Green Circulation Draft of 2-14-2020
REG-124850-08
CC:INTL:Br1:LABanjanin

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-124850-08]

RIN 1545-B104

Information Reporting on Transactions With Foreign Trusts and on Large Foreign Gifts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to information reporting on United States persons' transactions with, and ownership of, foreign trusts and on the receipt of large foreign gifts or bequests. This document also contains proposed regulations relating to loans from, and uses of property of, foreign trusts, as well as proposed amendments to the regulations relating to foreign trusts having one or more United States beneficiaries. The proposed regulations affect United States persons who engage in transactions with, or are treated as the owner of, foreign trusts, and United States persons who receive large gifts or bequests from foreign persons.

DATES: Written or electronic comments and requests for a public hearing must be received by [**INSERT DATE 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER**].

ADDRESSES: Submit electronic submissions via the Federal eRulemaking Portal at

www.regulations.gov (indicate IRS and REG-124850-08) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG-124850-08), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations generally, Lara A. Banjanin or Tracy M. Villecco at (202) 317-6933 (not a toll-free number); concerning the submissions and hearing, Regina Johnson at (202)-317-6901 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

I. In General

This document contains proposed amendments to 26 CFR part 1 under sections 643(i), 679, 6039F, 6048, and 6677 of the Internal Revenue Code (Code) (the "proposed regulations"). Section 6048, as significantly modified by the Small Business Job Protection Act of 1996 (1996 Act), Public Law 104-188 (110 Stat. 1755), and further amended by the Taxpayer Relief Act of 1997 (1997 Act), Public Law 105-34 (111 Stat. 788), and the Hiring Incentives to Restore Employment Act (HIRE Act), Public Law 111-147 (124 Stat. 71), generally requires U.S. persons to report transactions that involve foreign trusts. Section 6677, as significantly modified by the 1996 Act and further amended by the HIRE Act, imposes penalties on U.S. persons for failing to comply with

section 6048. Section 6039F, which was added to the Code by the 1996 Act, requires U.S. persons to report the receipt of large gifts or bequests from foreign persons, and in the event of a failure to provide this information, section 6039F(c) imposes penalties and allows the IRS to recharacterize the purported gift or bequest as income. Section 643(i), which was added to the Code by the 1996 Act and further amended by the HIRE Act, and section 679, as amended by the 1996 Act and the HIRE Act, provide additional rules intended to prevent taxpayers from avoiding U.S. income tax consequences through the use of foreign trusts. On June 2, 1997, the Treasury Department and the IRS issued Notice 97-34, 1997-1 CB 422, which provides guidance on sections 643(i), 679, 6039F, 6048 and 6677 (the "foreign trust and gift provisions") as enacted or modified by the 1996 Act. In 2001, the Treasury Department and the IRS issued final regulations under section 679. TD 8955 (66 FR 37866).

Taxpayers currently provide information required by the foreign trust and gift provisions on Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, and Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner (Under section 6048(b)). In 2015, section 2006(b)(9) and (10) of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (Surface Transportation Act), Public Law 114-41 (129 Stat. 443), modified the due dates for Forms 3520 and 3520-A for taxable years beginning after December 31, 2015. On [February XX, 2020], the Treasury Department and the IRS issued Revenue Procedure [XXXX], which exempts from section 6048 information reporting requirements certain U.S. individuals' transactions with, and ownership of, certain tax-favored foreign trusts that are established and operated exclusively or almost

exclusively to provide pension or retirement benefits, or to provide medical, disability, or educational benefits.

II. Purpose of Foreign Trust and Gift Provisions

During the mid- to late-1990s, abusive tax schemes, including offshore schemes involving foreign trusts, reemerged in the United States after last peaking in the 1980s. GAO, *Efforts to Identify and Combat Abusive Tax Schemes Have Increased, But Challenges Remain*, GAO-02-733 (Washington D.C.: May 22, 2002). Foreign trusts were used to transfer large amounts of assets offshore, where it would be much more difficult for the IRS to identify whether U.S. taxpayers owned an interest in such trusts, and whether such taxpayers were reporting and paying their fair share of taxes on their income from such trusts. Many of the trusts were established in tax haven jurisdictions with bank secrecy laws. Before the 1996 Act amended sections 6048 and 6677, there was not any requirement for U.S. persons to report distributions from foreign trusts, and the penalty for failing to report transfers to a foreign trust, or an annual foreign trust information return (on Form 3520-A), was limited to 5 percent of the transfer or trust corpus, as applicable, not to exceed $1,000. It was difficult for the IRS to obtain information about income earned by U.S.-owned foreign trusts and distributions to U.S. beneficiaries of foreign trusts, and sections 6048 and 6677 were generally ineffective at ensuring that taxpayers provided this information. The result was “rampant tax avoidance.” 141 Cong. Rec. S13859 (daily ed. Sept. 19, 1995) (remarks of Senator Moynihan).

The foreign trust and gift provisions in the 1996 Act were designed to accommodate changes in the use of foreign trusts and to limit avoidance and evasion of

U.S. tax. The most significant changes were changes to sections 6048 and 6677 that enhanced the IRS's ability to obtain the information necessary to enforce the tax laws that apply to U.S. persons' transactions with, and ownership of, foreign trusts. Other changes included enactment of new section 643(i) and amendments to section 679, each of which is designed to prevent tax avoidance through the use of foreign trusts. In addition, the legislation included new section 6039F, which enables the IRS to obtain information about large foreign gifts or bequests received by U.S. persons.

III. Overview

A. Section 643(i)

Section 643(i), as originally enacted in 1996, generally provided that, if a foreign trust makes a loan of cash or marketable securities directly or indirectly to any grantor or beneficiary of the foreign trust who is a U.S. person (other than an entity that is exempt from tax under Chapter 1 of the Code), or to a U.S. person related (under sections 267 and 707(b)) to such a grantor or beneficiary, the amount of the loan will be treated as a distribution by the trust to the grantor or beneficiary. Section 643(i) also authorizes the Secretary to issue regulations providing exceptions, under which a loan by a foreign trust would not be treated as a distribution to the grantor or beneficiary of the trust. Congress intended that the Treasury Department and the IRS, in exercising their regulatory authority to create exceptions under section 643(i), would give consideration to whether there is a reasonable expectation that the grantor, beneficiary, or related person would repay the loan. H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess., at 334 (1996).

Section V.A of Notice 97-34 provides that a loan of cash or marketable securities

by a foreign trust to a U.S. grantor or U.S. beneficiary of the trust, or to a U.S. person who is related to a U.S. grantor or U.S. beneficiary of the trust, will be treated as a distribution under section 643(i) unless the loan is made in consideration for a "qualified obligation" that satisfies certain specified requirements. Notice 97-34 states that the qualified obligation rules will be issued in regulations. (Section III.C of Notice 97-34 provided similar qualified obligation rules that apply with respect to transfers to foreign trusts. See section II.B of this background section.)

In 2010, Congress expanded the scope of section 643(i) in response to concerns that taxpayers were avoiding the application of section 643(i) by using trust property other than cash or marketable securities without compensating the trust for the use of the property. Section 533 of the HIRE Act amended section 643(i) to provide that any uncompensated use of foreign trust property by a U.S. grantor or U.S. beneficiary of the foreign trust, or any U.S. person related to such U.S. grantor or U.S. beneficiary, will generally be treated as a distribution of the fair market value of the use of such property to the U.S. grantor or U.S. beneficiary. This rule does not apply if the trust is paid fair market value for the use of the trust property within a reasonable amount of time.

Loans and use of trust property must be reported on Part III of Form 3520. Taxpayers provide this information based on guidance in section V.A of Notice 97-34, as well as the instructions to Form 3520. This information allows the IRS to determine whether the loan or use of trust property should be treated as a distribution pursuant to section 643(i).

C. Section 679

1. As Enacted in 1976

Section 679 was enacted by the Tax Reform Act of 1976 (1976 Act), Public Law 94-455 (90 Stat. 1520), to prevent U.S. persons from avoiding U.S. tax by establishing foreign trusts that received only foreign source income that was not subject to U.S. tax. Although U.S. beneficiaries of these trusts were subject to U.S. tax when they received distributions from the foreign trusts, the use of such trusts permitted tax-free accumulations of income because the trusts were not required to pay U.S. tax on the accumulated income. To address this problem, Congress enacted section 679. Section 679(a)(1) provides generally that if a U.S. person directly or indirectly transfers property to a foreign trust, that U.S. person is treated as the owner, for his taxable year, of the portion of the foreign trust attributable to such property if the trust has a U.S. beneficiary. This rule does not apply to transfers to certain compensatory and charitable trusts.

Section 679(a)(2) provides exceptions for transfers by reason of death and certain transfers for fair market value.

Section 679(c)(1) provides that a foreign trust is treated as having a U.S. beneficiary unless (A) under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a U.S. person and (B) if the trust were terminated during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of a U.S. person.

2. 1996 Act Amendments

Section 1903 of the 1996 Act made several changes to section 679. These changes focused primarily on areas where taxpayers could improperly avoid the application of section 679. For example, Congress was concerned that taxpayers were

attempting to avoid the application of section 679(a)(1) by transferring property to a foreign trust in exchange for obligations from the foreign trust that might not be repaid and arguing that such obligations satisfied the fair market value exception in section 679(a)(2). H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess., at 334-335 (1996). Accordingly, Congress added new section 679(a)(3), which generally provides that obligations issued by the foreign trust, by any grantor or beneficiary of the trust, or by any person related to any grantor or beneficiary, are not taken into account in applying the fair market value exception except as provided in regulations.

Section III.C of Notice 97-34 implemented the fair market value exception of section 679(a)(2)(B) and (a)(3) by providing that if a U.S. person transfers money or other property to a related foreign trust in exchange for an obligation issued by the trust or by a person related to such trust, the obligation will be taken into account for purposes of determining whether the U.S. transferor received fair market value from the foreign trust only if the obligation is a "qualified obligation" that satisfies certain specified requirements. The section 679 qualified obligation rules are included in final regulations issued by the Treasury Department and the IRS in 2001 in TD 8955 (66 FR 37886). See §1.679-4(d). (Section V.A of Notice 97-34 provides similar qualified obligation rules that apply with respect to loans from foreign trusts. See section III.B of this background section.)

Transfers to a foreign trust are reported on Part I of Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, together with information about qualified obligations received from the trust.

3. HIRE Act Amendments

In 2010, the HIRE Act made five amendments to section 679, three of which are consistent with existing regulations under section 679, and two of which set forth new rules not reflected in the existing regulations.

First, section 531(a) of the HIRE Act added new language to section 679(c)(1) to clarify that an amount is treated as accumulated for the benefit of a U.S. person even if the U.S. person's interest in the trust is contingent on a future event. This statutory amendment is consistent with existing regulation §1.679-2(a)(2)(i), which states that the determination as to whether income or corpus may be paid to or accumulated for the benefit of a U.S. person is made without regard to whether the income or corpus is actually distributed to the U.S. person during the year, or whether the U.S. person's interest in the trust income or corpus is contingent on a future event.

Second, section 531(b) of the HIRE Act added a new paragraph (4) to section 679(c) to clarify that if any person has the discretion to make a distribution from the foreign trust to or for the benefit of any person, the trust shall be treated as having a U.S. beneficiary unless the terms of the trust specifically identify the class of persons to whom such distributions may be made, and none of those persons are U.S. persons during the taxable year. This statutory amendment is consistent with existing regulation §1.679-2(a)(1), which provides that a foreign trust is treated as having a U.S. beneficiary unless no part of income or corpus may be paid or accumulated to or for the benefit of a U.S. person, and if the trust is terminated at any time during the taxable year, no part of the income or corpus could be paid to or for the benefit of a U.S. person.

Third, section 531(c) of the HIRE Act added a new paragraph (5) to section

679(c) to clarify that if any U.S. person who directly or indirectly transfers property to a foreign trust is directly or indirectly involved in any agreement or understanding that may result in the income or corpus of the trust being paid or accumulated to or for the benefit of a U.S. person, then such an agreement or understanding shall be treated as constituting a term of the trust. This statutory amendment is consistent with existing regulation §1.679-2(a)(4)(i), which, assuming that a transferor of property to a trust is generally directly or indirectly involved with any agreements regarding the accumulation or disposition of the income and corpus of the trust, allows the IRS to treat a foreign trust as having a U.S. beneficiary by looking beyond the language of the trust instrument to all written and oral agreements and understandings related to the trust; memoranda or letters of wishes; all records that relate to the actual distribution of income and corpus; and all other documents relating to the trust, whether or not of any purported legal effect.

Fourth, section 532 of the HIRE Act added a new paragraph (d) to section 679, which provides a presumption that a foreign trust has a U.S. beneficiary in certain circumstances. If a U.S. person directly or indirectly transfers property to a foreign trust (other than certain compensatory and charitable trusts), the IRS may treat such trust as having a U.S. beneficiary for purposes of applying section 679 to such transfer unless such person submits such information to the IRS as the IRS may require and demonstrates to the satisfaction of the IRS that the trust satisfies the requirements of section 679(c)(1). Under section 679(d), the IRS may treat a foreign trust as having a U.S. beneficiary if the U.S. person who makes a transfer to the foreign trust fails to provide adequate responses to the relevant questions on Part I of Form 3520 or fails to

respond to additional requests for information demonstrating that the trust satisfies the requirements of section 679(c)(1).

Finally, section 533(c) of the HIRE Act added a new paragraph (6) to section 679(c), which generally treats a loan of cash or marketable securities to, or the use of any other trust property by, any U.S. person, whether or not a beneficiary under the terms of the trust, as paid or accumulated for the benefit of a U.S. person. Section 679(c)(6) does not apply to the extent that the U.S. person repays the loan at a market rate of interest or pays the fair market value of the use of such property within a reasonable period of time. The effect of section 679(c)(6) is that if a foreign trust is not already treated as having a U.S. beneficiary, a loan by the trust of cash or marketable securities to a U.S. person or the uncompensated use of trust property by a U.S. person may cause the foreign trust to be treated as having a U.S. beneficiary, with the result that a U.S. person who transferred property to the trust may be treated as the owner of the trust under section 679(a).

