust becoming a foreign trust with the enactment of section 684 as part of the Taxpayer Relief Act of 1997 (Public Law 105-34). Under section 684(a), the transfer of property by a U.S. person to a foreign estate or trust is characterized as a deemed sale or exchange of assets, in which case the transferor is required to recognize gain; gain recognition is also required under section 684(c) when a domestic trust which becomes a foreign trust, in which case the domestic trust is treated as having transferred its assets to the foreign trust immediately before the change in situs. Thus, Congress expressly intended to treat the outbound migration of a domestic trust to a foreign trust as a taxable event through the enactment of section 684(c); however, no such rule currently exists characterizing the inbound migration of a foreign trust to a domestic trust as a taxable event, particularly within the context of section 6048.

For these reasons, the proposed regulations should clarify that the inbound migration of a foreign trust without an actual distribution of assets is not a taxable event and is characterized as a distribution solely for purposes of the information reporting requirements of section 6048.

2. Exception for Treaty Protected Foreign Pensions and Similar Accounts

A. Supplement the Prop. Reg. § 1.6048-5(b) provisions in the regulations for "tax-favored foreign retirement trusts" with an additional category that covers retirement plans located in certain treaty countries.

Overview

Proposed Reg. § 1.6048-5(b) provides for a reporting exception for any eligible individual's transactions with, or ownership of, a "tax-favored foreign retirement trust" (TFRT) (as specially defined). We believe that this exception can apply to contributions which are made to a TFRT; to income realized by a TFRT (including increases in the value of its investment assets); to distributions that are eventually made by a TFRT to an eligible individual; and possibly to other situations. Depending on a particular individual's circumstances, however, the definition of a TFRT may not be broad enough to cover certain foreign retirement trusts that are based in a tax treaty country, including situations where the treaty provides a tax exemption or a tax deferral with respect to gross income that would otherwise be taxable currently to the individual under the Code. Because the Service has long provided a reporting exception under section 6048 for certain retirement plans based in Canada (Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs)) where the Canada-U.S. treaty provides for an exemption or deferral of income tax that is imposed under the Code, it would be appropriate to provide similar relief for retirement plans that are based in other treaty countries where the treaty provides for a U.S. tax exemption or deferral with respect to particular items.

Recommendation

We recommend that the provisions in the regulations for "tax-favored foreign retirement trusts" be supplemented with an additional category that covers retirement plans located in certain treaty countries. Thus, where an eligible individual has an interest in a foreign retirement trust based in a tax treaty country, and where the treaty provides relief from current taxation under the Code with respect to (i) contributions to the plan, or (ii) income or accretions within the trust, or (iii) distributions from the trust, sections 6048(a) through 6048(c) and Prop. Reg. §§ 1.6048-2 through 1.6048-4 should not apply to the individual's transactions with, or ownership of, an interest in such a trust. Such a trust could be referred to as a "treaty-eligible foreign retirement trust." This exemption from reporting would not be construed as providing an exemption from income tax with respect to the individual's participation in such a trust (where required under the Code or under the applicable provisions of the relevant tax treaty), nor would it be construed as providing an exemption from reporting on Form 8938, *Statement of Specified Foreign Financial Assets*, under section 6038D.

Analysis

As noted above, the Service has provided a broad exception from Form 3520 and Form 3520-A reporting for Canadian RRSPs and RRIFs, where income that is realized within the plan is taxable currently under the Code but is tax-exempt or tax-deferred by treaty. See Rev. Proc. 2014-55 (and prior to the effective date thereof, Rev. Proc. 2002-23 and Notice 2003-75). Based on this

precedent, it should be appropriate for a similar exception to be available under section 6048 where a treaty provides for similar U.S. tax exemptions or tax deferrals, especially because the treaty's information-exchange provisions would permit the two governments to monitor these provisions. For example, Article 18 of the U.S.-United Kingdom tax treaty provides for potential exemptions from U.S. tax with respect to contributions to a United Kingdom-based retirement plan, with respect to income arising within such a plan (including unrealized increases in the value of assets within a plan), and with respect to certain distributions from such a plan [Articles 17 and 18 of the 2016 U.S. model tax treaty also contain similar provisions]. Because the two countries have a broad information-exchange program, these exemptions and deferrals are routinely monitored by the U.S. and United Kingdom tax authorities. Furthermore, before these kinds of provisions are even included in a tax treaty, the U.S. Treasury while negotiating a treaty is fully familiar with the treaty country's plans and approves the availability of these reliefs.

Finally, it should be stressed that if our recommendation is adopted, many and perhaps most individuals who participate in a "treaty-eligible foreign retirement trust" would be required to report information about their participation on Form 8938 (under section 6038D), in the same manner as would an individual who participates in a TFRT under the proposed regulations. In such a situation the Service would still obtain timely information about the individual's participation in the particular foreign plan.

B. Include in Prop. Reg. § 1.6048–5(b)(5) definitions of "rollover" and "transfer" and provide guidance as to the scenarios that may satisfy the requirements for a rollover of assets or transfer of funds.

Overview

Proposed Reg. § 1.6048–5(b)(5) provides that a trust that otherwise meets the requirements of Proposed Reg. § 1.6048–5(b)(2) and (b)(3) will not fail to be treated as a tax-favored foreign retirement or non-retirement savings trust solely because it may receive a rollover of assets or funds transferred from another tax-favored foreign retirement or non-retirement savings trust established and operated under the laws of the same jurisdiction, provided that the trust transferring assets or funds also meets the requirements of paragraph (b)(2) or (b)(3). The text of the proposed regulation does not specify the manner in which the rollover or transfer of cash or property is required to be, or may be, executed. For instance, it is not clear whether the provision may apply to "trustee to trustee" rollovers or whether it may include distributions to a participant which are rolled into a plan.

Recommendation

We recommend that the Proposed Regulation § 1.6048–5(b)(5) include definitions of "rollover" and "transfer" and provide guidance as to the scenarios that may satisfy the requirements for a rollover of assets or transfer of funds.

Analysis

Non-U.S. commercial and regulatory practices may differ in local jurisdictions as to how assets may be rolled over or transferred from retirement savings. The requested clarification is required in order for taxpayers to rollover and transfer funds in a manner intended to comply with Prop. Reg. § 1.6048–5(b)(5) and the relief afforded thereunder.

C. Modify the regulations to provide additional analysis and guidance related to treaty-protected foreign pensions and similar accounts.

Overview

Proposed Reg. § 1.6048–5(c) implements the exception from section 6048(c) reporting provided in section V of Notice 97–34 for distributions from certain foreign compensatory trusts described in Treas. Reg. § 1.672(f)–3(c)(1), which the preamble to the proposed regulations describes as "section 402(b) employee trusts and foreign rabbi trusts."[12] The exception applies only if the U.S. individual who receives the distribution reports the distribution as compensation income on a federal income tax return. While Prop. Reg. § 1.6048-5(c) does not reference Treas. Reg. § 1.672(f)–3(c)(2) (Exceptions), authority is provided to the Commissioner in Treas. Reg. § 1.672(f)–3(c)(2) to designate categories of compensatory trusts to which the general rule of paragraph Treas. Reg. § 1.672(f)–3(c)(1) may apply. The proposed regulations and Treas. Reg. § 1.672(f)–3(c)(1) make reference to ambiguous terms such as foreign compensatory trusts, rabbi trusts, and employees' nonexempt trusts and the regulations, read both separately and together, lack sufficient clarity in order for a taxpayer to assess a particular arrangement and comply with applicable tax reporting and income inclusion requirements. Expansion under the proposed regulations as to what does and does not constitute a "foreign compensatory trust" is central to the administration of the proposed regulations.

Recommendations

i. Although we acknowledge that the proposed regulations are intended to provide guidance specific to arrangements subject to section 6048 and that the issuance of guidance specific to other regulations, including Treas. Reg. § 1.672(f)–3(c)(1), is outside the scope of the proposed regulations, we recommend that Treasury and the IRS issue additional analysis and guidance under these regulations to expand on the distinction between a foreign trust covered by the regulations and foreign compensatory trusts under Treas. Reg. § 1.672(f)–3(c)(1) given that both types of trusts may be utilized in a primary or incidental manner in the administration and delivery of compensatory payments, benefits, and property to employees and other service providers, and it is recommended, to the extent possible, that Treasury and the IRS provide examples of each.

ii. With respect to trust arrangements not subject to Prop. Reg. § 1.6048-5(a) and (b), which pertain to tax-favored foreign retirement trusts and non-retirement savings trusts (including those used to provide medical, dental, disability or education benefits), we

[12] 89 Federal Register 39454 (May 8, 2024).

recommend that the regulations include a definition of a foreign trust that is subject to section 6048 and not exempt under Treas. Reg. § 1.672(f)–3(c)(1), and we recommend that the regulations include the factors and characteristics that must be assessed in order to assess the tax treatment of such an arrangement.

Analysis

In general, there is a lack of regulatory and other guidance pertaining to Treas. Reg. § 1.672(f)–3(c)(1) and what types of arrangements may be considered a 402(b) employees' trust or another type of compensatory trust. Given the wide-ranging types and uses of foreign trusts or similar arrangements, it is often difficult to assess the application of Treas. Reg. § 1.672(f)–3(c)(1) and section 6048 to particular arrangements. Aside from compensatory trusts described in Treas. Reg. § 1.672(f)–3(c)(1), foreign trusts subject to section 6048 may also in fact be used in connection with arrangements that are compensatory in nature whereby an individual may be considered to be the owner, grantor, or beneficiary of a foreign trust.

The expanded use of foreign employee trusts and nominee arrangements that are structured for local country purposes (often related to non-tax matters such as regulatory and governance requirements) further complicates the distinction between a Treas. Reg. § 1.672(f)–3(c)(1) compensatory trust, a foreign trust subject to section 6048 requirements or other type of arrangement. For instance, it is a common practice for United Kingdom companies to utilize an "employee benefits trust," (referred to as an EBT), to warehouse company shares due to United Kingdom non-tax regulatory requirements. EBT arrangements are often utilized to facilitate the operation of employer share-based incentive plans and employees may have various interactions with an EBT, including holding vested shares in an EBT or the sale of shares to an EBT in exchange for a note. Given the myriad of potential compensation plan designs and transaction scenarios, questions often arise as to whether an EBT is a foreign trust and whether such arrangement is a section 402(b) compensatory trust or a foreign trust of which a U.S. taxpayer is an owner, grantor, or beneficiary and subject to section 6048. Another example of the complications facing U.S. taxpayers to comply with U.S. tax rules involves Australian superannuation plans, which are either a section 402(b) trust or foreign trust subject to section 6048 depending on whether the plan is employer-sponsored or self-managed.

Without the advice of sophisticated tax advisors, U.S. taxpayers are generally unprepared to assess individual tax reporting and filing requirements that may be triggered in connection with transactions involving foreign trusts. However, given the lack of guidance as to what constitutes a foreign compensatory trust or not, even sophisticated tax practitioners often struggle with the characterization of certain arrangements that can lead to inconsistent tax treatment, non-compliance with applicable tax requirements, and significant individual tax penalties for compliance failures. Providing additional clarity and guidance under the proposed regulations would likely result in increased U.S. tax compliance with the requirements of section 6048, which should be a primary policy goal of the issuance of regulatory guidance.

D. **Clarify the application of the "value threshold" to make clear that the focus is on the value of a foreign retirement trust(s) during the tax year and that it is not a requirement that local law prescribe such a limit.**

Overview

Proposed Reg. § 1.6048-5(b)(2)(iv) provides that in order for a foreign trust to be classified as a TFRT, in part it must satisfy either a "value threshold" (in -5(b)(2)(iv)(1)) or a "contribution limitations" test (in -5(b)(2)(iv)(2)). The "value threshold" provides the foreign law governing the trust must require that the aggregate value of the trust(s) in the trust's jurisdiction is limited to not more than $600,000 at any point in time during the taxable year.

Recommendation

We recommend that the "value threshold" be clarified to provide that the $600,000 test is applied on the basis of the actual value of the trust(s), without regard to whether the provisions of applicable foreign law require that the value must at all times be $600,000 or less. As discussed below, we also request that the value threshold be increased from $600,000 to $1,000,000, for the reasons discussed in that separate section.

Analysis

Proposed Reg. § 1.6048-5(b)(2)(iv)(1) requires that that the provisions of the foreign law governing the operation of the trust must require that the value of the trust(s) may not exceed $600,000 at any point during the year. This conclusion is based on the introductory language in § 1.6048-5(b)(2) (immediately before the language in Prop. Reg. § 1.6048-5(b)(2)(i)) which in effect states that the "value threshold" is one of the "requirements established by the laws of the jurisdiction governing the trust . . ." Proposed Reg. § 1.6048-5(b)(2)(iv)(1) itself then states that the "aggregate value . . . in the trust's jurisdiction is limited to no more than $600,000" (emphasis added). We understand why the IRS wishes to place various limitations on foreign retirement-related funds that are to be exempted from reporting under section 6048, but as drafted this rule seems arbitrary. If the applicable foreign law contains no maximum monetary limitation at all (a situation that is common in many foreign countries) or a limitation that is higher than $600,000, the trust will fail the value threshold, even if the particular U.S. person's trust(s) is always below $600,000.

We assume that what is intended by the proposal is that the value of the U.S. person's trust(s) in the foreign jurisdiction should never exceed $600,000. Instead of providing that the value threshold will only be satisfied if the applicable foreign law happens to contain a specific monetary maximum, we recommend that the rule be changed as to require that value of the U.S. person's trust(s) never exceeds $600,000. In order to make this change, the $600,000 rule would need to be placed somewhere in the regulations that is not dependent on what the foreign law says. That might be accomplished by removing the "value threshold" from Prop. Reg. § 1.6048-5(b)(2)(iv) and instead adding some flush language at the very end of Prop. Reg. § 1.6048-5(b)(2) stating that if the foreign trust(s) fails the "contribution limitations" under Prop. Reg. § 1.6048-5(b)(2)(iv), the foreign trust may nevertheless qualify as a TFRT if the individual participant's foreign trust(s) at

no time exceeds $600,000 during the taxable year. However, there may be a more efficient way of making this drafting change.

