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July 8, 2024

Hon. Daniel I. Werfel
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Regulations under Sections 643(i), 679, 6039F, 6048, and 6677

Dear Commissioner Werfel:

Enclosed please find comments on regulations under sections 643(i), 679, 6039F, 6048 and 6677 regarding transactions with foreign trusts and information reporting on transactions with foreign trusts and large foreign gifts. These comments are submitted on behalf of the Section of Taxation and the Section on Real Property, Trust and Estate and have not been reviewed or approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation or Section of Real Property, Trust and Estate would be pleased to discuss these comments with you or your staff.

Sincerely,

Scott D. Michel
Chair, Section of Taxation

Robert S. Freedman
Chair, Section of Real Property, Trust and Estate

Enclosure

cc: Aviva Aron-Dine, Acting Assistant Secretary (Tax Policy), Department of the Treasury
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AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on Regulations under Sections 643(i), 679, 6039F, 6048, and 6677 Regarding Transactions with Foreign Trusts and Information Reporting on Transactions with Foreign Trusts and Large Foreign Gifts

These comments ("**Comments**") are submitted on behalf of the American Bar Association Section of Taxation (the "**Tax Section**") and Section of Real Property, Trust and Estate Law (the "**RPTE Section**" and "collectively, the "**Sections**") and have not been reviewed or approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Marianne Kayan of the RPTE Section and Parag P. Patel of the Tax Section. Substantial contributions were made by Max Biedermann, Brett Bissonnette, Garrett Brodeur, Naeemah Clark, Joseph M. Erwin, Heather Fincher, John M. Fusco, David Goldstein, Carol D. Hipwell, Nicholas Heuer, Eric Huang, Michael Karlin, Juliya Ismailov, Alex Lyden, Dianne Mehany, Kavit Nathwani, Priya Royal, Lawrence Sannicandro, Joseph Barry Schimmel, John Shoemaker, Chad M. Vanderhoef, Thomas G. Vurno, Utena Yang, and Zeinat Zughayer. The Comments have been reviewed by Carlyn McCaffrey of the Committee on Government Submissions ("**COGS**") for the RPTE Section and approved by the RPTE Section's Executive Committee. The Comments have also been reviewed by John Colvin and Michael Desmond of the Tax Section's COGS Committee, and Lisa Zarlenga, Vice-Chair for Government Relations for the Tax Section.

The Sections request to speak at the public hearing, and the outline of topics to be discussed is provided in the Executive Summary contained herein.

Although members of the Sections may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Sections' diverse membership includes government officials, no government official was involved in any part of the drafting or review of these Comments.

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Date: July 8, 2024

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EXECUTIVE SUMMARY

On May 8, 2024, the U.S. Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**Service**") published proposed regulations under sections[1] 643(i) (the "**Proposed Section 643(i) Regulations**"), 679 (the "**Proposed Section 679 Regulations**"), 6039F (the "**Proposed Section 6039F Regulations**"), 6048 (the "**Proposed Section 6048 Regulations**"), and 6677 (the "**Proposed Section 6677 Regulations**") (collectively, the "**Proposed Regulations**").[2] The Proposed Regulations pertain to the tax treatment of loans from, and the uses of property of, foreign trusts and also information reporting concerning loans, distributions, and other transactions with foreign trusts and the receipt of large foreign gifts. The Proposed Section 6048 Regulations are largely comprised of guidance previously issued under Notice 97-34[3] and Revenue Procedure 2020-17,[4] with some additions and updates to offer clarity and relief to taxpayers. Among others, the Proposed Regulations adopt and expand the exceptions for filing Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts* ("**Form 3520**") and Form 3520-A, *Annual Information Return of Foreign Trust With a U.S. Owner* ("**Form 3520-A**") for certain tax-favored foreign trusts that were previously provided in Revenue Procedure 2020-17.

The Sections commend Treasury and the Service for providing guidance and make the recommendations set forth below in these Comments.

Prop. Treas. Reg. §§ 1.643(i)-1, -2.

Section 643(i) concerns the tax treatment of loans from, and the uses of property of, foreign trusts. Section 643(i) was added to the Code by the Small Business Job Protection Act of 1996 ("**1996 Act**") [5] and amended in 2010 by the Hiring Incentives to Restore Employment Act (the "***HIRE* Act**").[6]

As amended, section 643(i) generally provides that a loan of cash or marketable securities from a foreign trust, directly or indirectly, to a U.S. grantor, a U.S. beneficiary, or a U.S. person related to either of them (or the use of foreign trust property by any such person) shall be treated as a distribution from the foreign trust to the U.S. grantor or U.S. beneficiary. The Secretary was expressly authorized to issue regulations providing exceptions to this general rule. Congress anticipated that such regulations would exclude

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[1] Unless indicated otherwise, all references to (i) "**section**" or "**subsection**" are to the Internal Revenue Code of 1986, as amended (the "**Code**"); (ii) "**Treas. Reg. §**" are to the Treasury Regulations promulgated thereunder currently in effect (the "**Treasury Regulations**"); and (iii) "**Prop. Treas. Reg. §**" are to the Proposed Regulations.

[2] 89 Fed. Reg. 30,440 (May 8, 2024).

[3] Notice 97-34, 1997-1 C.B. 422.

[4] Rev. Proc. 2020-17, 2020-12 I.R.B. 539.

[5] Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1906(c), 110 Stat. 1755, 1915.

[6] Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 533, 124 Stat. 71, 114 (2010).

loans with arm's length terms and for which there was a reasonable expectation of repayment.[7]

After section 643(i) was added to the Code, Treasury and the Service provided initial guidance regarding the new provision in Notice 97-34. Notice 97-34 does provide an exception to the general rule for loans, but only to the extent that a loan satisfies the conditions for “qualified obligations.”

The Proposed Section 643(i) Regulations, if adopted as final, would be the first regulations to address section 643(i) and the Congressional mandate concerning exceptions to the general rule providing for distribution treatment.

The Sections make the following recommendations regarding the Proposed Section 643(i) Regulations:

1. Modify the proposed definition of a “qualified obligation” to accomplish the legislative intent of providing exceptions for loans with arm’s length terms and for which there is a reasonable expectation of payment.

2. Eliminate the portions of Proposed Section 643(i) Regulations that treat obligations of grantor trusts settled by non-U.S. persons as distributions.

3. Enlarge the de minimis use exception to what constitutes a taxable trust distribution.

4. Withdraw the two-year anti-abuse rule because it is overly burdensome, and will retroactively deem bona fide loans to be distributions, despite the lack of any abuse.

Prop. Treas. Reg. § 1.6039F-1

Section 6039F(a) requires any U.S. person that receives a large gift, inheritance, bequest, or devise from a foreign individual, foreign estate, or other foreign person (such as a corporation or a partnership) to disclose the gifts to the Service. Section 6039F(c) imposes penalties for failure to disclose gifts and allows the Service to determine the tax consequences of the receipt of the gift, which may include recharacterizing the purported gift or bequest as income.

Section 6039F was enacted as a part of the 1996 Act. Congressional comments prior to the enactment of section 6039F reflected that requiring U.S. persons to disclose the receipt of large foreign gifts to the Service was intended “to allow the [Service] to verify that such purported gifts are not, in fact, disguised income to the U.S. recipients.”[8]

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[7] H.R. Rep. No. 104-737, at 334 (1996).

[8] 141 Cong. Rec. S13842 (daily ed. Sep. 19, 1995).

On June 2, 1997, Treasury and the Service issued Notice 97-34, which included guidance on the application of section 6039F. Under section VI.B.1 of Notice 97-34, a U.S. person is required to report gifts from a foreign individual or foreign estate only if the aggregate amount of all gifts from all foreign individuals or foreign estates exceeds $100,000 during the U.S. person's taxable year. Further, Notice 97-34 provided that "once the $100,000 threshold has been met, it is expected that Form 3520 will require the donee to separately identify each gift in excess of $5,000, but will not require the identification of the donor."[9]

The Proposed Section 6039F Regulations provide rules concerning information that must be reported under section 6039F with respect to U.S. persons receiving foreign gifts.

The Sections make the following recommendations regarding the Proposed Section 6039F Regulations:

1. Withdraw the "anti-avoidance rule" of Prop. Treas. Reg. § 1.6039F-1(b)(2) in its entirety and/or provide for delinquent return filing relief for taxpayers who are otherwise compliant.

2. Increase the reporting threshold under Prop. Treas. Reg. § 1.6039F-1(c)(2).

3. Provide an exception from the requirements under section 6039F for interspousal transfers.

4. Withdraw the requirement to disclose transferor information under Prop. Treas. Reg. § 1.6039F-1(e)(2).

5. Provide additional guidance and clarification with respect to what constitutes reasonable cause under Prop. Treas. Reg. § 1.6039F-1(e)(2).

6. Provide additional guidance regarding the application of the "dual resident taxpayer" rules under Prop. Treas. Reg. § 1.6039F-1(e)(2).

Prop. Treas. Reg. § 1.6677-1

Section 6677 imposes penalties on U.S. persons who fail to file a required information return under section 6048. Prop. Treas. Reg. § 1.6677-1(f) provides that the Service may treat married U.S. persons who file a joint income tax return under section 6013 as a single U.S. person for purposes of assessing penalties, on a joint and several basis, where such married U.S persons fail to file the information returns required under section 6048.

We respectfully request that Treasury and the Service withdraw Prop. Treas. Reg. § 1.6677-1(f), which imposes joint and several liability under section 6677 for married

[9] Notice 97-34, 1997-1 C.B. 422.

U.S. persons who file a joint income tax return but fail to file the information required under section 6048, because the liability for a penalty under section 6677 is not a joint and several liability.

Prop. Treas. Reg. § 1.6048-4

The Proposed Section 6048 Regulations provide rules concerning information that must be reported under section 6048 with respect to foreign trusts. Prop. Treas. Reg. § 1.6048-2 requires a responsible party to give notice of a reportable event occurring during the taxable year with respect to a foreign trust. Prop. Treas. Reg. § 1.6048-3 sets forth rules applicable to a U.S. owner of a foreign trust to ensure that the trust provides certain information about the trust's activities and operations for the year to the Service and to any U.S. person (within the meaning of section 7701(a)(30)) who is treated as an owner of the trust or who receives a distribution from the trust. Prop. Treas. Reg. § 1.6048-4 generally requires a U.S. person to report the receipt of a distribution from a foreign trust during the U.S. person's taxable year. Prop. Treas. Reg. § 1.6048-5 provides exceptions to the rules of Treas. Reg. §§ 1.6048-2 through 1.6048-4. Treas. Reg. § 1.6048-6 provides special rules, including rules concerning dual resident taxpayers (described in Treas. Reg. § 301.7701(b)-7(a)(1)) and dual status taxpayers (described in Treas. Reg. § 1.6012-1(b)(2)(ii)) who compute their U.S. income tax liability as nonresident aliens for part or all of the taxable year. Prop. Treas. Reg. § 1.6048-7 provides applicability dates.

The Sections make the following recommendations regarding the Proposed Section 6048 Regulations:

1. Confirm that the requirement under Prop. Treas. Reg. § 1.6048-4(b)(4) that an inbound migration of a foreign trust is treated as a distribution from the foreign trust to the domestic trust for information reporting purposes only and is not required to be included in the gross income of the domesticated trust.

2. Remove the Form 3520 filing obligation for U.S. owners of foreign trusts that file a Form 3520-A.

3. Harmonize the filing deadlines for Form 3520 and Form 3520-A.

4. Clarify the application of the Default Method (as defined below) under Prop. Treas. Reg. § 1.6048-4(d)(3).

Prop. Treas. Reg. § 1.6048-5

In Revenue Procedure 2020-17, the Service exempted certain tax-favored foreign trusts from the section 6048 reporting requirements that were not statutorily exempted under section 6048(a)(3)(B)(ii) (*e.g.*, transfers to foreign compensatory trusts, which include section 402(b) employee trusts). The Proposed Regulations expand this relief by applying the exemption to certain tax-favored foreign retirement trusts if the trust has a

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value of less than $600,000 (adjusted for inflation),[10] or if the trust limits contributions (including limited allowance for unemployed individuals) to: (i) a percentage of earned income of the participant;[11] (ii) $75,000 annually (adjusted for inflation);[12] or (iii) $1 million in a lifetime (adjusted for inflation).[13] Similarly, the exemption for tax-favored non-retirement trusts generally remains the same, except the Proposed Regulations adjust the contribution limitation for a tax-favored foreign non-retirement savings trust ($10,000 annually, $200,000 in a lifetime) for inflation.[14] Additionally, the Proposed Regulations exempt a third category of tax-favored foreign trusts, "tax-favored foreign de minimis savings trust," from the section 6048 reporting requirements.[15]

A tax-favored foreign de minimis savings trust is a foreign trust that is established under the laws of a foreign jurisdiction and is not a tax-favored foreign retirement or non-retirement savings trust.[16] The trust operates as a savings vehicle if it is generally exempt from income tax or is otherwise tax-favored in the trust's jurisdiction, provides annual information reporting to the relevant tax authorities in the trust's jurisdiction, and limits the aggregate value to no more than $50,000 (adjusted for inflation) at any point during the tax year.[17] Under the Proposed Regulations, a trust would not fail to be treated as a tax-favored foreign retirement or non-retirement savings trust solely because it received a rollover of funds from another tax-favored foreign retirement or non-retirement savings trust.[18]

The Sections make the following recommendations regarding the Proposed Section 6048 Regulations:

1. Revise the requirement for an "eligible individual" under Prop. Reg. § 1.6048-5(b)(1) to ensure filing compliance solely for the tax year in question.

2. Provide additional guidance and clarification on the treatment and available exemptions for U.K. Self-Invested Personal Pension ("**SIPP**") and Australian Superannuation plans under Prop. Reg. § 1.6048-5(b)(2).

3. Expand Prop. Treas. Reg. § 1.6048-5(b)(2)(iii) to allow limited contributions in excess of earned income regardless of whether a person is employed, self-employed, or unemployed.

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[10] Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(1).

[11] Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(2)(i).

[12] Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(2)(ii).

[13] Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(2)(iii).

[14] Prop. Treas. Reg. § 1.6048-5(b)(3)(iii).

[15] Prop. Treas. Reg. § 1.6048-5(b)(4).

[16] *Id*.

[17] Prop. Treas. Reg. § 1.6048-5(b)(4)(i)-(iii).

[18] Prop. Treas. Reg. § 1.6048-5(b)(5).

4. With respect to Prop. Treas. Reg. § 1.6048-5(b)(2)(iv), we recommend:

a. A "per pension" exception, even where the aggregate threshold of $600,000 (as adjusted) is exceeded and clarify that the trusts in the jurisdiction to aggregate are only these tax-favored foreign retirement trusts;

b. A higher limit overall;

c. Further clarity on the wording of the value threshold in Prop. Treas. Reg. § 1.6048-5(b)(2)(iv) to link it to the value of the individual's balances;

d. Removal of U.S. dollar-based limitations and expansion of the contribution limitations within Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(2) as we are unaware of actual contribution limits in these foreign plans, which will allow a wider range of foreign pension plans to qualify;

e. Addition of an exemption for benefit plans established in countries that have a comprehensive income tax treaty with the United States; and

f. Removal or modification of the reference to the July 1 exchange rate. As the aggregate value test is applied over the entire year but the exchange rate is at a fixed point in time, it would be preferable to allow the exchange rate on the date of the highest balance to be used, if lower, and otherwise the end of year rate would be used.

5. Clarify the criteria outlined under Prop. Treas. Reg. § 1.6048-5(b)(2)(vi)(A) to (C), ensuring their application does not unjustly disadvantage foreign plans predominantly comprised of nonresident alien participants. Alternatively, remove these additional criteria, as they seem unnecessary with Prop. Treas. Reg. § 1.6048-5(b)(2)(v).