Although final regulations were issued under section 679 in 2001, there is no guidance on the HIRE Act amendments to section 679 other than the instructions for Form 3520 and Form 3520-A.

D. Section 6039F

Section 1905 of the 1996 Act created new reporting requirements under section 6039F for U.S. persons (other than certain exempt organizations) that receive large gifts (including bequests) from foreign persons. The new information reporting provisions require U.S. donees to provide information concerning the receipt of large amounts that the donees treat as foreign gifts, giving the IRS an opportunity to review the

characterization of these payments and determine whether they are properly treated as gifts. Taxpayers are currently required to report certain information about such foreign gifts on Part IV of Form 3520.

Section 6039F(b) generally defines the term foreign gift as any amount received from a person other than a U.S. person that the recipient treats as a gift or bequest. However, a foreign gift does not include a qualified transfer (within the meaning of section 2503(e)(2)) or any distribution from a foreign trust. A distribution from a foreign trust must be reported as a distribution under section 6048(c) (discussed in section III.E of this background section) and not as a gift under section 6039F.

Section 6039F(c) provides that if a U.S. person fails, without reasonable cause, to report a foreign gift as required by section 6039F, then (i) the tax consequences of the receipt of the gift will be determined by the Secretary and (ii) the U.S. person will be subject to a penalty equal to 5 percent of the amount of the gift for each month the failure to report the foreign gift continues, with the total penalty not to exceed 25 percent of such amount. Under sections 6039F(a) and (d), reporting is required for aggregate foreign gifts in excess of $10,000, as modified by cost-of-living adjustments. Under section VI.B.1 of Notice 97-34, however, a U.S. person is required to report gifts from a nonresident alien or foreign estate only if the aggregate amount of gifts from that nonresident alien or foreign estate exceeds $100,000 during the U.S. person's taxable year. The Notice states that once the $100,000 threshold has been met, Form 3520 will require the U.S. recipient to identify separately each gift in excess of $5,000, but that Form 3520 will not require the U.S. recipient to identify the donor. Section VI.B.3 of Notice 97-34 provides guidance on when a U.S. person must aggregate foreign gifts

received from foreign persons that the U.S. person knows or has reason to know are related to each other.

U.S. persons who receive gifts or bequests from foreign persons that exceed the threshold amounts must report such gifts or bequests on Part IV of Form 3520.

The only existing guidance under section 6039F, other than the instructions to Form 3520, is found in Notice 97-34.

E. Section 6048

Section 6048(a) through (c) contains three distinct and separate reporting obligations with respect to a U.S. person's transactions with, and ownership of, foreign trusts.

1. Section 6048(a)

Section 6048(a) generally requires a responsible party to file information returns upon the occurrence of certain reportable events. A reportable event is (a) the creation of any foreign trust by a U.S. person; (b) the direct or indirect transfer of any money or property to a foreign trust, including a transfer by reason of death; or (c) the death of a U.S. citizen or resident if the decedent was treated as the owner of any portion of the trust or any portion of a foreign trust was included in the gross estate of the decedent. Section 6048(a)(3)(B)(i) provides an exception for transfers for fair market value (the fair market value exception), and section 6048(a)(3)(B)(ii) provides an exception for transfers to certain deferred compensation and charitable trusts. (There are similar exceptions in section 679(a)(1) and (a)(2)(B). See section III.C of this background section.)

Reportable events are reported in Part I of Form 3520. Taxpayers provide this

information based on guidance in section III of Notice 97-34, as well as the instructions to Form 3520. Section 6048(a) enables the IRS to obtain the information necessary to enforce sections 679 (discussed in section II of this background section) and 684 (added by section 1131(b) of the 1997 Act to provide for recognition of gain on certain transfers to foreign trusts).

2. Section 6048(b)

Section 6048(b)(1) generally requires a U.S. person who is treated as the owner of any portion of a foreign trust under the grantor trust rules (U.S. owner) to ensure that the trust (i) files an annual information return to provide full accounting of all the trust activities for the trust's taxable year and (ii) furnishes an annual information statement to each U.S. owner and to any other U.S. person who receives (directly or indirectly) any distribution from the trust during the year (U.S. beneficiary). In addition, the U.S. owner must submit such information as the IRS may prescribe with respect to the trust.

Section 6048(b)(2) provides that unless a foreign trust with a U.S. owner appoints a U.S. agent, the Secretary may determine the amounts required to be taken into account with respect to such trust by the U.S. owner under the grantor trust rules. The U.S. agent will be required to act as the trust's limited agent solely for purposes of applying sections 7602, 7603, and 7604 with respect to any request or summons by the Secretary in connection with the tax treatment of any items related to the trust. Certain rules (similar to the rules of section 6038A(e)(2) and (4)) relating to the enforcement of requests for certain records with respect to foreign-owned corporations will apply. Information about the U.S. agent must be reported on both the U.S. owner's Form 3520 and the trust's Form 3520-A.

Section 6048(d)(5), which was added to the Code by the 1997 Act, provides that the U.S. owner's treatment of any item reported by a foreign trust to such person as an owner of the trust must be consistent with the trust's treatment of such item or the Secretary must be notified of the inconsistency.

The foreign trust's annual information return is Form 3520-A, and any additional information required to be submitted by the U.S. owner is provided on Part II of Form 3520. The information statements that the trust must furnish to each U.S. owner and each U.S. beneficiary who receives a distribution are the Foreign Grantor Trust Owner Statement and the Foreign Grantor Trust Beneficiary Statement, as applicable. Taxpayers provide this information based on guidance in section IV of Notice 97-34, as well as the instructions to Form 3520 and Form 3520-A. If the foreign trust fails to file Form 3520-A, section 6677 imposes a penalty on the U.S. owner. In order to avoid penalties under section 6677, the U.S. owner must complete a substitute Form 3520-A for the foreign trust and attach it to the U.S. owner's Form 3520. See instructions for Part II of Form 3520.

3. Section 6048(c)

Section 6048(c)(1) provides that any U.S. person who directly or indirectly receives any distribution from a foreign trust is required to file an information return to report the name of the trust, the aggregate amount of the distributions received, and any other information that the Secretary may prescribe. Section 6048(c)(2) generally provides that if adequate records are not provided to the Secretary to determine the proper treatment of a distribution from a foreign trust, the distribution will be treated as an accumulation distribution. However, to the extent provided in regulations, this rule

will not apply if the foreign trust authorizes a U.S. person to act as its limited agent under rules similar to the rules of section 6048(b)(2)(B) (discussed in section III.E of this background section). Section 6048(d)(5) (discussed in section III.E of this background section) provides that a U.S. person's treatment of a distribution from a foreign trust must be consistent with the trust's treatment of such item or the Secretary must be notified of the inconsistency.

Distributions from a foreign trust are reported on Part III of Form 3520. Taxpayers provide this information based on guidance in section V of Notice 97-34, as well as the instructions to Form 3520. Section 6048(c) enables the IRS to obtain the information it needs to enforce the rules relating to the taxation of accumulation distributions (sections 665 through 669), as well as sections 672(f), 643(h), and 643(i).

There are two opinions that interpret section 6048(c), In re Wyly, 553 B.R. 318 (2016) (concluding, in part, that trust distributions need to come directly from the trust and that certain annuity payments were not trust distributions or gratuitous transfers under section 6048(c)) and Emily Wilson et. al. v. U.S, No. 2:19-cv-5037-BMC (E.D.N.Y. 2019) (concluding, in part, that a U.S. person treated as the owner of a foreign trust may only be subject to a 5 percent penalty under section 6677(b) with respect to a failure by the owner to comply with sections 6048(b) and 6048(c)). The government [has appealed] the decision in Wilson, as the court's conclusion, which is not supported by the text of section 6048(c) or section 6677, seems to suggest that a U.S. owner of a foreign trust does not have to comply with section 6048(c) reporting if he or she receives a distribution from such trust (at least if he or she has not also complied with section 6048(b)). Section 6048(c) requires reporting by *any U.S. person* that receives a

distribution from a foreign trust, which includes a U.S. owner of a foreign trust.

4. Section 6048(d)

Section 6048(d)(1) provides that, for purposes of section 6048, in determining whether a U.S. person makes a transfer to, or receives a distribution from, a foreign trust, the fact that a portion of the trust is treated as owned by another person under the grantor trust rules is disregarded.

Section 6048(d)(2) provides that, to the extent provided in regulations, a domestic trust will be treated as a foreign trust for purposes of sections 6048 and 6677 if the trust has substantial activities, or holds substantial property, outside the United States. Congress intended "that in exercising its regulatory authority to treat a U.S. trust as a foreign trust for purposes of information reporting purposes, the Secretary of the Treasury will take into account the information that such a trust reported under the domestic trust reporting rules." H.R. Conf. Rep. 737, 104th Cong., 2d Sess. at 338 (1996). Section VIII.C of Notice 97-34 states that the Treasury Department and the IRS are studying the appropriate scope of section 6048(d)(2) and that until further guidance is issued, domestic trusts will not be treated as foreign trusts pursuant to section 6048(d)(2).

Section 6048(d)(3) provides that any notice or return required under section 6048 will be made at such time and in such manner as the Secretary prescribes. The rules are currently prescribed in Notice 97-34, the instructions for Form 3520, and the instructions for Form 3520-A.

Section 6048(d)(4) authorizes the IRS to suspend or modify any requirement of section 6048 if the IRS determines that the United States has no significant tax interest

in obtaining the required information.

Section 6048(d)(5) (added by section 1027(b) of the 1997 Act) provides that a U.S. person who is treated as an owner of any portion of a foreign trust, or a U.S. person who receives (directly or indirectly) any distribution from a foreign trust must treat any item reported by the trust to such U.S. person in a manner that is consistent with the trust's treatment of such item or the Secretary must be notified of the inconsistency. A similar rule in section 6034A(c) (added by section 1027(a) of the 1997 Act) generally provides that a beneficiary of an estate or trust is required to file its return in a manner that is consistent with the information received from the estate or trust, unless the beneficiary files with its return a notification of inconsistent treatment identifying the inconsistency. Congress intended the rules in sections 6034A(c) and 6048(d)(5) to be comparable to the consistency rules that already applied to S corporation shareholders and partners in partnerships. H.R. Conf. Rep. 220, 105th Cong., 1st Sess. at 551 (1997). Taxpayers may use a Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), for this purpose.

Although there are regulations issued under section 6048, these regulations are obsolete because they were issued under an earlier version of section 6048, and have been removed as a result of regulations issued pursuant to Executive Order 13789. See TD 9849 (84 FR 9231).

F. Section 6677

Under section 6677, as amended by section 1901(b) of the 1996 Act, a U.S. person who fails to file a required information return under section 6048(a) or (c) is subject to an initial penalty of 35 percent of the gross reportable amount (generally the

value of the property transferred or received). If an information return required under section 6048(b) is not filed, the U.S. person who is treated as the owner of the trust is subject to an initial penalty of 5 percent of the gross reportable amount (the trust corpus at the end of the year). In all cases, an additional $10,000 penalty is imposed for each 30-day period (or fraction thereof) during which the failure to file an information return continues (beginning after the expiration of a 90-day period after the IRS mails notification of the failure). The total amount of the penalties with respect to any failure cannot exceed the gross reportable amount with respect to that failure. If the gross reportable amount is partially reported, then the penalties are applied based on the amount that is unreported. Section VII of Notice 97-34.

Section 535 of the HIRE Act strengthened the penalty structure further by amending section 6677 to allow the IRS to impose penalties when it does not have enough information to determine the gross reportable amount. Section 6677, as amended, provides that the initial penalty is the greater of $10,000 or 35 percent (5 percent in the case of a failure to comply with section 6048(b)) of the gross reportable amount. Thus, the IRS may impose an initial penalty of $10,000 on persons who fail to report information with respect to certain foreign trusts without having any information about the trust's gross reportable amount. The amendment did not change the rules for the additional penalties of $10,000 for each 30-day period (or fraction thereof) during which the failure to report continues.

Section 6677, as amended, also provides that if the IRS, after having assessed penalties, obtains sufficient information to determine the gross reportable amount, any subsequent penalty imposed will be reduced as necessary to assure that the aggregate

amount of the penalties does not exceed the gross reportable amount. To the extent that the amount already paid exceeds the gross reportable amount, the IRS will refund the excess pursuant to section 6402.

Section 6677(d) provides that no penalty will be imposed on any failure that is shown to be due to reasonable cause and not due to willful neglect. It further provides that the fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause.

Section 6677(e) provides that subchapter B of chapter 63 (relating to deficiency procedures for income estate, gift, and certain excise taxes) will not apply in respect of the assessment or collection of any penalty imposed under section 6677.

There are two opinions that interpret section 6677, In re Wyly and Wilson. In Wilson, the court concluded that a U.S. person treated as the owner of a foreign trust may only be subject to a 5 percent penalty under section 6677(b) with respect to a failure by the owner to comply with sections 6048(b) and 6048(c). The government [has appealed] the decision because this conclusion is not supported by the text of sections 6677 and 6048. Penalties under sections 6677(a) and 6677(b) apply separately to each section 6048 failure as set out under section 6677(c), which defines three separate gross reportable amounts to which the penalties apply, allowing for multiple penalties. In In re Wyly, the court held that the taxpayers' failure to file Form 3520-A under section 6048(b), resulted in a section 6677 penalty of 5 percent of the gross value of the taxpayer's foreign trusts.