E. Increase the $600,000 value threshold in Prop. Reg. § 1.6048-5(b)(2)(iv)(1) to $1,000,000 and index for inflation.

Overview

As noted above in 2.D., Prop. Reg. § 1.6048-5(b)(2)(iv)(1) provides that in order for a foreign trust(s) to be classified as a "tax-favored foreign retirement trust" (TFRT), it may be required to satisfy a "value threshold" of $600,000.

Recommendation

In addition to our Recommendation immediately above in 2.D. (that the $600,000 value threshold be based not on foreign law but on the value of the individual U.S. person's actual foreign trust(s)), we recommend that the $600,000 threshold amount be increased to $1,000,000 and indexed for inflation.

Analysis

We believe that a value threshold of $1,000,000 is more realistic in view of the fact that a U.S. person who either previously worked abroad or currently works abroad with coverage in a foreign-based pension plan is likely to remain in the plan for many years. A larger group of individuals may be those foreign nationals who have worked abroad for many years and who become resident aliens following a temporary or permanent move to the U.S., thereby subjecting them to all of the U.S. information reporting requirements. In either case, even a middle-level "rank and file" employee may have an account that builds up in a foreign retirement plan to considerably more than $600,000 after years of service, especially when employer contributions and accretions in the value of the plan are taken into account. The $600,000 amount appears to be somewhat arbitrary, and indeed it may have been adapted from the $600,000 filing threshold under IRS Form 8938 for a married couple living abroad, or from the $600,000 threshold in section 877A(a)(3)(A).

We should stress that while increasing the threshold to $1,000,000 would result in reduced reporting under section 6048, reducing the compliance burden for the foreign retirement trusts of many individuals is a worthwhile objective of the tax law, especially because the very substantial penalties for nonfiling operate so frequently as a trap for the unwary (especially in the case of rank and file foreign nationals who move to the U.S.), and can significantly imperil their retirement security. In addition, the IRS will have sufficient information under section 6038D (Form 8938) to identify situations where it feels the need to pursue inappropriate tax deferrals.

F. Eliminate the requirement in Prop. Reg. § 1.6048-5(b)(2)(iii) that, "Generally, only contributions with respect to income earned from the performance of personal services are permitted." If it is not eliminated, we recommend in the alternative that it be substantially changed so that if contributions are allowed to a foreign retirement trust other than with respect to income earned from the performance of personal services ("earned income"), those contributions in the aggregate may not exceed a certain percentage of all contributions to the specific individual's trust(s).

Overview

Proposed Reg. § 1.6048-5(b)(2)(iii) provides, "Generally, only contributions with respect to income earned from the performance of personal services are permitted (with allowances made for limited contributions made by unemployed individuals)." Because the sentence is introduced by the word "Generally," and because the introductory language concerning TFRTs in Prop. Reg. § 1.6048-5(b)(2) states that a TFRT is to operate "exclusively or almost exclusively" to provide "pension or retirement benefits and ancillary or incidental benefits," there is an implication that a foreign trust may qualify as a TFRT even though some of the contributions are other than in respect to income from the performance of services (such as unearned investment income). However, this is not clear from the language of the proposed regulation.

Recommendation

For the reasons discussed below, we recommend that this provision in the proposed regulations be eliminated. If it is not eliminated, we recommend in the alternative that it be substantially changed so that if contributions are allowed to a foreign retirement trust other than with respect to income earned from the performance of personal services ("earned income"), those contributions in the aggregate may not exceed a certain percentage of all contributions to the specific individual's trust(s).

Analysis

Although there is an implication in the language of Prop. Reg. § 1.6048-5(b)(2)(iii) (and in the introductory language of Prop. Reg. § 1.6048-5(b)(2)) that a foreign trust may qualify as a TFRT if contributions are allowed other than with respect to earned income, the language could nevertheless be construed as requiring that 100% of the contributions must be made with respect to earned income (other than contributions made by an unemployed person). This would disqualify many retirement plans in numerous countries, where members of a retirement plan are often permitted to make additional cash contributions (subject to limitations) that are not measured by the contributor's earned income. Those provisions are a reflection of the fact that many foreign countries wish to encourage their residents to make additional contributions in order to reduce the risk that they may not have enough funds to live on during their retirement. Provisions of this type are not oriented towards highly-paid employees, but are usually motivated by an effort to encourage rank-and-file employees to set aside additional amounts towards their retirement.

Because it is so common among foreign countries for tax-favored retirement trusts to permit additional employee contributions without reference to their earned income, the apparent

requirement in Prop. Reg. § 1.6048-5(b)(2)(iii) that foreign law must only permit contributions based on earned income is overly restrictive, and would automatically disqualify a large number of plans that otherwise would qualify as TFRTs. We note that even a foreign plan that permitted additional contributions to be made by a nonworking spouse would apparently run afoul of the "only earned income" requirement. Because U.S. law has for many years permitted individual retirement account (IRA) contributions to be made by a nonworking spouse, the proposal would even disqualify a foreign plan that was designed to "mirror" U.S. law.

A failure to remove or limit the earned income rule will result in plans that currently qualify for the exception later failing to qualify if the laws of a country are modified so as to allow enhanced funding (from sources other than earned income) in order to deal with concerns about inadequate pension funding by individuals, most of whom are rank and file participants. Changes of this kind will create traps for the unwary, who along with their U.S. tax advisors may not become aware of foreign law changes that require them to begin filing returns under section 6048. This will be especially common where the foreign law is changed to permit enhanced funding and where the particular individual does not make any such contributions. This places an undue burden on individuals to monitor ongoing changes in foreign law.

If Treasury and the IRS are not amenable to simply eliminating in its entirety the "earned income" rule in Prop. Reg. § 1.6048-5(b)(2)(iii), we recommend in the alternative that it be eliminated, but with a "backstop" providing that a foreign pension trust will not qualify as a TFRT if the particular individual has historically made contributions not related to earned income that exceed a certain percentage of all contributions. Our recommendation is that this percentage be fixed at 25%. As an example, if the sum of contributions with respect to earned income historically has been $75,000, up to $25,000 of additional contributions could be made without respect to earned income in order to comply with this rule. Because this rule would not be related to foreign law but instead would be employee-specific, as a drafting matter we suggest that it also be included in the flush language of Prop. Reg. § 1.6048-5(b)(2), in a manner similar to our recommendation in 2.D., above.

G. Limit the need for participants in a tax favored foreign retirement trust to monitor changes in foreign law related to the requirements in Prop. Reg. § 1.6048-5(b)(2) only to tax years when contributions are made to the trust.

Overview

Proposed Reg. § 1.6048-5(b)(2) provides that one of the requirements for a foreign trust to qualify as a TFRT is that it meets a number of "requirements established by the laws of the jurisdiction governing the trust." This rule requires that the individual participant in a trust that qualifies as a TFRT must monitor changes in the applicable foreign law on an annual basis in order to ensure that the trust continues to comply with the requirements of the regulation.

Recommendation

In order not to impose an undue hardship on individuals who participate in a foreign trust that qualifies as a TFRT, we recommend that if no contributions are made to the trust during a particular

year, the status of the trust as a TFRT will not be affected by changes or other provisions in the applicable foreign law that would otherwise disqualify the trust for TFRT status for that year. The status of the trust as of the last year in which contributions are made is in effect fixed and not subject to change in a subsequent year. However, if contributions are once again made to the trust, the foreign law governing the trust must satisfy all of the requirements of -5(b)(2) for that subsequent year in order for the trust to qualify as a TFRT.

Analysis

The requirement that the foreign law governing the trust must satisfy all of the requirements in -5(b)(2) means that if the provisions of foreign law happen to be changed in some year so that less than all of the regulatory requirements are satisfied, then the trust will no longer qualify as a TFRT. Although most of the requirements are "generic" to retirement trusts worldwide and are unlikely to be changed in the relevant foreign country, the applicable provisions of foreign law could well change from time to time with respect to the "earned income" requirement in -5(b)(2)(iii), or the "value threshold" in -5(b)(2)(iv)(1), or the "contribution limitations" in -5(b)(2)(iv)(2). We can understand the IRS's concern that the applicable foreign law should continue to satisfy these requirements if current contributions to the trust are being made, but it would be extremely burdensome for an individual (and the individual's U.S. tax advisor) to continue to monitor the provisions of foreign law if no contributions are made to the trust for the current year. This could happen if the individual's account in the trust was "frozen" for any number of reasons, such as retirement, a change in employment, a move into the United States (in the case of a foreign national or a returning U.S. "expatriate"), or from one foreign country to another (in the case of many long-term U.S. "expatriates").

Accordingly, we request that if a foreign trust qualifies as a TFRT for one or more years but if in a subsequent year no contributions of any kind are made to the trust, the trust will continue to qualify as a TFRT even though for such year the applicable foreign law may be changed so as to potentially disqualify the trust as a TFRT. However, if in a subsequent year, additional contributions are made to the trust by any person and for whatever reason, then the applicable foreign must satisfy all of the requirements of -5(b)(2) in order for the trust to continue to be classified as a TFRT for that particular year. For this purpose, the increase in value of the funds within the trust (from either realized income or unrealized gains) would not be treated as contributions to the trust.

H. Revise Prop. Reg. § 1.6048-5(b)(1) to expressly provide a filing exception for "tax-favored foreign de minimis savings trusts" described in Prop. Reg. § 1.6048-5(b)(4). Similarly, Prop. Reg. § 1.6048-5(b)(5) should be revised so as to provide that tax-favored foreign de minimis savings trusts will also benefit from the rollover provisions in that paragraph.

Overview

Proposed Reg. § 1.6048-5(b)(4) defines certain trusts as "tax-favored foreign de minimis savings trusts," but we believe that there are drafting errors in this section.

Recommendation

Proposed Reg. § 1.6048-5(b)(1) should be revised so as to expressly provide a filing exception for "tax-favored foreign de minimis savings trusts" described in §1.6048-5(b)(4). Similarly, Prop. Reg. § 1.6048-5(b)(5) should be revised so as to provide that tax-favored foreign de minimis savings trusts will also benefit from the rollover provisions in that paragraph.

Analysis

We believe that the intention of the drafters is to treat "tax-favored foreign de minimis savings trusts" in a manner similar to TFRTs and tax-favored non-retirement savings trust (described in Prop. Reg. § 1.6048-5(b)(3)), so that a filing exception should be available where a foreign trust meets the definition of a tax-favored foreign de minimis savings trust. If so, these rules should be made explicit in the proposed regulations. As Prop. Reg. § 1.6048-5(b)(1) is now drafted, we cannot see an express filing exception for tax-favored foreign de minimis savings trusts, nor can we see a provision that includes tax-favored foreign de minimis savings trusts in the favorable rollover provisions in Prop. Reg. § 1.6048-5(b)(5).

I. Amend the regulations to state that Canadian retirement plans are not subject to the tax-favored retirement trust reporting requirements set forth under the regulations and, instead, are subject to the provisions of Notice 97-34 and Rev. Proc 2014-55, which provide an exception to the section 6048 reporting requirements.

Overview

Section 6048(d)(4) authorizes the IRS to suspend or modify any requirement of section 6048 if the IRS determines that the United States has no significant tax interest in obtaining the required information. The Treasury Department and the IRS previously have issued guidance providing that information reporting under section 6048(a) through (c) is not required with respect to certain Canadian retirement plans. See Notice 97–34, 1997-1 C.B. 422; Rev. Proc. 2014–55, 2014–44 I.R.B. 753. Under the Supplementary Information section of the proposed regulations, section IV of the "Explanation of Provisions"[13] states that the proposed regulations generally implement the rules set forth in Notice 97-34, Rev. Proc 2014-55, and Rev. Proc. 2020-17, 2020-12 I.R.B. 539. However, the proposed regulations do not explicitly state or otherwise confirm that the exception from information reporting under section 6048(a) through (c) for Canadian retirement plans provided under Notice 97-34 and Rev. Proc. 2014-55 will still apply after the final regulations under section 6048 are promulgated. Due to lack of specific regulatory guidance for Canadian retirement plans, taxpayers may question whether the proposed regulation rules for tax-favored retirement trusts supersede or contravene the exceptions to information reporting provided for under Notice 97-34 and Rev. Proc. 2014-55. Explicit regulatory guidance for Canadian retirement plans is required by taxpayers to either continue to rely on the exception from reporting or to comply with the tax-favored retirement trust reporting set forth under the proposed regulations. Without the regulatory guidance, taxpayers may assume new administrative burdens and costs associated with section 6048 reporting for Canadian retirement plans to avoid potential penalties for non-compliance.

[13] 89 Federal Register 39451 (May 8, 2024).

Recommendation

The regulations should be amended to state that Canadian retirement plans are not subject to the tax-favored retirement trust reporting requirements set forth under the regulations and, instead, are subject to the provisions of Notice 97-34 and Rev. Proc 2014-55, which provide an exception to the section 6048 reporting requirements.

Analysis

This suggested specific regulatory guidance for Canadian retirement plans will clarify for taxpayers that the regulations' rules for tax-favored retirement trusts do not supersede or contravene the exceptions to information reporting provided for under Notice 97-34 and Rev. Proc. 2014-55. Our suggested explicit regulatory guidance for Canadian retirement plans will assist taxpayers to continue to rely on the exception from reporting. Our suggested regulatory guidance will assist taxpayers in avoiding new administrative burdens and costs associated with section 6048 reporting for Canadian retirement plans to avoid potential penalties for non-compliance.

3. **Clarify that the section 6048 reporting exception for tax-favored foreign retirement trusts, nonretirement savings trusts, and de minimis savings trusts, shall apply retroactively to all years in the taxpayer's holding period of that investment.**

Overview

Proposed Reg. § 1.6048-7(b) provides that the exceptions to reporting provided in Prop. Reg. § 1.6048-5 apply on a prospective basis with reference to the date the final regulations are published in the Federal Register. The regulations do not address how a taxpayer should report their historical interest in a qualifying pension or savings plan where the taxpayer did not report their interest previously.