6. With respect to Prop. Treas. Reg. § 1.1068-5(b)(3), we recommend:

a. Provide additional guidance and clarification on which tax-favored non-retirement arrangements are considered "trusts."

b. Provide specific reporting exceptions under Prop. Treas. Reg. § 1.6048-5(b) for Canadian Tax-Free Savings Accounts ("**TFSA**").

c. Increase the contribution limitation for a tax-favored foreign non-retirement savings trust under Prop. Treas. Reg § 1.6048-5(b)(3) and establish a minimum reporting threshold of $200,000-$600,000 for contributions.

7. Increase the dollar limitation for a "tax-favored foreign de minimis savings trust" under Prop. Treas. Reg. § 1.6048-5(b)(4).

8. Revise Prop. Treas. Reg. § 1.6048-5(e) regarding definitional terms exempting certain mirror code possession trusts.

Generally Applicable Provisions

The Proposed Regulations would apply the section 2203 definition of "executor" for purposes of sections 6039F and 6048, as well as require the executor of a deceased U.S. person's estate to file a Form 3520 and report foreign gifts on behalf of the decedent.

Section 2006(b) of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (the "**Surface Transportation Act**") requires Treasury to modify the appropriate regulations to provide that Form 3520 shall have a maximum extension of the six-month period ending October 15.[19] While most individual income tax returns will also have an extended due date ending October 15, there are situations in which taxpayers may obtain valid extensions beyond October 15.

The Sections make the following recommendations regarding this set of Proposed Regulations:

1. In defining "executor" under the Proposed Regulations, withdraw all references to section 2203.

2. Provide additional guidance that if a taxpayer has a Form 1040 filing date beyond October 15 due to a valid extension, a filing of Form 3520 and 3520-A (under the supplemental procedure) by the Form 1040 filing date, even if beyond October 15, will not be treated as a late filing for purposes of imposing failure to file penalties.

3. Include language in the court and control test regulation or the trust regulation (Treas. Reg. §§ 301.7701-7 and -4, respectively) setting out how and under what circumstances foreign, civil law juridical persons can be equated to the common law trust.

4. Define the grantor of a trust as the person whose economic contributions funded the trust (or, stated differently, the person who furnishes "the major portion of consideration for the trust's creation."). Alternatively, the parenthetical contained in the third sentence of Treas. Reg. § 1.671-2(e)(1) should be amended to include a cross-reference to 31 C.F.R. § 1010.350.

DISCUSSION

I. Proposed Treas. Reg. § 1.643(i)-1, -2

A. Modify Definition of Qualified Obligation

1. Background

Section 643(i) generally provides that a loan of cash or marketable securities from a foreign trust directly or indirectly to a U.S. grantor, a U.S. beneficiary, or a U.S. person

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[19] Pub. L. No. 114-41, § 2006(b)(10), 129 Stat. 443, 458 (2015).

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related to either of them or the use of foreign trust property by such persons is treated as a distribution from the foreign trust to the U.S. grantor or U.S. beneficiary "for purposes of subparts B, C, and D" of Subchapter J of the Code. Section 643(i)(2)(E) excepts from section 643(i) distribution treatment the use of trust property (other than a loan of cash or marketable securities) to the extent the trust receives fair market value for such use within a reasonable period of time.

There are no statutory exceptions to section 643(i)'s distribution treatment for loans. However, in 1997, the Service issued Notice 97-34 indicating that loans that met the requirements to be treated as "qualified obligations" would be excepted from distribution treatment.[20] In Notice 97-34, the Service defined a "qualified obligation" as a loan that is (i) in writing, (ii) for a term of no more than five years, (iii) with payments denominated in U.S. dollars, (iv) with certain interest and yield to maturity requirements, but (v) only if the U.S. person reports the loan on Form 3520 every year it is outstanding and extends the period for assessment of income tax.

a. Definition of a Qualified Obligation

Prop. Treas. Reg. § 1.643(i)-2(b)[21] would adopt the existing provisions of the qualified obligation standard provided in Notice 97-34 and add new requirements, including requirements to (i) make payments of principal and interest in cash (not in-kind property) and on a timely basis according to the terms of the obligation, which now cannot provide a grace period of more than 30 days for late payments; (ii) issue the obligation at par; and (iii) provide for stated interest at a fixed rate or qualified floating rate within the meaning of Treas. Reg. § 1.1275-5(b), together with a requirement that all stated intertest must be "qualified stated interest" within the meaning of Treas. Reg. § 1.1273-1(c).

b. Indirect Loans or Uncompensated Use of Trust Property

Prop. Treas. Reg. § 1.643(i)-1(b) states that an indirect loan from a foreign trust to a U.S. grantor or beneficiary, or to a U.S. person related to a U.S. grantor or beneficiary, will result in a deemed distribution from the foreign non-grantor trust. A similar rule would apply to the indirect use of foreign trust property by such a person, also resulting in a deemed distribution.[22]

Prop. Treas. Reg. § 1.643(i)-1(b)(2) includes as examples of indirect loans (i) a loan by a person related to a foreign trust that is made to a U.S. grantor or beneficiary of the trust or a person related to either, and (ii) a loan made by a foreign trust to a foreign person other than a foreign grantor or beneficiary that is made to a U.S. grantor or beneficiary or a person related to either. A loan by a foreign parent to their U.S. wholly

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[20] *See* Notice 97-34, 1997-1 C.B. 422.

[21] Separately, Prop. Treas. Reg. § 1.679-4(d) would introduce a definition of "qualified obligation" with respect to grantor trusts under section 679 that generally mirrors the definition proposed under section 643(i). Although similar considerations are involved, the focus here is on section 643(i).

[22] *See* Prop. Treas. Reg. § 1.643(i)-1(c).

owned U.S. corporation would fit within the first example if the parent had created a foreign trust for his U.S. child. Similarly, Prop. Treas. Reg. § 1.643(i)-1(c)(2) illustrates the "indirect use" of trust property as the use by a foreign person, other than a nonresident alien individual beneficiary of the trust, of trust property if the foreign person is related to a U.S. grantor or beneficiary.

However, such use by a foreign person will not be treated as a section 643(i) distribution if the U.S. grantor or beneficiary satisfies information reporting requirements with respect to the use and includes an explanatory statement on a Federal income tax return demonstrating, to the satisfaction of the Service, that the use of trust property would have been allowed without regard to the fact that the U.S. grantor or beneficiary is a grantor or beneficiary of the foreign trust.[23]

c. Allocation of Section 643(i) Distributions Among Multiple U.S. Grantors and Beneficiaries

Prop. Treas. Reg. § 1.643(i)-3(b) provides that if a loan is made from a foreign trust to a person related to multiple U.S. grantors and beneficiaries, each U.S. grantor and each U.S. beneficiary who must or may receive current distributions from the trust will be treated as having received an equal share of the distribution.

d. Safe Harbors Related to Short-term Loans and Qualified Stated Interest

Under the existing and proposed definitions of "qualified obligation," an obligation's yield to maturity must not be less than 100% of the applicable Federal rate ("**AFR**") and not greater than 130% of the AFR, where the AFR for an obligation is the AFR in effect under section 1274(d) for the day on which the obligation is issued.[24] Furthermore, the term of the obligation has a maximum limit—not to exceed five years—but does not have a minimum length.[25] Therefore, it appears that section 643(i) may apply to situations where funds are returned within hours or days of the initial advance.

2. Recommendation(s)

We recommend that the final regulations relax the loan requirements, including, for example, by utilizing a "bona fide debt" standard with respect to qualified obligations. Taxpayers have relied on the bona fide debt standard in other contexts, including for determining whether an intra-family cash advance should be respected as a loan or treated as a gift, for decades. Foreign trust loans often also occur in the context family wealth and succession planning.

Our recommendations with respect to indirect loans and the allocation of a section 643(i) distribution among multiple beneficiaries are discussed below. Principally, we

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[23] *See* Prop. Treas. Reg. § 1.643(i)-1(c)(2)(ii).

[24] *See* Notice 97-34, 1997-1 C.B. 422; Prop. Treas. Reg. § 1.643(i)-2(b)(2)(iii)(A)(5).

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

recommend that the final regulations include relief provisions, particularly where: (i) the U.S. grantor or beneficiary did not know or have reason to know of the loan or property use; or (ii) the loan was commercially reasonable.

3. Explanation(s)

a. Definition of Qualified Obligation

The use of qualified obligation as defined in the Proposed Regulations as a requirement of escaping section 643(i) distribution treatment seems inconsistent with Congressional intent. The legislative history of the 1996 Act indicates that Congress intended Treasury and the Service to provide a regulatory exception to Code section 643(i) for loans with arm's-length terms that, when applied, embody a reasonable expectation that the grantor, beneficiary, or related person would repay the loan.[26] The House Conference Report states:

> It is expected that Treasury regulations will provide an exception from this treatment for loans with arm's-length terms. In applying this exception, it is further expected that consideration be given to whether there is a reasonable expectation that a loan will be repaid.[27]

Although Treasury and the Service referenced this legislative history in Notice 97-34[28] when introducing the exception for qualified obligations, they did not explain how the exception for qualified obligations was consistent with Congressional intent.

The proposed qualified obligation rules adopt those first described in Notice 97-34. These qualified obligation rules apply a set of requirements that is narrower than is necessary to ensure a beneficiary loan is at "arm's-length" with a reasonable expectation of repayment, making it unduly burdensome for a taxpayer to receive a loan from a foreign trust. Commercially reasonable loans that are expected to be repaid, and that would be respected as debt in other contexts (*e.g.*, "bona fide debt"), often do not have all of the features the Proposed Regulations require for treatment as "qualified obligations."

Further, there are myriad potentially valid reasons why beneficiary loans may not contain all of the features required for "qualified obligation" treatment. For example, as a threshold matter, an otherwise commercially reasonable foreign loan might fail to be a qualified obligation because it is not denominated in U.S. dollars. It is particularly unlikely that a commercially reasonable loan by a foreign trust to a foreign person would be denominated in dollars. Further, the five-year repayment term is unduly burdensome and arbitrarily short. The purpose behind section 643(i) is to prohibit abuse, *i.e.*, allowing persons access to funds in foreign trusts through distributions disguised as loans. But there is nothing inherently abusive with respect to a loan with a term of more

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[26] *See* Preamble to Proposed Regulations, 89 Fed. Reg. 39,440, 39,441 (May 8, 2024) (citing H.R. Rep. No. 104-737, at 334 (1996) (Conf. Rep.)).

[27] H.R. Rep. No. 104-737, at 334 (1996) (Conf. Rep.).

[28] 1997-1 C.B. 422.

than five years. The five-year repayment requirement would, for example, prevent foreign trust beneficiaries from receiving loan terms equivalent to certain industry-standard third-party loans (*e.g.*, 15- and 30-year mortgages). While courts have considered many factors in determining whether to respect a loan for tax purposes, we are not aware of any cases where a court adopted the Proposed Regulations' restrictive approach and refused to respect a loan based solely on the loan's denomination in U.S. dollars or for a repayment term exceeding five years. We do not see how such stringent limitations are necessary to prevent abuse. The legislative history is clear that the standard for a "qualified obligation" should be whether the terms are similar to those that unrelated parties would enter into and there is a reasonable expectation of repayment.

Therefore, we recommend that the final regulations utilize the "bona fide debt" standard with respect to loans from a foreign trust. If Treasury and the Service intend to retain the qualified obligation standard, the requirement that the loan be denominated in dollars and lengthen the five-year period should be eliminated. The rule and the related example under which a second or subsequent loan is deemed to extend the term of a loan that otherwise meet the qualified obligation requirements should also be removed.[29]

In addition, because it is likely that a trust grantor or beneficiary will have no knowledge of a loan by his, her, or their trust to a related party, we suggest that the obligation to report the loan on Form 3520 be suspended until such time as the grantor or beneficiary has actual knowledge of the loan.

b. Indirect Loans and Uncompensated Use of Trust Property

We believe that it is problematic for indirect loans to, or uncompensated use of trust property, by a foreign relative of a U.S. grantor or U.S. beneficiary or a loan by a person related to a foreign trust to be treated as potentially taxable section 643(i) distributions to a U.S. grantor or beneficiary. Accordingly, we recommend that the final regulations include relief provisions, particularly where: (i) the U.S. grantor or beneficiary did not know or have reason to know of the loan or property use; or (ii) the loan was commercially reasonable.

We do not believe that the exception in Prop. Treas. Reg § 1.643(i)-1(c)(2) should depend on a taxpayer's affirmative provision of a statement demonstrating "to the satisfaction of the Commissioner" that use by a foreign relative would have been allowed without regard to the fact that the U.S. grantor or beneficiary is a grantor or beneficiary of the foreign trust. The requirement seems to invite an extensive narrative that would require significant compliance costs and equally significant resources for the Service to review. Further, the Proposed Section 643(i) Regulations do not provide sufficient guidance regarding which criteria might be relevant to securing the Commissioner's satisfaction, eschewing clarity, and potentially leading to inconsistent administration of the law due to a lack of a consistent standard. Finally, we believe that the Service's examination procedures, already in use for similar disputed matters, provide an

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[29] Prop. Treas. Reg. § 1.679-4(d)(6)(vii).

appropriate path for the Service to propose adjustments to the taxpayer's income tax return.

c. Allocation of Section 643(i) Distributions

Under Prop. Treas. Reg § 1.643(i)-3(b), an equal allocation of a section 643(i) distribution among all U.S. grantors and beneficiaries who are related to a person who received a loan from a foreign trust will often lead to inappropriate results. For example, it would be inappropriate to allocate a distribution equally among all the U.S. beneficiaries of a trust when the distribution was caused by a loan to the spouse of one of them. We suggest that an allocation rule be designed that will allocate the distribution to the grantor or beneficiary most closely related to the person to whom the loan was made.

d. Include Exceptions for Short-Term Loans and Qualified Stated Interest

Under Prop. Treas. Reg. § 1.643(i)-2(a)(1), qualified obligations are excluded from distribution treatment. But there is no exclusion for short-term loans that do not meet the yield-to-maturity requirement under section 1274(d) but otherwise satisfy the requirements of a qualified obligation. This is problematic, because the yield-to-maturity requirements under section 1274(d) do not apply to loans with a term of less than six months.[30]

We request clarification as to whether section 643(i) should apply to loans with a term of six months or less. We recommend including within the definition of qualified obligation any loan with a term less than six months. However, if Treasury and the Service determine that section 643(i) should apply to any short-term loan, it should use a different rate than the short-term AFR for any loan with a term up to six months.

Along similar lines, Prop. Treas. Reg. § 1.643(i)-2(b)(iii)(A)(6) references qualified stated interest within the meaning of Treas. Reg. § 1.1273-1(c), but does not indicate whether the de minimis rules under Treas. Reg. § 1.1273-1(d) should apply. We request clarification as to whether these de minimis rules should apply.

B. The Proposed Section 643(i) Regulations Should Not Apply to Grantor Trusts Settled by Non-U.S. Persons

1. Background

Prop. Treas. Reg. § 1.643(i)-2(d) would treat as a reportable distribution "a loan of cash or marketable securities from, or the use of any property of, a foreign grantor or non-grantor trust to or by a U.S. person . . . irrespective of whether the loan or use of trust property is a section 643(i) distribution." Further, Prop. Treas. Reg. § 1.643(i)2(e), Ex. 5,

[30] *See* I.R.C. § 1274(c)(1)(B).

indicates that a taxpayer must report use of foreign grantor trust property even where the grantor is a nonresident alien for federal income tax purposes.

2. Recommendation(s)

We recommend that Treasury the Service eliminate the references in the Proposed Section 643(i) Regulations to obligations falling on U.S. beneficiaries of grantor trusts settled by non-U.S. persons with current foreign grantor trust classification.