G. Section 643(a)(7)

Section 643(a)(7), which was added to the Code by the 1996 Act, provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of part I of subchapter J of chapter 1 of the Code (sections 641 through 685), including regulations to prevent avoidance of such purposes.

H. Information return due dates

Section 2006(b) of the Surface Transportation Act provides that in the case of returns for taxable years beginning after December 31, 2015, the Secretary, or the Secretary's designee, shall modify the appropriate regulations addressing certain due dates. Section 2006(b)(9) provides that the due date of Form 3520-A shall be the 15th day of the third month after the close of the trust's taxable year, and the maximum extension shall be a 6-month period beginning on such day. Section 2006(b)(10) states that the due date of Form 3520 for calendar year filers shall be April 15 with a maximum extension for a 6-month period ending on October 15.

Explanation of Provisions

I. Section 643(i) – Loans to and Uses of Foreign Trust Property by U.S. Persons

These proposed regulations provide rules relating to loans from foreign trusts to U.S. persons and uses of foreign trust property by U.S. persons. They generally incorporate the section 643(i) guidance that was provided in Notice 97-34 (discussed in the background section of this preamble), with certain modifications to address abuses of which the IRS has become aware. In addition, they provide guidance under the HIRE Act amendments to section 643(i).

A. Application of section 643(i) to loans or uses of trust property

1. General Rules

Proposed §1.643(i)-1 provides rules for determining when a loan from a foreign nongrantor trust to, or the use of property belonging to a foreign nongrantor trust by, a U.S. person who is either a beneficiary of the foreign trust or is related to a U.S. person who is a beneficiary of the foreign trust will be treated as a distribution under subchapter J of chapter 1 of the Code (a section 643(i) distribution) to the U.S. beneficiary of the foreign trust. These rules are applicable for purposes of subparts B, C, and D of part I of subchapter J of chapter 1 of the Code, and thus section 643(i) does not apply in the case of a loan from a foreign grantor trust under subpart E of part I of subchapter J.

Proposed §1.643(i)-1(b)(1) provides that, unless an exception applies (see proposed §1.643(i)-2 for exceptions), any loan of cash or marketable securities from a foreign trust (whether from trust corpus or income) directly or indirectly to a U.S. beneficiary of the trust or any U.S. person related to a U.S. beneficiary of the trust will be treated as a section 643(i) distribution to the U.S. beneficiary as of the date on which the loan is made. For these purposes, a loan to a grantor trust or a disregarded entity is treated as a loan to the owner of the grantor trust or the disregarded entity (for example, as a loan to the single member owner of a single member LLC treated as a disregarded entity).

Proposed §1.643(i)-1(b)(2)(i) describes indirect loans for purposes of section 643(i), which include loans made by an intermediary or an agent or nominee of the foreign trust, or loans made to an agent or nominee of the U.S. borrower. Proposed §1.643(i)-1(b)(2)(i) clarifies that indirect loans include the following: (1) a loan made by

any person (lender) to the U.S. beneficiary of a foreign trust or any U.S. person related to a U.S. beneficiary (U.S. borrower) if the foreign trust guarantees (within the meaning of §1.679-3(e)(4)) the loan; (2) a loan made by any person related (within the meaning of proposed §1.643(i)-1(d)(4)) to the foreign trust to a U.S. beneficiary of the foreign trust or a U.S. person related to a U.S. beneficiary; and (3) a loan made by a foreign trust to a foreign person, other than to a nonresident alien individual beneficiary of the trust, if the foreign person is related (within the meaning of proposed §1.643(i)-1(d)(4)) to a U.S. beneficiary of the trust. See proposed §1.643(i)-1(b)(2)(i)(A) through (C). However, proposed §1.643(i)-1(b)(2)(ii) limits the rules of proposed §1.643(i)-1(b)(2)(i)(B) and (C) by excepting such loans from section 643(i) treatment if the U.S. beneficiary of the foreign trust satisfies the information reporting requirements of proposed §1.6048-4 with respect to the loan, and attaches to its U.S. income tax return and to its Form 3520, filed pursuant to the requirements of proposed §1.6048-4, an explanatory statement that demonstrates to the satisfaction of the IRS that the loan would have been made without regard to the U.S. beneficiary's relationship to the foreign trust. See proposed §1.643(i)-1(b)(2)(ii). There is no such limitation for loans made by any person that are guaranteed (within the meaning of §1.679-3(e)(4)) by the foreign trust.

Proposed §1.643(i)-1(b)(2)(iii) provides that loans from a foreign trust to a U.S. beneficiary or U.S. person related to a U.S. beneficiary through an intermediary are treated as made directly from the foreign trust to the U.S. beneficiary or U.S. person related to a U.S. beneficiary.

In order to discourage beneficiaries of a foreign trust from changing their U.S. residence in a particular year to avoid the application of section 643(i), proposed §1.643(i)-1(b)(3) provides an anti-abuse rule for a nonresident alien who is a beneficiary of a foreign trust when they receive a loan from the foreign trust and who subsequently becomes a U.S. person. If the nonresident alien beneficiary receives a loan from a foreign trust and becomes a U.S. resident within 2 years of that date, that person will be subject to section 643(i) with respect to the outstanding amount of the loan as of the date the individual acquires U.S. residence or citizenship if the obligation is not a qualified obligation as of the date that it was made.

Proposed §1.643(i)-1(c) provides that any use of other property of a foreign trust, directly or indirectly, by a U.S. beneficiary or any U.S. person related to a U.S. beneficiary will be treated as a section 643(i) distribution to the U.S. beneficiary in the taxable year in which such use occurs. Use of property of a foreign trust by a grantor trust or a disregarded entity would be treated as use by the owner of the grantor trust or the disregarded entity (for example, use of trust property by a single member LLC treated as a disregard entity will be treated as use by the owner).

2. Section 643(i) Does Not Apply to Foreign Grantor Trusts

Since the rules under section 643(i) only apply for purposes of subparts B, C, and D of part I of subchapter J of chapter 1 of the Code, section 643(i) does not apply to foreign trusts that are grantor trusts described in subpart E (sections 671 through 679) of part I of subchapter J. Although section 643(i) by its terms also applies to loans from a foreign trust to, or uncompensated uses of trust property by, a U.S. grantor or a U.S. person related to a U.S. grantor, the references to a U.S. grantor or a U.S. person

related to a U.S. grantor are from the pre-HIRE Act version of section 643(i) and are no longer relevant for purposes of section 643(i). Under section 679(c)(6), enacted as part of the HIRE Act, a U.S. grantor of a foreign trust that receives a loan or use of trust property from the foreign trust that would have been treated as receiving a section 643(i) distribution is instead treated as the owner of the trust. Section 679(c)(6) provides that any direct or indirect loan of cash or marketable securities to a U.S. person, or direct or indirect use of any other trust property by a U.S. person, whether or not such U.S. person is a beneficiary under the terms of the trust, will be treated as paid or accumulated for the benefit of the U.S. person, unless an exception applies (see proposed §1.679-2(a)(5)(iii)). If a foreign trust has a living U.S. grantor that is not already treated as the owner of the trust, the loan or uncompensated use of trust property will cause the foreign trust to be treated as acquiring a U.S. beneficiary for purposes of §1.679-2, and the trust (or portion of the trust) will therefore be treated as owned by the U.S. grantor under section 679. Under proposed §1.679-2(a)(5)(v), section 643(i) does not apply, and instead, under §1.679-2(c)(1), the U.S. grantor will be treated as receiving an accumulation distribution and immediately transferring that amount back to the foreign trust. See Example 5 under proposed §1.679-2(a)(5)(vi)(E). Since the rules under section 679(c)(6) address the treatment of a loan from a foreign trust to, or uncompensated use of trust property by, a U.S. grantor or a U.S. person related to a U.S. grantor, it is not necessary to provide regulations under section 643(i).

B. Exceptions

Proposed §1.643(i)-2(a) provides three exceptions to the general rule of proposed §1.643(i)-1(a):

First, the general rule will not apply to any loan of cash in exchange for a qualified obligation within the meaning of proposed §1.643(i)-2(b)(2)(iii) (and discussed in section I.C of this Explanation of Provisions). The proposed regulations do not provide an exception from the general rules for loans of marketable securities. The Treasury Department and the IRS request comments on whether qualified obligation rules are needed for loans of marketable securities.

Second, in the case of a use of trust property other than a loan of cash or a loan of marketable securities, the general rule will not apply to the extent that the trust receives the fair market value of such use within a reasonable period of time (described in proposed §1.643(i)-2(a)(2)(ii) as 60 days or less) from the start of the use of the trust property. The fair market value of the use will be based on all the facts and circumstances, including the type of property used and the period of use.

Third, the general rule will not apply to any de minimis (described in proposed §1.643(i)-2(a)(3) as 14 days or less during the taxable year) use of trust property, other than a loan of cash or marketable securities, by a U.S. beneficiary or a U.S. person related to a U.S. beneficiary.

C. Qualified obligations

Proposed §1.643(i)-2(b) provides rules for determining whether a loan of cash is made in exchange for a qualified obligation from a U.S. beneficiary or a U.S. person related to a U.S. beneficiary for purposes of applying proposed §1.643(i)-2(a)(1). The proposed regulations do not provide rules regarding qualified obligations from a U.S. grantor or a U.S. person related to a U.S. grantor because a U.S. grantor that receives a loan or use of trust property that would have been treated as a section 643(i)

distribution is instead treated as the U.S. owner of the trust under section 679. See discussion in section I.A.2 of this Explanation of Provisions.

Proposed §1.643(i)-2(b)(2) defines the terms obligor, obligation, and qualified obligation for purposes of proposed §§1.643(i)-2 through 1.643(i)-5. The definitions of obligation and qualified obligation are consistent with the amended definitions of obligation and qualified obligation in proposed §1.679-1(c)(6) and §1.679-4(d), respectively. The term obligor means a person who issues an obligation (within the meaning of proposed §1.643(i)-2(b)(2)(ii)) to a foreign trust in exchange for a loan of cash. The term obligation means any instrument or contractual arrangement that constitutes indebtedness under general principles of Federal income tax law (for example, a bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other evidence of indebtedness), and an annuity contract that would not otherwise be classified as indebtedness under general principles of Federal income tax law. Under proposed §1.643(i)-2(b)(2)(iii)(A), the term qualified obligation means an obligation that satisfies all of the following requirements:

First, the obligation must be reduced to writing by an express written agreement.

Second, the term of the obligation must not exceed five years. For purposes of determining the term of the obligation, the obligation's maturity date is the last possible date the obligation can be outstanding under the terms of the obligation.

Third, all payments on the obligation must be made in cash in U.S. dollars. The Treasury Department and the IRS stress this requirement to make all payments in cash in U.S. dollars, in light of abusive transactions in which taxpayers used over-inflated valuation of in-kind property to purportedly repay an obligation.

Fourth, the obligation must be issued at par and must provide for stated interest at a fixed rate or a qualified floating rate within the meaning of §1.1275-5(b).

Fifth, the yield to maturity must be not less than 100 percent and not greater than 130 percent of the applicable Federal rate in effect under section 1274(d) on the day in which the obligation is issued. The yield to maturity and the applicable Federal rate must be based on the same compounding period. If an obligation is a variable rate debt instrument that provides for stated interest at a qualified floating rate, the rules in §§1.1274-2(f)(1) and 1.1275-5(e) apply to determine the obligation's yield to maturity.

Sixth, all stated interest on the obligation must be qualified stated interest within the meaning of §1.1273-1(c).

In addition to these six initial requirements, for the first year and each year that the obligation remains outstanding, a U.S. beneficiary must also satisfy the three requirements of proposed §1.643(i)-2(b)(2)(iii)(B) in order for the obligation to remain a qualified obligation. First, the U.S. beneficiary (as the person who would be subject to income tax if an obligation is not a qualified obligation or ceases to be a qualified obligation) must extend the period for assessment (under rules described in proposed §1.643(i)-2(b)(2)(iii)(B)(1)) of any income tax attributable to the loan and any consequent income tax changes for each year that the obligation is outstanding to a date not earlier than three years after the maturity date of the obligation issued in consideration for the loan. Second, the U.S. beneficiary must report the status of the obligation, including any payments made, in Part III of Form 3520. Third, the U.S. obligor must make all payments of principal and interest on the obligation according to the terms of that obligation.

Proposed §1.643(i)-2(b)(3) provides that if the terms of a qualified obligation are modified and the modification is treated as an exchange under §1.1001-3, the new obligation that is deemed issued in the exchange under §1.1001-3 must satisfy the requirements in proposed §1.643(i)-2(b)(2)(iii) to be a qualified obligation. If the modification is not treated as an exchange under §1.1001-3, then the qualified obligation is retested as of the date of the modification to determine whether the obligation, as modified, continues to satisfy the requirements in proposed §1.643(i)-2(b)(2)(iii) to be a qualified obligation.

Proposed §1.643(i)-2(b)(4) provides that if, while an original obligation is outstanding, the U.S. obligor directly or indirectly issues another obligation to the foreign trust in exchange for cash, the original obligation is deemed to have the maturity date of any such subsequent obligation for purposes of determining whether the term of the original obligation exceeds the specified 5-year term. The original outstanding obligation must be retested as of the issue date of the additional obligation to determine whether the obligation, as modified, continues to be a qualified obligation, as defined in proposed §1.643(i)-2(b)(2)(iii). The new obligation must also be separately tested to see if it satisfies the requirements in proposed §1.643(i)-2(b)(2)(iii).

Proposed §1.643(i)-2(b)(5) provides that the IRS may treat two or more obligations issued by a U.S. obligor as a single obligation that is not a qualified obligation if the transactions giving rise to the obligations are structured with a principal purpose to avoid the application of section 643(i).