Recommendation

We recommend that the regulations clarify that if a particular investment meets the definition of tax-favored foreign retirement trust, nonretirement savings trust, or de minimis savings trust, the taxpayer should apply the exception for section 6048 reporting retroactively to all years in the taxpayer's holding period of that investment.

Analysis

Proposed Reg. § 1.6048-5(b) through (e) provides additional exceptions from section 6048 reporting based on the authority granted to the IRS by section 6048(d)(4) to suspend or modify the requirements of section 6048.

Proposed Reg. § 1.6048-5(b) provides an exception from section 6048(a) through (c) and Prop. Regs. §§ 1.6048-2 through 1.6048-4 for certain eligible U.S. individuals' transactions with, or ownership of, certain tax-favored foreign retirement trusts, nonretirement savings trusts, and de

minimis savings trusts. These exceptions to section 6048 reporting generally follow the exceptions provided under Rev. Proc. 2020-17 with some modifications.

Treasury and the IRS are of the view that it would be appropriate to exempt U.S. individuals from the requirement to provide information about these foreign trusts for the following reasons:

i. These foreign trusts generally are subject to written restrictions, such as contribution limitations, conditions for withdrawal, and information reporting, under the laws of the country in which they are established that are broadly consistent with the eligibility requirements under the Code for U.S. trusts serving similar policy goals.

ii. U.S. individuals with an interest in these trusts may be required under section 6038D to separately report information about their interests in accounts held by, or through, these trusts.

iii. With respect to tax favored foreign de minimis savings trusts and tax-favored foreign retirement trusts, Treasury and the IRS are of the view that exempting U.S. individuals from the section 6048 requirements based on the value of the trust is appropriate and consistent with the reporting thresholds under section 6038D.

The proposed regulations do not address how a taxpayer who has held an interest in an investment vehicle that now meets the definition of a tax-favored foreign retirement trust, nonretirement savings trust, or de minimis savings trust under the proposed regulations should report their historical interest in such a retirement savings vehicle. For example, where an investment now qualifies under the proposed regulations, but a taxpayer did not report the investment before the effective date of the final regulations, it is unclear if Treasury and the IRS intend to levy penalties for non-filing of prior year Forms 3520 and 3520-A. It is also unclear if Treasury and the IRS expect taxpayers to retroactively file Form 3520 and 3520-A up to the effective date of the final regulations, and then, thereafter, the taxpayer should not report these investments on Form 3520 and 3520-A. To implement consistency in tax reporting and minimize the burden on both the taxpayer and Treasury and the IRS, we recommend that the regulations clarify that if the investment meets the definition of a tax-favored foreign retirement trust, nonretirement savings trust, or de minimis savings trust the taxpayer should apply the exception for section 6048 reporting retroactively.

4. Actual Calculation Method and Default Calculation Method

A. Update Prop. Reg. § 1.6048-4 to specifically permit the use of the default method by U.S. beneficiaries who receive accumulation distributions from domestic trusts that were formerly foreign trusts.

Overview

Revenue Ruling 91-6 contemplates that a foreign trust can be domesticated in a manner that does not cause a termination of the trust or the constructive distribution of trust assets. Sections 665-668 and the Revenue Ruling would treat subsequent accumulation distributions from the

domesticated trust to a U.S. beneficiary as being subject to throwback tax and an interest charge, but there is no clear guidance on whether the U.S. beneficiary can use the default method for distributions from the domesticated trust.

Recommendation

Treasury and the IRS should update the proposed regulations to specifically permit the use of the default method by U.S. beneficiaries who receive accumulation distributions from domestic trusts that were formerly foreign trusts.

Analysis

There does not seem to be a compelling policy reason why the default method would be permitted for a distribution from a foreign nongrantor trust but would be prohibited for a distribution from a domestic trust that represents income that was previously accumulated by a foreign nongrantor trust. Treasury and the IRS should seek to provide similar treatment to similarly situated taxpayers.

B. Modify Prop. Reg. § 1.6048-4(d)(1) to permit the use of the actual method on an amended Form 3520 and amended income tax return if the statement is received by the time the U.S. person files their amended income tax return.

Overview

Proposed Reg. § 1.6048-4(d)(1) provides that the default method must be used when a U.S. person does not receive a statement under Prop. Reg. § 1.6048-4(c) by the extended due date of the filer's income return.

Recommendation

The regulation should be modified to permit the use of the actual method on an amended Form 3520 and amended income tax return if the statement is received by the time the U.S. person files their amended income tax return.

Analysis

Section V.B of Notice 97-34 provides that the U.S. beneficiary of a foreign trust may determine the tax consequences of the distribution in accordance with the information in a Foreign Grantor Trust Beneficiary Statement or Foreign Nongrantor Trust Beneficiary Statement only if the beneficiary has a copy of the relevant beneficiary statement(s) at the time he or she files his or her income tax return. The provision in Prop. Reg. § 1.6048-4(d)(1)(iii) is arguably stricter than Notice 97-34, as it does not seem to allow for the possibility of filing an amended return in reliance upon a properly completed beneficiary statement which is received after the extended due date of the taxpayer's income tax return. The deadline in the proposed regulation seems unnecessarily strict. It would be appropriate to permit the use of the actual method on an amended Form 3520 and amended income tax return if the statement is received by the time the U.S. person files his or her amended income tax return. As an analogy, the income tax charitable substantiation rules have

some of the most strict compliance requirements in the Code, but Treas. Reg. § 1.170A-13(c)(3)(iv)(B) permits a taxpayer to claim an income tax deduction for the first time on an amended income tax return if the related qualified appraisal is received before the date on which the amended return is filed and the other criteria for the deduction are satisfied. There does not seem to be a compelling policy reason why the deadline for the receipt of a trust beneficiary statement should be stricter than the deadline for the receipt of a qualified appraisal for an income tax charitable deduction.

C. Modify Prop. Reg. § 1.6048-4(d)(3)(iii) to require the character of a terminating distribution to be substantiated either by a Foreign Nongrantor Trust Beneficiary Statement provided by the trustee <u>or</u> the recalculation of amounts by the beneficiary using information provided by the trustee as proposed.

Overview

Proposed Reg. § 1.6048-4(d)(3)(iii) states that a U.S. person who has previously used the default calculation method with respect to distributions from a foreign trust may, for the year in which the foreign trust terminates, determine the tax consequences of a distribution from the same trust by using the actual calculation method provided that, before the due date of the U.S. person's income tax return (including extensions), the trust provides to the U.S. person complete and accurate information about all previous distributions from such foreign trust. The proposed regulation further states that the U.S. person must use this information to recalculate the tax effect of all previous distributions from such foreign trust under the actual calculation method in order to determine the portion attributable to current income, accumulated income, and principal in the year that the foreign trust terminates. This provision deviates from the normal procedure whereby substantiation is made by the trustee in the form of a beneficiary statement. It could also create a compliance burden for the beneficiary and potential concerns for trustees with respect to privacy and compliance with fiduciary law.

Recommendation

The regulation should be modified to require the character of a terminating distribution to be substantiated either by a Foreign Nongrantor Trust Beneficiary Statement provided by the trustee <u>or</u> the recalculation of amounts by the beneficiary using information provided by the trustee as proposed.

Analysis

It would be more reasonable to permit the trustee to have the option of providing a properly completed Foreign Nongrantor Trust Beneficiary Statement to the beneficiary rather than making a recalculation of amounts by the beneficiary the sole option for substantiation. There does not seem to be a compelling policy reason why the only procedure for substantiating the character of a terminating distribution from a foreign nongrantor trust should vary completely from the procedure for substantiating the character of all other distributions. Requiring this recalculation to be made by the beneficiary could force the trustee to provide the beneficiary with detailed

information about distributions to other beneficiaries, which may be undesirable from a fiduciary law and privacy perspective.

D. Modify Prop. Reg. § 1.6048-4(d)(3) to allow taxpayers, in the absence of a trust beneficiary statement, to determine the number of years a foreign trust has existed by providing other information or documentation establishing years of existence with their Form 3520, as currently permitted in the instructions to Line 32 of the Form 3520.

Overview

For purposes of calculating the interest charge under the default calculation method, the proposed regulations require taxpayers to assume that a foreign nongrantor trust has been in existence for 10 years unless actual information is provided on a trust beneficiary statement.

Recommendation

We recommend that the regulations allow taxpayers, in the absence of a trust beneficiary statement, to determine the number of years a foreign trust has existed by providing other information or documentation establishing years of existence with their Form 3520, as currently permitted in the instructions to Line 32 of the Form 3520.[14]

Analysis

Proposed Reg. § 1.6048-4(d)(3) requires an assumption that a foreign nongrantor trust has existed for 10 years for purposes of computing the interest charge under the default method, in the absence of actual information provided on a trust beneficiary statement described in Prop. Reg. § 1.6048-4(c).

The number of years a foreign trust has existed is used to determine the interest charge under the default method, which applies if a U.S. beneficiary has not received a trust beneficiary statement. The instructions to Line 32 of the Form 3520 currently provide:

> To the best of your knowledge, state the number of years the trust has been in existence as a foreign trust and attach an explanation of your basis for this statement. Consider any portion of a year to be a complete year. If this is the first year that the trust has been a foreign trust, do not complete the rest of Part III (you do not have an accumulation distribution).

Taxpayers should be permitted to provide other information, in the absence of a trust beneficiary statement, which would sufficiently establish a foreign trust's years of existence. For example, a trust may have become a foreign nongrantor trust due to the death of the grantor. While a U.S. beneficiary may not have received a trust beneficiary statement, the beneficiary may have other information, such as the trust deed and grantor's date of death, that would enable him or her to determine years of foreign trust existence. Requiring U.S. beneficiaries to calculate the interest

[14] *See* page 10, https://www.irs.gov/pub/irs-pdf/i3520.pdf.

charge based on a 10-year assumption for the foreign trust's existence, simply because the actual years of existence are not provided on a trust beneficiary statement, is overly punitive. This is especially true when a taxpayer can readily establish that the foreign trust existed for less than 10 years using other available information. Consequently, we recommend that the regulations provide taxpayers the ability to demonstrate years of foreign trust existence with other existing information in the absence of a trust beneficiary statement.

5. Original and Extended Due Dates for Form 3520

Overview

Under the current statutory guidance, the original and extended due date of Form 3520 is not tied to the original and extended due date of Form 1040, U.S. Individual Income Tax Return, for U.S. persons. Specifically, individuals living abroad who are eligible for the December extended due date are precluded from utilizing this extended filing date for purposes of filing Form 3520.

Recommendations

A. We recommend that the regulations clarify that the June 15 due date also applies for Forms 3520 filed by U.S. citizens and residents who are on military or naval duty outside the U.S. and Puerto Rico, consistent with the June 15 due date provided for these individuals' U.S. federal income tax returns under Treas. Reg. § 1.6081-5(a)(6).

B. We also recommend, consistent with Treasury and the IRS's authority under section 6081 and Section 2006(b) of the Act, as well as sections 6039F(e) and 6048(d)(3), that the regulations provide that U.S. citizens and residents who live, or are on military or naval duty, outside the U.S. and Puerto Rico may extend the due date of their Form 3520 to December 15, synchronizing it with the extended due date of their U.S. federal income tax return.

Analysis

This proposal for the regulations to provide for an extension of the due date for Form 3520 to December 15 for U.S. citizens and residents who live, or are on military or naval duty, outside the United States and Puerto Rico would align the Form 3520 due date with the extended due date for their U.S. federal income tax return. It would reduce confusion for both the IRS and taxpayers by establishing the same extended due dates for income tax returns and Forms 3520 for the same tax year. Additionally, it would minimize systemic penalties assessed by the IRS on unsuspecting taxpayers who are in good faith complying with their U.S. federal tax obligations and accustomed to filing all their required forms with the IRS by the same due date.

Section 2006(b) of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (the "Act"), Pub. L. No. 114–41, provides that "[f]or returns for taxable years beginning after December 31, 2015, the Secretary of the Treasury, or the Secretary's designee, shall modify appropriate regulations" to provide for specific due dates and extended due dates for certain forms. For some of the forms identified, section 2006(b) provides the due dates and extended due dates

for certain taxpayers. In particular, section 2006(b)(10) of the Act provides: “The due date of Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, for calendar year filers shall be April 15 with a maximum extension for a 6-month period ending on October 15.”

Section 2006(b)(10) is silent on whether the Form 3520 filing due dates it provides applies to both U.S. citizens and residents living in the United States and abroad. It only provides that the regular Form 3520 due date for calendar year filers shall be April 15, the starting point for a maximum 6-month extension to October 15. However, these dates are consistent with the regular U.S. federal income tax return due date and extended due date that apply to calendar year U.S. citizens and residents who live in the United States.

The IRS has discretion under section 6081 to provide U.S. citizens and residents living abroad with longer extensions of time, in comparison to those that apply to U.S. citizens and residents living in the U.S., to file any return, declaration, statement, or other document required by the Internal Revenue Code or by regulations. Section 2006 of the Act does not address or conflict with the discretion that Treasury and the IRS have under section 6081 to provide U.S. citizens and residents abroad with longer extended filing due dates than those that apply to such taxpayers living in the U.S. Furthermore, Treasury and the IRS have broad discretion under sections 6039F(e) and 6048(d)(3) to issue regulations to carry out those Code provisions’ respective information reporting requirements relating to U.S. persons’ receipt of large foreign gifts and ownership of or transactions with foreign trusts.

We appreciate that Prop. Reg. § 1.6048-2(a)(2)(ii) has already incorporated June 15 as the regular Form 3520 due date for U.S. citizens and residents who live outside the U.S. and Puerto Rico (*i.e.*, where their tax homes and abodes, in a real and substantial sense, are abroad). The proposed regulations align these individuals’ Form 3520 due date with the regular due date for their U.S. federal income tax return under Treas. Reg. § 1.6081-5(a)(5).

We recommend that the regulations clarify that the June 15 due date also applies for Forms 3520 filed by U.S. citizens and residents who are on military or naval duty outside the U.S. and Puerto Rico, consistent with the June 15 due date provided for these individuals’ U.S. federal income tax returns under Treas. Reg. § 1.6081-5(a)(6). Furthermore, we also recommend, consistent with Treasury and the IRS’s authority under section 6081 and Section 2006(b) of the Act, as well as sections 6039F(e) and 6048(d)(3), that the regulations provide that these taxpayers may extend the due date of their Form 3520 to December 15, synchronizing it with the extended due date of their U.S. federal income tax return.