3. Explanation(s)

Section 643(i) explicitly applies only to "Subparts B, C, and D [of Subchapter J of the Code]", but not to Subpart E (*i.e.*, the grantor trust provisions). However, the Form 3520 Instructions have treated certain loans from, and use of property owned by, a foreign grantor trust as reportable distributions. Accordingly, there has been considerable uncertainty regarding whether section 643(i) applies to foreign grantor trusts. Given the clear statutory language of section 643(i), which applies only to loans to or use of property by U.S. persons, we believe it is beyond the scope of the statute to utilize regulatory authority under section 643(i) to create any filing requirements for loans from, or use of property owned by, a foreign grantor trust where the grantor is a nonresident alien.

Further, imposing a Form 3520, Part III, filing requirement with respect to loans from or use of property owned by a foreign grantor trust does not square with Congress' intent that section 643(i) exists to ensure proper taxation of disguised foreign trust distributions. Reporting such loans or property use on Form 3520, Part III does not assist the Service in collecting revenue because the "distribution" is tax-free. Instead, by requiring Form 3520, Part III reporting in this context, the Proposed Regulations simply create unwarranted penalty risk for taxpayers. We further suggest that Prop. Treas. Reg. § 1.6048-4(a), (b)(5)-(6) reflect the same exceptions.

C. The Proposed Section 643(i) Regulations Should Contain a Broader De Minimis Safe Harbor

1. Background

Prop. Treas. Reg. § 1.643(i)-2(a) introduces a de minimis safe harbor. Prop. Treas. Reg. § 1.643(i)-2(a)(3) provides that usage of trust property will not be treated as a section 643(i) distribution if the use is de minimis. The Proposed Section 643(i) Regulations would consider use of trust property "de minimis" if "aggregate use by members of the group consisting of the U.S. grantors, U.S. beneficiaries, and the U.S. persons related to any U.S. grantor or beneficiary does not exceed 14 days during the calendar year."[31]

[31] Prop. Treas. Reg. § 1.643(i)-2(a)(3).

2. Recommendation(s)

We recommend that the de minimis safe harbor should be expanded to allow greater flexibility.

3. Explanation(s)

The proposed de minimis exception would allow for up to 14 days of use of foreign-trust property without that use being viewed as a potentially taxable trust distribution.[32] However, in practice, this might not be a meaningful, or even a reasonably material, safe harbor. For example, if a family of four (including a U.S. beneficiary of a foreign non-grantor trust, U.S. spouse, and two U.S. children) enjoys rent-free use of a vacation home owned by the trust for four days, it appears the Proposed Section 643(i) Regulations would treat that use as 16 days in the aggregate.

We suggest expanding the de minimis use exception to ease tax administration and provide a reasonably meaningful exception. Use of the same property on the same day by multiple beneficiaries should only be counted as one day. An additional exemption for days used by spouses and minor children should also be included.

D. The Proposed Section 643(i) Regulations Impose an Unnecessary Two-Year Anti-Abuse Rule

1. Background

Prop. Treas. Reg. § 1.643(i)-1(b)(3) proposes a new "anti-abuse" rule under which a nonresident alien who is a grantor or beneficiary of a foreign trust would be subject to section 643(i) distribution treatment if the nonresident alien receives a loan from that trust and then becomes a U.S. citizen or federal income tax resident within two years. The Proposed Section 643(i) Regulations treat the outstanding amount of such a loan as a distribution from the foreign trust to the individual on the date the nonresident alien establishes federal income tax residency or becomes a U.S. citizen, unless the loan was structured as a "qualified obligation as of the date it was made."[33]

2. Recommendation(s)

We recommend that the Proposed Section 643(i) Regulations omit the proposed two-year anti-abuse rule. Alternatively, as noted above, we recommend that the final regulations under section 643(i) adopt "bona fide indebtedness," rather than "qualified obligation," as the relevant standard. If the anti-abuse rule is retained, we recommend that the final regulations provide specific relief provisions allowing for the modification of a foreign trust loan when it becomes apparent that the recipient intends to become a U.S. citizen or federal income tax resident.

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[32] Prop. Treas. Reg. § 1.643(i)-2(a)(3).

[33] Preamble to Proposed Regulations, 89 Fed. Reg. at 39,445.

3. Explanation(s)

If finalized, the two-year anti-abuse rule would treat a loan received by a nonresident alien from a foreign trust within two years of establishing federal income tax residency (or acquiring U.S. citizenship) differently from a "pure" distribution received during that same time frame. Unless such a loan meets the exacting "qualified obligation" criteria as of the date it is made, which can be problematic for foreign taxpayers from a practical perspective, the Proposed Regulations would treat the loan as a distribution from the foreign trust on the date the individual becomes a U.S. person. As a result, the individual may be retroactively subject to federal income tax and information reporting obligations with respect to the loan that might not have otherwise existed, even where the loan meets the long-established criteria of "bona fide indebtedness" or is otherwise commercially reasonable.

Further, the Proposed Regulations' requirement that a foreign trust loan meet the qualified obligation criteria "as of the date it is made," without further providing relief to modify such loans, is problematic in scenarios where a nonresident alien receives a loan from a foreign trust, but does not form the intent to become a federal income tax resident or U.S. citizen until after disbursement (*e.g.*, unanticipated U.S. employment assignments/transfers, inadvertently establishing federal tax residency). Such persons may not have access to—nor believe they have any reason to consult with—U.S. tax advisors.

On the other hand, the Code and Treasury Regulations do not treat an actual distribution received by a nonresident alien within two years of becoming a U.S. person as a loan to a U.S. person. We do not see a reason to draw a distinction between a pre-residence outright distribution and a loan. Moreover, we also do not see any statutory basis for such a rule.

II. Prop. Treas. Reg. § 1.6039F-1

A. General Background

Section 6039F(a) requires any U.S. person that receives a large gift, inheritance, bequest, or devise from a foreign individual, foreign estate, or other foreign person (such as a corporation or a partnership) to disclose the gifts to the Service. Section 6039F(c) imposes penalties for failure to disclose gifts and allows the Service to determine the tax consequences of the receipt of the gift, which may include recharacterizing the purported gift or bequest as income.

The Proposed Section 6039F Regulations provide rules concerning information that must be reported under section 6039F with respect to U.S. persons receiving foreign gifts. The Proposed Section 6039F Regulations incorporate the following rules from Notice 97-34:

1. Prop. Treas. Reg. § 1.6039F-1(a) requires any U.S. person, or the executor of a U.S. person's estate, who treats an amount received from a foreign person as a foreign gift during a taxable year, to report that amount on Form 3520.

2. Prop. Treas. Reg. § 1.6039F-1(b) defines "foreign gift" for purposes of section 6039F and provides an "anti-avoidance rule" that permits the Service to recharacterize, based on all facts and circumstances, a transfer to a recipient who does not treat such transfer as a gift, bequest, devise, or inheritance for federal income tax purposes as a gift.

3. Prop. Treas. Reg. § 1.6039F-1(c) provides exceptions to the general reporting rules proposed in Prop. Treas. Reg. § 1.6039F-1(a).[34]

4. Prop. Treas. Reg. § 1.6039F-1(d) provides rules regarding the valuation of foreign gifts for purposes of section 6039F.

5. Prop. Treas. Reg. § 1.6039F-1(e)(1) provides penalties for failure to furnish the information required therein and includes a reasonable cause exception.

6. Prop. Treas. Reg. § 1.6039F-1(f) provides special rules, including rules concerning dual resident taxpayers (described in Treas. Reg. § 301.7701(b)-7(a)(1)) and dual status taxpayers (described in Treas. Reg. § 1.6012-1(b)(2)(ii)) who compute their U.S. income tax liability as nonresident aliens for part or all of the taxable year.

7. Prop. Treas. Reg. § 1.6039F-1(g) provides examples illustrating the application of the Proposed Section 6039F Regulations.

8. Prop. Treas. Reg. § 1.6039F-1(h) provides applicability dates.

B. The Anti-Avoidance Rule Should Be Withdrawn

1. Background

Section 6039F was enacted by Congress to allow the Service to identify taxpayers disguising taxable income as purported nontaxable gifts in an attempt to avoid federal income taxation. The stated purpose of the anti-avoidance rule of Prop. Treas. Reg. § 1.6039F-1(b)(2) is to recharacterize purported loans that "objectively have all the indicia of being a gift . . . as foreign gifts that should have been reported under section 6039F."[35]

2. Recommendation(s)

We recommend that the Proposed Regulations, when finalized, omit the anti-avoidance rule of Prop. Treas. Reg. § 1.6039F-1(b)(2) in its entirety.

We further recommend that the Proposed Regulations, when finalized, provide penalty relief and/or delinquent Form 3520 filing procedures for taxpayers who are otherwise compliant.

[34] Prop. Treas. Reg. § 1.6039F-1(c)(2)(v) adjusts the $100,000 reporting threshold annually for inflation.

[35] Preamble to Proposed Regulations, 89 Fed. Reg. at 39,450.

3. Explanation(s)

The "anti-avoidance rule" of Prop. Treas. Reg. § 1.6039F-1(b)(2) is inconsistent with Congressional intent behind section 6039F: to allow the Service to identify taxable income disguised as purported gifts and recharacterize such gifts as taxable income received by the taxpayer. It is not to identify loans that are disguised as gifts. The Congressional intent behind the enactment of section 6039F was not to collect information regarding bona fide gifts received by U.S. persons from foreign individuals, foreign estates, other foreign persons. If the amounts in question "objectively have all the indicia of being a gift,"[36] then the recharacterization of purported loans as foreign gifts subject to reporting under section 6039F only serves to penalize taxpayers that have failed to report bona fide gifts rather than properly penalizing taxpayers attempting to disguise taxable income as purported gifts.

Instead of, or in addition to, finalizing the anti-avoidance rule of Prop. Treas. Reg. § 1.6039F-1(b)(2), we recommend that the Service consider the provision of penalty relief—*e.g.*, the First Time Abate penalty relief[37] or a variation of the streamlined filing compliance procedures[38]—for taxpayers who have otherwise fully disclosed their taxable income but have simply failed to disclose one or more bona fide foreign gifts on a non-willful basis (such as through a genuine mistake or ignorance of the law) that may not otherwise qualify for relief under the reasonable cause exception under Prop. Treas. Reg. § 1.6039F-1(e)(2). The provision of penalty relief or streamlined filing compliance procedures would foster greater voluntary delinquent disclosure of bona fide gifts, and would reduce the compliance and penalty burden placed upon taxpayers that have acted in good faith to disclose all taxable income but simply failed to disclose a nontaxable transfer, whether in the form of a bona fide gift or loan. Again, Congress has tasked the Service, through the enactment of section 6039F, to identify those taxpayers who sought to disguise taxable income as nontaxable gifts, not to penalize taxpayers that have failed to disclose a bona fide foreign gift on a non-willful basis.

Alternatively, if the anti-avoidance rule of Prop. Treas. Reg. § 1.6039F-1(b)(2) is finalized, we recommend that Treasury and the Service consider providing a substantive example of an application of the rule which provides guidance on the "facts and circumstances" referenced in Prop. Treas. Reg. § 1.6039F-1(b)(2)(i).

C. Increase Reporting Thresholds

1. Background

Currently, section VI.B.1 of Notice 97-34 requires a U.S. person to report gifts from a foreign individual or foreign estate only if the aggregate amount of gifts from that

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[36] *Id*.

[37] *See* I.R.M. 20.1.1.3.3.2.1 (03-29-2023).

[38] *See* Streamlined Filing Compliance Procedures, *available at* https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures (last visited June 16, 2024).

foreign individual or foreign estate exceeds $100,000 during the U.S. person's taxable year. Once the $100,000 threshold has been met, the U.S. person must identify each foreign gift in excess of $5,000, but is not required to identify the transferor.[39] Prop. Treas. Reg. § 1.6039F-1(c)(2)(i)(A) incorporates the $100,000 reporting threshold amount, and Prop. Treas. Reg. § 1.6039F-1(c)(2)(v) provides for an annual cost-of-living adjustment to this threshold amount. Prop. Treas. Reg. § 1.6039F-1(c)(2)(i)(B) incorporates the $5,000 threshold amount for separately identifying each gift, but the Proposed Section 6039F Regulations do not provide for a cost-of-living adjustment to this amount.

2. Recommendation(s)

We recommend that the Proposed Regulations, when finalized, increase the reporting threshold amount under Prop. Treas. Reg. § 1.6039F-1(c)(2)(i)(A) to $500,000, subject to yearly cost-of-living adjustments. We also recommend that the Proposed Regulations, when finalized, provide for an annual cost-of-living adjustment to the $5,000 threshold amount for separately identifying each gift under Prop. Treas. Reg. § 1.6039F-1(c)(2)(i)(B).

3. Explanation(s)

Given the reduction in the value of a dollar in the 27 years since the issuance of Notice 97-34, amounts transferred by gift or bequest to U.S. persons have increased. Although the annual gift exclusion and lifetime gift exemption have been adjusted for inflation since 1997, the threshold amount for reporting the receipt of large foreign gifts has not kept pace. As section 6039F's stated intent is to capture taxable income transfers disguised as gifts, maintaining such a low reporting threshold on actual gifts creates an unnecessary burden to those who receive bona fide gifts or bequests. Therefore, an increase to the reporting threshold that aligns with increases in the prevailing cost of living would be appropriate and bring the section 6039F reporting requirements into harmony with other aspects of gift reporting.

D. Exception for Interspousal Transfers

1. Recommendation(s)

We recommend that the Proposed Regulations, when finalized, provide an exception from the requirements under section 6039F for transfers from a foreign spouse to a U.S. person spouse.

2. Explanation(s)

An exception for interspousal transfers will greatly ease tax administration, especially for the high number of U.S. citizens married to non-U.S. persons, thus allowing the taxpayers to remain tax compliant. An exception for interspousal transfers

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[39] Notice 97-34, 1997-1 C.B. 422.

also eliminates unusual and complex questions as to what constitutes a gift, loan, or other transfer between spouses. Taxpayers and their advisors around the world would welcome this essential and simple change.

E. Requirement to Disclose Transferor Information Should Be Withdrawn

1. Background

Currently, specific identifying information about the transferor is not required to be provided on Form 3520. Prop. Treas. Reg. § 1.6039F-1(c)(2)(B) requires the U.S. person to provide identifying information about the transferor for each foreign gift in excess of $5,000.

2. Recommendation(s)

We recommend that the Proposed Regulations, when finalized, omit the requirement to provide identifying information about the transferor for each foreign gift in excess of $5,000.

Alternatively, we recommend that the Proposed Regulations, when finalized, provide guidance on the identifying information required, and provide that the failure or inability provide identifying information will not trigger penalties.

3. Explanation(s)

Requiring the disclosure of transferor information is burdensome, especially in light of the heavy penalties imposed under Prop. Treas. Reg. § 1.6039F-1(e) on any failure to furnish the information required by Prop. Treas. Reg. § 1.6039F-1(a). We also do not see the purpose, in terms of tax administration, for the Service to collect identifying information about non-U.S. persons who make gifts to U.S. persons. Transferor information may be provided by the taxpayer in the event that the Service believes a purported gift was taxable income and an audit has been initiated. Requiring the disclosure of transferor information may also have a chilling effect, given concerns by non-U.S. persons about the privacy of their identifying information, and may therefore reduce the incidence and amount of lawful gifts to U.S. persons who may rely on such remittances for support.

F. Additional Guidance on Reasonable Cause Standard

1. Recommendation(s)

We recommend that the Proposed Regulations, when finalized, provide further guidance and clarification regarding the standard for demonstrating reasonable cause under Prop. Treas. Reg. § 1.6039F-1(e)(2).

2. Explanation(s)

The reasonable cause exception in Prop. Treas. Reg. § 1.6039F-1(e)(2) cross references Treas. Reg. § 1.6664-4 and Treas. Reg. § 301.6651-1(c). However, these two regulations are not entirely consistent. Treas. Reg. § 301.6651-1(c) requires a showing of "ordinary business care and prudence,"[40] whereas Treas. Reg. § 1.6664-4 only requires that the taxpayer act with "reasonable cause and in good faith"[41].