Proposed §1.643(i)-2(b)(6) provides that if a qualified obligation ceases to be a qualified obligation (for example, because a modification causes the term of the

obligation to exceed five years), the U.S. beneficiary will be treated as receiving a section 643(i) distribution from the trust. In general, the amount of the section 643(i) distribution is the obligation's outstanding stated principal amount plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273-1(c)) as of the date of the event that causes the obligation to no longer be a qualified obligation. If a series of obligations is treated as a single obligation that is not a qualified obligation under proposed §1.643(i)-2(b)(5), then, under proposed §1.643(i)-2(b)(6)(ii), the amount of the section 643(i) distribution will not exceed the combined outstanding stated principal amount of the obligations plus any accrued but unpaid qualified stated interest as of the date determined under proposed §1.643(i)-2(b)(6)(iii).

Proposed §1.643(i)-2(b)(6)(iii) addresses the timing of a section 643(i) distribution that arises when an obligation ceases to be a qualified obligation. As a general rule, a U.S. beneficiary is treated as receiving a section 643(i) distribution on the date of the event that causes the obligation to no longer be a qualified obligation. However, based on all the facts and circumstances, if the obligation is structured with a principal purpose of avoiding the application of section 643(i), the IRS may deem a section 643(i) distribution to have occurred on any date on or after the issue date of the obligation.

D. Trust property attributable to nongrantor trust portion

Proposed §1.643(i)-2(c) provides rules for determining the extent to which a loan or use of trust property from a partial nongrantor trust will be attributable to the nongrantor trust portion. Generally, a loan or use of trust property from a partial nongrantor trust must be apportioned in a manner that is reasonable based on all the

facts and circumstances, including the terms of the governing instrument, local law, and the practice of the trustee, if it is reasonable and consistent. However, if a loan or use of trust property can be made from only one portion of the trust because the type of property loaned or used is held only by that portion, then the loan or use of property is attributable to that portion.

E. Reporting

The Treasury Department and the IRS have determined that it is appropriate to require reporting, pursuant to the authority granted to the Treasury Department and the IRS by section 643(a)(7), of all loans and uses of trust property that are potentially subject to section 643(i), in order to ensure that the IRS has the information necessary to enforce taxpayer compliance with these rules. Thus, proposed §1.643(i)-2(d) provides that any loan of cash or marketable securities by a foreign trust to a U.S. person and any use by a U.S. person of property belonging to a foreign grantor or nongrantor trust, without regard to whether such loan or use of property is treated as a section 643(i) distribution, will also be a distribution within the meaning of proposed §1.6048-4(b) and subject to the information reporting described under proposed §1.6048-4(a). See proposed §1.6048-4(b)(3)(ii) and (iii) and (b)(4)(ii) and (iii).

F. Amount treated as section 643(i) distribution

Proposed §1.643(i)-3(a) provides rules for determining the amount that is treated as a section 643(i) distribution if an exception does not apply. In the case of a loan of cash, the amount of the section 643(i) distribution is the issue price of the loan as of the date the loan is treated as a distribution from the trust. In the case of a loan of marketable securities, the amount of the section 643(i) distribution is the fair market

value of the securities as of the date the loan is treated as a distribution from the trust. In the case of use of trust property, the amount of the section 643(i) distribution is the fair market value of the use of the property less any payments made for the use of the property within a reasonable period of time.

G. Allocation of section 643(i) distribution among more than one U.S. beneficiary

Proposed §1.643(i)-3(b) provides a rule for allocating a section 643(i) distribution among two or more U.S. beneficiaries. If a U.S. person who is not a U.S. beneficiary of a foreign trust but who is related to more than one U.S. beneficiary of the foreign trust receives a loan of cash or marketable securities from such trust, or uses trust property, that is treated as a section 643(i) distribution, then each U.S. beneficiary that is related to the U.S. person receiving the loan or using trust property is treated as receiving an equal share of the section 643(i) distribution.

H. Tax consequences of a section 643(i) distribution

Proposed §1.643(i)-3(c) provides rules to determine the tax consequences of a section 643(i) distribution to a foreign trust and to any U.S. beneficiaries treated as receiving the distribution. Proposed §1.643(i)-3(c)(2) provides that a foreign trust treated as making a section 643(i) distribution must generally treat the section 643(i) distribution as an amount properly paid, credited, or required to be distributed by the trust as described in section 661(a)(2) for which the trust is allowed a distribution deduction in computing its taxable income.

In addition to a section 643(i) distribution being treated as an amount properly paid, credited, or required to be distributed by the trust as described in section 661(a)(2), a section 643(i) distribution of marketable securities will cause a trust to be

deemed to have elected to have section 643(e)(3) apply to such distribution, which will cause the trust to recognize gain or loss as if the marketable securities had been sold to a U.S. beneficiary at fair market value. Any capital gain recognized by the foreign trust will be included in the trust's distributable net income (DNI) pursuant to section 643(a)(6)(C). As a result of the deemed election, a U.S. beneficiary will be treated as including in gross income under section 662(a)(2) the fair market value of the marketable securities, and the foreign trust will be allowed to deduct the fair market value of the marketable securities under section 661(a)(2) in computing its taxable income.

Proposed 1.643(i)-3(c)(2)(iii) provides that the foreign trust may issue a Foreign Nongrantor Trust Beneficiary Statement (described in proposed §1.6048-4(c)(2)) to each U.S. beneficiary who receives any loan of cash or marketable securities or has any use of other trust property during the taxable year of the trust or is related to a U.S. person who receives any loan of cash or marketable securities or has any use of other trust property during the taxable year of the trust, whether or not such U.S. beneficiary would be required to take the amount into account as a section 643(i) distribution. A U.S. beneficiary who does not receive a Foreign Nongrantor Trust Beneficiary Statement with respect to a section 643(i) distribution will be required to determine the tax consequences of the distribution under the default method in proposed §1.643(i)-3(c)(3)(ii).

Proposed §1.643(i)-3(c)(3) provides that a U.S. beneficiary who is treated as receiving a section 643(i) distribution must determine the tax consequences of the distribution using either the actual calculation method or the default method. Under the

actual calculation method, set out under proposed §1.643(i)-3(c)(3)(i), a U.S. beneficiary must treat a section 643(i) distribution as an amount properly paid, credited, or required to be distributed by the trust as described in section 662(a)(2) (relating to inclusions in gross income by beneficiaries of trusts accumulating income or distributing corpus). The tax consequences of the section 643(i) distribution to a U.S. beneficiary are determined by using the actual information provided in the Foreign Nongrantor Trust Beneficiary Statement and applying the rules of subparts C and D of part I of subchapter J of chapter 1 of the Code.

Under the default method, as provided in proposed §1.643(i)-3(c)(3)(ii), a U.S. beneficiary must determine the tax consequences of the section 643(i) distribution under the rules provided in proposed §1.6048-4(d)(3). For an explanation of the default method, see section IV.C of this Explanation of Provisions.

A U.S. beneficiary may not use the actual calculation method unless the U.S. beneficiary has received a Foreign Nongrantor Trust Beneficiary Statement (described in proposed §1.6048-4(c)(2)) from the foreign trust. A U.S. beneficiary who has previously used the default method must consistently use the default method to determine the tax consequences of all subsequent distributions from the same foreign trust (including distributions other than section 643(i) distributions), except in the year in which such foreign trust terminates. See proposed §1.6048-4(b) for the definition of the term distribution and see proposed §1.6048-4(d)(3)(iii) for rules relating to the tax consequences to a U.S. beneficiary in the year in which a foreign trust terminates.

I. Subsequent transactions

Proposed §1.643(i)-3(d)(1) provides rules regarding the treatment of any subsequent transaction between a trust and an obligor regarding the principal of any loan of cash or marketable securities (or use of trust property) that is treated as a section 643(i) distribution, including complete or partial repayment, satisfaction, cancellation, discharge, or otherwise, but not including payments of interest (or return of trust property). Proposed §1.643(i)-3(d)(1)(i) provides that any subsequent transaction with respect to the principal of any loan of cash or marketable securities or return of trust property treated as a section 643(i) distribution will have no tax consequences to a foreign trust. However, payment to a foreign trust other than the repayment of principal of any loan treated as a section 643(i) distribution, such as the payment of interest, will be treated as income to the trust.

Proposed §1.643(i)-3(d)(1)(ii) provides the consequences to an obligor of subsequent transactions between a trust and the obligor related to a section 643(i) distribution. Generally, any subsequent transaction regarding the principal of any loan of cash or marketable securities or return of trust property treated as a section 643(i) distribution will be treated as a transfer that is not a gratuitous transfer by a U.S. person for purposes of the definition of grantor under §1.671-2(e)(2)(i), or as a transfer that is not subject to tax for purposes of the estate tax, gift tax, and generation skipping transfer (GST) tax rules of chapters 11, 12, and 13, and will have no tax consequences to the obligor. Thus, the repayment of principal will not cause an obligor to be treated as the owner of such foreign trust, nor will it cause the obligor to be treated as making a taxable gift for purposes of the gift tax, estate tax, or GST rules. However, if an obligor

satisfies the principal of any loan of cash or marketable securities treated as a section 643(i) distribution through a transfer of appreciated property to the foreign trust, the obligor will recognize as gain the appreciation in the property transferred under the rules of section 1001 and the regulations issued under section 1001.

Proposed §1.643(i)-4 sets forth examples illustrating the rules of proposed §§1.643(i)-1 through 3.

II. Section 679 – Foreign Trusts Treated as Having a U.S. Beneficiary

As described in this section II, the proposed regulations amend the definition of U.S. person in §1.679-1(c)(2), the definition of obligation in §1.679-1(c)(6), and the definition of qualified obligation in §1.679-4(d). The amended definitions are generally consistent with the definitions of the same terms in proposed §1.643(i)-2(b)(2), except that the definition of a U.S. person in proposed §1.679-1(c)(2) does not exclude tax-exempt entities.

The proposed regulations also make two additions to §1.679-2 that provide guidance on two statutory provisions added to section 679 by the HIRE Act. First, proposed §1.679-2(a)(5) and proposed §1.679-2(b)(3) provide guidance to determine when a loan from a foreign trust to a U.S. person or the use of foreign trust property by a U.S. person will cause the foreign trust to be treated as having a U.S. beneficiary. Second, proposed §1.679-2(d) implements section 679(d), which generally provides that if a U.S. person directly or indirectly transfers property to a foreign trust, the trust will be presumed to have a U.S. beneficiary in certain situations when the transferor is unable to supply adequate information about the transfer to the IRS.

A. Definition of U.S. person

Proposed §1.679-1(c)(2) amends the current definition of U.S. person for purposes of §§1.679-1 through 1.679-6. Although the definition of U.S. person under §1.679-1(c)(2) specifically provides that a nonresident alien individual who elects under section 6013(g) to be treated as a resident of the United States will be a U.S. resident for purposes of section 679, the proposed regulations remove this explicit rule without intending a substantive change from the existing regulation regarding the treatment of persons who make an election under section 6013(g). Additionally, a U.S. person for purposes of section 679 will include a nonresident alien individual who elects under section 6013(h) to be treated as a resident of the United States. Both sections 6013(g) and (h) are effective for purposes of chapter 1 of the Code.

Under the amended definition of U.S. person in the proposed regulations, however, a dual resident taxpayer (within the meaning of §301.7701(b)-7(a)(1)) will not be treated as a U.S. person with respect to any taxable year (or portion of a taxable year) for which such person computes U.S. tax liability as a nonresident alien pursuant to §301.7701(b)-7. The Treasury Department and the IRS do not believe it is necessary to treat a dual resident taxpayer that has elected to compute such person's income tax liability as a nonresident alien, as a U.S. person for purposes of §§1.679-1 through 1.679-6 in order to carry out the purposes of section 679. However, see §1.679-5 for rules that may apply if a dual resident taxpayer who has been computing U.S. tax liability as a nonresident alien begins to compute tax liability as a resident alien.

B. Definition of obligation

Proposed §1.679-1(c)(6) amends the current definition of obligation for purposes

of §§1.679-1 through 1.679-6 to conform with the definition of obligation in proposed §1.643(i)-2(b)(2)(ii).

C. Loans from foreign trusts and uses of trust property

Proposed §1.679-2(a)(5)(i) provides guidance under section 679(c)(6), which was added to the Code by the HIRE Act. As a general rule, any loan of cash or marketable securities (whether from trust corpus or income) by a foreign trust, directly or indirectly, or the use of any other property of a foreign trust or portion of a foreign trust, directly or indirectly, by any U.S. person (whether or not a beneficiary under the terms of the trust) will be treated as paid or accumulated for the benefit of a U.S. person for purposes of §1.679-2(a)(1). For these purposes, a loan to, or use of any other property of a foreign trust by, a grantor trust or a disregarded entity would be treated as a loan to, or use of trust property by, the owner of the grantor trust or the disregarded entity (for example, a loan to a single member LLC treated as a disregard entity will be treated as a loan to the owner of the LLC). Consequently, a foreign trust (or portion of a foreign trust) that is not already treated as having a U.S. beneficiary under §1.679-2 will be treated as having a U.S. beneficiary for purposes of §1.679-1, with the result that a U.S. grantor of the foreign trust (or portion thereof) will be treated as the owner of the trust (or portion thereof). See §1.679-1(c)(4) for the definition of property and proposed §1.679-1(c)(2) for the definition of U.S. person for purposes of §1.679-2. See proposed §1.6048-4 for rules relating to information reporting with respect to loans from foreign trusts and the use of property of a foreign trust.