6. Provide that the deadline for Foreign Nongrantor Trust Beneficiary Statements and Foreign-Owned Grantor Trust Beneficiary Statements is the due date for filing of the beneficiary’s income tax return.

Overview

The proposed regulations provide a filing deadline for Foreign Nongrantor Trust Beneficiary Statements and Foreign-Owned Grantor Trust Beneficiary Statements that is earlier than the

original due date of a Form 1040-NR, U.S. Nonresident Alien Income Tax Return, for a foreign non-grantor trust, if one were required.

Recommendation

Treasury and the IRS should provide that the deadline for Foreign Nongrantor Trust Beneficiary Statements and Foreign-Owned Grantor Trust Beneficiary Statements is the due date for filing of the beneficiary's income tax return.

Analysis

Proposed Reg. § 1.6048-4(c)(2) states that a foreign non-grantor trust may issue, by the fifteenth day of the third month after the end of the trust's taxable year, a Foreign Nongrantor Trust Beneficiary Statement to each U.S. person who receives a distribution from the foreign trust during the trust's taxable year.

The deadline in this regulation seems arbitrary, as it is earlier than the original due date of a Form 1040-NR, U.S. Nonresident Alien Income Tax Return, for a foreign non-grantor trust, if one were required.

Section V.B. of Notice 97-34 states that the U.S. beneficiary may determine the tax consequences of the distribution in accordance with the information in the beneficiary statement only if the beneficiary has a copy of the relevant beneficiary statement(s) at the time he or she files his or her income tax return. That deadline would be more appropriate. The same reasoning would apply to the Foreign-Owned Grantor Trust Beneficiary Statement discussed at Prop. Reg. § 1.6048-4(c)(3).

7. **Incorporate into the regulations or administrative procedures, administrative relief including mandating (i) review of reasonable cause prior to penalty assessment, and (ii) First Time Abate (FTA) for sections 6677 and 6039F penalties.**

Overview

Under current procedures, Treasury and the IRS have been quick to assess section 6677 penalties regardless of the taxpayer's record or any reasonable cause statement provided by the taxpayer.

Recommendation

Considering the complexity inherent in international informational return penalty administration and the significant burden that is placed on unsophisticated and innocent taxpayers, we recommend incorporating into the regulations or administrative procedures administrative relief including mandating (i) review of reasonable cause prior to penalty assessment, and (ii) FTA for sections 6677 and 6039F penalties.

Analysis

We appreciate that the IRS explicitly incorporated the section 6664 and section 6651 reasonable cause standards into the proposed regulations and provided guidance there. Since section 6651 is subject to FTA, we think these penalties should be subject to FTA too.

The IRS National Taxpayer Advocate has publicly stated that international information return (IIR) penalties disproportionately impact lower and middle-income individuals and small businesses.[15]

Further, the IRS's overall high abatement rates for IIR penalties demonstrate that the IRS's penalty administration is not operating efficiently or effectively for taxpayers or the IRS. Because the IRS has not altered its systematic assessment of IIRs for Form 3520 and Form 3520-A, we recommend that the regulations provide penalty relief. Although Treasury and the Associate Chief Counsel International may perceive that regulations are not the appropriate method for addressing the IRS's penalty administration, because the IRS has not altered its systematic assessment of penalties, we advocate for penalty relief within the foreign trust and foreign gift and inheritance regulations (or alternatively the issuance of separate administrative guidance on penalty administration in this area). We recommend incorporating into the regulations or administrative procedures administrative relief including implementing (i) reviewing reasonable cause prior to penalty assessment, and (ii) FTA for section 6677 penalties.

Both sections 6677 and 6039F contain exceptions to penalties based on reasonable cause. Arguably, the IRS is required to consider reasonable cause before assessing penalties under these Code sections. But at least over the past several years, the IRS has not considered reasonable cause before assessing penalties under these Code sections. We request modification of the regulations or administrative procedures to require that if a reasonable cause statement is submitted with a late Form 3520 or Form 3520-A, then the IRS must consider and analyze reasonable cause before assessing penalties.

The statutory penalties for late filing of Form 3520 and Form 3520-A can be crushing for many taxpayers and bear no relation to taxpayer income or ability to pay. The National Taxpayer Advocate has observed:

> Though the IRS abates so many penalties, taxpayers still experience great financial cost and emotional toll fighting them. Imagine the stress from opening a collection notice from the IRS demanding payment when you believe your reasonable cause statement provided the information necessary to establish that the IRS should not assert the penalty. Imagine the frustration to learn the IRS did not even read your reasonable cause letter, and you are left in limbo wondering whether it will grant relief. And if you happen to live abroad, imagine the challenges created by having to dispute these penalties through administrative procedures and perhaps even in

[15] IRS National Taxpayer Advocate blog, "Foreign Information Penalties: Provide Taxpayers Their Rights Before Assessment," May 23, 2024, https://www.taxpayeradvocate.irs.gov/news/nta-blog/foreign-information-penalties-provide-taxpayers-their-rights-before-assessment/2024/05/.

> court while residing in a country that may be thousands of miles away, in a different time zone, and in a language that may not be your own.[16]

In addition, we note that currently there is the egregious presumption that reasonable cause does not exist simply due to a refusal on the part of a foreign trustee to provide information for any reason, including difficulty in producing the required information or the existence of provisions in the trust instrument that prevent the disclosure of required information. We think the IRS should consider such refusal to be a factor for consideration.

Finally, we recommend implementing in the regulations or administrative procedures the administrative penalty waiver known as FTA for all IIRs for Form 3520 and Form 3520-A. The IRS Commissioner has complete and unfettered discretion in providing for penalty administration and administrative relief under sections 7803 and 7805 as well as the reasonable cause provisions in sections 6677 and 6039F. We urge the IRS Commissioner to implement in the regulations or administrative procedures FTA to encourage voluntary compliance. Practitioners have commented on the impact of the IRS's practice of systemic penalty assessment on voluntary compliance in various public comments to the IRS. Moreover, nonwillful foreign gift reporting may not be eligible for penalty relief under the IRS's current Streamlined Filing Compliance Procedures because one of the eligibility requirements for a submission is generally some quantum of underreporting income from foreign financial assets. Unreported foreign gifts or inheritances required to be reported on a Form 3520 do not alone constitute unreported income from a foreign financial asset. Accordingly, penalty relief may not be available either through unread reasonable cause statements, or proactive efforts to get into compliance through the Streamlined Filing Compliance Procedures. Thus, we reiterate the importance of allowing taxpayers the opportunity to correct benign mistakes and the opportunity to file late Form 3520 and Form 3520-A when the IRS has not initiated a civil examination or criminal investigation.

8. Provide guidance regarding the classification of certain foreign trusts and entities organized under the laws of a foreign or civil law jurisdiction.

Overview

Taxpayers often have trouble classifying certain employee benefit plans and trusts for purposes of mandatory U.S. reporting and disclosure requirements. Specifically, taxpayers often encounter uncertainty when attempting to apply section 6048 reporting requirements to trusts, entities, or retirement vehicles organized in foreign jurisdictions (in particular, when the existence of a 'trust' is not necessarily clear).

Recommendation

Treasury and the IRS should provide guidance regarding the classification of certain foreign trusts and entities organized under the laws of a foreign or civil law jurisdiction.

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[16] IRS National Taxpayer Advocate blog, "Foreign Information Penalties: Provide Taxpayers Their Rights Before Assessment," May 23, 2024, https://www.taxpayeradvocate.irs.gov/news/nta-blog/foreign-information-penalties-provide-taxpayers-their-rights-before-assessment/2024/05/.

Analysis

Section 6048 imposes mandatory reporting and disclosure requirements on certain U.S. persons with respect to their interactions with and ownership of foreign trusts; taxpayers who fail to comply with these reporting requirements are potentially subject to penalties under section 6677. In certain cases, taxpayers may encounter uncertainty when attempting to apply these reporting requirements to trusts, entities, or retirement vehicles organized in foreign jurisdictions (in particular, when the existence of a 'trust' is not necessarily clear). To help promote voluntary compliance and alleviate the frequency of penalties, further guidance is needed on the proper classification of foreign trusts for U.S. tax purposes.

Most civil law countries offer methods to hold property and transfer wealth in a manner that resembles trust ownership in the U.S., without formally recognizing the existence of a 'trust.' In such cases, the proper classification of these entities for U.S. tax purposes may be ambiguous, which affects the IRS's ability to properly administer and enforce the section 6048 information reporting requirements. Summarized below are a few practical examples of when this uncertainty may arise:

- **Usufructs**

  A Usufruct is the right that allows an individual, the Usufructuary, to use the property of another individual, the bare owner, and to receive income from the property. As there are currently no regulations regarding the taxation of Usufructs, taxpayers must rely on the facts and circumstances of their Usufruct agreement and interpretations of prior private letter rulings (PLRs). For U.S. income tax purposes, a Usufruct may be considered a life estate, or co-ownership, if there is no separate fiduciary or title owner, and the individual is only entitled to the income or use of the assets during the individual's lifetime,[17] resulting in bare or direct ownership of the assets. Alternatively, it could be classified as an ordinary grantor trust,[18] such as in PLR 9121035 in which the IRS ruled that the Usufruct arrangement was classified as a trust for U.S. purposes as the usufructuary had both Usufruct rights and administrative powers over the assets, similar to the powers of a trustee.

  Bare ownership of the assets versus ownership through a grantor trust would result in different filing requirements under section 6048. Usufructs are also often used in foreign jurisdictions and structures that could result in the creation of a foreign trust or gifts from foreign persons. Therefore, it is important that taxpayers be provided with more clearly defined regulations to allow them to identify the correct tax entity classification of their Usufructs. Without a complete understanding of the Usufruct agreement, property held in a Usufruct can result in non-compliance for U.S. taxpayers, including penalties for failure to file Forms 3520 and/or 3520-A.

[17] Private Letter Ruling 8748043 (September 1, 1987).
[18] Revenue Ruling 66-86, 1966-1 C.B. 216.

- **Anstalts and Stiftungs**

  An Anstalt is an entity which can be thought of as a hybrid between a company and a foundation. An Anstalt has no members, participants, or shareholders and unlike a company or a trust, there is no duty to return profit back to the shareholders/beneficiaries. IRS Memo AM2009-012 states that the classification of Liechtenstein Stiftungs and Liechtenstein Anstalts must be determined on a case-by-case basis and that the classification is dependent upon the facts and circumstances of each case.[19] Generally, Anstalts are not treated as trusts under Treas. Reg. § 301.7701-4(a) of the regulations because, in most situations, their primary purpose is to actively carry on business activities. Therefore, in most cases, Anstalts are classified as business entities under Treas. Reg. § 301.7701-2(a). However, a Stiftung is usually treated as a trust under Treas. Reg. § 301.7701-4(a) of the regulations because their primary purpose is to protect or conserve the property transferred to the Stiftung for the beneficiaries, and it is not created for carrying on business activities. The decision to classify Anstalts and Stifungs on a case-by-case basis becomes confusing for the taxpayer and can lead to misclassification of the entity and penalties due to missed filings.

- **Foreign Pensions**

  Qualified pension plans are structured as trusts created or organized in the U.S. by an employer for the benefit of employees making up part of the stock bonus, pension or profit-share plans. These can include state pensions, workplace pension plans and personal (private) pension plans.[20] Pensions are generally considered to be tax deferred retirement accounts for which individuals will report taxable income on their personal return upon distribution from the pension. However, foreign pension plans may not be considered qualified pension plans and therefore may not be eligible for tax deferral under the Code. As such, if a foreign pension is classified as a foreign grantor trust, then the deemed owner would face potentially onerous reporting requirements, including the need to file Form 3520, Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner, and/or Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b), as well as possible informational reporting associated with the pension's underlying investments. The ability to clarify classification of pensions reduces the risk of missed filings by taxpayers.

  To reduce uncertainty, avoid the misclassification of entities, and alleviate tax penalties due to non-compliance, IRS and Treasury should provide further guidance on the appropriate classification of entities in civil-law jurisdictions. Currently, Treas. Reg. § 301.7701-4(b) does not recognize ambiguity in classification (such as with Usufructs, Anstalts, and foreign pensions). These are just some of the practical examples of situations where taxpayers may encounter uncertainty and need further guidance.

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[19] IRS Chief Counsel Attorney Memorandum 2009-012 (October 16, 2009).
[20] Section 401.

9. Clarify how the spousal attribution rule in section 672(e) applies in the content of section 672(f).

Overview

Section 672(f)(2) provides an exception to the general rule that trusts cannot be grantor with respect to non-U.S. persons. However, it is unclear how the spousal attribution rule under section 672(e) is applied and whether powers and interests held by a taxpayer's spouse are factored into this section 672(f) analysis.

Recommendation

We recommend that the regulations clarify how the spousal attribution rule in section 672(e) applies in the content of section 672(f).

Analysis

Clarification of these rules is relevant in determining whether a foreign trust is a grantor or nongrantor trust and impacts U.S. grantors' and/or U.S. beneficiaries' U.S. federal income tax and information reporting obligations under section 6048 relating to the foreign trust.

Section 672(e) provides that for purposes of subpart E of subchapter J (sections 671-679), a grantor is treated as holding any power or interest held by any individual who was the grantor's spouse at the time of creation of the power or interest or any individual who became the grantor's spouse after the date of creation (but only for the periods after the individual became the grantor's spouse).

Section 672(f)(1) provides that "[n]otwithstanding any other provision of this subpart [E]," the rules of subpart E apply only to the extent application of those provisions results in current taxation of a U.S. citizen or resident, or a domestic corporation, on any trust income as owner of the trust. However, section 672(f)(2) provides that a foreign grantor will be treated as the owner of any portion of a trust if the foreign grantor has the sole power to revest in the grantor title to trust property related to that portion of the trust, or distributions from such portion (whether income or corpus) during the lifetime of the grantor are distributable only to the grantor or the grantor's spouse.