G. Additional Guidance on Application of Dual Resident Taxpayer Rules

1. Background

Under Prop. Treas. Reg. § 1.6039F-1(f), neither a "dual resident taxpayer" nor a "dual status taxpayer" is treated as a U.S. person for purposes of Prop. Treas. Reg. § 1.6039F-1 during a taxable year, or any portion of a taxable year, that the taxpayer is treated as a nonresident alien for purposes of computing U.S. tax liability. "These rules are relevant both for purposes of determining whether a dual resident taxpayer or dual status taxpayer who receives a foreign gift is a U.S. person required to report the foreign gift on Form 3520 and for purposes of determining whether a gift or bequest from a dual resident taxpayer or dual status taxpayer is a gift from a foreign person."[42]

2. Recommendation(s)

We recommend that the Proposed Regulations, when finalized, provide further guidance and clarification regarding the application of Prop. Treas. Reg. § 1.6039F-1(f) in the event a U.S. person donee has limited or inadequate information about the status of a donor.

3. Explanation(s)

Prop. Treas. Reg. § 1.6039F-1(f) would obligate the U.S. person donee to know that the donor took a treaty position to be treated as a resident of an income tax treaty partner under Treas. Reg. § 301.7701(b)-7 at the time of the gift or bequest. Since the donee would be required to have personal knowledge of the donor's tax position and filing. In addition, the timing of the donor's income tax treaty position and the donee's reporting are not linked. Thus, further guidance should be provided as to what information the U.S. donee may rely on regarding donor's foreign status, or the Service should recognize reasonable cause, when a donee fails to furnish the required information due to lack of information regarding whether the donor is in fact foreign.

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[40] Treas. Reg. § 301.6651-1(c).

[41] Treas. Reg. § 1.6664-4(b).

[42] Preamble to Proposed Regulations, 89 Fed. Reg. at 39,451.

III. Prop. Treas. Reg. § 1.6677-1

A. Background

Prop. Treas. Reg. § 1.6677-1(f)(2) would provide a general rule that married U.S. persons who file a joint income tax return under section 6013 for a tax year will have joint and several liability for all penalties under section 6677, unless the married persons are able to establish that only one spouse had an interest in property transferred to, or received from, a foreign trust. The Proposed Regulations suggest that this joint and several liability may extend to penalties for the filing requirement under sections 6039F and 6048 (at least where a return under section 6048 was required). The preamble to the Proposed Regulations states that it can be difficult for the Service to determine who, between spouses, should be responsible for filing under section 6048 "because, for example, a transfer of property to, or the receipt of property from, a foreign trust was made from (or to) a joint bank account."[43]

B. Recommendation(s)

We recommend that the Proposed Regulations, when finalized, omit Prop. Treas. Reg. § 1.6677-1(f)(2) in its entirety, or provide that the Service may only assess penalties against each joint owner where "a transfer of property to, or the receipt of property from, a foreign trust was made from (or to) a joint bank account."

C. Explanation(s)

We acknowledge that a transfer made from or to a joint bank account can make it difficult to determine who should be responsible for filing under sections 6048 or 6039F. In the case of a joint bank account, there would not be any impediment to the Service finding each joint owner responsible. This would be true regardless of the joint owners' marital status or filing status. Section 6013, however, provides no statutory authority for joint liability other than for taxes arising from income under Subtitle A.[44]

Tying liability under section 6677 to a joint return filing under section 6013(a) creates a number of additional problems that were not addressed by the Proposed 6677 Regulations. Under section 6013(a)(3), in the case of death of one spouse, the surviving spouse may file a joint return with respect to the surviving spouse and the deceased spouse, which would serve to unilaterally cause the deceased spouse's estate to be jointly liable for the surviving spouse's penalties. Moreover, under section 6015, a taxpayer may request innocent spouse relief and may obtain Tax Court review of an adverse decision by the Service. Section 6015 applies only to income taxes; an innocent spouse held jointly liable under both sections 6013 and 6677 could obtain innocent spouse relief from the Tax Court under section 6015, still be required to pay a penalty under section 6677, then would need to seek a refund in the appropriate refund jurisdiction. As section 6015 applies only to income taxes, even the Tax Court's right to review collection cases

[43] Preamble to Proposed Regulations, 89 Fed. Reg. at 39,456.

[44] *See* I.R.C. § 6013(a).

under sections 6320 and 6330 may not encompass the right to determine that a spouse should not be jointly liable under section 6677.

IV. Prop. Treas. Reg. § 1.6048-4

A. Inbound Migration as a Distribution

1. Background

Code section 6048(c) imposes reporting requirements on a U.S. person who receives a distribution from a foreign trust. Prop. Treas. Reg. § 1.6048-4(b)(4) provides that a distribution includes the inbound migration of a foreign trust, which occurs when a foreign trust becomes a domestic trust.

2. Recommendation(s)

We recommend that the final regulations clarify that an inbound migration is treated as a distribution only for purposes of the Form 3520 filing requirements under Prop. Treas. Reg. § 1.6048-4(a) and that the regulation does not affect whether this event will be treated as a distribution for purposes of imposing tax on distributable net income ("**DNI**")/undistributed net income ("**UNI**") from the foreign non-grantor trust.

3. Explanation(s)

Examples 11 and 12 in Prop. Treas. Reg. § 1.6048-4(g) confirm that Form 3520 must be filed when a foreign trust becomes a domestic trust and when a foreign trust distributes or decants its assets to a domestic trust. However, neither the Proposed Regulations nor the current version of the instructions to Form 3520 provide guidance as to how a domestication or decanting should be reported or as to whether a domestication or decanting causes the trust to recognize income.

Since a distribution from a foreign trust to a U.S. person would ordinarily be treated as a distribution for income tax purposes, most tax professionals have assumed that such a distribution required the U.S. trust to report as income the foreign trust's DNI and UNI at the time of distribution (assuming an accumulation distribution occurs). It is unclear whether Prop. Treas. Reg. § 1.6048-4(b)(4)'s required information reporting of a migration as a distribution from a foreign trust to a domestic trust will also require similar income tax treatment.

The alternative approach, which we consider correct, would be for the trust's DNI and UNI to remain suspended in the domestic trust until it is subsequently distributed to a U.S. beneficiary. Section 665 subjects domesticated trusts to the throwback rules, and Revenue Ruling 91-6[45] concludes that a domesticated trust continues to be subject to the interest charge imposed by section 668 on distributions of accumulated income. However, this also raises the question as to how a U.S. beneficiary will have the

[45] Rev. Rul. 91-6, 1991-1 C.B. 89.

information necessary to be able to report a distribution of UNI that relates back to an old foreign trust that no longer exists (see also discussion of the Default Method in Section IV.D below).

In addition, assuming that neither a domestication nor a decanting is a taxable event, Form 3520 does not currently provide for taking a "reporting only" position. For example, the form in its current state would still require a foreign non-grantor trust beneficiary statement to be attached.

B. Form 3520 Obligation for U.S. Owners of Foreign Trusts that File a Form 3520-A

1. Background

The Proposed Section 6048 Regulations require any U.S. person who is treated as the owner of any portion of a foreign trust under the grantor trust rules to ensure that the foreign trust: (i) files Form 3520-A with the Service by the fifteenth day of the third month after the end of the trust's taxable year (March 15 if the trust's taxable year is a calendar year) with a maximum extension of a six-month period beginning on such day; (ii) furnishes a Foreign Grantor Trust Owner Statement (described in Prop. Treas. Reg. § 1.6048-4(c)(1)(i)) to each U.S. owner of the foreign trust; and (iii) furnishes a Foreign Grantor Trust Beneficiary Statement (described in Prop. Treas. Reg. § 1.6048-4(c)(1)(ii)) to each U.S. person to whom the trust made distributions during the trust's taxable year.

2. Recommendation(s)

We recommend that the Form 3520 filing obligation be removed for U.S. owners of foreign trusts that file a Form 3520-A.

3. Explanation(s)

In the case of a foreign grantor trust (with a U.S. owner), Form 3520-A already provides the Service with:

1. A balance sheet of the Trust;

2. An income statement computed under U.S. tax principles;

3. Details of distributions made to both U.S. and non-U.S. beneficiaries of the trust as well as distributions made to the grantor;

4. A Foreign Grantor Trust Owner Statement; and

5. Potentially, a Foreign Grantor Trust Beneficiary Statement.

The requirement for a U.S. owner of a foreign grantor trust to also file a Form 3520 appears unnecessary, because all information requested on Parts 2 and 3 of the Form 3520 is already included on Form 3520-A. This additional reporting obligation is

duplicative and the penalties for filing the form late are overly punitive (given that a U.S. owner of a foreign trust may be subject to both Forms 3520-A and 3520 filing penalties).

We recommend that the requirement for a Form 3520 by a U.S. owner of a foreign trust be removed if Form 3520-A is filed. Form 3520-A could be revised to include details included on Part 1 of the Form 3520 (Transfers by U.S. Persons to a Foreign Trust During the Current Tax Year).

C. Due Dates of Form 3520-A and Form 3520

1. Background

Form 3520-A is due on the 15th day of the 3rd month after the end of the trust's taxable year (March 15th if the trust's taxable year is a calendar year) with the option to extend the due date by six months (by filing a timely extension).

2. Recommendation(s)

We recommend that the due date for Forms 3520-A be harmonized with the due date of domestic trust returns (*i.e.*, April 15 for calendar year trusts with the opportunity to extend a further five and a half months) or be aligned with the Form 3520 due date. We acknowledge how helpful the supplemental procedure is to remedy a missed Form 3520-A, by attaching it to the Form 3520, by the extended deadline of the Form 3520.

In addition, the due date for filing Form 3520 is April 15, but can be extended to October 15.

D. The Default Method and Related Matters Concerning Undistributed Net Income

1. Background

Under the Default Method provided in Prop. Treas. Reg. § 1.6048-4(d)(3)(i)(A) (the "**Default Method**"), a U.S. person who has received a distribution from a foreign trust treats a portion of the distribution as a distribution of current income based on the average amount of the distributions that the U.S. person received from the foreign trust during the prior three taxable years, with only the excess amount of the distribution (that is, the amount that exceeds 125% of that average) treated as an accumulation distribution within the meaning of section 665(b) (consisting of UNI of the foreign trust). In applying the Default Method, in the absence of actual information provided on a statement described in Prop. Treas. Reg. § 1.6048-4(c), the U.S. person must presume that the applicable number of years the foreign trust has been in existence is ten years and that no taxes described in section 665(d) have been imposed on the trust in any applicable previous year (even if a distribution has been made and the tax under section 665(d) has previously been imposed). These rules are consistent with the Default Method that is currently prescribed in the instructions for Part III of Form 3520. The U.S. person's use

of the Default Method does not affect any calculations made by the foreign trust for purposes of trust accounting.[46]

2. Recommendation(s)

We recommend that a U.S. beneficiary who uses the Default Method be permitted to use the actual number of years that the trust was in existence as a foreign non-grantor trust if the number of years can be easily determined. Additionally, we recommend that certain aspects regarding the application of the Default Method in Prop. Treas. Reg. § 6048-4(d)(3)(i)(A) be clarified.

3. Explanation(s)

The Proposed Regulations state that a U.S. beneficiary must assume "in the absence of actual information provided on a [Foreign Non-grantor Trust Beneficiary Statement]" that the trust has been in existence for ten years. Ten years is a fair number to use for the Default Method, except in cases where the U.S. beneficiary has information supporting that the number of years is less than ten.

The Default Method was presumably created to deal with the situation where the beneficiary does not have access to information about the financial position of the trust. For example, the trust may have predated the existence of a U.S. beneficiary, or the foreign trustee may simply have failed to maintain records that would enable DNI and UNI to be computed under the requirements of the Code. While there appears to be no statutory basis for the Default Method, the Service is to be commended for developing a method to deal with the problem of unavailable information.

However, the date of formation and funding of a trust or the date a trust became a non-grantor trust may be known with a high level of certainty, and in those circumstances, it would make sense to permit the U.S. beneficiary to use the known age of the trust or the known period of time that has elapsed since the trust became a non-grantor trust. Examples of trusts the duration of which is easily determined include trusts created by the will of a decedent whose date of death is known, trusts with a foreign grantor that had met the requirements of section 672(f)(2) to be treated as foreign grantor trusts and ceased to meet those requirements, and trusts that became non-grantor trusts on the death of their grantors.

The Proposed Regulations also do not clarify whether ten years is a starting point (*e.g.*, reduced by one year each subsequent year) or if ten years is to be used by a U.S. beneficiary for all future years reporting under the Default Method.

Currently, in order to determine the rate of interest to be applied on an accumulation distribution calculated under the Default Method,[47] the applicable number of years of the trust is equal to the number of years the trust has been a foreign trust

[46] *See* Prop. Treas. Reg. § 1.6048-4(d)(3)(ii).

[47] *See* Schedule A, Part III, Line 38 of Form 3520.

divided by two. Therefore, under the Proposed Regulations, the deferral interest charge would appear to be limited to five years (*i.e.*, the assumed years the trust has been foreign trust of ten years divided by two). We believe it is unlikely that the Proposed Regulations are intended to cap the deferral interest charge on the Default Method to 5 years and, as a result, Form 3520 should be revised to reflect Treasury and the Service's intention.

We recommend that the final regulations address the availability of the use of the Default Method in situations where a foreign trust domesticates, and a U.S. beneficiary subsequently receives a distribution of the original foreign trust's accumulated income. In such a situation, the final regulations should clarify whether the U.S. beneficiary is able to use the Default Method to report distributions of accumulated income from the formerly foreign trust.

We also recommend that the final regulations clarify the tax treatment of accumulated trust income that arose in a foreign trust prior to:

1. The birth of a U.S. beneficiary; and

2. A beneficiary becoming a U.S. tax resident.

In such cases, the Proposed Regulations should clarify whether the receipt of UNI that arose prior to the birth of a U.S. beneficiary should be treated as ordinary income or a tax-free return of trust corpus. The Proposed Regulations should also clarify the treatment of an accumulation distribution that arose prior to a beneficiary becoming a U.S. tax resident.

We note that relief from the deferral interest charge is offered under section 668(a)(4) by disregarding any years that a beneficiary was not a U.S. person from being treated as an accumulation year. We also recommend that the instructions to Form 4970, *Tax on Accumulation Distribution of Trusts*, be revised to show how to calculate the deferred tax on income allocated to a throwback year in which the beneficiary was unborn or not a U.S. person.

V. Prop. Treas. Reg. § 1.6048-5

A. Revise Eligible Individual Requirement

1. Background

Prop. Treas. Reg. § 1.6048-5(b)(1) provides that an eligible individual's transactions with, or ownership of, certain tax-favored foreign retirement trusts or non-retirement savings trusts are not reportable on Forms 3520 and 3520-A. The section defines an "eligible individual" as a person who "is compliant (or comes into

compliance) with all requirements for filing a federal income tax return (or returns) covering the period such individual was a U.S. person."[48]

2. Recommendation(s)

We recommend that an individual will be deemed to satisfy the filing compliance requirement for an "eligible individual" if such individual has come into compliance under an approved IRS disclosure procedure.

3. Explanation(s)

The current phrasing may unduly restrict the scope of this section, potentially subjecting individuals who have made efforts to comply with more burdensome requirements. For instance, taxpayers with unreported income or unpaid taxes are not barred from submitting delinquent information returns under the Service's Delinquent International Information Return Submission Procedures ("**DIIRSP**").[49] For those individuals utilizing DIIRSP to achieve compliance, if they have unreported income from a previous year and have not filed an amended income tax return, it should be treated as if they have met "all requirements for filing a federal income tax return (or returns) for the period during which they were U.S. persons." Otherwise, they would not qualify as "eligible individuals" and, consequently, could not take advantage of any filing exceptions provided by Prop. Treas. Reg. §1.6048-5(b).