Proposed §1.679-2(a)(5)(ii) provides that for purposes of the general rule of proposed §1.679-2(a)(5)(i), indirect loans from a foreign trust to a U.S. person include

loans made by any person, whether U.S. or foreign, if the foreign trust provides a guarantee (within the meaning of §1.679-3(e)(4)) for the loans. Indirect loans from a foreign trust to a U.S. person also include loans made through an intermediary, such as an agent or nominee of the foreign trust or the U.S. beneficiary, and loans from the foreign trust to foreign persons related (within the meaning of proposed §1.643(i)-1(d)(4)) to the foreign trust or U.S. beneficiary. Section 1.679-2(b) contains a rule addressing indirect U.S. beneficiaries of a foreign trust, which would address indirect loans from a foreign trust to a U.S. person including loans made through an intermediary, such as an agent or nominee, and loans from the foreign trust to certain foreign persons with relationships to the U.S. beneficiary. The indirect beneficiary rule under proposed §1.679-2(b)(3) is discussed later in this section II.C of this Explanation of Provisions.

Proposed §1.679-2(a)(5)(iii) provides three exceptions to the general rule of proposed §1.679-2(a)(5)(i).

First, the general rule does not apply if the U.S. person who receives the loan of cash or marketable securities or the use of trust property is described in section 501(c)(3) (without regard to the requirement of section 508(a) (referring to notice requirements)).

Second, the general rule does not apply to any loan of cash received by a U.S. person in exchange for a qualified obligation within the meaning of proposed §1.643(i)-2(b)(2)(iii) (but without regard to the requirements for an extension of the period for assessment and the completion of Form 3520 reporting as described in proposed §1.643(i)-2(b)(2)(iii)(B)(1) and (2)).

Third, the general rule does not apply if the U.S. person who uses trust property (other than a loan of cash or marketable securities) pays the trust the fair market value of the use of such property within a reasonable period of time (as described in the proposed regulations) from the date of the start of the use of the property. The fair market value will be based on all the facts and circumstances, including the type of property used and the period of use. Proposed §1.679-2(a)(5)(iv) provides two safe harbors for purposes of when this fair market value exception will apply. Proposed §1.679-2(a)(5)(v) addresses the interaction of proposed §1.679-2(a)(5) with section 643(i) and confirms that section 643(i) does not apply to a situation in which, as a result of proposed §1.679-2(a)(5), a foreign trust is treated as having acquired a U.S. beneficiary and therefore is treated as owned by a U.S. person under section 679 (discussed in section I.A of this Explanation of Provisions).

Proposed §1.679-2(b)(3) provides that a loan of cash or marketable securities or the use of trust property that does not qualify for the exceptions described in proposed §1.679-2(a)(5)(iii) will be treated as paid or accumulated for the benefit of a U.S. person if such loan is made to, or such property is used by, a foreign entity described in §1.679-2(b)(1), or if such loan is made through an intermediary or is made by any other means where a U.S. person may obtain an actual or constructive benefit, as described in §1.679-2(b)(2).

D. Presumption that foreign trust has U.S. beneficiary

Proposed §1.679-2(d)(1) provides guidance under section 679(d) regarding whether a foreign trust is deemed to have a U.S. beneficiary. As a general rule, if a U.S. person directly or indirectly transfers property to a foreign trust other than a

compensatory or charitable trust described in §1.679-4(a)(2) or (3), the IRS may treat the trust as having a U.S. beneficiary for purposes of applying §1.679-1 unless the U.S. person, for the tax year in which the transfer was made, (i) satisfies the information reporting requirements of proposed §1.6048-2 with respect to the transfer, (ii) attaches a copy of the Form 3520 filed pursuant to §1.6048-2 to the U.S. person's federal income tax return, and (iii) attaches an explanatory statement to the U.S. persons' federal income tax return demonstrating to the satisfaction of the IRS that the trust satisfies the requirements of §1.679-2(a)(1) immediately after the transfer. Section 1.679-2(a)(1) provides that a foreign trust is treated as having a U.S. beneficiary unless during the taxable year of the U.S. transferor (i) no part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, directly or indirectly, a U.S. person and (ii) if the trust is terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of, directly or indirectly, a U.S. person.

Proposed §1.679-2(d)(2) provides that the IRS may request additional information related to the trust and its potential beneficiaries in order to determine whether the trust satisfies the requirements of §1.679-2(a)(1). Unless such additional information is provided upon the IRS's written notice and request to the U.S. person, the trust will be presumed to have a U.S. beneficiary. The U.S. person will have 60 days (90 days if the notice is addressed to a person outside the United States) to respond to the notice and request.

E. Definition of qualified obligation

Proposed §1.679-4(d) amends the current definition of qualified obligation for

purposes of §1.679-4 to conform with the definition of a qualified obligation in proposed §1.643(i)-2(b)(2)(iii) and the additional rules in proposed §§1.643(i)-2(b)(3) through (7) (discussed in section I.C of this Explanation of Provisions).

III. Section 6039F – Information Reporting Rules for U.S. Recipients of Foreign Gifts

These proposed regulations provide information reporting rules for U.S. recipients of foreign gifts. They generally incorporate the section 6039F guidance that was provided in Notice 97-34 (discussed in the background section). They also provide additional guidance that is needed to implement all of section 6039F and to address certain abuses of which the IRS has become aware and relevant statutory developments since 1997, including the enactment of section 2801, dealing with gifts and bequests from certain expatriates.

A. In general

Proposed §1.6039F-1(a) provides that, as a general rule, any U.S. person who treats an amount received from a foreign person as a gift (foreign gift) during a taxable year must report that amount on Part IV of Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, by the fifteenth day of the fourth month after the close of the U.S. person's taxable year. Proposed §1.6039F-1(a)(1) provides that in the case of a U.S. person who has been granted an extension of time to file its income tax return pursuant to section 6081, an extension of time for filing Form 3520 is automatically granted to the fifteenth day of the tenth month following the close of the U.S. person's taxable year. No additional extension of time to file Form 3520 is allowed. Proposed §1.6039F-1(a)(2) provides that if a U.S. person dies during the calendar year, the executor of the U.S. person's estate must report the

gift on Part IV of Form 3520 by the fifteenth day of the fourth month after the close of the taxable year of the U.S. person who died. In the case of an executor who has been granted an extension of time to file the decedent's income tax return for the decedent's year of death pursuant to authority under section 6081, an extension of time for filing Form 3520 is automatically granted to the fifteenth day of the tenth month following the close of the decedent's taxable year, but no additional extension of time to file Form 3520 is allowed.

For purposes of proposed §1.6039F-1, the term U.S. person means a United States person as defined under section 7701(a)(30). However, under proposed §1.6039F-1(f), a dual resident taxpayer and a dual status taxpayer will not be treated as a U.S. person for purposes of proposed §1.6039F-1 for a taxable year or any portion of a taxable year that the individual is treated as a nonresident alien for purposes of computing U.S. tax liability. See section III.F of this Explanation of Provisions.

B. Definition of "foreign gift" and coordination with section 6048(c)

For purposes of proposed §1.6039F-1, the term foreign gift is defined to include any amount received from a person other than a U.S. person that the recipient treats as a gift or bequest for income tax purposes. The term, however, does not include any qualified transfer within the meaning of section 2503(e)(2) (relating to certain transfers for educational or medical expenses) or any transfer from a foreign trust that is treated as a distribution (within the meaning of proposed §1.6048-4(b)) and reported on a return under proposed §1.6048-4. The fact that a transfer is a covered gift or covered bequest under section 2801(e) has no impact on the application of the definition of a foreign gift for purposes of proposed §1.6039F-1. Proposed §1.6039F-1(b)(1) also provides that a

U.S. person who receives a transfer from a foreign trust must treat that transfer as a distribution from the trust that is reportable under proposed §1.6048-4, rather than reportable as a foreign gift under proposed §1.6039F-1(a), even if the U.S. person treats the transfer as a gift for another purpose, such as computing the person's Federal income tax liability.

Proposed §1.6039F-1(b)(2) provides that the term foreign gift includes transfers from a person other than a U.S. person that the recipient does not treat as a gift or bequest for income tax purposes, such as a purported loan, if based on all the facts and circumstances the IRS determines that the transfer was in substance a gift. The IRS has become aware of taxpayers who are seeking to circumvent the section 6039F information reporting rules by claiming that the amounts they receive from foreign persons are not foreign gifts reportable for section 6039F purposes because they do not treat them as gifts but that are otherwise not taxable (claiming instead that the transfers are loans). These purported transfers, however, objectively have all the indicia of being a gift. Based on all the facts and circumstances, the IRS will therefore recharacterize such transfers as gifts that should have been reported under section 6039F.

C. Exceptions

Proposed §1.6039F-1(c) provides a number of exceptions to the general rule in proposed §1.6039F-1(a).

Proposed §1.6039F-1(c)(1) provides that the general rule does not apply if the recipient of the foreign gift is described in section 501(c) and exempt from tax under section 501(a).

Proposed §1.6039F-1(c)(2)(i) through (iii) provides three de minimis rules:

First, in the case of foreign gifts from foreign individuals or foreign estates (other than covered gifts or covered bequests within the meaning of section 2801(e)), the general rule does not apply if the aggregate amount of foreign gifts received, directly or indirectly, from any particular individual or estate does not exceed $100,000 during the U.S. person's taxable year. If the aggregate amount of all these foreign gifts exceeds the $100,000 de minimis amount, these proposed regulations would also require the U.S. person to separately identify the aggregate amount of all foreign gifts received from each foreign individual or foreign estate in excess of $5,000, and provide identifying information about such foreign individual or foreign estate (for example, name and address). Specific identifying information about the foreign individual or estate is a change from what is currently provided on Form 3520 and may be help for compliance efforts and the burden imposed on the U.S. person is minimal, in part, the U.S. person would need to know about the person if applying the aggregation rule. The proposed regulations provide rules for aggregating and reporting foreign gifts from related persons.

Second, in the case of covered gifts or covered bequests, the general rule does not apply if the aggregate amount of covered gifts or covered bequests received by the U.S. person during the calendar year does not exceed the section 2801(c) amount, which is the dollar amount of the per-donee exclusion in effect under section 2503(b) for that calendar year ($14,000 for 2016). See proposed §1.6039F-1(h)(2) for special effective date rules that affect the application of proposed §1.6039F-1 to covered gifts and covered bequests.

Third, in the case of foreign gifts received by a U.S. person from a foreign corporation or partnership, the general rule does not apply if the aggregate amount of transfers from any particular corporation or partnership does not exceed $10,000 during the U.S. person's taxable year, as modified by cost of living adjustments. The proposed regulations provide rules for aggregating and reporting foreign gifts from related persons.

Proposed §1.6039F-1(c)(2)(iv) provides that with respect to spouses who file joint returns under section 6013, each spouse must apply the de minimis amounts separately on an individual basis to the foreign gifts received by each spouse, directly or indirectly, from any particular individual or estate.

D. Valuation principles

Proposed §1.6039F-1(d) provides that the amount of a foreign gift is the value of the property at the time of the transfer. The value of the property is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts. The value is to be determined in accordance with the federal gift tax valuation principles of section 2512 and sections 2701 through 2704 (chapter 14 of the Code) and the related regulations.

E. Penalty for failure to file information

Proposed §1.6039F-1(e) describes penalties for failure to furnish the information required by proposed §1.6039F-1(a) by the due date (including extensions) of the Form 3520. First, the tax consequences of the receipt of the foreign gift will be determined by the IRS based on all the facts and circumstances. Second, the U.S. person who fails to

furnish the required information will be subject to a penalty equal to 5 percent of the amount of the foreign gift for each month (or portion thereof) for which the failure to report the foreign gift on Form 3520 continues, but not to exceed 25 percent of the amount of the foreign gift. No penalty will be imposed, however, if the U.S. person shows that the failure to comply was due to reasonable cause and not due to willful neglect. The determination of whether a failure was due to reasonable cause and not due to willful neglect will be made under the principles set out in §1.6664-4 and §301.6651-1(c) and will be made on a case-by-case basis, taking into account all pertinent facts and circumstances.

For purposes of determining the tax consequences of the receipt of the foreign gift, the IRS may take into account the purported gift rules in §1.672(f)-4 (which addresses the treatment of a purported gift from a partnership or foreign corporation). Unless an exception described in §1.672(f)-4(b), (e) or (f) applies, §1.672(f)-4 generally requires a U.S. person who receives a purported gift or bequest, directly or indirectly, from a partnership or foreign corporation to include the purported gift or bequest in gross income as ordinary income.

F. Special rules for dual resident and dual status taxpayers

Proposed §1.6039F-1(f)(1) provides a special rule for dual resident taxpayers (within the meaning of §301.7701(b)-7(a)(1)). A dual resident taxpayer who, pursuant to a provision of an income tax treaty that provides for resolution of conflicting claims of residence by the United States and the treaty partner, claims to be treated as a resident of the treaty partner as provided in §301.7701(b)–7 will be taxed as a nonresident for U.S. tax purposes for the portion of the taxable year that the individual is treated as a

nonresident. The Treasury Department and the IRS have concluded that because the taxpayer's filing of relevant forms pursuant to §301.7701(b)–7 provides adequate information for the IRS to identify individuals in this category in order to ensure their tax compliance, reporting on Form 3520 by such a taxpayer is not essential to effective IRS tax enforcement efforts relating to this category of U.S. residents.

Similarly, proposed §1.6039F-1(f)(2) provides a special rule for dual status taxpayers. As provided in §1.6012-1(b)(2)(ii), a dual status taxpayer who, during the taxable year, abandons U.S. citizenship or U.S. residence or acquires U.S citizenship or U.S. residence will not be treated as a U.S. person for the part of the year that the individual is treated as a nonresident alien for purposes of computing the individual's income tax liability as reflected on the Form 1040NR or other similar schedule attached to such Form 1040NR.

These rules are relevant both for purposes of determining whether a dual resident or dual status taxpayer who receives a foreign gift or bequest is a U.S. person required to report the gift or bequest on Form 3520 and for purposes of determining whether a gift or bequest from a dual resident or dual status taxpayer is a gift from a foreign person.