It is not clear whether powers and interests held by a taxpayer's spouse are factored into the section 672(f) analysis. Section 672(c) provides that the term "related and subordinate party" as defined in that paragraph applies for purposes of section 672(f). However, section 672(e) does not indicate that it applies for purposes of section 672(f).

For example, consider a scenario where a nonresident alien spouse has the power to revoke a foreign trust and reacquire trust assets but subject to the consent of her U.S. citizen spouse. The U.S. citizen spouse did not make contributions to the trust and has no other powers with respect to the foreign trust. In this situation, further clarification is needed to determine whether the U.S. citizen's veto power is attributed to the nonresident alien spouse under section 672(e). If so, the

nonresident alien would be treated as the grantor owner of the trust under section 672(f)(2), as she would have the sole power to revoke the trust and revest the assets in herself.

The 1997 Prop. Reg. § 1.672(f)-3(a)(3) contained the below example:

> *Example 5. Husband treated as holding power held by wife*. H and his wife, W, both nonresident aliens, create and fund a trust, T, using community property. The power to revoke T and revest absolutely in H and W title to the trust property is exercisable either by W acting alone or by H with the consent of W. W has advised H that she will not consent to any decision by H to revoke T. Although W is a related or subordinate party to H within the meaning of § 1.672(c)-1, the presumption that W is subservient to H is rebutted by a preponderance of the evidence. However, pursuant to section 672(e), H is treated as holding the power to revest that is held by W. Therefore, under paragraph (a)(1) of this section, T is not subject to the general rule of § 1.672(f)-1. H and W are treated as the owners of T.[21]

This example was not included in the final regulations under section 672(f), but taxpayers would benefit from having similar guidance which clarifies the interaction between these provisions. One possibility would be to adopt this example, but without the discussion of the subjective determination as to whether W is subservient to H, focusing instead on the more objective attribution of W's power to H.

10. Distributions, Deemed Distributions, and Related Party Loan Transactions

A. Modify the requirements included in Prop. Reg. § 1.643(i)-2(b)(2)(iii).

Overview

Proposed Reg. § 1.643(i)-2(b)(2)(iii) unnecessarily restricts the definition of a qualified obligation.

Recommendations

i. The proposed regulations should modify the requirement that "all payments on the obligation must be made in cash in U.S. dollars" to permit loans denominated in foreign currency to be considered qualified obligations.

ii. The requirement that a qualified obligation must have a yield to maturity based upon the applicable Federal rate (AFR) should be modified in cases where such a rate is not viable in the marketplace and a trustee therefore may not be willing to issue such a loan.

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[21] 62 Federal Register 30794 (June 5, 1997).

Analysis

Notice 97-34 and Treas. Reg. § 1.679-4(d) established certain criteria for qualified obligations.[22] These criteria were largely reiterated in the proposed regulations, with certain additions.

As expressed in the legislative history for the 1996 Act, the original premise for the qualified obligation exception is that an exception to deemed distribution treatment would be created for loans with arm's-length terms, with consideration to be given to whether there is a reasonable expectation that a loan will be repaid.[23] Consistent with this premise, the proposed regulations should be updated to permit qualification of obligations denominated in foreign currencies. The denomination of a loan in U.S. dollars (USD) is not material to whether the loan will be considered *bona fide* debt, whether there is a reasonable expectation that the loan will be repaid, or whether the loan is a transaction that would be considered arm's length in nature. Notice 97-34 and the proposed regulations seem to indicate that the intent of these "qualified obligation" requirements is to prevent trust distributions that have been disguised as loan transactions.[24] The preamble to the proposed regulations also discusses the fact that Treasury and the IRS have specifically included the requirement that a loan must be repaid in cash in USD to prevent abusive transactions in which taxpayers have used inflated valuations of in-kind property to purportedly repay an obligation.[25] This goal could arguably be accomplished by requiring the denomination of loans in currency but not necessarily USD.

If this proposal to allow qualified obligations to be denominated in foreign currency is adopted, the required interest rate should be a market interest rate in the currency in which the loan is denominated, as the AFR does not constitute a worldwide standard interest rate. As an analogy, Prop. Reg. § 1.7872-11(f)(1) provides that if a loan is denominated in a currency other than the U.S. dollar, then for purposes of section 7872 and the regulations thereunder, a rate that constitutes a market interest rate in the currency in which the loan is denominated shall be substituted for the applicable Federal rate. Treasury and the IRS could utilize a similar approach for purposes of establishing the required interest rate for a loan denominated in non-U.S. currency.

As an additional point about the interest rate, a yield to maturity in a range of 100 to 130 percent of the AFR may not always reflect market conditions or fiduciary obligations. Particularly when interest rates have been extraordinarily low in the last few years, trustees may not have been confident that making a loan to a beneficiary at, for example, the 0.13% short-term AFR in November 2020 would be consistent with their fiduciary obligations. If, for example, local fiduciary law would require a greater interest rate, it would be appropriate for that interest rate to be substituted for the AFR in this context.

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[22] Notice 97-34, 1997-1 C.B. 422, Section III.C.2.

[23] H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess., at 334 (1996).

[24] Notice 97-34, 1997-1 C.B. 422, Section III.C.1; 89 Federal Register 39441 (May 8, 2024).

[25] 89 Federal Register 39446 (May 8, 2024).

B. Clarify Prop. Reg. § 1.643(i)-1(b)(2)(i).

Overview

The definition and treatment of indirect loans is extremely broad under the proposed regulations. A literal reading of the language included in the proposed regulations could be read to include reporting for a foreign person who receives the loan and is not acting as an intermediary, agent, or nominee of the U.S. grantor or beneficiary.

Recommendations

i. Treasury and the IRS should clarify whether in the example in Prop. Reg. § 1.643(i)-1(b)(2)(i)(B), the lender is acting as an intermediary, agent, or nominee of the trust.

ii. Similarly, Treasury and the IRS should clarify whether in the example in Prop. Reg. § 1.643(i)-1(b)(2)(i)(C) the foreign person who receives the loan is acting as an intermediary, agent, or nominee of the US grantor or beneficiary. Otherwise, the examples might suggest that loan transactions that have no connection to the foreign trust are treated as indirect distributions.

iii. To better establish a connection between loan transactions and foreign trusts, Treasury and the IRS should consider adopting intermediary rules for this purpose like the existing provisions of Treas. Reg. § 1.643(h)-1(a) and Treas. Reg. § 1.679-3(c).

Analysis

Section 643(i) generally provides that if a foreign non-grantor trust makes a loan of cash or marketable securities (or permits the use of any other trust property) directly or indirectly to or by any grantor or beneficiary of the trust who is a U.S. person, or a U.S. person that is related to such grantor or beneficiary, the amount of such loan (or the fair market value of the use of such property) shall be treated as a distribution by such trust to such grantor or beneficiary.[26] Notice 97-34 and Treas. Reg. § 1.643(h)-1 provided primary guidance regarding related parties under this code section before the proposed regulations were released on May 8, 2024.[27]

Proposed Reg. § 1.643(i)-1(b)(2)(i) provides three examples of indirect loans:

1) Loans made by any person other than the trust to either a U.S. grantor or beneficiary of a foreign trust or any U.S. person related to a U.S. grantor or beneficiary if the foreign trust provides a guarantee (within the meaning of § 1.679-3(e)(4)) for the loan;

2) Loans made by any person related to a foreign trust, to either a U.S. grantor or beneficiary of the trust, or a U.S. person related to a U.S. grantor or beneficiary; and

[26] Section 643(i).
[27] Notice 97-34,1997-1 C.B. 422, Section V.A; Treas. Reg. 1.643(h)-1.

3) Loans made by a foreign trust to a foreign person, other than to a nonresident alien individual grantor or beneficiary of the trust, if the foreign person is related to a U.S. grantor or beneficiary of the trust.[28]

Proposed Reg. § 1.643-1(i)(b)(2)(ii) provides a limited exception to the indirect loan examples listed above. Under the proposed regulations, loans described in items (2) or (3) above will not be treated as a section 643(i) distribution if the U.S. grantor or beneficiary (i) satisfies the information reporting requirements of Prop. Reg. §1.6048-4 with respect to the loan, and (ii) includes an explanatory statement attached to the U.S. grantor or beneficiary's Federal income tax return that demonstrates to the satisfaction of the Commissioner that the loan would have been made without regard to the fact that the U.S. grantor or beneficiary is a grantor or beneficiary of the foreign trust.[29]

As drafted, the scope of the indirect loan rules assumes an unreasonable level of knowledge with respect to loans from a foreign trust, loans from parties related to that trust, guarantees provided by the trust on applicable loans, and other potential transactions that would fall under the indirect loan examples presented above. U.S. beneficiaries and grantors of foreign trusts cannot be expected to have knowledge of all transactions entered into by a trustee, nor to report information that is not made available to them.

Moreover, the scope of information that would need to be provided to a U.S. grantor or beneficiary to comply with the regulation as drafted could give rise to reasonable concerns on the part of fiduciaries with respect to the privacy of information and compliance with their fiduciary obligations. In this regard, an independent trustee may be willing and able to provide a beneficiary with information about what that beneficiary received (e.g., a properly completed beneficiary statement), but not what someone else received.

The information reporting requirements outlined in Prop. Reg. § 1.6048-4 include all "distributions" whether direct or indirect that are treated as made to a U.S. person. Under Prop. Reg. § 1.6048-4(b)(5)(iii), the loan of trust property must be reported on Part III of Form 3520 by the U.S. person that receives the loan and, if the recipient of the loan is related to a U.S. grantor or beneficiary, by the U.S. grantor or beneficiary, regardless of whether that loan would have any U.S. income tax consequences to the U.S. grantor or beneficiary of the foreign trust.[30] In addition to the extensive information required as part of Part III of Form 3520, the proposed regulations establish a requirement for the U.S. grantor or beneficiary to include an explanatory statement regarding the loan transaction with the grantor or beneficiary's Federal income tax return.

Under the proposed regulations of section 643(i) and section 6048, there is a significant emphasis on indirect transactions, particularly with related parties.[31] However, it is unclear from the preamble and proposed regulations how far the scope of these indirect loan rules extends. A literal reading of the proposed regulations suggests that the indirect loan rules will treat certain indirect or related party transactions that do not necessarily have a clear connection to the trust as taxable

[28] 89 Federal Register 39445 (May 8, 2024); Prop. Treas. Reg. § 1.643(i)-1(b)(2)(i).
[29] Proposed Reg. § 1.643(i)-1(b)(2)(ii).
[30] 89 Federal Register 39453 (May 8, 2024); Proposed Reg. § 1.6048-4(b)(5)(iii).
[31] 89 Federal Register 39453 (May 8, 2024).

section 643(i) distributions, nevertheless. For example, a literal reading of Prop. Reg. § 1.643(i)-1(b)(2)(i)(B) would suggest that if an individual who is related to a foreign trust makes a loan to a U.S. person who is related to the U.S. grantor or beneficiary, there will be a section 643(i) distribution from the trust to the U.S. grantor or beneficiary, even if the loan is just a transaction between two individuals which does not otherwise have any connection to the trust. As a practical matter, the U.S. grantor or beneficiary may also be unaware of the existence of this loan.

Existing regulations provide a useful guidepost for creating rules with respect to related party transactions that will predicate treatment as a taxable distribution on an appropriate nexus to the foreign trust but will nonetheless capture potentially abusive transactions within their scope. Related party transactions are also contemplated in section 643(h), section 679 and related regulations. These related party transactions relate to indirect trust distributions and contributions, respectively.

Treasury Reg. § 1.643(h)-1(a) establishes that any property (including cash) that is transferred to a U.S. person by another person (an intermediary) who has received property from a foreign trust will be treated as property transferred directly by the foreign trust to the U.S. person if the intermediary received the property from the foreign trust pursuant to a plan one of the principal purposes of which was the avoidance of U.S. tax. For this purpose, a transfer will be deemed to have been made pursuant to a plan one of the principal purposes of which was the avoidance of U.S. tax if the U.S. person --

i. is related to a grantor of the foreign trust, or has another relationship with a grantor of the foreign trust that establishes a reasonable basis for concluding that the grantor of the foreign trust would make a gratuitous transfer to the U.S. person;
ii. Receives from the intermediary, within the period beginning twenty-four months before and ending twenty-four months after the intermediary's receipt of property from the foreign trust, either the property the intermediary received from the foreign trust, proceeds from such property, or property in substitution for such property; and
iii. Cannot demonstrate to the satisfaction of the Commissioner that—
    (A) The intermediary has a relationship with the U.S. person that establishes a reasonable basis for concluding that the intermediary would make a gratuitous transfer to the U.S. person;
    (B) The intermediary acted independently of the grantor and the trustee of the foreign trust;
    (C) The intermediary is not an agent of the U.S. person under generally applicable U.S. agency principles; and
    (D) The U.S. person timely complied with the reporting requirements of section 6039F, if applicable, if the intermediary is a foreign person.

Treasury Reg. § 1.679-3(c) establishes an indirect transfer rule that is essentially a mirror image of the rules in Prop. Reg. § 1.643-1(a), applied to contributions to foreign trusts rather than distributions. The indirect transfer rules established under these two regulations provide a reasonable basis for establishing related party rules under Prop. Reg. § 643(i) for indirect distributions from foreign trusts.

C. Update the regulations to incorporate related party rules similar to those that have long been included as part of Treas. Reg. § 1.643(h)-1(a) and Treas. Reg. § 1.679-3(c).

Overview

Proposed Reg. § 1.643(i)-4 provides multiple examples that illustrate the rules of Prop. Regs. §§ 1.643(i)-1 through 1.643(i)-3, however, these examples do not fully provide an example that would demonstrate a loan has been made without regard to a relevant relationship.

Recommendation

Treasury and the IRS should update the regulations to incorporate related party rules similar to those that have long been included as part of Treas. Reg. § 1.643(h)-1(a) and Treas. Reg. § 1.679-3(c).[32]

Analysis

As discussed above, Treas. Reg. § 1.643(h)-1(a) and Treas. Reg. § 1.679-3(c) establish intermediary rules for indirect distributions from, and contributions to, foreign trusts. These rules seek to prevent transactions of which one of the principal purposes is tax avoidance. By utilizing a deemed principal purpose of tax avoidance in certain circumstances, Treas. Reg. § 1.643(h)-1(a) and Treas. Reg. §1.679-3(c) manage to target intermediary transactions that might otherwise avoid reporting. As such, it is reasonable to apply similar related party rules to section 643(i) direct and indirect distributions from foreign trusts.