Equally, individuals who have come forward under the Streamlined Filing Compliance Procedures are asked to file or amend three years of tax returns for which the original due date has passed along with other international informational returns; they are also asked to file or amend six years of FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* ("**FBAR**") for which the deadline has passed. Those individuals are coming into compliance as recommended by the Service, but this compliance will not necessarily cover all periods such individual was a U.S. person.

B. Prop. Treas. Reg. § 1.6048-5(b)(2) Exception for Tax-Favored Retirement Trusts

1. Background

Prop. Treas. Reg. § 1.6048-5(b)(2) provides that a tax-favored foreign retirement trust is a trust created under the laws of a foreign jurisdiction operating exclusively (or almost exclusively) to provide, or to earn income for the provision of, pension or retirement benefits and ancillary or incidental benefits, in addition to meeting certain additional requirements such as information reporting and setting limitations based on the

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[48] Prop. Treas. Reg. § 1.6048-5(b)(1).

[49] *See* Delinquent international information return submission procedures, *available at* https://www.irs.gov/individuals/international-taxpayers/delinquent-international-information-return-submission-procedures (last visited June 26, 2024).

amount of contribution, thresholds for value, and conditions for withdrawal.[50] There are several criteria under Prop. Treas. Reg. § 1.6048-5(b)(2)(i) to (vi), all of which need to be met for the exemption to apply:

1. The trust generally is exempt from the income tax or is otherwise tax-favored under the laws of the trust's jurisdiction;

2. Annual information reporting is provided to the tax authority of the trust's jurisdiction;

3. Only contributions with respect to income earned from personal services are permitted;

4. The must meet either of the following two tests: (i) the Value Threshold test, or (ii) the Contribution Limitations test. A July 1 exchange rate is proposed in determining the U.S. dollar amount. Each test is briefly summarized as follows:

    a. Value Threshold test: the trust(s) in that jurisdiction has an aggregate value of less than $600,000 (adjusted for inflation).[51]

    b. Contribution Limitations test: the trust limits contributions (including limited allowance for unemployed individuals) to: (i) a percentage of earned income of the participant;[52] (ii) $75,000 annually (adjusted for inflation);[53] or (iii) $1 million in a lifetime (adjusted for inflation).[54]

5. Withdrawals, distributions, or payments from the trust are conditioned upon reaching a specified retirement age, disability, or death, or penalties apply;

6. In the case of an employer-maintained trust, the trust is (i) a nondiscriminatory trust, (ii) actually provides significant benefits to a substantial majority of eligible employees, or (iii) benefits actually provided are nondiscriminatory.

2. Recommendation(s)

We welcome the expansion of reporting exemptions for foreign pensions established as trusts in their respective jurisdictions. However, as drafted, these exemptions do not appear to achieve the objective of meaningfully reducing the reporting burden for foreign pensions.

The expansion of the exception for tax-favored foreign trusts, specifically foreign retirement plans, could have a broader application than outlined in Revenue Procedure

[50] Prop. Treas. Reg. § 1.6048-5(b)(2).

[51] Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(1).

[52] Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(2)(i).

[53] Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(2)(ii).

[54] Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(2)(iii).

2020-17, due to the addition of inflation adjustments and the value threshold, the latter of which allows tax-favored foreign retirement trusts to qualify for the exception if they do not exceed the $600,000 threshold during the tax year. As an increasing number of taxpayers relocate abroad or move to the United States from other countries, many continue to hold tax-favored foreign retirement trusts. These trusts may fall under the reporting obligations of section 6048. Countries with such retirement plans, including Australia, Canada, and the United Kingdom, have long faced the complexities associated with their citizens moving to the United States and confronting the stringent Forms 3520 and 3520-A reporting requirements. Those citizens can face complicated reporting requirements and potential penalties with regard to what are, effectively, bona fide tax-deferral regimes accepted in such countries.

We therefore make the following recommendations:

1. Provide clarification on the treatment and available exemptions for U.K. SIPP and Australian Superannuation plans under Prop. Treas. Reg. § 1.6048-5(b)(2). These plans have sparked considerable debate regarding their reportability on Forms 3520 and 3520-A, as well as the relevant exemptions. We suggest that the Treasury and the Service engage in discussions with the U.K. and Australian governments to tailor exemptions specifically for these types of plans.

2. Expand Prop. Treas. Reg. § 1.6048-5(b)(2)(iii) to allow limited contributions in excess of earned income regardless of whether an individual is employed, self-employed, or unemployed. We recommend also allowing additional contributions to be made if penalties arise on such excess contributions.

3. For Prop. Treas. Reg. §1.6048-5(b)(2)(iv), we recommend:

a. A "per pension" exception, even where the aggregate threshold of $600,000 (as adjusted) is exceeded and clarify that the trusts in the jurisdiction to aggregate are only these tax-favored foreign retirement trusts;

b. A higher limit overall;

c. Further clarity on the wording of the value threshold in Prop. Treas. Reg. § 1.6048-5(b)(2)(iv) to link it to the value of the individual's balances;

d. Removal of U.S. dollar-based limitations and expansion of the contribution limitations within Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(2) as we are unaware of actual contribution limits in these foreign plans, which will allow a wider range of foreign pension plans to qualify;

e. Addition of an exemption for benefit plans established in countries that have a comprehensive income tax treaty with the United States; and

f. Removal or modification of the reference to the July 1 exchange rate. As the aggregate value test is applied over the entire year but the exchange rate is at

a fixed point in time, it would be preferable to allow the exchange rate on the date of the highest balance to be used, if lower, and otherwise the end of year rate would be used.

4. Clarify the purpose of Prop. Treas. Reg. § 1.6048-5(b)(2)(vi) or omit it. Clarify the criteria outlined under Prop. Treas. Reg. § 1.6048-5(b)(2)(vi)(A) to (C), ensuring their application does not unjustly disadvantage foreign plans predominantly comprised of nonresident alien participants. The better approach is simply removing these additional criteria, as they seem unnecessary with Prop. Treas. Reg. § 1.6048-5(b)(2)(v).

3. Explanation(s)

a. Clarification on Treatment of U.K. SIPP and Australian Superannuation Plans

There is a lack of clarity over whether certain types of foreign pension plans, including the U.K. SIPP and Australian Superannuation plans, should be treated as foreign grantor trusts, employee benefit trusts, or contractual pension arrangements. The Proposed Regulations do not clearly specify which exemptions apply to those plans. Streamlining the filing process for these plans could be achieved by adding additional sections that specifically address the application to these plans, or make certain these common plans fit within the exception of Prop. Treas. Reg. § 1.6048-5(b)(2).

b. Prop. Treas. Reg. § 1.6048-5(b)(2)(iii) Earned Income Limitation

Prop. Treas. Reg. § 1.6048-5(b)(2)(iii) allows only unemployed individuals to make pension contributions in excess of earned income; as <u>all</u> subsections (i) to (vi) thereof have to be met, this requirement could make the exception to reporting ineffective for all U.K. pensions.[55] For example, two situations where a U.K. pension plan would not qualify are described below:

1. Contributions in excess of allowable limits do not have to be withdrawn but do not receive tax relief and could be taxable when later distributed; and

2. A person is allowed to contribute up to £3,600 a year to his or her U.K. SIPP plan even if she is unemployed. Non-residents can also continue to contribute at this level.

c. Prop. Treas. Reg. § 1.6048-5(b)(2)(iv) Value and Contribution Limits

We believe that the collective value cited in Prop. Treas. Reg. § 1.6048-5(b)(2)(iv) aims to deter individuals from dividing their pensions into multiple smaller accounts to qualify for this exemption. However, it is also impractical to mandate the

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[55] Prop. Treas. Reg. §1.6048-5(b)(2)(i)-(iv).

submission of numerous forms in a year when there are pensions with minor balances with an aggregate value of $600,000. Further, some individuals have changed jobs and with that, their pension plans, and thus have accumulated multiple small such plans (just as this might occur as to a U.S. taxpayer who has held multiple jobs and thus holds, perhaps, multiple section 401K plans).

Each required pension report exposes the individual to a considerable risk of penalties. For tax collection purposes, it is redundant to mandate filings for all small pension plans simply because their combined value surpasses $600,000. The disclosure of such smaller pensions is already covered by FBAR and Form 8938, *Statement of Specified Foreign Financial Assets*. Consequently, imposing an additional requirement to report small pensions on Forms 3520 and 3520-A seems duplicative. For instance, if an individual holds $500,000 in Pension 1, $100,000 in Pension 2, $10,000 in Pension 3, and $10,000 in Pension 4, and does not qualify for any other exemptions, they would be obligated to file four separate sets of Form 3520.

We suggest that the threshold of $600,000 be raised and also adjusted for inflation. The phrasing of the draft clause appears intended to apply to the aggregate value of the individual's pension plans within that jurisdiction. However, the wording "in the trust's jurisdiction is limited to no more than $600,000" does not clearly indicate that only tax favored retirement type trusts are considered.

Prop. Treas. Reg. § 1.6048-5(b)(2)(iv)(2) seems to provide an additional exemption for plans that meet certain criteria, even if they exceed the $600,000 value threshold. However, establishing a set of criteria that is not only based on a fixed dollar amount but also restrictive may not fulfill this objective. For example, U.K. plans do not satisfy criterion (2)(i) because they permit a small contribution of up to £3,600 regardless of income. U.K. plans also do not meet criterion (2)(ii) because they allow for catch-up contributions if pension contributions were not maximized in the past three years. Furthermore, they may permit contributions exceeding $75,000 (adjusted for inflation), depending on exchange rates, and they allow for accumulations of more than $1,000,000 (adjusted). It is probable that pension plans from other countries would encounter similar difficulties in adhering to the specified criteria.

Introducing more flexibility into Prop. Treas. Reg. § 1.6048-5(b)(2)(iv) for benefit plans established in countries that have a comprehensive income tax treaty with the United States, and their participants. One approach would be to incorporate a third criterion that could be satisfied if the value threshold or contribution limits are not met. This could take the form of a "Treaty Deferral" provision. Thus, if no income or gains are taxable prior to distributions, the requirement to complete Forms 3520 and Forms 3520-A would be waived for pension plans that are eligible for deferral of income and gains in the foreign jurisdiction under a U.S. income tax treaty. Such an amendment would effectively exempt U.K. and similar foreign qualified pension plans.

The language in Prop. Treas. Reg. § 1.6048-5(b)(2)(iv), which references the July 1 exchange rate for determining dollar limitations, leads to confusion given that the FBAR mandates the use of a December 31 exchange rate. The discrepancy between the

two dates for exchange rate determination does not seem justifiable because it necessitates an additional set of calculations, which results in inconsistencies across reported amounts on various forms. Specifically, the value calculated for the limitation based on the July 1 exchange rate will not align with the figures reported on the FBAR, Form 8398, or Forms 3520 and 3520-A. This misalignment could potentially complicate compliance and financial reporting for taxpayers; it could also lead to unnecessary examinations due to inconsistent amounts being reported (even though reported properly).

d. Prop. Treas. Reg. § 1.6048-5(b)(2)(vi) Non-discriminatory Benefits

If trusts under section 402(b) are not subject to the reporting requirements for foreign grantor trusts by individuals, then there is no need for an additional exception in this context. The term "non-discriminatory," as used in the Proposed Section 6048 Regulations, lacks clarity. Applying the detailed non-discrimination criteria from pension legislation to non-U.S. pension plans is challenging given many non-resident aliens are excluded from the statutory tests. Clarification is necessary regarding the reporting obligations of individuals with respect to foreign grantor trusts. Additionally, a more detailed explanation, or ideally, an exemption, would be beneficial. There is also a need for further clarification on how the concept of "non-discrimination" applies to non-U.S. pension plans given the complexities involved.

C. Prop. Treas. Reg. § 1.6048-5(b)(3) Exception for Tax-Favored Non-retirement Savings Trusts

1. Background

Prop. Treas. Reg. § 1.6048-5(b)(3) exempts from reporting a foreign tax favored non-retirement savings trust that meets the following requirements under the law of the trust's jurisdiction:

1. The trust generally is exempt from income tax or otherwise is tax-favored;[56]

2. Annual information reporting is provided, or otherwise is available, to the relevant tax authorities in the trust's jurisdiction;[57] and

3. Contributions to the trust are limited to: (i) $10,000 or less annually or (ii) $200,000 or less on a lifetime basis.[58]

[56] Prop. Treas. Reg. § 1.6048-5(b)(3)(i).

[57] Prop. Treas. Reg. § 1.6048-5(b)(3)(ii).

[58] Prop. Treas. Reg. § 1.6048-5(b)(3)(iii).

2. Recommendation(s)

We make the following recommendations:

1. Provide additional guidance on which tax-favored foreign non-retirement arrangements are considered "trusts;"

2. Provide specific exceptions for Canadian TFSAs; and

3. Remove the contribution limitation for a tax-favored foreign non-retirement savings trust under Prop. Treas. Reg. § 1.6048-5(b)(3). Instead, establish a minimum reporting threshold for contributions between $200,000-$600,000.

3. Explanation(s)

a. Clarification on Whether Tax-Favored Foreign Non-Retirement Arrangements are Considered "Trusts" for U.S. Tax Purposes

In general, it may be difficult to apply the requirements of Prop. Treas. Reg. § 1.6048-5(b)(3) to foreign non-retirement arrangements, including the core determination of whether such arrangements are considered to be "trusts" for federal income tax purposes. Without trying to narrow the broader issue of what constitutes a trust for U.S. federal income tax purposes, we provide a test case example of Canadian TFSAs, as an example for the need for broader exemptions for tax-favored foreign non-retirement arrangements.

b. TFSA

A TFSA is a savings vehicle that provides for tax-free treatment of earnings, for Canadian income tax purposes, while the earnings accumulate in the TFSA and when the principal/earnings are withdrawn.[59] TFSA contributions are made with after-tax income.[60] The maximum contribution that can be made to a TFSA accrues each year, and such contributions are designated by a year-to-year schedule.[61] For example, between 2019 and 2024, maximum contributions that can be made to a TFSA range from $6,000-$7,000.[62] Consequently, it is unusual for a TFSA at issue to be over $150,000.

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[59] Canada Income Tax Act ("**ITA**"), R.S.C. 1985, c. 1 (Can.), section 146.2(6), (7); ITA section 149(1)(u.2).

[60] *Id*.

[61] RC343, *Worksheet—TFSA contribution room*, *available at* www.canada.ca/en/revenue-agency/services/forms-publications/forms/rc343.html (last visited June 24, 2024).

[62] *Id*.

TFSA holders are generally permitted to withdraw funds at any time, for any reason, and without any restrictions.[63] A TFSA must meet the following requirements:

1. Be a "qualifying arrangement" under section 146.2(1) of the Canadian Income Tax Act, which requires that funds be held either in an "arrangement in trust,"[64] an annuity contract,[65] or a "deposit arrangement";[66]

2. Be maintained for the exclusive benefits of the holder;[67]

3. No person other than the TFSA holder, during the TFSA holder's life, may have any rights relating to the amount and timing of distributions and investing of funds;[68]

4. Contributions may be made only by TFSA;[69]

5. Exemption from Canadian income tax;[70] and

6. The issuer is required to transfer any amounts held in the arrangement to another TFSA at the direction of the holder.[71]

Applicable TFSA holders lack guidance regarding whether to report their TFSA assets on Forms 3520 and 3520-A. The existing and proposed guidance by the Service regarding exemptions from section 6048 reporting do not provide clarity regarding whether Forms 3520 and 3520-A are required to be filed with respect to transactions involving TFSAs. Reporting under section 6048 provides an exemption for Canadian retirement plans falling within the scope of paragraph 7 of Article XVIII (Pensions and Annuities) of the United States-Canada Income Tax Treaty, such as Registered Retirement Savings Plans and Registered Retirement Income Funds. However, TFSAs do not meet the criteria for an exemption under paragraph 7 of Article XVIII (Pensions and Annuities) of the United States-Canada Income Tax Treaty.