IV. Section 6048 – Information with Respect to Certain Foreign Trusts

A. Section 6048(a) – Notice of certain events

The proposed regulations under section 6048(a) require a responsible party, as defined in proposed §1.6048-2(c), to provide notice of reportable events, as defined in proposed §1.6048-2(b), that occur during the taxable year on Part I of Form 3520. See proposed §1.6048-2. Form 3520 generally must be filed by the fifteenth day of the

fourth month after the close of the responsible party's taxable year, but no later than the fifteenth day of the tenth month if responsible party received an extension of time to file its income tax return under section 6081. See proposed §1.6048-2(a)(2). If the grantor or transferor has passed away, the executor of the decedent's estate must file Form 3520 by the fifteenth day of the fourth month after the close of the U.S. person decedent's taxable year. Id. A responsible party is the grantor in the case of the creation of an inter vivos trust, the transferor in the case of a transfer of property to a foreign trust by a U.S. person other than a transfer by reason of death, or the executor of the decedent's estate in any other case, even if the executor is not a U.S. person. See proposed §1.6048-2(c).

The proposed regulations define a reportable event as: (i) the creation of a foreign trust by a U.S. person, (ii) any direct, indirect, or constructive transfer, within the meaning of §1.679-3 or §1.684-2, of property (including cash) to a foreign trust by a U.S. person, including transfers by reason of death, and (iii) the death of a citizen or resident of the United States if the decedent was treated as the owner of any portion of a foreign trust under the grantor trust rules or if any portion of a foreign trust was included in the gross estate of the decedent. See proposed §1.6048-2(b). A reportable event includes a U.S. person's transfer of property to a domestic trust that becomes foreign trust, as described in §1.684-4 (outbound migrations of domestic trusts), and a U.S. person's transfer of property in exchange for any obligation of the trust or a related person, as described in §1.679-4, without regard to whether the obligation is a qualified obligation. See proposed §1.6048-2(b)(2). A reportable event does not include transfers to certain foreign charitable trusts, foreign compensatory trusts, and tax-

favored foreign retirement and non-retirement savings trusts, as discussed in section IV.D.2.i of this Explanation of Provisions. See proposed §1.6048-5.

B. Section 6048(b) – U.S. owners of foreign trusts

The proposed regulations under section 6048(b) generally require any U.S. person who is treated as the owner (U.S. 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 IRS 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 6-month period beginning on such day, (ii) furnishes a Foreign Grantor Trust Owner Statement (described in proposed §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 proposed §1.6048-4(c)(1)(ii)) to each U.S. person to whom the trust made distributions during its taxable year. The foreign trust must attach copies of each Foreign Grantor Trust Owner Statement and each Foreign Grantor Trust Beneficiary Statement to the Form 3520-A. See proposed §1.6048-3(a)(1). If the foreign trust does not comply with all the requirements of proposed §1.6048-3(a)(1), the U.S. owner is required to: (i) complete and file Part II of Form 3520 by the U.S. owner's Form 3520 due date, and (ii) complete the foreign trust's Form 3520-A and related statements and file them with Part II of the U.S. owner's Form 3520. See proposed §1.6048-3(a)(2). If neither the foreign trust nor the U.S. owner complies with these requirements, the penalty for failure to comply will be imposed on the U.S. owner. See proposed §1.6677-1(b). If the trustee of the foreign trust willingly and knowingly fails to comply with its federal reporting requirements, the U.S. owner should seek to replace the existing trustee with a new

trustee who will to comply with the requirements imposed by federal law. As discussed in section IV.D.2.i of this Explanation of Provisions, the proposed regulations under section 6048(b) do not apply to tax-favored foreign retirement and non-retirement savings trusts. See proposed §1.6048-5.

The proposed regulations require a U.S. person who receives a Foreign Grantor Trust Owner Statement or Foreign Grantor Trust Beneficiary Statement from a foreign trust to treat any item reported by the trust consistently with the trust's treatment of such item unless the U.S. person notifies the IRS about any inconsistent treatment on Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR). See proposed §1.6048-3(c). If the U.S. person fails to notify the IRS about inconsistent treatment, or if the U.S. person receives incorrect information from the foreign trust, then similar to the rules of section 6034A(c), any adjustment relating to an unreported is treated as a mathematical or clerical error under section 6213(b), with the result that the adjustment would not be subject to the usual restrictions on assessment and the U.S. grantor or U.S. beneficiary would have no right to file a Tax Court petition based on the adjustment.

Proposed §1.6048-3(d) provides that unless a foreign trust with a U.S. owner appoints a limited U.S. agent, the determination of amounts required to be taken into account with respect to the trust by a U.S. person under the grantor trust rules will be determined by the IRS based on all the facts and circumstances. Proposed §1.6048-3(e) provides rules relating to the appointment and duties of the limited U.S. agent. Proposed §1.6048-3(e) also provides rules concerning the issuance of a summons to a U.S. person (either directly or as the limited agent of the trust) or to the foreign trust to

produce records or testimony to determine the amounts required to be taken into account under the grantor trust rules.

C. Section 6048(c) – Reporting by U.S. persons receiving distributions from foreign trusts

1. In General

Unless an exception described in proposed §1.6048-5 applies, proposed regulations under section 6048(c) generally require any U.S. person that receives a distribution from any foreign trust (including a foreign trust that the U.S. person is treated as owning under the grantor trust rules) to complete and file Part III of Form 3520 for each taxable year in which the U.S. person receives a distribution from a foreign trust by the due date of the U.S. person's Form 3520. See proposed §1.6048-4(a)(1). Contrary to the implication in Wilson, the proposed regulations would require a U.S. person treated as the owner of a foreign grantor trust to report the receipt of a distribution from that trust on Part III of Form 3520. Id. The Treasury Department and the IRS interpret section 6048(c) as requiring any U.S. person, including U.S. owners, to report the receipt of foreign trust distributions. This interpretation is consistent with both the plain language of section 6048(c) and its purpose, to address Congress's concerns that U.S. taxpayers were avoiding their U.S. tax obligations through the use foreign trusts that are less visible to the IRS, which empowers the IRS to obtain information that would allow it to enforce U.S. tax laws.

Proposed §1.6048-4(a)(2) provides that if a U.S. person that receives a distribution from any foreign trust dies in the year of receipt of a trust distribution, the executor of the U.S. person's estate must file the Form 3520 and report the distribution on Part III by the fifteenth day of the fourth month after the close of the taxable year of

the U.S. person who died. In the case of an executor who has been granted an extension of time to file the decedent's income tax return for the decedent's year of death pursuant to section 6081, an extension of time for filing Form 3520 is automatically granted to the fifteenth day of the tenth month following the close of the decedent's taxable year which includes the decedent's death, but no additional extension of time to file Form 3520 is allowed.

2. Distributions

Proposed §1.6048-4(b)(1) provides that, as a general rule, the term distribution for purposes of proposed §1.6048-4 means any transfer of property from a foreign trust received directly or indirectly by a U.S. person to the extent such property exceeds the fair market value of any property or services, if any, received by the foreign trust in exchange, without regard to whether any portion of the trust is treated as owned by a U.S. or foreign grantor or another person under the grantor trust rules and without regard to whether the recipient is designated as a beneficiary under the terms of the trust or whether the distribution has any income tax consequences. For these purposes, a transfer of property to a grantor trust or a disregarded entity is treated as a transfer to the U.S. owner of the grantor trust or the disregarded entity. A distribution includes any amount actually or constructively received, and includes the receipt of trust corpus and the receipt of a gift or bequest described in section 663(a).

Proposed §1.6048-4(b)(2) provides that the term distribution includes any indirect transfer of property from a foreign grantor or nongrantor trust received by a U.S. person through an intermediary, nominee or agent. In such a case, the intermediary, nominee or agent is generally treated as an agent of the foreign trust and the property is treated

as distributed to the U.S. person in the year the property is transferred or made available to the U.S. person. However, proposed §1.6048-4(b)(2)(ii) and (iii) provide that if the Commissioner determines that the intermediary, nominee or agent is an agent of the U.S. person, under generally applicable U.S. agency principles, then the property will be treated as transferred from the foreign trust to the U.S. person on the date of the transfer from the foreign trust to the intermediary and the intermediary is not treated as having transferred the property to the U.S. person. Regardless of the income tax consequences of such a transfer, pursuant to proposed §1.6048-4(b)(2)(iv), the U.S. person receiving an indirect transfer of property from a foreign trust must report on Part III of the Form 3520.

Proposed §1.6048-4(b)(3)(i) provides that a distribution includes any loan of cash or marketable securities from a foreign grantor or nongrantor trust (whether from trust corpus or income) directly or indirectly to a U.S. person. It also clarifies that a loan to a grantor trust or to an entity disregarded as an entity separate from its owner will be treated as a loan to the owner of the grantor trust or of the disregarded entity. Loans from a foreign trust also include any loans made by any foreign or U.S. person if the foreign trust guarantees the loan, as well as loans made to a U.S. person by any intermediary, nominee or agent.

Proposed §1.6048-4(b)(3)(ii) further provides that a distribution includes any loan of cash or marketable securities made directly or indirectly to a U.S. beneficiary (as defined in proposed §1.643(i)-1(d)(5)) of a foreign nongrantor trust or to a U.S. person related (as defined in proposed §1.643(i)-1(d)(4)) to a U.S. beneficiary of such foreign nongrantor trust without regard to whether the foreign trust receives an obligation (within

the meaning of proposed §1.643(i)-2(b)(2)(ii)) in exchange for the loan. Proposed §1.6048-4(b)(3)(iii) provides that a loan of cash or marketable securities from a foreign trust must be reported by the U.S. person that receives the loan without regard to whether the loan would have any income tax consequences to a U.S. beneficiary of the foreign trust. If the U.S. person who receives the loan is related to a U.S. beneficiary of a foreign nongrantor trust, then the U.S. beneficiary must also report the distribution.

Proposed §1.6048-4(b)(4)(i) provides that a distribution includes the fair market value of the use of trust property directly or indirectly by a U.S. person without regard to whether the use of trust property would be treated as having any income tax consequences to a U.S. beneficiary of the foreign trust. For these purposes, the use of trust property by a grantor trust or a disregarded entity is treated as used by the U.S. owner of the grantor trust or the disregarded entity, respectively. Proposed §1.6048-4(b)(4)(ii) further provides that a distribution includes the fair market value of the use of trust property directly or indirectly by a U.S. beneficiary of a foreign nongrantor trust or by a U.S. person related to such U.S. beneficiary without regard to whether the foreign trust is paid the fair market value for such use. Proposed §1.6048-4(b)(4)(iii) provides that the use of trust property must be reported on Part III of Form 3520 by the U.S. person that uses the trust property without regard to whether the use of trust property would have any income tax consequences to a U.S. beneficiary of the foreign trust. If the U.S. person who uses the trust property is related to a U.S. beneficiary of a foreign nongrantor trust, then the U.S. beneficiary must also report the distribution.

The Treasury Department and the IRS have determined that given the high potential for tax avoidance through the use of foreign trusts, it is appropriate to require

reporting by both the U.S. person receiving a distribution from a foreign trust and the U.S. beneficiary of the foreign trust in the case where the U.S. person who receives a distribution from a foreign trust is related to the U.S. beneficiary pursuant to the authority granted by section 643(a)(7) to ensure that the IRS has information for tax compliance efforts.

Proposed §1.6048-4(b)(5) provides that the term distribution also includes any covered gift or covered bequest (within the meaning of section 2801(e)) that is received as a transfer from a foreign trust.

3. Information Statements

Proposed §1.6048-4(c) lists four types of information statements that may be provided by a foreign trust to a U.S. person who receives a distribution (including a loan of cash or marketable securities or the use of other trust property) from that foreign trust. A U.S. person who receives one of these statements may use the statement in determining the tax consequences of the distribution.

If a distribution is received from a foreign trust that is treated as owned by a U.S. person (U.S. owner) under the grantor trust rules, and the person who receives the distribution is the U.S. owner, the U.S. owner should receive a Foreign Grantor Trust Owner Statement pursuant to proposed §1.6048-3(b)(1)(ii). This statement is part of Form 3520-A.

If a distribution is received from a foreign trust that is treated as owned by a U.S. owner under the grantor trust rules, any U.S. person who receives such a distribution (other than the U.S. owner) should receive a Foreign Grantor Trust Beneficiary Statement pursuant to proposed §1.6048-3(b)(1)(iii). This statement is part of Form

3520-A. See also the instructions for Form 3520-A for information about the items that must be included on a Foreign Grantor Trust Beneficiary Statement.

If a distribution from a foreign trust that is not treated as owned by a U.S. or foreign grantor or any other person under the grantor trust rules, is received by a U.S person, the U.S. person who receives the distribution may receive a Foreign Nongrantor Trust Beneficiary Statement. If the distribution is a loan from a foreign trust, or the use of property of a foreign trust, and the U.S. person who receives the distribution is not a U.S. beneficiary of the trust but is related to a U.S. beneficiary of the trust, the U.S. beneficiary (in addition to the U.S. person who receives the distribution) may receive a duplicate Foreign Nongrantor Trust Beneficiary Statement from the foreign trust. See the instructions for Form 3520 for a list of items that must be included on a Foreign Nongrantor Trust Beneficiary Statement.

If a distribution is received from a foreign trust that is treated as owned by a foreign person under the grantor trust rules, then the U.S. person who receives the distribution may receive a Foreign-Owned Grantor Trust Beneficiary Statement. The instructions for Form 3520 will be amended to include a list of items that must be included on a Foreign-Owned Grantor Trust Beneficiary Statement. The list will be similar to the lists of items that must be included on the Foreign Grantor Trust Beneficiary Statement and the Foreign Nongrantor Trust Beneficiary Statement.