D. Eliminate Prop. Reg. § 1.643(i)-1(b)(3), or if that is not possible, revise it in one or more of the suggested ways.

Overview

Proposed Reg. § 1.643(i)-1(b)(3) creates a provision whereby a nonresident alien individual who is a grantor or beneficiary of a foreign trust, receives a loan from the trust, and, while the loan is outstanding, subsequently becomes a U.S. person within two years of the loan origination date, will be deemed to have received a distribution from the foreign trust with respect to the outstanding amount of the loan as of the first day the individual is considered a U.S. person.

Recommendations

This provision of the proposed regulations should be eliminated. If it is not possible to eliminate this provision, the regulations should be revised in one or more of the following ways:

i. Treat the existing obligation as a distribution from the foreign trust as of the loan origination date.

[32] Treasury Reg. § 1.643(h)-1(a); Treas. Reg. § 1.679-3(c).

ii. The rule should be revised to provide that it will only apply if, prior to the individual's resident alien status, the individual was a resident alien for a period of at least three consecutive calendar years (referred to as the "initial residency period") and after ceasing to be a resident alien became a resident alien once again before the close of the third calendar year beginning after the close of the initial residency period**.**

iii. Clarify the tax treatment for taxpayers with loans other than qualified obligations ("nonqualified loans") originated within this two-year period which are fully repaid by the taxpayer.

iv. Implement this provision in a prospective manner with a specific time horizon for implementation.

Analysis

Under Prop. Reg. § 1.643(i)-1(b)(3) as written, a foreign person who receives a distribution from a foreign trust in the two-year period prior to becoming a U.S. resident (within the meaning of section 7701(b)) or a U.S. citizen, would be treated differently (and generally more favorably) than a foreign person that received a nonqualified loan from a foreign trust in the two-year period prior to becoming a U.S. person.

As an example, assume that two nonresident alien individuals are beneficiaries of a foreign nongrantor trust. Beneficiary A receives a distribution of $100,000, and, on the same day, Beneficiary B receives a nonqualified loan of $100,000. Within two years of the date of the distribution and loan, both Beneficiary A and Beneficiary B become U.S. persons under section 7701(a)(30), and the loan remains outstanding at that time. The distribution to Beneficiary A will carry no U.S. tax consequences unless the foreign nongrantor trust somehow had U.S.-source income in its distributable net income or undistributed net income. The nonqualified loan to Beneficiary B, however, will be treated as a taxable distribution in the year that Beneficiary B becomes a U.S. person, thus resulting in Beneficiary B being taxed on any current-year, world-wide distributable net income of the foreign nongrantor trust and, if that amount is exhausted by the deemed distribution, any undistributed net income of the trust. Moreover, when Beneficiary B repays the nonqualified loan pursuant to its terms, existing guidance seems to provide no relief for the income taxes paid with respect to the amount of the repaid loan. This discrepancy in treatment between loans and distributions indicates that Prop. Reg. § 1.643(i)-1(b)(3) as drafted is a punitive overreach which should be eliminated in the final regulations.

If this provision were implemented in its current form, one of the major effects will be to create a significant trap for unsophisticated persons. Under the provision as drafted, a well-advised taxpayer who planned to immigrate to the United States would consider the following options:

1) Distribute or forgive any loan existing in the foreign trust prior to the foreign person becoming a U.S. person; or

2) Make any applicable distributions from the foreign trust to the foreign person prior to the start of their U.S. person status.

However, taxpayers without specialized professional advice would be disproportionately impacted because they would not have the benefit of pre-immigration planning. For example, in countries such as Australia and New Zealand, it is very common for individuals – including those who are not highly wealthy – to have one or more trusts with loans. These taxpayers may subsequently become U.S. persons with loans still outstanding, thus subjecting themselves to deemed distribution rules that could have been avoided. This would act as another taxpayer trap within the already complex foreign trust information reporting system. This complexity is not new within this area of tax. In fact, prior AICPA comment letters, including "Recommendations for the 2024-2025 Guidance Priority Plan (Notice 2024-28)," submitted by the AICPA to the IRS on May 17, 2024, have referenced the complexity of the foreign trust information reporting system.[33]

Rather than treating a nonqualified loan as a deemed distribution in the year that the obligor becomes a U.S. person, existing case law regarding taxpayers who migrate from being non-U.S. persons to U.S. persons suggests that a nonqualified loan should be treated as a distribution in the year that the loan is made. For example, case law regarding the adjusted basis of property which nonresident taxpayers acquired before becoming resident taxpayers illustrates that U.S. income tax principles are essentially applied retroactively to transactions occurring in the taxpayer's nonresident years, even if the taxpayer was not filing U.S. income tax returns for that period.[34]

Similarly, case law established that U.S. income tax principles are applied in the calculation of "accumulated profits" of a foreign corporation for the purpose of the now-repealed credit to a U.S. corporation for taxes paid by a foreign subsidiary under section 902.[35] Based upon the retroactive application of U.S. income tax principles to the transactions of non-U.S. taxpayers, a nonqualified loan received by a non-U.S. person would be treated as a foreign trust distribution upon receipt of the loan rather than being held in suspension for deemed treatment as a distribution upon the recipient becoming a U.S. person.

We understand from the preamble to the proposed regulations that Prop. Reg. § 1.643(i)-1(b)(3) was intended to address concerns regarding potential abuse in the form of nonqualified loans obtained from foreign trusts by individuals during a brief lapse in their status as resident aliens. Specifically, the preamble[36] states that this provision was created as "an anti-abuse rule" with the intent "to discourage grantors and beneficiaries of a foreign trust from changing their U.S. residence in a particular year to avoid the application of section 643(i)…." However, as drafted, the proposed regulation would apply to a much broader class of taxpayers than individuals who take nonqualified loans during a brief respite in their status as resident aliens. In fact, the provision as drafted would apply to any nonqualified loan which is obtained by a nonresident alien who is a grantor or beneficiary of a foreign trust and which remains outstanding when the obligor becomes a U.S. citizen or resident. Thus, the provision as drafted would apply even when the recipient of the loan was never previously a U.S. citizen or resident. If this provision is not eliminated, it should

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[33] See footnote 121 of AICPA comments, "Recommendations for the 2024-2025 Guidance Priority Plan (Notice 2024-28)," May 17, 2024

[34] *Gutwirth v. Commissioner*, 40 TC 666 (1963), *acq. in result*, 1966-2 C.B. 5; *Reisner v. Commissioner*, 34 T.C. 1122 (1960), *acq.*, 1961-2 C.B. 5.

[35] *United States v. Goodyear Tire & Rubber Co*., 493 U.S. 132 (1989).

[36] 89 Federal Register 39445 (May 8, 2024).

be much more carefully targeted to apply only to loans received by individuals during a brief respite in their treatment as U.S. persons.

The Code and Treasury Regulations already have provisions to prevent brief lapses in the status of individuals as resident aliens. Specifically, section 7701(b)(2)(A)(i) and Treas. Reg. § 301.7701(b)-4(e)(1) provide that an alien individual who was a U.S. resident during any part of the preceding calendar year and who is a U.S. resident for any part of the current year will be considered taxable as a resident at the beginning of the current year. Similarly, section 7701(b)(2)(B)(iii) and Treas. Reg. § 301.7701(b)-4(e)(2) provide that an alien individual who is a U.S. resident for any part of the current year and who is also a U.S. resident for any part of the following year (regardless of whether the individual has a closer connection to a foreign country than the U.S. during the current year) will be taxable as a resident through the end of the current year. Also, section 7701(b)(10) provides that the certain individuals whose resident alien status lapses for less than three years will be subject while they are nonresidents to the alternative tax regime of section 877(b), which alters the normal income sourcing rules for nonresident aliens and applies progressive tax rates to certain U.S.-source income. Specifically, section 7701(b)(10) applies when an alien individual i) was treated as a resident alien for any period which includes at least three consecutive calendar years (the "initial residency period"), ii) became a nonresident alien, and iii) subsequently becomes a resident alien again within three calendar years after the end of the initial residency period.

If this provision is not eliminated, we recommend that the proposed two-year rule be revised so as to reflect the provisions of section 7701(b)(10). Adopting those specific definitional rules means that the proposed two-year rule would apply only if the loan was made to an individual who previously was a resident alien (for at least the requisite three-year period), and if the loan was made within two years before the individual resumed his or her resident alien status.

If Prop. Reg. § 1.643(i)-1(b)(3) is retained in the final regulations, a separate provision should also be created to provide relief to the taxpayer for the income taxes paid with respect to the outstanding amount of the loan that is repaid by the taxpayer. A discussion of relief for previously taxed (and repaid) amounts is included below.

E. Revise Prop. Regs. §§ 1.643(i)-3(a)(2) and 1.643(i)-3(c)(2)(ii) to establish that indirect distributions due to nonqualified loans, in the form marketable securities, will not be subject to mark-to-market (MTM) treatment, unless an affirmative election is made in accordance with section 643(e).

Overview

Proposed Regs. §§ 1.643(i)-3(a)(2) and 1.643(i)-3(c)(2)(ii) establish that a nonqualified loan of marketable securities recognized as a direct or indirect distribution will trigger a deemed section 643(e) election and force the foreign trust to recognize mark-to-market (MTM) gain as part of the trust's current year distributable net income (DNI).

Recommendation

The regulation should be revised to establish that indirect distributions due to nonqualified loans, in the form marketable securities, will not be subject to MTM treatment, unless an affirmative election is made in accordance with section 643(e).

Analysis

Proposed Reg. § 1.643(i)-3(a)(2) states that "In the case of a loan of marketable securities treated as a section 643(i) distribution, the amount of the section 643(i) distribution is the fair market value of the securities as of the date the loan is treated as a section 643(i) distribution."[37] The assertion that a loan of marketable securities will be treated as a distribution at fair market value as of the date the loan is treated as a section 643(i) distribution is inconsistent with section 643(e). Under the general rule of section 643(e)(1), "the basis of any property received by a beneficiary in a distribution from an estate or trust shall be the adjusted basis of such property in the hands of the estate or trust immediately before the distribution, adjusted for any gain or loss recognized to the estate or trust on the distribution."[38] Furthermore, in the case of a distribution of property other than cash, the amount taken into account is generally the lesser of the basis of the property in the hands of the beneficiary or the fair market value.[39] Alternatively, an affirmative election can be made to recognize gain under section 643(e)(3) at the trust level.[40] Treating a loan of marketable securities less favorably than a distribution of marketable securities suggests a punitive overreach.

The forced recognition of gain is also arguably outside the terms of section 643(i) which refers to "the amount" being a distribution.

F. Proposed Reg. § 1.643(i)-2(a)(4)

Overview

Proposed Reg. § 1.643(i)-2(a)(4) creates an exception to treatment as a section 643(i) distribution for a loan of cash that is made by a foreign corporation to a U.S. beneficiary of a foreign trust to the extent the aggregate amount of all such loans to the beneficiary does not exceed undistributed earnings and profits of the foreign corporation attributable to amounts that are, or have been, included in the beneficiary's gross income under sections 951, 951A, or 1293. The preamble[41] states that this provision is intended to prevent double taxation that could result by reason of the application of section 643(i) to an amount that has already been included in the U.S. beneficiary's gross income as a subpart F income inclusion, a global intangible low-taxed income inclusion, an inclusion by reason of a controlled foreign corporation's investment of earnings in U.S. property, or a qualified electing fund inclusion.

[37] Proposed Reg. § 1.643(i)-3(a)(2).
[38] Section 643(e)(1).
[39] Section 643(e)(2).
[40] Section 643(e)(3).
[41] 89 Federal Register 39446 (May 8, 2024).

Recommendations

i. This provision is helpful and welcome. The AICPA suggests giving amounts previously taxed at the beneficiary level the same type of prioritization as section 965 previously taxed earnings & profits (PTEP) received in Notice 2019-1 such that these amounts are deemed distributed first before other amounts.

ii. We suggest the creation of an additional PTEP relief provision to address the potential double taxation of distributions (in addition to loans) from foreign corporations owned by foreign non-grantor trusts that can reasonably be traced to amounts that have already been included in the U.S. beneficiary's gross income as a subpart F income inclusion, a global intangible low-taxed income inclusion, an inclusion by reason of a controlled foreign corporation's investment of earnings in U.S. property, or a qualified electing fund inclusion.

iii. In addition, we also suggest that a separate relief provision be created for loans that do not meet the exceptions in Prop. Reg. § 1.643(i)-2 (and are thus treated as section 643(i) distributions) but are repaid by the obligor/beneficiary consistent with the loan terms using the currency from a subsequent distribution from the trust to the obligor/beneficiary. Absent such a relief provision, the obligor/beneficiary would be taxed with respect to two distributions from a foreign non-grantor trust, even though one of those distributions was returned to the trust as required and did not enrich the obligor/beneficiary.

Analysis

The AICPA applauds this effort to alleviate potential double taxation of amounts previously included in the trust beneficiary's gross income under sections 951, 951A, or 1293. The preamble[42] states that Treasury and the IRS request comments on whether ordering rules to determine the sourcing of loan amounts, for example, rules based on the principles of section 959 or similar to the provisions of Treas. Reg. § 1.672(f)-4(c)(3) are necessary. A relatively simple approach for this purpose would be to treat amounts previously taxed at the beneficiary level akin to the way section 965 PTEP were prioritized in Notice 2019-1 as being distributed first before other PTEP items. Alternatively, applying the PTEP principles of section 959 would provide an existing framework to utilize, particularly when the forthcoming regulations on PTEP are published.

