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Foreign Gifts and Foreign Trusts: Proposed Regulations

On May 8, 2024, Treasury published proposed regulations that may affect U.S. taxpayers who receive gifts from abroad, have set up a foreign trust, or are beneficiaries of foreign trusts. The rules governing transactions with foreign trusts are complex, and failure to follow them carefully may result in significant penalties.

Below is an overview of some of the key existing rules, along with brief highlights from the proposed regulations. If you have questions about the new regulations and how they may apply to you, please contact any member of your Choate team.

Reporting

Foreign Gifts

In general, under the existing rules, a U.S. person who receives a large gift or bequest from abroad must report it to the IRS by filing a Form 3520. At a high level:

- Gifts or bequests in excess of $100,000 in a single year from a foreign individual (or multiple related persons) must be reported.
- If the total gifts from a foreign individual meet the reporting threshold, you must identify each gift greater than $5,000, provide a description of the property received, and report the date of receipt and fair market value of the gift on that date.
- If you receive a gift from a foreign corporation or partnership, special rules apply.

Notably, if the proposed regulations are enacted, they would require the U.S. recipient to disclose the donor of a reportable foreign gift (removing the anonymity currently enjoyed by foreign donors who are individuals), and index for inflation the $100,000 reporting threshold for gifts from individuals. In addition, the proposed regulations incorporate a new anti-avoidance rule allowing the IRS to recharacterize certain loans from abroad as reportable gifts.

Foreign Trusts

U.S. taxpayers who have funded foreign trusts or who are beneficiaries of foreign trusts are also subject to reporting obligations under the existing rules. Generally speaking, if all substantial decisions for a trust are made by a U.S. person and the trust is administered exclusively within the U.S., it is not a foreign trust. If a trust does not meet both criteria, it may be a foreign trust.

- If you transfer property to a foreign trust or engage in certain other transactions with a foreign trust, you will need to file a Form 3520 with the IRS.
- Likewise, distributions from a foreign trust must also be reported on a Form 3520.
- If you are treated as the tax owner of a foreign grantor trust, you must file a Form 3520 annually. In addition, you are also responsible for ensuring that the trustee files an annual information return (on Form 3520-A) and provides you and any U.S. beneficiaries with additional tax information.

The proposed regulations provide additional guidance regarding how certain transactions with foreign trusts should be reported and include a broader exception for specified tax-favored foreign trusts.

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Certain Transactions with Foreign Trusts

In addition to the reporting requirements outlined above, loans between U.S. taxpayers and foreign trusts and the uncompensated use of property owned by foreign trusts are subject to complex tax rules. In general:

- If not structured properly, a loan from a foreign trust or the uncompensated use of foreign trust property could in certain cases be treated as a distribution from the trust or cause the trust to be treated as having a U.S. beneficiary.
- Debt obligations issued by a foreign trust in connection with transactions between the trust and the donor can, in some instances, be disregarded unless they meet several technical requirements.

The proposed regulations provide additional guidance on the treatment of loans and the application of grantor trust rules to foreign trusts with U.S. beneficiaries.

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