4. Tax Consequences of Distributions

Proposed §1.6048-4(d) describes the rules that a U.S. person (other than a U.S. person who is treated as the owner of the distributing trust) must use to determine the tax consequences of a distribution from a foreign trust. There are two methods: (i) the

actual calculation method and (ii) the default method. If the U.S. person who receives the distribution does not receive a copy of the relevant statement (see proposed §1.6048-4(c)) before filing a return, the U.S. person must determine the tax consequences of the distribution under the default method. A U.S. person who receives the relevant statement before filing a return generally may compute the tax consequences of the distribution under either the actual calculation method or the default method. However, if the U.S. person has previously used the default method with respect to distributions from the same trust, the U.S. person must consistently use the default method to determine the tax consequences of any subsequent distributions from that trust in all future years, except in the year in which the trust terminates.

Under the actual calculation method provided in proposed §1.6048-4(d)(2), a U.S. person who receives a Foreign Grantor Trust Beneficiary Statement or a Foreign-Owned Grantor Trust Beneficiary Statement from the foreign trust may determine the income tax consequences of the distribution as if the distribution were received directly from the owner of the trust. Thus, if the distribution is a gift under section 102, the U.S. person should not include the distribution in gross income, but the distribution remains subject to the proposed §1.6048-4 reporting requirements. A U.S. person who receives a Foreign Nongrantor Trust Beneficiary Statement may determine the tax consequences of the distribution by applying the rules of subchapter J of chapter 1 of the Code.

Under the default method provided in proposed §1.6048-4(d)(3), the U.S. person may treat a portion of the distribution as a distribution of current income based on the amount of the average distribution received in the prior three years, with only the excess

amount of the distribution (i.e., the amount in excess of 125 percent of the average distribution that the U.S. person received from the foreign trust during the three immediately preceding taxable years) treated as an accumulation distribution within the meaning of section 665(b) consisting of undistributed net income of the foreign trust. In applying the default method, in the absence of actual information provided on a statement described in proposed §1.6048-4(c), the U.S. person must presume that the applicable number of years the 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 tax under section 665(d) has previously been imposed). These rules are consistent with the default method that is currently prescribed in the instructions to Part III of Form 3520. The U.S. person's use of the default method will not affect any calculations made by the trust for purposes of trust accounting.

5. U.S. Agents

Proposed §1.6048-4(e) provides that the trustee of the foreign trust may authorize a U.S. person to act as the trust's limited agent under the rules prescribed in proposed §1.6048-3(e). If the trustee does not authorize a U.S. agent and if a U.S. person to whom a summons is issued fails to respond to the summons (in accordance with the rules of proposed §1.6048-3(e)), then a U.S. person who receives a distribution from the foreign trust (within the meaning of proposed §1.6048-4(b)) (other than a loan or use of trust property that is not treated as a section 643(i) distribution under proposed §1.643(i)-1) but does not receive a Foreign Grantor Trust Beneficiary Statement, Foreign-Owned Grantor Trust Beneficiary Statement, or Foreign Nongrantor Trust

Beneficiary Statement from the foreign trust, must determine the tax consequences of the distribution under the default method in proposed §1.6048-4(d)(3).

6. Coordination Rule with Reporting Large Foreign Gifts

Proposed §1.6048-4(f) addresses the interaction of proposed §1.6048-4 and proposed §1.6039F-1. If a U.S. person receives a distribution from a foreign trust, the U.S. person must report the distribution under proposed §1.6048-4(a) and not under proposed §1.6039F-1, regardless of whether the distribution is taxable to the U.S. person.

D. Exceptions

1. Exceptions to Reporting Transfers of Property to Foreign Trusts

Proposed §1.6048-5(a) provides an exception from section 6048(a) reporting based on section 6048(a)(3)(B). The proposed regulations provide that for purposes of proposed §1.6048-2, a reportable event does not include any of the following: (1) transfers of property to a foreign trust that are transfers for fair market value within the meaning of §1.679-4(b) (except a transfer by a U.S. transferor that is a related person (as defined in §1.679-1(c)(5)) with respect to the foreign trust in exchange for any obligation of the trust or a related person regardless of whether such obligation is a qualified obligation described in §1.679-4(d)); for a qualified obligation as described in §1.679-4(b)) ; (2) any transfer of property to certain compensatory foreign trusts, as described in section 402(b), 404(a)(4), or 404A; and (3) any transfer of property to a foreign trust described in section 501(c)(3) provided that the trust has received a determination letter from the IRS that has not been revoked recognizing the foreign trust's exemption from federal income tax under section 501(a) as an exempt

organization described in section 501(c)(3). However, it does apply to transfers for fair market value if the transfer is by a U.S. transferor that is a related person (as defined in §1.679-1(c)(5)) with respect to the foreign trust in exchange for any obligation of the trust or a related person (without regard to whether such obligation is a qualified obligation described in §1.679-4(d)).

2. Additional Exceptions to Reporting Transactions with Foreign Trusts

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

i. Tax-favored foreign retirement and non-retirement savings trusts

Proposed §1.6048-5(b) provides an exception from sections 6048(a) through (c) and proposed §§1.6048-2 through -4 for certain eligible U.S. individuals' transactions with, or ownership of, certain tax-favored foreign retirement and non-retirement savings trusts, as described in proposed §1.6048-5(b)(2) and (3). A tax-favored foreign retirement trust means a foreign trust that is established under the laws of a foreign jurisdiction to operate exclusively or almost exclusively to provide, or to earn income for the provision of, pension or retirement benefits and ancillary or incidental benefits, and that meets certain additional requirements, such as contribution limitations, conditions for withdrawal, and information reporting. See proposed §1.6048-5(b)(2). A tax-favored foreign non-retirement savings trust means a foreign trust that is established under the laws of a foreign jurisdiction to operate exclusively or almost exclusively to provide, or to earn income for the provision of, medical, disability, or educational benefits, and that also meets certain additional requirements, such as contribution limitations, conditions

for withdrawal, and information reporting. See proposed §1.6048-5(b)(3). The Treasury Department and the IRS have determined that, because these trusts generally are subject to written restrictions, such as contribution limitations, conditions for withdrawal, and information reporting, which are imposed under the laws of the country in which the trust is established, and because U.S. individuals with an interest in these trusts may be required under section 6038D to separately report information about their interests in accounts held by, or through, these trusts, it would be appropriate to exempt U.S. individuals from the requirement to provide information about these trusts under section 6048.

ii. Distributions from certain foreign compensatory trusts

The proposed regulations implement the exception from section 6048(c) reporting provided in section V of Notice 97-34 for distributions from certain foreign compensatory trusts described in §1.672(f)-3(c)(1) (section 402(b) employee trusts and foreign rabbi trusts). Proposed §1.6048-5(c). The exception applies only if the recipient of the distribution reports the distribution as compensation income on a federal income tax return.

iii. Distributions received by certain domestic charitable organizations

Proposed §1.6048-5(d) implements the exception from section 6048(c) reporting provided in section V of Notice 97-34 for distributions received by a domestic organization described in section 501(c)(3). The exception applies only if the organization has received a determination letter from the IRS that has not been revoked recognizing the domestic organization's exemption from federal income tax under section 501(a) as an organization described in section 501(c)(3).

iv. Certain trusts located in a mirror code possession

Proposed §1.6048-5(e) provides an exemption from sections 6048(a) through (c) for a trust located in a mirror code possession to the extent the responsible party (within the meaning of section 6048(a)(4)), U.S. owner, or U.S. recipient is a bona fide resident (within the meaning of §1.937-1(b)) of the mirror code possession. For this purpose, a mirror code possession is a possession that administers income tax laws that are identical (except for the substitution of the name of the possession for the term "United States" where appropriate) to those in the United States. A trust is located in a mirror code possession if a court within such mirror code possession is able to exercise primary supervision over the administration of the trust and one or more bona fide residents of the mirror code possession have the authority to control all substantial decisions of the trust.

v. Exceptions pursuant to subsequent guidance

Proposed §1.6048-5(f) provides that the Treasury Department and the IRS may provide additional exceptions to the rules provided in sections 6048(a) through 6048(c) in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin.

E. Special rules

Proposed §1.6048-6(a) provides a special rule for dual resident taxpayers (within the meaning of §301.7701(b)-7(a)(1)) that generally results in excluding this category of taxpayers from section 6048 reporting for the portion of the year they are treated as a nonresident for purpose of calculating their income tax liability. This rule could also affect the reporting obligations of U.S. persons in certain circumstances. For example,

assume a U.S. person (U.S. owner) is treated as the owner of a foreign trust that makes a distribution to a dual resident taxpayer during a taxable year. If the dual resident taxpayer is treated as a U.S. person during that taxable year, proposed §1.6048-3(b) provides that the U.S. owner is responsible for ensuring that the foreign trust issues a Foreign Grantor Trust Beneficiary Statement to the dual resident taxpayer and is responsible for issuing the statement if the trust fails to do so. However, this statement will not be required if the dual resident taxpayer is not treated as a U.S. person for that taxable year.

Under proposed §1.6048-6(a)(1), a dual resident taxpayer who, pursuant to a provision of an income tax treaty that provides for resolution of conflicting claims of residence by the United States and the treaty partner, claims to be treated as a resident of the treaty partner as provided in §301.7701(b)–7 will be taxed as a nonresident for U.S. tax purposes for the taxable year (or portion of the taxable year) that the individual is treated as a nonresident. The Treasury Department and the IRS have concluded that because the taxpayer's filing of relevant forms pursuant to §301.7701(b)–7 provides adequate information for IRS to take tax compliance efforts, reporting on Form 3520 or Form 3520-A by such a taxpayer will not be required.

Similarly, under proposed §1.6048-6(a)(2), a dual status taxpayer who abandons his U.S. citizenship or residence during the tax year or acquires U.S. citizenship or residence during the taxable year as provided in §1.6012-1(b)(2)(ii) will not be treated as a U.S. person for purposes of proposed §§1.6048-2 through 1.6048-4 for the part of the year when such individual is treated as a nonresident alien for computing the

individual's income tax liability, as reflected on the Form 1040NR or other similar schedule attached to such Form 1040NR.

Proposed §1.6048-6(b) provides that in determining whether a U.S. person makes a transfer to, or receives a distribution from, a foreign trust, the fact that the trust, or a portion of the trust, is treated as owned by a grantor or another person under the grantor trust rules is disregarded.

Proposed §1.6048-6(c) is reserved for rules under section 6048(d)(2). Section 6048(d)(2) provides that to the extent provided in regulations, a domestic trust will be treated as a foreign trust for purposes of sections 6048 and 6677 if the trust has substantial activities, or holds substantial property, outside the United States.

Proposed §1.6048-6(d) provides that married U.S. persons who are both transferors, grantors, or owners of the same foreign trust, or who both receive a distribution from the same foreign trust, may file one Form 3520 with respect to such trust, but only if they otherwise file a joint income tax return under section 6013.

V. Section 6677 – Civil Penalties for Failure to File Information with Respect to Certain Foreign Trusts

Proposed §1.6677-1 provides rules for civil penalties that may be assessed if any notice or return required to be filed under proposed §§1.6048-2 through 1.6048-4 is not timely filed or contains incomplete or incorrect information. Contrary to Wilson, the proposed regulations provide for three separate civil penalties that correspond to each separate reporting requirement under proposed §1.6048-2, §1.6048-3, and §1.6048-4. The Treasury Department and the IRS interpret section 6677 as assessing a penalty based on a percentage of a gross reportable amount, a term that is defined under section 6677(c) and in the proposed regulations with respect to each corresponding

section 6048 reporting requirement. This interpretation is consistent with the plaint text of sections 6048 and 6677 and the purpose of the 1996 Act's modifications to these sections, which was to discourage U.S. taxpayers from using foreign trusts used to avoid their U.S. tax obligations.

A. General rules

Proposed §1.6677-1(a)(1) provides that, as a general rule, a person who fails to timely file a required notice or return, or fails to provide complete and correct information, is subject to a penalty equal to the greater of $10,000 or 35 percent of the applicable "gross reportable amount" (defined in proposed §1.6677-1(c)) for each such failure (or each year in the case of a failure under proposed §1.6048-3 relating to information reporting about U.S. owners of foreign trusts). If an amount that is less than the gross reportable amount is reported, the penalty will be based on the amount that is unreported. See proposed §1.6677-1(b), discussed in this section, for special rules that apply to failures to comply with proposed §1.6048-3, as related to U.S. owners of foreign trusts.

Proposed §1.6677-1(a)(2) provides that if the failure to comply with the applicable reporting requirement continues for more than 90 days after the day on which the IRS mails notice of the failure to the person required to pay the penalty, such person is required to pay an additional penalty of $10,000 for each 30-day period (or fraction thereof) during which the failure continues.

Proposed §1.6677-1(a)(3)(i) addresses maximum penalties. Proposed §1.6677-1(a)(3)(i) provides that the aggregate amount of the penalty imposed by proposed §§1.6677-1(a)(1) and (2) (as modified by proposed §1.6677-1(b), if applicable) with

respect to any single failure may not exceed the gross reportable amount with respect to that failure (provided that the IRS receives enough information to accurately determine the gross reportable amount). In some cases, the IRS can begin to assess penalties before it has received enough information to determine the gross reportable amount. If the aggregate amount of the penalty already collected with respect to a failure at the time the IRS is able to determine the gross reportable amount exceeds the gross reportable amount with respect to that failure, the IRS will refund the excess amount pursuant to section 6402.

Proposed §1.6677-1(a)(3)(ii) provides that the limitations provided for claims for refund under section 6511(a) and (b) apply to the refund of any excess amount.

B. Failures to comply with proposed §1.6048-3

Proposed §1.6677-1(b) makes two modifications to the rules of proposed §1.6677-1(a) in the case of a notice or return required to be filed under proposed §1.6048-3 (relating to information reporting about U.S. owners of foreign trusts). First, in the case of a notice or return required to be filed by a foreign trust under proposed §1.6048-3(b), the U.S. owner, rather than the foreign trust, must pay the penalty. Second, the amount of any penalty that is initially imposed under proposed §1.6677-1(a)(1) is the greater of $10,000 or 5 percent of the gross reportable amount, rather than 35 percent.