To help address the potential double taxation of loans, we suggest the creation of a separate provision for loans which are treated as section 643(i) distributions but are repaid by the obligor/beneficiary consistent with the obligation terms using the proceeds of a subsequent distribution to the obligor/beneficiary from the trust. As an illustration of this issue, assume that Individual A is a beneficiary of a foreign non-grantor trust which owns shares of a foreign corporation which is neither a controlled foreign corporation nor a passive foreign investment company. In Year 1, Individual A receives from the trust a loan of $150,000 which does not qualify for any of the exceptions in Prop. Reg. § 1.643(i)-2 and is thus treated as a section 643(i) distribution. The deemed distribution to Individual A under section 643(i) carries out DNI of the

[42] *Id.*

trust and could result in a throwback tax if the deemed distribution exceeds DNI and the trust has undistributed net income (UNI). In Year 3, the foreign corporation pays a dividend to the trust, and the trust distributes $150,000 to Individual A, who uses the cash to repay the loan from the trust pursuant to its terms. Based upon receiving the dividend from the foreign corporation, the foreign non-grantor trust has DNI in Year 3 which will pass to Individual A with the distribution. Under current guidance, Individual A would thus be taxed on a total of $300,000 of distributions from the foreign non-grantor trust, even though $150,000 was returned to the trust as required and did not actually enrich Individual A.

In addition to this provision for loans, there should be an expansion of the relief to address the potential double taxation of distributions from foreign corporations owned by foreign non-grantor trusts that can reasonably be traced to amounts that have already been included in the U.S. beneficiary's gross income as a subpart F income inclusion, a global intangible low-taxed income inclusion, an inclusion by reason of a controlled foreign corporation's investment of earnings in U.S. property, or a qualified electing fund inclusion.

As it currently stands, the rules for distributions from foreign corporations and distributions from foreign non-grantor trusts are poorly coordinated. This creates a significant potential for double taxation. For example, Treas. Reg. § 1.961-1(a)(1)(ii) provides that the basis of a U.S. shareholder's "property" by reason of the ownership of which he is considered under section 958(a)(2) as owning stock in a controlled foreign corporation is increased by the amount required to be included in the shareholder's gross income under section 951(a). For this purpose, "property" is defined in Treas. Reg. § 1.961-1(b) as stock in a foreign corporation, an interest in a foreign partnership, a beneficial interest in a foreign estate or trust. In practice, an adjustment to the basis in stock of a foreign corporation or an interest in a foreign partnership may ultimately provide a significant benefit to a U.S. shareholder, but an increased basis in a beneficial interest in a foreign trust or estate is effectively of no use to the beneficiary. Specifically, even in the limited cases in which a trust interest acquired by gift or bequest is sold, there is no concept of a separate basis for that interest. Instead, any basis in the interest being sold is a portion of the trust's basis in its assets.[43] Thus, an increase to the basis in a trust interest is meaningless.

In the context of foreign non-grantor trusts, applying the concept of PTEP distributions from foreign corporations under current law can be hindered by the rule[44] in which distributions of accumulated income to a U.S. person lose their character. For example, assume that Individual B reports $100,000 of subpart F income in Year 1 which is attributable to a controlled foreign corporation which is wholly owned by a foreign non-grantor trust of which Individual B is the sole current beneficiary. If the controlled foreign corporation makes a distribution of $100,000 cash to the foreign non-grantor trust in Year 1, the trust will have distributable net income from that distribution, as the trust itself is unable to apply any concept of PTEP for amounts received by Individual B. If the foreign non-grantor trust distributes the $100,000 to B in Year 1, trust conduit principles and general principles of PTEP should arguably allow Individual B to treat the $100,000 amount as a tax-free distribution of PTEP. However, if the foreign non-grantor trust does not distribute that $100,000 of cash to Individual B in Year 1, it would become UNI under section 665(a). If the foreign non-grantor trust then distributes the $100,000 of cash in Year 2, the amount

[43] Treasury Reg. § 1.1014-5(a); Treas. Reg. § 1.1015-5(b); Private Letter Ruling 8943056 (July 31, 1989).
[44] Public Law No. 94-455, §701; Sections 662(b), 667(a) and 667(d).

will arguably lose its character as PTEP and will thus be treated as a taxable accumulation distribution, notwithstanding that the amount conceptually represents a distribution of amounts previously taxed to Individual B. This potential double taxation should be addressed in future guidance from the IRS.

G. Create exceptions in the regulations under section 643(i) for loans made by or guaranteed by a foreign trust to a related person

Overview

The proposed regulations do not include and should include exceptions under section 643(i) for loans made by or guaranteed by foreign trusts to persons who are related to a U.S. grantor or beneficiary but who are not themselves beneficiaries.

Recommendations

The regulations should create an exception under section 643(i) for loans made by foreign trusts to persons who are related to a U.S. grantor or beneficiary but who are not themselves beneficiaries if the loan is bona fide (there is a reasonable expectation of repayment), the loan is made on commercially reasonable terms, and the loan was not made for the principal purpose of tax avoidance, using the standards adopted in section 643(h) for determining when a distribution to a beneficiary is deemed to have been made indirectly through an intermediary.

Additionally, no reporting requirement should be imposed on a U.S. grantor or beneficiary with respect to a loan made by a foreign trust to a related person unless the U.S. grantor or beneficiary knew or had reason to know that the loan had been made.

Similarly, a trust's guarantee of a loan to a related person should not cause section 643(i) to apply if the terms of the guarantee are commercially reasonable.

Analysis

Loans to trust beneficiaries may require stricter standards to avoid being taxed as a distribution due to the latitude a trustee has to decide whether to transfer funds to a beneficiary either as a distribution or as a loan. This option does not exist for loans made to related persons, thereby justifying broader exceptions.

Any rule that imposes tax on a person who has received nothing and has no right to approve or disapprove the exercise of a lending power may violate due process.

For the same reason, no reporting requirement should be imposed on a U.S. grantor or beneficiary with respect to a loan made by a foreign trust to a related person unless the U.S. grantor or beneficiary knew or had reason to know that the loan had been made.

11. Valuing Foreign Gifts for Purposes of International Information Reporting

A. Regarding the requirement under Prop. Reg. § 1.6039F-1(c)(2)(ii) and Prop. Reg. § 1.6039F-1(h)(2) for the lower reporting threshold for covered gifts or bequests from a covered expatriate, reserve for public comment until after the final regulations under section 2801 have been promulgated.

Overview

Pursuant to Prop. Reg. § 1.6039F-1(c)(2)(ii) and Prop. Reg. § 1.6039F-1(h)(2), beginning on the date on which final regulations under section 2801 apply, a much lower reporting threshold – specifically, the dollar amount of the per-donee gift tax exclusion in effect under section 2503(b) for the calendar year ($18,000 for 2024) – would apply to covered gifts or bequests from a covered expatriate than would generally apply to most foreign gifts. There are practical concerns about the proposed regulations under section 2801, which have yet to be resolved, including how the U.S. person who receives a foreign gift will be able to obtain documentation regarding whether the donor is a covered expatriate.

Recommendation

Because of the unresolved concerns regarding the proposed regulations under section 2801, this item should be reserved for public comment until after the final regulations under section 2801 have been promulgated. Otherwise, the comment period on this provision could expire before the regulations under 2801 regulations are finalized. If that were to occur, the public would effectively be deprived of the opportunity to comment on this provision, as potential concerns regarding this item are inextricably linked to the details of the final regulations under section 2801.

Analysis

Proposed Reg. § 28.2801-7(a) states that it is the responsibility of the U.S. citizen or resident receiving a gift or bequest from an expatriate or a distribution from a foreign trust funded at least in part by an expatriate to ascertain the taxpayer's obligations under section 2801, which includes making the determination of whether the transferor is a covered expatriate and whether the transfer is a covered gift or covered bequest.

Proposed Reg. § 28.2801-7(b)(1) provides that, in certain circumstances, the IRS may be permitted, upon request of a U.S. citizen or resident in receipt of a gift or bequest from an expatriate, to disclose to the U.S. citizen or resident return or return information of the donor or decedent expatriate that may assist the U.S. citizen or resident in determining whether the donor or decedent was a covered expatriate and whether the transfer was a covered gift or covered bequest. The circumstances under which such information may be disclosed and the procedures for requesting such information from the IRS will be as provided by publication in the Internal Revenue Bulletin.

Under Prop. Reg. § 28.2801-7(b)(2), unless a living donor expatriate authorizes the disclosure of his or her relevant return or return information to the U.S. citizen or resident receiving the gift,

there is a rebuttable presumption that the donor is a covered expatriate and that the gift is a covered gift. A taxpayer who reasonably concludes that a gift or bequest is not subject to section 2801 may file a protective Form 708, U.S. Return of Gifts or Bequests from Covered Expatriates, in accordance with Prop. Reg. § 28.6011–1(b) to start the period for the assessment of any section 2801 tax.

When the proposed regulations under section 2801 were released, Treasury and the IRS acknowledged the challenges that taxpayers may have in determining whether they are liable for any tax under section 2801.[45] Similarly, commentators expressed concerns about how taxpayers would be able to establish whether the transferor is a covered expatriate and whether the transfer is a covered gift or covered bequest. Specifically, the AICPA expressed reservations about how donees would be able to fulfill the requirement that they obtain documentation regarding whether the donor is a covered expatriate.[46] The New York State Bar Association recommended that a taxpayer be able to file a protective Form 708 not only when the taxpayer is able to conclude that the transferor is not a covered expatriate and that the gift, bequest or trust distribution is not subject to the section 2801 tax, but also when the taxpayer has conducted a reasonably diligent investigation and is unable to make a determination as to the transferor's status.[47] To date, it is unknown how these practical concerns and recommendations will be addressed in the final regulations under section 2801.

The acknowledged challenges that taxpayers have in concluding whether they are liable for tax under section 2801 have a direct relationship to the separate filing threshold for reporting covered gifts and bequests under Prop. Reg. § 1.6039F-1(c)(2)(ii). If taxpayers are uncertain as to whether the foreign gift or bequest that they received is subject to tax under section 2801, they will be similarly uncertain as to whether the lower filing threshold for covered gifts or bequests is applicable. If taxpayers are forced to assume that the lower filing threshold for covered gifts or bequests is applicable in the absence of clear documentation to the contrary, the lower filing threshold will effectively supplant the general filing threshold in all but a limited number of cases.

Based upon the unresolved concerns regarding the proposed regulations under section 2801, the AICPA recommends that Prop. Reg. § 1.6039F-1(c)(2)(ii) be reserved for public comment until after the final regulations under section 2801 have been promulgated. Otherwise, the comment period on this provision could expire before the regulations under 2801 regulations are finalized. In that event, the public would effectively be deprived of commenting on this provision.

B. Expand reporting exceptions for large foreign gifts and inheritances.

Overview

The current $100,000 threshold (as indexed for inflation) that has been established under Prop. Reg. §1.6039-1(c)(2) does not reflect the economic reality of 2024.

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[45] 80 Federal Register 54453 (September 10, 2015).

[46] AICPA comments, "IRS Proposed Regulations on Guidance Under Section 2801 Regarding the Imposition of Tax on Certain Gifts and Bequests From Covered Expatriates (REG-112997-10)," May 17, 2016.

[47] 1364 Report.pdf (nysba.org)

Recommendations

We recommend expanding reporting exceptions, including:

i. Increase reporting thresholds for large foreign gifts and inheritances from individuals to $1,000,000 and index for inflation, and

ii. Provide an exception for all reporting of large foreign gifts and inheritances between spouses.

Analysis

The current proposed regulations at Prop. Reg. § 1.6039F-1(c)(2) provide for reporting large foreign gifts and inheritances from individuals in excess of $100,000 with that threshold indexed for inflation. We applaud the indexing for inflation, but the reporting threshold should first be adjusted for economic reality. The $100,000 threshold was adopted in IRS Notice 97-34 over 26 years ago. We recommend adjusting the reporting threshold to $1,000,000 and indexing that amount for inflation.

Further, we recommend excepting from reporting gifts and inheritances between spouses. Transfers from a nonresident alien spouse to a U.S.-person spouse should be completely excluded from the section 6039F reporting regime. Requiring reporting between married spouses is an unnecessary invasion of familial and marital privacy. Additionally, information concerning spousal transfers would likely provide no useful information to the IRS. In the context of spousal transfers, especially inter vivos transfers between spouses, the IRS would gain no useful information. In many cases, transfers between spouses constitute routine support, which does not fit into the dichotomy of gift or income provided in the proposed regulations.

C. Create a standalone form with instructions for reporting large foreign gifts and inheritances.

Overview

The current Form 3520 allows for the reporting of large foreign gifts and inheritances on Part IV of the form; however, this requirement is often missed by uninformed tax preparers that incorrectly assume Form 3520 applies solely to transactions with foreign trusts rather than transactions with foreign trusts and receipt of certain foreign gifts.

Recommendation

We recommend creating a standalone form with instructions for reporting large foreign gifts and inheritances.

Analysis

Historically the income tax return preparation community has been ignorant of the requirement to report large foreign gifts and inheritances on Form 3520. Foreign gift and inheritance reporting has proven to be a trap for the unwary. Innocent taxpayers who reasonably relied on uninformed tax preparers have been severely penalized by the IRS and have even been forced to litigate IRS inaction concerning reasonable cause. *See generally Wrzesinski v. United States*, docket no. 22-cv-03568, U.S.D.C. W.D. Pen. (IRS conceded the § 6039F penalty without filing a responsive pleading).

D. Clarify in the regulations the reporting of partial or incomplete foreign gifts under section 6039F.

Overview

The proposed regulations under section 6039F do not acknowledge the potential for gifts of a partial interest in property and/or incomplete gifts under the laws of foreign jurisdictions.

Recommendation

We recommend clarifying in the regulations the reporting of partial or incomplete foreign gifts under section 6039F.

Analysis

At times, foreign gifts may consist of partial interests in property, for example property subject to usufructs. *See generally* PLR 201032021. Further, at times foreign gifts may involve transfers that are incomplete given the operation of foreign law. We recommend clarifying in the regulations how to value completed gifts of partial interests in property and whether reporting is necessary for incomplete gifts which may be undone by the foreign grantor. For example, under German law, certain gifts, including gifts of cash and other property, may be fully revoked by the transferor within a specified number of years.