Further, Revenue Procedure 2020-17 does not provide reporting relief to TFSAs. Revenue Procedure 2020-17 provides that certain non-U.S. tax-favored trusts are eligible for the reporting exemption if they only permit withdrawals for limited purposes, notably

[63] *See* TFSA Guide For Individuals, *available at* Tax-Free Savings Account (TFSA), Guide for Individuals - Canada.ca (last visited July 8, 2024).

[64] ITA section 146.2(1)(b)(i).

[65] ITA section 146.2(1)(b)(ii).

[66] ITA section 146.2(1)(b)(iii).

[67] ITA section 146.2(2)(a).

[68] ITA section 146.2(2)(b).

[69] ITA section 146.2(2)(c).

[70] ITA section 146.2(2)(d).

[71] ITA section 146.2(2)(e).

the provision of retirement, medical, disability, or educational benefits. TFSA holders are permitted to withdraw funds at any time, for any reason, and without any restrictions and, thus, are not eligible for the reporting exemption provided under Revenue Procedure 2020-17.

The exemptions under Prop. Treas. Reg. § 1.6048-5 do not apply to TFSAs. Prop. Treas. Reg. § 1.6048-5(b)(2) provides the reporting exemption for non-U.S. tax-favored trusts created exclusively to provide, or earn income, for retirement benefits. Prop. Treas. Reg. § 1.6048-5(b)(3) provides the exemption for those trusts created exclusively for medical, disability, or educational benefits. For de minimis trusts that are not described under Prop. Treas. Reg. §§ 1.6048-5(b)(2) or 1.6048-5(b)(3), Prop. Treas. Reg. § 1.6048-5(b)(4) provides a reporting exemption if the aggregate value of the trust in the trust's jurisdiction is limited to no more than $50,000 during the taxable year. TFSA holders are not eligible for the reporting exemption provided under any of these sections because the holders can withdraw funds for any purposes, and there is not a $50,000 limitation on the amounts.

We recommend explicitly exempting Canadian TFSAs from reporting under section 6048 because they are not trusts for U.S. tax purposes. The determination of whether both deposit arrangements and arrangements in trust are subject to the reporting requirements under section 6048 (*i.e.*, Forms 3520 and 3520-A) hinges on whether such arrangements are classified as trusts for federal tax purposes.

TFSAs are not trusts: TFSA deposit arrangements and TFSA arrangement in trusts are examples of principal-agency relationships that do not reflect a "trust" within the meaning of Treas. Reg. § 301.7701-4. In addition, TFSA arrangement in trusts do not clearly meet the criteria of nominee trusts because TFSAs do not neatly fall withing the narrow language of Revenue Ruling 92-105[72] and Revenue Ruling 2013-14,[73] which involved specific land trust arrangements where the beneficiaries in question held the "exclusive" right to direct or control the property. The items above are not any type of entity for federal tax purposes because TFSAs do not have a non-tax business purpose; rather, their purpose is to provide TFSA holders a means to hold assets in a tax-efficient manner under Canadian law and, absent a business purpose, it follows that the more appropriate classification of TFSAs are as principal-agent relationship between the TFSA holders and the financial institutions that operate TFSAs.

While title to the assets in TFSAs are held by the third-party financial institution offering the TFSA, the applicable Canadian law does not contemplate the establishment of a fiduciary relationship between the TFSA holder and TFSA issuer/trustee when the holder sets up the TFSA or the existence of such a relationship while the holder maintains the TFSAs, which is a critical element for what constitutes a "trust" for U.S. tax purposes. Notably, the relevant financial institutions do not have any role in making any investment decisions regarding the TFSA assets or protecting and conserving them for

[72] Rev. Rul. 92-105, 1992-2 C.B. 204.

[73] Rev. Rul. 2013-14, 2013-26 I.R.B. 1267.

the benefit of the holder. Rather than creating a trust for federal tax purposes, the holder creates a principal-agency relationship with the financial institution when the holder sets up a TFSA, allowing the holder, at his or her sole discretion, to direct the financial institution on how to invest the assets in the TFSA in order to achieve the goal of tax-free savings in the TFSA and to distribute the funds.

c. Remove Contribution Limitation and Establish a Minimum Reporting Threshold Between $200,000-$600,000

U.S. tax professionals often struggle to determine the contribution limits of foreign plans. An exemption based on the amounts actually contributed would offer significant relief. We recommend setting a minimum reporting threshold, such as between $200,000-$600,000, which aligns with the typical values observed in practice for these plans.

D. Prop. Treas. Reg. 1.6048-5(b)(4) Exception for De Minimis Trusts

1. Background

Prop. Treas. Reg. § 1.6048-5(b)(4) exempts from reporting certain foreign trusts, the aggregate value of which is limited to no more than $50,000 at any point during the taxable year.

2. Recommendation(s)

We recommend increasing the dollar limitation.

3. Explanation(s)

We are in favor of this new exemption, but believe that an increase in the dollar limitation would permit more taxpayers to benefit from the exemption without undermining the purpose of the Proposed Regulations. We suggest $200,000-$400,000, adjusted for inflation, as this will greatly aid in tax administration.

E. Prop. Treas. Reg. § 1.6048-5(e)

1. Background

a. In General

The Proposed Regulations provide an exception to subsections 6048(a) through (c), which require reporting of "reportable events," status as the "owner" of a foreign trust, and distributions from a foreign trust with respect to trusts "located in a mirror code possession" where the "responsible party . . ., U.S. owner, or U.S. recipient is a bona fide resident" of the territory.

b. Income Taxation of Persons in U.S. Territories

i. The U.S. Territories and Taxation

Through its powers under the Territories Clause of the U.S. Constitution,[74] Congress maintains plenary authority over the territories of the United States.[75] Grants of authority for self-government have been made to American Samoa, Guam, the Commonwealth of the Northern Mariana Islands (the "**CNMI**"), Puerto Rico, the United States Virgin Islands (the "**Virgin Islands**"), and Puerto Rico through specific legislation. Other territories of the United States are administered by one government agency or another, as is appropriate, because there is no activity on many of the islands, or such activities as do occur are related to military or scientific research functions or are wildlife sanctuaries. Each of the five populated, self-governing territories has a system of income taxation.

The income tax law of the Virgin Islands is the Code (in mirror form), but locally administered and enforced. Congress imposed the Code on the territory in 1921 as part of the Naval Services Appropriation Act (the territory was at that time under the jurisdiction of the U.S. Navy).[76]

The Guam Territorial Income Tax is the Code of 1954, as applied to Guam.[77] Prior to 1951, the income tax laws of the United States did not apply to Guam.

The income tax law of the CNMI is the Code, which was made applicable to the territory by the covenant it made with the United States.[78] References in the Code to Guam are deemed to also refer to CNMI, to the extent not incompatible with the Code or the Covenant.[79]

Unlike the other American territories, the Code was not imposed on American Samoa. Instead, American Samoa was allowed to adopt its own income tax system and did so by adopting the Code as its local income tax in 1963.[80] Congress reiterated this

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[74] U.S. Const. art. IV, §3, cl. 2.

[75] *See, e.g.*, *Harris v. Boreham*, 233 F.2d 110, 113 (3d Cir. 1956)("It is settled that Congress has sovereignty over the territories of the United States and accordingly has power to legislate for a territory with respect to all subjects upon which the legislature of a state might legislate within the state.").

[76] Naval Services Appropriation Act of 1922, Pub. L. No. 67-35, 42 Stat, 122, 123 (1921), *amended by* Pub. L. No. 94-392, § 5, 90 Stat. 1193, 1195 (1976), codified at 48 U.S.C. § 1397.

[77] 48 U.S.C. § 1421i. *See Laguana v. Ansell*, 102 F. Supp. 919 (D. Guam 1952), *aff'd per curiam*, 212 F.2d 207 (9th Cir. 1954), *cert. denied*, 348 U.S. 830 (1954).

[78] Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, Pub. L. No. 94-241, § 601(a), 90 Stat. 263, 269 (1976), *amended by* Pub. L. No. 98-213, § 9, 97 Stat. 1459, 1461 (1983), Pub. L. No. 99-396, § 10, 100 Stat. 837, 840 (1986), and Pub. L. No. 104-208, Div. A, Title I, §101(d) [Title I], 110 Stat. 3009-196 (1996) ("**Covenant**").

[79] Covenant, § 601(c).

[80] Am. Sam. Pub. L. No. 8-1 (1963), *as amended by* Am. Sam. Pub. L. No. 15-52, §1 (1977), *codified at* A.S.C. §11.0403. *See* H.R. Rep. No. 99-426, at 484 (1986); Conf. Rep. No. 99-841, at II-679 (1986).

principle in the Tax Reform Act of 1986 ("**1986 TRA**"),[81] but Congress conditioned this authority on the existence of a tax implementation agreement between American Samoa and the United States.[82]

Puerto Rico has its own income tax system modeled after the Code.[83] The Code does apply to all residents of Puerto Rico, but Puerto Rico source income is excluded from gross income for U.S. income tax purposes.[84]

Under the Code, a trust is "foreign" if it is not a "United States person."[85] The term "United States person" includes a trust if it meets the court test and control tests as set out in section 7701(a)(3) and regulations thereunder.[86]

ii. The Mirror Code Territories

(a). Guam and the Commonwealth of the Northern Mariana Islands

As noted above, Guam has an income tax system that mirrors that of the Code. Provisions of the Code do not apply that are "manifestly inapplicable or incompatible" to the purpose of mirroring the Code to Guam (referenced herein as the "**Mirror Code**", as applicable).[87] The applicable provisions of the Code are read by substituting "Guam" for "United States," and making other changes, including omitting "inapplicable language," where necessary to give effect to the intent of the Mirror Code.[88]

The 1986 TRA authorized Guam to enact an income tax law itself to replace the Mirror Code, but only if an agreement between the United States and Guam provided for information exchange and other provisions.[89] Such an agreement was prepared and signed in April 1989,[90] but its implementation has been delayed indefinitely.[91] Because

[81] 1986 TRA, Pub. L. No. 99-514, Subtitle G, Part 1, 100 Stat. 2085, 2591.

[82] 1986 TRA § 1271(a), 100 Stat. at 2591.

[83] 48 U.S.C. § 734 ("The statutory laws of the United States . . . shall have the same force and effect in Puerto Rico as in the United States, except the internal revenue laws . . . .").

[84] I.R.C. § 933(1).

[85] I.R.C. § 7701(a)(31)(B).

[86] I.R.C. § 7701(a)(30)(E); Treas. Reg. § 301.7701-7. A U.S. citizen is always a "United States person." I.R.C. § 7701(a)(30)(A).

[87] 48 U.S.C. § 1421i(d); *Sayre & Co., Ltd. v. Riddell*, 395 F.2d 407, 410 (9th Cir. 1968) (en banc).

[88] 48 U.S.C. § 1421i(e).

[89] 1986 TRA §1277(b), 100 Stat. at 2600, *as amended by* Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, §1012(z)(2), 102 Stat. 3342, 3530.

[90] Tax Implementation Agreement Between the United States of America and Guam, 1989-1 C.B. 342.

[91] Treasury Department News Release, Dec. 27, 1990, *Tax Notes Today*, 90 TNT 263-22.

this tax implementation agreement is not in effect, the amendments made by the 1986 TRA with respect to Guam are not generally in force, and thus prior law applies.[92]

Also as noted above, the income tax law of the CNMI piggybacks on the Guam Mirror Code: references in the Code to Guam are also deemed to refer to CNMI to the extent not incompatible with the Code or the Covenant. The CNMI has also not entered into the so-called implementation agreement required by the 1986 TRA so that pre-1986 law applies in some instances.

(b). Virgin Islands

The income tax law of the Virgin Islands is a Mirror Code. The Mirror Code is applied in the Virgin Islands by what has become known as the "mirror theory," by which the words "Virgin Islands" are substituted for the words "United States."[93]

(c). Distinguishing Feature of Mirror Code Territories

The distinguishing feature of the Mirror Code territories—Guam, CNMI, and the Virgin Islands—is that individuals who are bona fide residents of the territory satisfy their filing and paying obligations under the Code as it applies generally by filing a single income tax return with the tax authority of the territory.[94]

iii. Definition of Bona Fide Resident

The reference in Prop. Treas. Reg. § 1.6048-5(e) to "bona fide resident (within the meaning of § 1.937-1(b))" is correct and appropriate. That regulation applies to determine the status of an individual (but not juridical persons) as a bona fide resident of any of the U.S. territories.

2. Recommendation(s)

a. Mirror Code Possessions

We recommend avoiding the use of the Proposed Regulations' new term, "mirror code possessions," because it is not used elsewhere in the Code or the Treasury Regulations. Instead, the three territories should simply identify those territories to which this rule applies—the Virgin Islands, Guam, and CNMI—with the qualification that such

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[92] However, section 877(c) (Expatriation to Avoid Tax—Exceptions) applies to U.S. persons who move to Guam, and the modification of section 884 (Branch Profits Tax) applies even if an information exchange agreement is not in place. 1986 TRA §1277(e), (f), 100 Stat. at 2600, *as amended by* Pub. L. No. 100-647, §1012(z)(2), 102 Stat. at 3530. For individuals, section 935 (Coordination of United States and Guam Individual Income Taxes), and for corporations, section 881(b) (Taxation of Foreign Corporations Not Connected With United States Business—Exception for Certain Possessions), both as in effect before the 1986 TRA, still apply.

[93] Abramson Enters. v. Government of the Virgin Islands, 994 F.2d 140, 142 (3d Cir.), cert. denied, 510 U.S. 965 (1993).

[94] I.R.C. §§ 932(c), 935(b)(1)(B), as they read prior to amendment by 1986 TRA.

status could change for Guam and CNMI if a "tax implementation agreement" is entered into as required by the 1986 TRA.

b. Use of "Location" of a Trust to Determine Reporting Requirements is Ambiguous

We recommend removing the Proposed Regulations' concept of trust "location," because it adds a new, undefined concept. Instead, the Proposed Regulation should use the existing framework for determining whether a trust is domestic or foreign. Whether the trust is a *foreign trust* is the keystone for determining whether Forms 3520 or 3520-A are filed by bona fide residents of the territory or not at all. The introduction of the concept of trust "location" creates ambiguity.[95]

A trust meeting the court test and control test as mirrored to the territory would be a territorial, domestic trust for which no section 6048 filing would be required with the territorial tax authority. A bona fide resident of the Mirror Code territory would have no section 6048 filing requirement with the territorial tax authority or the Service.

c. Suggested Language for Prop. Reg. § 1.6048-5(e)

The following language is recommended for Prop. Treas. Reg. § 1.6048-5(e):

> 1) (a) For purposes of this section, the term "specified territory" means the Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands; provided, however, that if Guam or the Commonwealth of the Northern Mariana Islands enter into a tax implementation agreement as provided by Pub. L. 99-514, §1277(b), as amended by Pub. L. No. 100-647, §1012(z)(2), such territory shall not be a "specified territory."
>
> (b) The term "bona fide resident" is defined in Treas, Reg. § 1.937-1(b).
>
> (2) The court test and control test of sections 7701(a)(30)(E) and 7701(a)(31)(B) and Treas. Reg. § 301.7701-7, as mirrored to the specified territory, apply in determining whether a trust is a foreign trust or a domestic trust for the income tax law of the specified territory. Sections 6048 and 6039F, as mirrored to the specified territory, apply to bona fide residents of the specified territory.
>
> (3) Sections 6048(a) through 6048(c) do not apply to a trust determined to be a domestic trust of the specified territory under the income tax law of the specified territory to the extent the responsible party (within

[95] For an excellent example of ambiguity in the territorial tax context, *see Danbury, Inc. v. Olive*, 627 F. Supp. 513 (D.V.I. 1986), *rev'd*, 820 F.2d 618 (3d Cir.), *cert. denied*, 484 U.S. 964 (1987) (application of the former "inhabitant rule" of 48 U.S.C. § 1642 (1985), a scenario the District Court judge called the "ultimate tax shelter").

the meaning of section 6048(a)(4)), U.S. owner, or U.S. recipient is a bona fide resident of such specified territory.