E. Revise Prop. Reg. § 1.6039F-1(d) to remove the reference therein to chapter 14 of the Code for the purpose of valuing foreign gifts, with such gifts instead being valued using the principles of section 2512 and the regulations thereunder.

Overview

Proposed Reg. § 1.6039F-1(d) would modify the definition of the amount of a foreign gift to consider chapter 14 of the Internal Revenue Code and the related regulations.

Recommendation

The regulation should be revised to remove the reference to chapter 14 of the Code in Prop. Reg. § 1.6039F-1(d) for the purpose of valuing foreign gifts, with such gifts instead being valued using the principles of section 2512 and the regulations thereunder.

Analysis

Section VII of Notice 97-34 provides that penalties under sections 6677 or 6039F(c) generally depend upon the "gross value" or "gross amount" of the property involved. The Notice also states that in determining the gross value or gross amount of property, the valuation principles of section 2512 and the regulations thereunder must be used, without regard to any prohibitions or restrictions on a person's interest in the property.

The Instructions for Form 3520 have taken a pragmatic approach to valuing foreign gifts. Specifically, as currently stated in the Instructions, "Although formal appraisals are not generally required, you should keep contemporaneous records of how you arrived at your good faith estimate."

Proposed Reg. § 1.6039F-1(d) states that the amount of a foreign gift is the value of the property at the time of its transfer, with the value of the property determined in accordance with the Federal gift tax valuation principles of section 2512 and sections 2701 through 2704 (chapter 14 of the Internal Revenue Code) and the regulations under section 2512 and sections 2701 through 2704. The AICPA believes that the reference in the regulation to chapter 14 of the Code represents a significant increase in the complexity of valuing foreign gifts which is unlikely to be justified by potential revenue to the government.

Chapter 14 is designed to be applied in the context of the federal transfer tax system. The application of chapter 14 in the context of valuing a gift for federal gift tax purposes helps to address potential abuses in the valuation of property that could otherwise have a direct impact upon the amount of transfer tax revenue received by the government. In contrast, the application of chapter 14 in the context of valuing a non-taxable foreign gift for information reporting purposes will not have a clear impact upon the amount of tax revenue received by the government.

As a practical matter, taxpayers who receive foreign gifts often may not have sufficient information to properly apply chapter 14. For example, a calculation of the value of a junior equity interest pursuant to Treas. Reg. § 25.2701-3 would require the donee to know, *inter alia*, i) the fair market value of all family-held interests in the entity, assuming that the interests are held by one individual and using a consistent set of assumptions,[48] ii) the sum of the fair market value of all family-held senior equity interests, (other than applicable retained interests held by the transferor or applicable family members),[49] iii) the fair market value of any family-held equity interests of the same class or a subordinate class to the transferred interests held by persons other than the transferor, members of the transferor's family, and applicable family members of the transferor,[50] and iv) the value of

[48] Treasury Reg. § 25.2701-3(b)(1)(i).
[49] Treasury Reg. § 25.2701-3(b)(2)(i)(A).
[50] *Id.*

all applicable retained interests held by the transferor or applicable family members (other than an interest received as consideration for the transfer) determined under Treas. Reg. § 25.2701-2, taking into account the adjustment described in Treas. Reg. § 25.2701-2(b)(5).[51] Even if all necessary information were available, the donee of such a gift would need to incur a significant expense for the services of an advisor with specialized technical expertise, all for the purpose of completing information reporting for a non-taxable amount received.

In addition, the application of at least one provision within chapter 14 would create a significant ambiguity with respect to the identity of the donee of the foreign gift. Specifically, section 2704(a) and Treas. Reg. § 25.2704-1(a)(1) treat the lapse of a voting right or a liquidation right in a corporation or partnership as a transfer by the individual directly or indirectly holding the right immediately prior to its lapse (the "holder") if the entity is controlled by the holder and members of the holder's family immediately before and after the lapse. The amount of the deemed transfer is the excess of i) the value of all interests in the entity owned by the holder immediately before the lapse (determined immediately after the lapse as if the lapsed right was non-lapsing), over ii) the value of those interests immediately after the lapse (determined as if all such interests were held by one individual).[52] Section 2704(a) is thus focused on capturing value that would otherwise be removed from the donor's gross estate without taxation. This provision does not, however, provide clear guidance as to the recipient of the deemed transfer. The donee of a deemed transfer associated with a lapse of a voting right would arguably be the other shareholders whose proportionate shares of the overall voting power is thus increased. However, the same principle would not necessarily apply to the lapse of a liquidation right if the other shareholders' liquidation rights are unchanged. The lack of a clearly identifiable donee in this circumstance would create uncertainty and potential exposure to penalties for failure to report foreign gifts.

To a significant degree, the application of chapter 14 is unnecessary to provide the government with the information necessary to oversee the potential taxation of foreign gifts. Gifts that would invoke chapter 14 will often exceed the threshold for reporting. Once the value of gifts received by a taxpayer from a foreign donor exceeds the applicable reporting threshold, the gift will be reported, including the newly required details regarding the identity of the transferor and related foreign persons. The government will thereby be aware of all such reported gifts and will have a reasonable opportunity to examine them, even without the application of chapter 14. Thus, applying chapter 14 in this context would create a disproportionate burden on taxpayers relative to the incremental value of the information provided to the government.

In addition, it is worth noting that the fair market value of a foreign gift generally has no bearing on the amount of tax which is owed to the government. Specifically, the recipient of a gift takes a carryover basis in the gift property rather than a basis which has been stepped up to fair market value. Also, with the limited exceptions of covered gifts from expatriates and gifts of U.S.-situs property by donors who are neither citizens nor domiciliaries of the U.S., most foreign gifts are not subject to U.S. transfer tax. Therefore, the exact fair market value of a foreign gift generally is not relevant other than to confirm whether the applicable threshold for reporting on Form 3520 has been met.

[51] Treasury Reg. § 25.2701-3(b)(2)(i)(B).
[52] Treas. Reg. § 25.2704-1(d).

F. Modify Prop. Reg. § 1.6677-1(c)(2) to remove the statement therein that would disregard the effect of taxes, expenses, liabilities or restrictions on the sale or use of property for valuation purposes. The gross value or gross amount of property would thus be determined in accordance with the valuation principles of sections 2512 and 2031 and the regulations thereunder.

Overview

Proposed Reg. § 1.6677-1(c)(2) states that the gross value or gross amount of property for the purpose of establishing the gross reportable amount is determined in accordance with the valuation principles of sections 2512 and 2031 and the regulations thereunder, though, in all events, without regard to any taxes, expenses, liabilities, or restrictions on the sale or use of the property.

Recommendation

The regulation should be modified to remove the statement in Prop. Reg. § 1.6677-1(c)(2) that would disregard the effect of taxes, expenses, liabilities or restrictions on the sale or use of property for valuation purposes. The gross value or gross amount of property would thus be determined in accordance with the valuation principles of sections 2512 and 2031 and the regulations thereunder.

Analysis

Sections 2512 and 2031 and the regulations thereunder define the value of property as being its fair market value. As noted, Section VII of Notice 97-34 states that in determining the gross value or gross amount of property, the valuation principles of section 2512 and the regulations thereunder must be used, without regard to any prohibitions or restrictions on a person's interest in the property. Prop. Reg. § 1.6677-1(c)(2) states that the gross value or gross amount of property is determined in accordance with the valuation principles of sections 2512 and 2031 and the regulations under sections 2512 and 2031, though, in all events, without regard to any taxes, expenses, liabilities, or restrictions on the sale or use of the property.

Section VII of Notice 97-34 states that the penalties under section 6677 apply only to the extent that the transaction is unreported. Thus, if a U.S. person transfers property worth $1,000,000 to a foreign trust, but reports only $400,000 of that amount, penalties may be imposed only on the unreported $600,000. Similarly, both the preamble[53] and text[54] of the proposed regulations provide that if a person reports less than the gross reportable amount, the penalty under section 6677 is based upon the amount that is unreported. Thus, the penalty in these circumstances is based upon the excess of the amount that should have been reported on Forms 3520-A or 3520 over the amount that was actually reported.

For many years, Form 3520-A and Form 3520 have correctly directed the taxpayer to report the fair market value of assets or property based upon the context. Notably:

[53] 89 Federal Register 39444 (May 8, 2024).
[54] Proposed Reg. § 1.6677-1(g)(1).

- Part I, Line 13 of Form 3520 directs the taxpayer to report the fair market value of property transferred.

- The instructions for Part II, Line 23 of Form 3520 tell the taxpayer to enter the fair market value of trust assets that the taxpayer is treated as owning. This is consistent with the required contents of a Foreign Grantor Trust Owner Statement as specified in Section IV.A of Notice 97-34.

- Part III, Line 24 of Form 3520 directs the taxpayer to report the fair market value of property received from a foreign trust. This is consistent with the requirements for a Foreign Grantor Trust Beneficiary Statement as specified in Section IV.A of Notice 97-34, the requirements for a Foreign Nongrantor Trust Beneficiary Statement as specified in Section V.B of Notice 97-34, as well as the current requirements for a Foreign Grantor Trust Owner Statement.

There should be no difference between the gross reportable amount applied in these contexts and the amount that must be reported on the forms. Along these lines, the Internal Revenue Code requires the use of fair market value – without any additional modifications – in applying several provisions related to foreign trusts, including the exception under section 6048(a)(3)(B)(i) to the normal information reporting requirements for transfers to a foreign trust in exchange for fair market value consideration. There is no reason why a transfer to a foreign trust in exchange for consideration equal to the normal definition of fair market value should technically be considered a failure to report the entire gross reportable amount under section 6677. Thus, the authority to create a modified definition of fair market value for this purpose is questionable.

12. Add an example to Prop. Reg. § 1.6048-6(a)(1) that reminds taxpayers that although reporting requirements are waived for the dual resident taxpayer, they are not waived for other taxpayers who have transactions with the same foreign trust.

Overview

Proposed Reg. § 1.6048-6(a)(1) provides unique relief to dual resident taxpayers that take a treaty position under Treas. Reg. § 301.7701(b)-1(a)(1) to be considered nonresident alien taxpayers for purposes of U.S. income taxation.[55] Taxpayers and fiduciaries may overlook that this relief does not extend to other parties associated with the trust that are still considered U.S. persons. As such, these U.S. persons could conflate the relief provided under the proposed regulation and inadvertently miss required information filings.

Recommendation

Proposed Reg. § 1.6048-6(a)(1) is helpful and welcome because it seeks to reduce unnecessary information reporting. To further this goal, Treasury and the IRS should add an example to the proposed regulations which reminds taxpayers that although reporting requirements are waived for the dual resident taxpayer, they are not waived for other taxpayers who have transactions with the same foreign trust.

[55] Proposed Reg. § 1.6048-6(a)(1).

Analysis

Proposed Reg. § 1.6048-6(a)(1) establishes that a dual resident taxpayer who takes a treaty position under Treas. Reg. § 301.7701(b)-1(a)(1) to be considered a nonresident alien for the applicable tax year and complies with all applicable requirements of Treas. Reg. § 301.7701(b)-1(b) and (c) will not be treated as a U.S. person for purposes of section 6048 with respect to the portion of the year the dual resident taxpayer is considered a nonresident alien.[56] However, taxpayers and fiduciaries may overlook that other parties who are considered U.S. persons and are associated with the foreign trust may still have a Form 3520 filing obligation.

Treasury and the IRS have shown an intent to reduce unnecessary information reporting.[57] This intention is welcome, but all interested parties would want to avoid confusion regarding the reporting requirements for related U.S. persons. An example within the proposed regulations that demonstrates a situation in which a dual resident is exempt from filing, but a related U.S. person is not exempt from filing would be sufficient to remind taxpayers of the relative reporting requirements. One such possibility for an example would provide that a dual resident taxpayer establishes/funds a foreign trust, and that trust makes a distribution to a U.S. person beneficiary in the same tax year.

13. Modify the regulations to exclude foreign trusts electing to be treated as an estate under section 645 from the filing requirements of section 6048.

Overview

Section 6048 falls within Subtitle F rather than Subtitle A. If the regulations are not clarified to specifically except section 645 electing foreign trusts from the filing requirements of section 6048, a U.S. beneficiary receiving a distribution from the foreign trust that is treated as an estate would be required to file Form 3520.

Recommendation

We recommend that the regulations exclude foreign trusts electing to be treated as an estate under section 645 from the filing requirements of section 6048.

Analysis

Section 645 was introduced to the tax law to allow qualified revocable trusts, including foreign qualified revocable trusts, to elect, in coordination with the executor of the deceased grantor's estate, to be treated as part of the estate rather than as a separate trust. However, the language of section 645 limits the scope of the election to Subtitle A dealing with income taxes. Section 6048 falls within Subtitle F and thus, absent clarification in the regulations specifically excepting section 645 electing foreign trusts from the filing requirements of section 6048, a U.S. beneficiary receiving a distribution from the foreign trust treated as an estate will be required to file Form 3520.

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[56] *Id.*
[57] 89 Federal Register 39451; 89 Federal Register 39455 (May 8, 2024).

Under the income tax rules of Subtitle A, the electing foreign trust will be subject to taxation as a part of the foreign estate. Section 6048 does not apply to foreign estates. Distributions to a U.S. beneficiary will only be subject to U.S. income tax if the distributions from the foreign estate include U.S.-source income.[58] This is because foreign-source income is only included in distributable net income of a foreign trust and not that of a foreign estate.[59] U.S.-source income paid to a section 645 electing foreign trust will be subject to U.S. withholding requirements.[60] As stated in the Preamble to the proposed regulations "the foreign trust and gift provisions in the 1996 Act were designed to accommodate changes in the use of foreign trusts and to limit avoidance and evasion of U.S. tax." Given the application of the income tax rules of Subtitle A to section 645 electing foreign trusts and minimal, if any, risk of avoidance or evasion of U.S. tax because of U.S. withholding requirements, we recommend the proposed regulations exercise the authority to suspend or modify the filing requirements under section 6048 because there is no significant tax interest in obtaining the required information.[61]

[58] Section 643(a).
[59] Section 643(a)(6).
[60] Sections 1441-1446.
[61] Section 6048(d)(4).