3. Explanation(s)

A trust is foreign if it is not a domestic trust, which is determined by application of the court test and control test. Under Mirror Code principles, a trust subject to the jurisdiction of a court in a territory should meet the court test of the regulations as mirrored.[96] The Proposed Regulations should state that the control test would be met if a bona fide resident of the territory had control. Additional authority for such regulation is found at section 7654(e).

The Proposed Regulations do not use court test regulation language of Treas. Reg. § 301.7701-7(a)(1)(i), that a court within the U.S. is able to exercise primary supervision over the trust, to determine whether a trust with connections to a territory is foreign for federal income tax purposes. Instead, the Proposed Regulations explain how a trust is deemed "located" in a territory, a status which may or may not make the trust a *foreign trust*.

The issues are (a) whether a bona fide resident of the territory has a filing obligation with the Service under section 6048 for territory and non-territory trusts, and (b) how section 6048, as mirrored, applies in the territory. The section 6048 filing requirements for the many and various combinations of locations—United States, territory, foreign country—of trustees, owners of grantor trusts, assets, and beneficiaries are not clarified by reference to a trust's location as that concept is not consistent with the definition of *foreign trust.* Under the Mirror Codes of the three territories, there is no general obligation to file a tax return with the United States for bona fide residents so long as such tax returns are filed in the relevant territory. Under the Mirror Code and its interpretations, bona fide residents are subject not only to the substantive rules of the Code as mirrored, which create tax liability, but also the procedural rules.[97] Whether the trust is a *foreign trust* is the keystone for determining whether Forms 3520 or 3520-A are filed by bona fide residents of the territory or not at all. The introduction of the concept of trust "location" is not helpful and creates ambiguity.[98]

Importantly, the Proposed Regulations do not explain whether bona fide residents of the territories are exempt from filing Forms 3520 and 3520-A with the Service for non-territory trusts. If the intent of the Proposed Regulations is to have bona fide

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[96] Treas. Reg. § 301.7701-7(c). As mirrored, the regulation would read, in pertinent part, "A trust satisfies the court test if . . . The trust instrument does not direct that the trust be administered outside of the Virgin Islands; The trust is in fact administered exclusively in the Virgin Islands . . . ."

[97] *Chase Manhattan Bank, N.S.*, 300 F.3d at 325 (both the substantive and the non-substantive procedural and administrative provisions of the Code is mirrored).

[98] For an excellent example of ambiguity in the territorial tax context see *Danbury v. Olive*, 627 F. Supp. 513 (D.V.I. 1986), *rev'd*, 820 F.2d 618 (3d Cir.), *cert. denied*, 484 U.S. 964 (1987) (application of the former "inhabitant rule" of 48 U.S.C. § 1642 (1985), a scenario the District Court judge called the "ultimate tax shelter").

residents of Mirror Code territories file the information returns required by section 6048 with respect to non-territory trusts (potentially including U.S. domestic trusts) with the Service, the Proposed Regulations should simply state that requirement. However, this would be contrary to existing practice and inconsistent with the information reporting requirements for non-territory corporations (*i.e.,* Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*) and partnerships (*i.e.,* Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*). In such cases, the reporting requirements are fulfilled by filing with the territorial tax authority.

VI. Generally Applicable Provisions

A. Definition of "Executor" for Purposes of Sections 6039F and 6048

1. Background

Section 6048(a) provides that the responsible party for providing notice of any reportable event that consists of the creation of a foreign trust by a U.S. person at death, the transfer of any property to a foreign trust by a U.S. person at death, or the death of a U.S. person if the U.S. person was treated as the owner of any portion of a foreign trust or if any portion of a foreign trust was included in the gross estate of the decedent is the executor of the decedent's estate.

Section 6039F does not require a decedent's executor to file Form 3520 on behalf of the decedent. Section 6048 does not provide a definition of "executor." Section 2203 does provide a definition for "executor" but solely for purposes of the estate tax. Section 2203 includes within the definition of executor, only if there is no executor or administrator appointed, qualified, and acting within the United States, "any person in actual or constructive possession of any property of the decedent." Treas. Reg. 20.2023-1 includes within the class of persons treated as executors, the decedent's agents, safe-deposit companies, and custodians of the decedent's property. Prop. Treas. Reg. § 1.6039F-1(a)(3) would extend the section 2203 definition to section 6039F. Prop. Treas. Reg. § 1.6048-1(b)(1) would extend the section 2203 definition to section 6048.

2. Recommendation(s)

We recommend that the Prop. Treas. Reg. §§ 1.6039F-1(a)(3) and 1.6048-1(b)(1) be revised to limit the responsibility for filing Form 3520 for a decedent to the persons responsible for filing the decedent's income tax return under section 6012(b)(1).

We further recommend that Prop. Treas. Reg. § 1.6677-1 clarify that an executor will not be individually liable for penalties unless the executor has been appointed prior to the due date of the Form 3520 and has failed to file the Form 3520 within a reasonable period of time after appointment.

3. Explanation(s)

While it is understandable that Treasury and the Service would seek to impose filing requirements under section 6039F on the representative of a deceased taxpayer,

Congress clearly did not intend to apply section 6039F to the broad group of individuals who fall within section 2203's definition of "executors." Section 6048(a), which is intended to apply to executors, appears to contemplate only those fiduciaries serving as executors under state law. This distinction is particularly significant given that Treasury and the Service intend to assess penalties under section 6677 against executors in their individual capacities (and not as representatives of the decedent's estate).

In the case of estate taxes, applying individual liability to "any person in actual or constructive possession of any property of the decedent" is reasonable because individual liability is limited to the extent of the value of the property in the person's possession.[99] The Service has previously provided informal guidance confirming that section 2203 applies *only* to estate tax.[100] In most cases, it would be impossible for a person merely in possession of a decedent's property to determine whether a decedent has a filing requirement under sections 6039F or 6048. Additionally, a person in possession would have no authority to obtain an income tax filing extension, meaning that a person in possession would have as little as three and one half months to gather information concerning a decedent's receipt of gifts or distributions from foreign trusts.

Section 6012(b)(1) provides a more appropriate definition by stating "[i]f an individual is deceased, the [individual's income tax return] shall be made by his executor, administrator, or other person charged with the property of such decedent."

B. Harmonize Filing Dates

1. Background

The Proposed Section 6048 Regulations do not provide any further extension of the Form 3520 due date for calendar-year taxpayers residing outside the United States who may have already extended the time to file their federal income tax returns to December 15. Section 2006(b) of the Surface Transportation Act requires Treasury to modify the appropriate regulations to provide that Form 3520 shall have a maximum extension for the six-month period ending October 15.[101] While in most cases an individual's income tax return will also have an extended due date ending October 15, there are situations in which taxpayers may obtain valid extensions beyond October 15. For example, an individual who has not completed the qualifying period for claiming the foreign earned income exclusion or deduction under section 911 may apply for an extension on Form 2350, *Application for Extension of Time to File U.S. Income Tax Return*.[102] Further, under Treas. Reg. § 1.6081-1(b)(1), an individual described in Treas.

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[99] Treas. Reg. § 20.2002-1.

[100] *See* CCA 2013120517500210, 2014 TNT 22-66 (Dec. 5, 2013), *available at* https://www.taxnotes.com/research/federal/irs-private-rulings/e-mail-chief-counsel-advice/statutory-executor-only-has-authority-in-estate-tax-regime/1fn27 ("The plain language of the statute limits the statutory executor to the estate tax regime. Section 2203 does not provide any authority in the income tax regime or in the gift tax regime or in the GSTT regime." [citations omitted]).

[101] Pub. L. No. 114-41, § 2006(b)(10), 129 Stat. 443, 458 (2015).

[102] *See* Treas. Reg. § 1.911-7(c)(2).

Reg. § 1.6081-5(a)(5) (*i.e.*, a U.S. citizen or resident whose "tax home" is outside the United States and Puerto Rico) is allowed to write a letter to the Service and request an extension to file their specified tax return(s) until December 15 of the applicable tax year for a stated reason (*e.g.*, the necessity of more time to gather income and expense information to accurately prepare such specified tax return). And section 7805A provides for postponement of certain tax-related deadlines due either to service in a combat zone or a Presidentially declared disaster.

While Treasury and the Service are bound to provide for a maximum extension consistent with the Surface Transportation Act, in any instance where a taxpayer has obtained a valid extension beyond October 15, there is a strong possibility that the taxpayer will believe such extension applies to Form 3520.

2. Recommendation(s)

We suggest the final date for the Forms 3520 and 3520-A (supplemental procedure) align with a taxpayer's valid extension of the relevant tax return, even if that extended deadline is December 15. If the Service determines that extension is not possible, the Proposed Regulations should consider it reasonable cause to file Forms 3520 and 3520-A (supplemental procedure) by the extended due date of the taxpayer's return, including the December 15 extension.

3. Explanation(s)

If October 15 is the final deadline for filing Form 3520, in any instance where a taxpayer has obtained a valid extension beyond October 15, there is a strong possibility that the taxpayer or taxpayer's advisors will believe such extension applies to a Form 3520. Further, taxpayers who are abroad may not have their returns fully drafted until after October 15, and this is often true even when an outside return preparer is assisting the taxpayer overseas. It seems to be textbook reasonable cause when a taxpayer resides outside the U.S. files a timely Form 1040 by December 15 and includes an unknowingly (and barely) delinquent Form 3520. Consequently, it would be helpful if, in determining whether an individual has reasonable cause for failure to file Form 3520 by October 15, the final regulations would specifically recognize having a Form 1040 filing date beyond October 15 as constituting reasonable cause with respect to Forms 3520 filed on or before the Form 1040 due date.

C. Definition of Trust Background

1. Background

a. Trusts—From the Common Law

It is well settled that state law determines the nature of a legal interest that a taxpayer may have as the Code creates no property rights but merely attaches tax

consequences to those rights created under state law (*e.g.*, trusts and their tax consequences).[103]

Generally, a trust is an arrangement under which one person is enabled to deal with property for the benefit of another person.[104] The origin and development of the principles, rules, and standards of what is now the law of trusts is largely attributable to the separate courts of common law and chancery in England, under which arose the distinction between legal interests (legal title) and equitable (or beneficial) interests—this is the basic premise of a trust.[105] Trust law throughout the United States (except Louisiana) is based on the common law.[106]

The Treasury Regulations describe what constitutes a trust for United States income tax purposes as follows:

> In general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually the beneficiaries of such a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries of such a trust may be the persons who create it and it will be recognized as a trust under the Internal Revenue Code if it was created for the purpose of

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[103] In *U.S. v. National Bank of Commerce,* 472 U.S. 713 (1985), the Supreme Court explained this principle:

"[I]n the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property." This follows from the fact that the federal statute "creates no property rights but merely attaches consequences, federally defined, to rights created under state law." And those consequences are "a matter left to federal law." "[O]nce it has been determined that state law creates sufficient interests in the [taxpayer] to satisfy the requirements of [the statute], state law is inoperative," and the tax consequences thenceforth are dictated by federal law.

472 U.S. at 722 (internal citations omitted).

[104] *Restatement 3d of Trusts*, Introductory Note (Am. Law Inst., 2003).

[105] *Restatement 3d of Trusts*, Introductory Note (Am. Law Inst., 2003)

[106] For example, the rule in Texas has been described as follows:

> [T]he "common law of England" remains the "rule of decision" in Texas except to the extent it is inconsistent with the Constitution or laws of this State. However, in this context, the "common law of England" was "that which was declared by the courts of the different states of the United States," rather than the common law in force in England in 1840 (when the original statute was enacted). Thus, where not otherwise provided by the Constitution or laws of Texas, the common law of the various states remains in effect here.

Thoroughbred Horsemen's Ass'n v. Dyer, 905 S.W.2d 752, 754 (Tex. App. 1995) (internal citations omitted). *See also* Tex. Civ. Prac. & Rem. Code § 5.001. For common law rules explicitly abrogated by statute, *see* Tex. Prop. Code §5.042 (Abolition of Common-Law Rules); *see also* Tex. Prop. Code § 111.005 (Reenactment of Common Law).

> protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.[107]

In *Textron, Inc. v. Commissioner*,[108] the Tax Court recited the three basic requirements for a trust found in American common law, stating: "An arrangement . . . will be classified as a trust for Federal income tax purposes if it is a bona fide transaction that involves a trustee, a beneficiary, and trust property (res)."[109] This simple statement reflects the longstanding definition of a trust in American jurisprudence.[110] Each of these three requirements must be met in order to establish the existence of a trust for U.S. income tax purposes.

The Code, Treasury Regulations, and extensive case law explain that estate planning trusts are generally recognized for tax purposes.[111] The trust as a taxpayer—like its characterization as a complex, simple, or a grantor trust—is purely a concept created under the Code.

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[107] Treas. Reg. § 301.7701-4(a).

[108] 117 T.C. 67 (T.C. 2001).

[109] 117 T.C. at 76; *see also Estate of Wedum v. Commissioner*, T.C. Memo 1989-184, at 21 ("The elements of a valid express trust . . . are: (1) a designated trustee subject to enforceable duties, (2) a designated beneficiary vested with enforceable rights, and (3) a definite trust res wherein the trustee's title and estate is separated from the vested beneficial interest of the beneficiary."), as quoted in Textron.

[110] *See Restatement 3d of Trusts*, §2 (Am. Law Inst., 2003) ("A trust . . . is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.").

[111] In *Estate of Petter v. Commissioner,* T.C. Memo 2009-280, at 8, *aff'd*, 653 F.3d 1012 (9th Cir. 2011), the Tax Court explains the various ways in which the different federal tax laws can be applied to the same trust:

> In late 2001, LeMaster set up two intentionally defective grantor trusts. (Although specialists call them "defective," these types of trusts are widely used by sophisticated estate planners for honest purposes.) Anne's trusts were defective because they allowed the trustee of either trust to purchase and pay premiums on a life insurance policy on the life of the grantor (Anne), in contravention of section 677(a)(3). This meant that for income-tax purposes—though not for any other purpose—Anne would be treated as the owner of the assets even though they were legally owned by a trustee, and she herself would remain liable for income taxes on the trust's income for the rest of her life. This arrangement did, however, remove those assets held in trust from Anne's estate, reducing her estate-tax liability. It also allowed her to make income-tax payments for the trusts without the IRS' treating those payments as additional gifts to her children.

b. A Foreign Trust

Guidance is needed as to how to determine when a foreign entity is a trust rather than another type of entity. The determination of "trust" entity classification is highly nuanced, and the result of an entity or arrangement being treated as an ordinary trust, rather than as an account or business entity, exposes the taxpayer to much higher penalties for Form 3520 and Form 3520-A noncompliance, compared to entity classification. The Proposed Regulations do not address the fundamental question of how the common law concept of a trust—a contractual arrangement between the settlor and trustee—is applied to foreign, civil law juridical persons. While many foreign arrangements deemed *foreign trusts* are easy to classify—because they are formed in a common law jurisdiction—there is a significant amount of foreign tax and estate planning done with foundations and similar legal entities. The regulations defining a domestic trust, one meeting the court test and control test, ignore the more fundamental question of whether the foreign entity is a trust at all.

There are no Treasury Regulations under sections 6048 or 6677 that explain what types of foreign entities or arrangements are deemed a trust. As if to emphasize the information void on this subject, what regulations that did exist—Temp. Reg. § 16.3-1[112] and Treas. Reg. § 404.6048-1[113]—were declared obsolete by Service counsel.[114] But even the obsolete regulations offered no insight into what types of foreign entities and foreign contractual arrangements might be deemed a *foreign trust.*

Treasury Regulations § 1.643(d)-1 defines foreign trust for purposes of Part 1, Subchapter J of the Code (§§ 641—685). This regulation pertains to determining that portion of a foreign trust susceptible to taxation in the United States under the trust income tax rules and not for reporting purposes of section 6048 (because there were no section 6048 regulations existing at that time).[115]

There is case law on non-common law entities being treated as foreign trusts for U.S. tax purposes, but the conclusions are not uniform. For example, in *MCA v. U.S.*,[116] the issue was whether a foreign entity was a partnership or a corporation for U.S. income tax purposes. The entity at issue was owned by another entity that was a controlled foreign corporation ("**CFC**") and a *stichting,* a Netherlands legal entity generally referred to as a foundation. The *stichting* was formed for the benefit of the senior employees of

[112] Added by T.D. 6632, 28 Fed. Reg. 277 (Jan. 10, 1963).

[113] Added by T.D. 7502, 42 Fed. Reg. 41,856 (Aug. 19, 1977).

[114] *See* CCA 201402006 (June 26, 2013) ("The regs cited predate the 1996 changes to section 6048 and 6677 and have no relevance today."). The Service did not remove those obsolete regulations until 2018. *See* 83 Fed. Reg. 6806, 6811, 6812 (Mar. 5, 2018).

[115] Treas. Reg. § 1.643(d)-1(a), *as added by* T.D. 6989, 34 Fed. Reg. 730, 732, (Jan. 17, 1969), *amended by* T.D. 9849, 84 Fed. Reg. 923 (Mar. 14, 2019). Prior to the 2019 amendment, the last sentence of the regulation read: "For provisions relating to the information returns which are required to be filed with respect to the creation of or transfers to foreign trusts, see section 6048 and § 16.3-1 of this chapter (Temporary Regulations under the Revenue Act of 1962)."

[116] 685 F.2d 1099 (9th Cir. 1982).

the two U.S. corporations that were each 49% shareholders in the CFC. The remaining 2% of the shares in the CFC were owned by the *stichting*. The *stichting* had a three-member board of trustees, two of which were appointed by the board of directors of the CFC. Those appointed directors were members of the class of beneficiaries of the *stichting* and were senior executives of the two U.S. corporations.

The Service contended that the CFC and the *stichting* were under common control and that the foreign entity at issue was a corporation. The Court characterized the *stichting* as a trust and focused on the fiduciary duties of its board of trustees to conclude that, as a trust, the *stichting* was independent from the U.S. corporations and the CFC. Thus, the court reasoned that the entity at issue was a partnership:

> The government's control theory disregards the Trustees' duty of loyalty to the *Stichting* beneficiaries. As fiduciaries, regardless of the breadth of their discretion, the *Stichting* Trustees have a duty to exercise their powers in good faith and without concern for their own personal interests or for those of third parties. *See* Bogert*, Trusts and Trustees*, § 543 (2d Ed. 1978). Thus, although the Trust Deed grants the Trustees broad investment discretion, and may effectively preclude judicial review of the Trustees' investment judgments, it does not, and cannot, relieve the Trustees of their fiduciary duty of loyalty to the trust beneficiaries.[117]

Although the Court applied the law of the forum in determining the scope of the trustees' duties, the key conclusion was that the *stichting* was a trust.

In *Estate of Swan*,[118] the question was whether property transferred to Liechtenstein and Switzerland *Stiftungen* was included within the gross estate of the decedent for U.S. estate tax purposes. The Tax Court held they were to be included in the estate based on the decedent's power to amend or revoke the *Stiftungen* within the meaning of the predecessor to current section 2036 as a transfer "by trust or otherwise" in which the transferor retains a life estate.[119] As the Tax Court noted in holding the assets to be part of the gross estate: "We think, therefore, that regardless of the precise nature of the Stiftung, transfers such as involved in the instant case are subject to the provisions of section 811(d)[120] [current §2036(a)]" so as to be included in the estate for estate tax

[117] 685 F.2d at 1103.

[118] 24 T.C. 829 (1955), *aff'd in part and rev'd in part on other grounds*, 247 F.2d 144 (2d Cir. 1957).

[119] 24 T.C. at 857.

[120] Subsection 811(d)(1) of the Code of 1939 read as follows:

> Gross Estate. The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—
>
> * * *
>
> (d) Revocable Transfers—
>
> (1) TRANSFERS AFTER JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona-fide sale for an adequate and

purposes.[121] On appeal, the Court of Appeals recognized that "[t]hese foundations have characteristics which are similar in some respects to those of a corporation, and in other respects to those of a trust."[122] In upholding the Tax Court's conclusion that the Stiftung was a trust, the Court of Appeals was equivocal, finding that the statutes were "not limited to trust arrangements but expressly refer to the broad category of all 'revocable transfers,' as shown by the specific references to 'a transfer . . . by trust or otherwise.'"[123] The Second Circuit was clear that its decision applied only in the context of transfer taxes:

> The fact that a Stiftung has been considered as a separate juridical entity for income tax purposes, cf. *Aramo-Stiftung v. Commissioner*, 2 Cir., 1949, 172 F.2d 896, does not militate against the Tax Court's conclusion. *The policies underlying choice of the taxable entity in the income tax area are quite different from the policies involved in the problem of whether certain transfers ought to be included in the gross estate*. Indeed, the issue of the taxability of the Stiftung as a separate entity was not discussed by the Court in *Aramo-Stiftung v. Commissioner*, supra.[124]

As acknowledged in *Estate of Swan*, courts have also treated a *Stiftung* as a corporation under the Code. In *Aramo-Stiftung v. Commissioner*,[125] the Court of Appeals respected the Service's treatment of the Liechtenstein *Stiftung* as a personal holding corporation for income tax purposes. In *Aramo-Stiftung*, there was no challenge to the status of Aramo-Stiftung as a corporation, only whether the corporation had constructively received certain dividends so as to be liable for the foreign personal holding company tax.

Associate Chief Counsel Advice, AM2009-012 (Oct. 7, 2009) (the "**2009 IRS Memorandum**"), reviews the characteristics of the *Anstalt* and the *Stiftung*, two of the types of entities that can be formed under the laws of the country of Liechtenstein. The 2009 IRS Memorandum concluded that a *Stiftung* is generally treated as a trust "subject to the facts and circumstances of each situation." The 2009 IRS Memorandum relies only on the lower court decision in *Estate of Swan v. Commissioner*, above, merely saying the court "concluded that the *Stiftungs* [*sic*] were comparable to *trusts for estate*

> full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death; . . . .

[121] 24 T.C. at 857.

[122] 247 F.2d at 145.

[123] 247 F.2d at 147.

[124] 247 F.2d at 147 n.3 (emphasis added).

[125] 172 F.2d 896 (2d Cir. 1949), *aff'g sub nom. Oak Commercial Corp. v. Commissioner*, 9 T.C. 947 (1947).

tax purposes, rather than corporations." [emphasis added]. Notably, *Aramo-Stiftung*, the case in which the Service treated a *Stiftung* as a corporation for purposes of the personal holding company tax, is not mentioned. Furthermore, the 2009 IRS Memorandum makes no mention of sections 6048 or 6677.

Since the changes to sections 6048, 6677, and 7701 in 1996, the Service has formally ruled on whether foreign entities and arrangements constitute trusts for federal income tax purposes in only a few instances, none involving the determination of whether a foreign, civil law legal entity was a trust. Most notably, however, Revenue Ruling 2013-14[126] concludes that an entity known in Mexico as a *fideicomiso*, generally translated as "Mexican Land Trust," is not to be treated as a trust for U.S. tax purposes, though under the laws of Mexico it is treated as a trust because it does not have "legal status of its own and instead represents a contractual arrangement between two parties . . . ."[127] In other words, the *fideicomiso* was disregarded.[128]

c. Definition of a Foreign Estate

The Code defines a foreign estate, not by the situs of its executor or administrator, the domicile or place of death of the decedent, or the location of the court under which the estate is administered, but by an analysis of the sources of its income, to wit:

> The term "foreign estate" means an estate the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income under subtitle A.[129]

Regarding this definition of *foreign estate*, a leading commentator has explained:

> It is the statement of a result rather than a rule governing an analysis; thus, it is very puzzling indeed. It would appear that determining whether an estate is foreign for income tax purposes requires even greater scrutiny of the individual facts and circumstances than determining the domicile of a non-citizen decedent for U.S. estate tax purposes.[130]

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[126] Rev. Rul. 2013-14, 2013-26 I.R.B. 1267.

[127] Manuel F. Solano & Terri L. Grosselin, *Business Operations in Mexico*, 7240 Tax Mngt. Port. (BNA) III.H.2 (2021).

[128] Treas. Reg. § 301.7701-1.

[129] I.R.C. § 7701(a)(31)(A). There are no income tax regulations explaining the meaning of this definition. To make things interesting, this definition applies only for income tax purposes. *See* I.R.C. § 2001(a) (estate tax); Treas. Reg. § 20.0-1(b).

[130] Michael A. Heimos, Tax Management Portfolio 6500-1st, *U.S. Taxation of Foreign Estates, Trusts and Beneficiaries*, section XXII.A.2.a. (Bloomberg BNA 2024).

As would be expected from a definition of this kind, the authorities are all fact-specific and case by case.[131] The Proposed Regulations do not offer any help on the quixotic statutory definition of a *foreign estate*.

2. Recommendation(s)

The Proposed Regulations should include language in the court and control test regulation or the trust regulation (Treas. Reg. §§ 301.7701-7 and -4, respectively) setting out how and under what circumstances foreign, civil law juridical persons can be equated to the common law trust.

3. Explanation(s)

The Proposed Regulations repeat an erroneous description of how one creates a trust that is already in the Treasury Regulations. As emphasized above, in order to create a trust, there must be (i) a transfer of property, (ii) to a trustee, (iii) for the benefit of a beneficiary.

Prop. Treas. Reg. § 1.6048-2(d)(1), Example 1 states: "A, an attorney, creates a foreign trust, FT, on behalf of B, A's client. A and B are both U.S. persons. Shortly thereafter, B transfers $100x to FT. A and B are both grantors of FT under § 1.671-2(e), even though only B transferred property to FT." The lack of detail regarding A's creation of the foreign trust, including whether A transferred any property, creates ambiguity because it implies that A set up a trust and someone else later transferred property to the same trust. The statement is ambiguous and suggests that attorneys will be deemed grantors merely by drafting the trust instrument.[132]

As explained above, foreign countries allow the establishment of entities that do not conform to common law concepts, even common law concepts refined through years of legislation and codified by the states.

[131] In Rev. Rul. 57-245, 1957-1 C.B. 286, *modified by* Rev. Rul. 62-154, 1962-2 C.B. 148, decedent's estate was a foreign estate, where citizenship and domicile were in foreign country, 90% of assets were in the United States, and will was probated in the United States. Rev. Rul. 58-232, 1958-1 C.B. 261, *superseded by* Rev. Rul. 62-154, 1962-2 C.B. 148, held that an estate with ancillary U.S. administration was foreign estate. *See also* Rev. Rul. 62-154, 1962-2 C.B. 148, reviewing Rev. Rul. 57-245 and Rev. Rul. 58-232 in light of Rev. Rul. 60-181 (trust established under foreign law but trading U.S. securities on U.S. exchanges was resident alien) and *B. W. Jones Trust v. Commissioner*, 46 B.T.A. 531 (1942), *aff'd*, 132 F.2d 914 (5th Cir. 1943); Rev. Rul. 81-112, 1981-1 C.B. 598, decedent's estate was a foreign estate, where decedent was U.S. citizen who had resided abroad for 20 years, estate was administered abroad, all assets were abroad, and the personal representative was foreign.

[132] The language in the Proposed Regulations appears to echo language in Treas. Reg. § 1.671-2(e)(1), which is similarly cryptic in its reference to someone who creates a trust without transferring property to it.

The case law is too inconsistent depending on the context; for example, the *Stiftung* can be either a trust[133] or a corporation.[134] Additional guidance in this area would be greatly appreciated by taxpayers and practitioners.

D. Greater Consistency is Needed Surrounding the Definition of the Term "Grantor"

1. Background

Sections 671 through 679 of the Code do not define the term "grantor." Prior to the finalization of Treasury Regulations providing a definition of the term "grantor" in 2000 (the "**2000 Regulations**"),[135] case law defined the grantor of a trust as the person whose economic contributions funded the trust (or, stated differently, the person who furnishes "the major portion of consideration for the trust's creation.").[136] Under this case law, where a settlor only nominally funds the trust they created, and another person made large gifts to the trust, the settlor was not the true grantor for purposes of the grantor trust rules; rather, the subsequent transferor was the actual grantor.[137] The 2000 Regulations effectively nullify this case law for information reporting purposes, providing:

> If a person creates or funds a trust on behalf of another person, both persons are treated as grantors of the trust. (See section 6048 for reporting requirements that apply to grantors of foreign trusts.) However, a person who creates a trust but makes no gratuitous transfers to the trust is not treated as an owner of any portion of the trust under sections 671 through 677 or 679.[138]

The above parenthetical is, of course, incomplete because additional requirements under Title 31 may also be triggered by virtue of Treasury's and the Service's expanded definition of the term "grantor."[139]

In the experience of our members, the Service, including the Office of Chief Counsel, in analyzing whether a U.S. person was required to file FBARs and Forms

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[133] See discussion of *Estate of Swan*, above.

[134] See discussion of *Aramco-Stiftung*, above.

[135] *See* Treas. Reg. § 1.671-2(e); *see also* Treas. Reg. § 1.679-7(a).

[136] *See Gould v. Commissioner*, 139 T.C. 418, 437 (2012) (citing *Stern v. Commissioner*, 77 T.C. 614, 641-642 (1981), *rev'd and rem'd on other grounds*, 747 F.2d 555 (9th Cir. 1984); *Bixby v. Commissioner*, 58 T.C. 757, 791 (1972), *acq.*, 1975-2 C.B. 1).

[137] *See, e.g., Stern*, 77 T.C. at 641-642; *Bixby*, 58 T.C. at 791 (1972) (both holding that if settlors only nominally funded the trusts they created, and other individuals made large gifts to the trusts, the settlors were not the true grantors for purposes of the grantor trust rules, but rather, the subsequent transferors were the actual grantors).

[138] Treas. Reg. § 1.671-2(e)(1).

[139] *See* 31 C.F.R. § 1010.350(e)(2)(iii).

3520-A (and is therefore subject to substantial penalties for the failure to file those forms), have occasionally (but not always) determined the grantor of a *foreign trust* by reference to who settled (*i.e.*, established) or controlled the trust, not whose economic contributions funded the trust. Depending upon whether the contributions to the foreign trust occurred before or after the effective date of the 2000 Regulations, such an interpretation has relied upon the above-referenced parenthetical or a sentence in Notice 97-34, which similarly provides: "a 'grantor' includes any person who creates a trust as well as any person who directly or indirectly makes a gratuitous transfer of money or other property to a trust."[140]

2. Recommendation(s)

We recommend that the Proposed Regulations be amended to reconcile inconsistencies in the definition of the term "grantor" under Treas. Reg. § 1.671-2(e)(1), Notice 97-34, and relevant case law. In this regard, we recommend that Treas. Reg. § 1.671-2 be amended to define the grantor of a trust as the person whose economic contributions funded the trust (or, stated differently, the person who furnishes "the major portion of consideration for the trust's creation."). Alternatively, we recommend that the parenthetical contained in the third sentence of Treas. Reg. § 1.671-2(e)(1) be amended to include a cross-reference to 31 C.F.R. § 1010.350.

3. Explanation(s)

The designation of grantor status, often with the correlative imposition of substantial penalties under these circumstances elevates form over substance and appears inconsistent with the underlying economic realities. Moreover, the Service's position that a person whose contributions did not economically fund a trust should nevertheless be treated as a grantor (and subject to significant penalties) is incompatible with established principles and case law defining a grantor as the person who furnishes the major portion of consideration for the trust's creation.

[140] Notice 97-34, 1997-1 C.B. 422, § II.