C. Gross reportable amount

Proposed §1.6677-1(c)(1) provides that the term gross reportable amount means (i) the gross value of the property involved in the reportable event (determined as of the date of the event) in the case of a failure relating to proposed §1.6048-2, (ii) the gross

value of the portion of the trust's assets (at the close of the trust's taxable year) treated as owned by the U.S. person in the case of a failure relating to proposed §1.6048-3, and (iii) the gross amount of the distribution or deemed distribution in the case of a failure relating to proposed §1.6048-4. Proposed §1.6677-1(c)(2) provides guidance on how to determine the gross value or gross amount of property for purposes of proposed §1.6677-1(c)(1).

D. Reasonable cause

Proposed §1.6677-1(d) provides that the penalty will not apply if the person required to file the notice or return (including a U.S. person who is treated as an owner of a foreign trust that fails to comply with proposed §1.6048-3(b)) demonstrates to the satisfaction of the IRS that the failure to file was due to reasonable cause and not due to willful neglect. The determination of whether a failure was due to reasonable cause and not due to willful neglect will be made under the principles set out in §1.6664-4 and §301.6651-1(c) and will be made on a case-by-case basis, taking into account all pertinent facts and circumstances. The fact that a foreign jurisdiction would impose a civil or criminal penalty on any person for disclosing the required information would not satisfy the reasonable cause exception. In addition, refusal on the part of a foreign trustee to provide information for any reason, including difficulty in producing the required information or the existence of provisions in the trust instrument that prevent the disclosure of required information, does not constitute reasonable cause.

E. Deficiency procedures

Proposed §1.6677-1(e) provides that deficiency procedures will not apply in the case of the assessment or collection of a penalty imposed under section 6677.

F. Joint filers

Proposed §1.6677-1(f) addresses a concern regarding U.S. taxpayers who set up abusive structures or engage in abusive transactions using foreign trusts and who fail to file information required by section 6048. In the case of married taxpayers, it can be difficult for the IRS to determine who, between married taxpayers filing joint income tax returns, should be treated as the grantor, owner, or even the beneficiary of a foreign trust in certain cases. Enabling the IRS to assess section 6677 penalties against married spouses who file a joint income tax return on a joint and several basis allows the IRS to properly enforce section 6048, while still providing these taxpayers a way to demonstrate that they should not be liable for the information reporting leading to section 6677 penalties.

Proposed §1.6677-1(f) provides that married U.S. individuals who file a joint income tax return under section 6013 and who are both transferors, grantors, or owners of the same foreign trust, or who both receive a distribution from the same foreign trust, are subject to penalties as if the married individuals are a single person, unless one of such individuals can prove to the satisfaction of the IRS that they did not have an interest in the underlying property giving rise to a reporting requirement under sections 6048(a) through (c) and proposed §§1.6048-2 through 1.6048-4. The liability of married individuals treated as a single person pursuant to proposed §1.6677-1(f) is joint and several.

VI. Applicability Date

These regulations are proposed to be effective with respect to transactions with foreign trusts and the receipt of foreign gifts in taxable years beginning on or after the

date on which the final regulations are published in the Federal Register. However, taxpayers may rely on these proposed regulations for all open tax years beginning before the final regulations apply, provided that the proposed regulations are applied consistently for all subsequent years until the date these regulations are published as final regulations.

Special Analyses

[To be inserted]

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules and as specifically requested in Section I.B. of this preamble, with respect to whether qualified obligation rules are needed for loans of marketable securities. All comments will be available at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are Lara A. Banjanin and Tracy M. Villecco of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order and amending entries for §§1.679-1, 1.679-2, and 1.679-4 to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.643(i)-1 also issued under 26 U.S.C. 643(i)(1) and 643(a)(7).

Section 1.643(i)-2 through 1.643(i)-4 also issued under 26 U.S.C. 643(i)(1), 643(a)(7), and 6048(d)(3) and (4).

Section 1.643(i)-5 also issued under 26 U.S.C. 643(i)(1) and 643(a)(7).

* * * * *

Section 1.679-1 also issued under 26 U.S.C. 643(a)(7) and 679(e).

Section 1.679-2 also issued under 26 U.S.C. 643(a)(7) and 679(d) and (e).

Section 1.679-4 also issued under 26 U.S.C. 643(a)(7) and 679(a)(3) and (e).

* * * * *

Section 1.6039F-1 also issued under 26 U.S.C. 6039F(e).

* * * * *

Sections 1.6048-1 through 1.6048-6 also issued under 26 U.S.C. 643(a)(7) and 6048(d)(3) and (4).

* * * * *

Section 1.6677-1 also issued under 26 U.S.C. 643(a)(7) and 6048(d)(3) and (4).

* * * * *

Par. 2. Sections 1.643(i)-1, 1.643(i)-2, 1.643(i)-3, 1.643(i)-4, and 1.643(i)-5 are added to read as follows:

§1.643(i)-1 Loans from foreign nongrantor trusts and use of trust property.

(a) Loans from foreign nongrantor trusts and use of trust property—(1) In general. For purposes of subparts B, C, and D of part I of subchapter J of chapter 1 of the Internal Revenue Code, a loan or use of trust property described in paragraph (b) or (c) of this section will be treated as a section 643(i) distribution from a foreign trust to a U.S. beneficiary of the foreign trust under subchapter J of chapter 1 of the Internal Revenue Code, as provided in such paragraphs. Paragraph (d) of this section provides definitions for this section and §§1.643(i)-2 through 1.643(i)-5. Section 1.643(i)-2 provides exceptions to the general rule. Section 1.643(i)-3 provides rules relating to the determination of the amount treated as a section 643(i) distribution and the tax consequences of a section 643(i) distribution. Section 1.643(i)-4 provides examples, and §1.643(i)-5 address the applicability dates of these regulations.

(2) Interaction with section 6048(c). For rules relating to information reporting of loans from foreign trusts and the use of property of a foreign trust, without regard to whether such loan or use of property is treated as a section 643(i) distribution or has any other tax consequences, and without regard to whether the foreign trust is a nongrantor or grantor trust, see §1.6048-4.

(b) Loan of cash or marketable securities from foreign nongrantor trust generally treated as a distribution—(1) In general. Except as provided in §1.643(i)-2, any loan of cash or marketable securities from a foreign trust (whether from trust corpus or income) directly or indirectly to any U.S. beneficiary or any U.S. person related to a U.S. beneficiary will be treated as a section 643(i) distribution to the U.S. beneficiary on the date such loan was made. For these purposes, a loan from a nongrantor trust to a grantor trust or a disregarded entity is treated as a loan to the owner of the grantor trust or the disregarded entity, respectively. (For example, a loan to a single member LLC treated as a disregard entity will be treated as a loan to the owner of the LLC.)

(2) Indirect loans—(i) In general. Except as provided in paragraph (b)(2)(ii) of this section, indirect loans from a foreign trust include loans made by an intermediary or an agent or nominee of a foreign trust, or loans made to an agent or nominee of a U.S. beneficiary or a U.S. person related to a U.S. beneficiary. Indirect loans also include:

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

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

(C) Loans made by a foreign trust to a foreign person, other than to a nonresident alien individual beneficiary of the trust, if the foreign person is related to a U.S. beneficiary of the trust.

(ii) Limitation. The loans described in paragraphs (b)(2)(i)(B) and (b)(2)(i)(C) of this section will not be treated as a section 643(i) distribution if the U.S. beneficiary:

(A) Satisfies the information reporting requirements of §1.6048-4 with respect to the loan, and

(B) Includes an explanatory statement attached to the U.S. beneficiary's federal income tax return and the Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, filed pursuant to §1.6048-4 that demonstrates to the satisfaction of the IRS that the loan would have been made without regard to the fact that the U.S. beneficiary is a beneficiary of the foreign trust.

(iii) Effect of indirect loans—(A) In general. In the case of a loan described in paragraph (b)(2)(i)(A) or (B) of this section, the person making the loan is treated as an agent of the foreign trust.

(B) Loans to a foreign person related to a U.S. beneficiary. In the case of a loan described in paragraph (b)(2)(i)(C) of this section, the foreign person related to the U.S. beneficiary is treated as an agent of the U.S. beneficiary, and the date the loan is made to the foreign person is treated as the date the loan is made to the U.S. beneficiary.

(3) Rule for nonresident alien individual beneficiaries of a foreign trust who become U.S. resident aliens. If a nonresident alien individual who is a beneficiary of a foreign trust receives a loan from the trust, and while the loan is outstanding, becomes a U.S. resident (within the meaning of section 7701(b)) within 2 years of the date the loan was made, the loan will be treated as a section 643(i) distribution with respect to the outstanding amount of the loan as of the date the individual acquires U.S. residence or citizenship unless an exception described in §1.643(i)-2 applies.

(c) Use of trust property generally treated as a distribution—(1) In general. Except as provided in §1.643(i)-2, any direct or indirect use of property of a foreign trust, other than as a result of a loan of cash or a loan of marketable securities, by any U.S. beneficiary or any U.S. person related to a U.S. beneficiary will be treated as a section 643(i) distribution to the U.S. beneficiary in the taxable year in which such use occurs. For these purposes, use of property of a nongrantor trust by a grantor trust or by a disregarded entity would be treated as use by the owner of the grantor trust or the disregarded entity, respectively. (For example, use of trust property by a single member LLC treated as a disregarded entity will be treated as use by the owner of the LLC.)

(2) Indirect use of trust property—(i) In general. Indirect use of property of a foreign trust includes use by an agent or nominee of a U.S. beneficiary or a U.S. person related to a U.S. beneficiary. Indirect use of trust property also includes use by a foreign person, other than a nonresident alien individual beneficiary of the trust, if the foreign person is related to a U.S. beneficiary of the trust, unless paragraph (c)(2)(ii) of this section applies.

(ii) Limitation. The use of trust property described in the second sentence of paragraph (c)(2)(i) of this section will not be treated as a section 643(i) distribution to the U.S. beneficiary if the U.S. beneficiary:

(A) Satisfies the information reporting requirements of §1.6048-4 with respect to the loan,

(B) Includes an explanatory statement attached to the U.S. beneficiary's federal income tax return and the Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, filed pursuant to §1.6048-4 that

demonstrates to the satisfaction of the IRS that the use of trust property would have been allowed without regard to the fact that the U.S. beneficiary is a beneficiary of the foreign trust.

(iii) Effect of indirect use of trust property. In the case of the use of trust property by a foreign person related to the U.S. beneficiary described in paragraph (c)(2)(i) of this section, such foreign person is treated as an agent of the U.S. beneficiary.

(d) Definitions. The following definitions apply for purposes of this section and §§1.643(i)-2 through 1.643(i)-5:

(1) Cash. The term cash includes foreign currencies.

(2) Loan of cash. Except as provided in §1.643(i)-2(a)(1), the term loan of cash includes an extension of credit.

(3) Marketable securities. The term marketable securities means marketable securities within the meaning of section 731(c)(2)(A), but not including foreign currencies.

(4) Related. A person will be considered to be related to another person if the relationship between such persons would result in a disallowance of losses under section 267 or 707(b). In applying section 267 for purposes of the previous sentence, section 267(c)(4) is applied as if the family of an individual includes the spouses of the members of the individual's family.

(5) Beneficiary. The term beneficiary means a person to whom, or for whose benefit, at any time during the life of the trust or upon termination, under the terms of the trust instrument or applicable local law, trust income or corpus may be paid (including pursuant to a power of appointment if the power has been exercised in favor of that

person) or accumulated, directly or indirectly. All references to a U.S. beneficiary mean a beneficiary who is a U.S. person.

(6) U.S. grantor. The term U.S. grantor means a U.S. person described in §1.671-2(e).

(7) U.S. person—(i) In general. Subject to paragraph (d)(7)(ii) of this section, the term U.S. person means a United States person as defined in section 7701(a)(30) but does not include an entity that is exempt from tax under chapter 1 of the Internal Revenue Code.

(ii) Special rules—(A) Dual resident taxpayers. If a dual resident taxpayer (within the meaning of §301.7701(b)-7(a)(1) of this chapter) computes U.S. income tax liability as a nonresident alien on the last day of the taxable year and complies with the filing requirements of §301.7701(b)-7(b) and (c) of this chapter, such individual will not be treated as a U.S. person with respect to the portion of the taxable year covered by Form 1040NR (or Form 1040NR–EZ).

(B) Dual status taxpayers. Except as provided in paragraph (b)(3) of this section, if a taxpayer abandons his U.S. citizenship or residence during the tax year or acquires U.S. citizenship or residence during the taxable year as provided in §1.6012-1(b)(2)(ii), such individual will not be treated as a U.S. person for the part of the year when the individual is treated as a nonresident alien for computing the individual's income tax liability, as reflected on the Form 1040NR or other similar schedule attached to such Form 1040.

(8) Section 643(i) distribution. The term section 643(i) distribution means a transaction described in paragraph (b) or (c) of this section.

(9) Grantor trust. The term grantor trust means a trust or any portion of a trust that is treated as owned by any person under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code.

(10) Nongrantor trust. The term nongrantor trust means a trust or any portion of a trust that is not treated as owned by any person under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code.

(11) Foreign person. The term foreign person means any person who is not a U.S. person within the meaning of section 7701(a)(30).

(12) Disregarded entity. The term disregarded entity means an entity that, under §§ 301.7701–1 through 301.7701–3 of this chapter, is disregarded as an entity separate from its owner.

§1.643(i)-2 Exceptions

(a) In general. A loan of cash or use of trust property will not be treated as a section 643(i) distribution if it is one of the following:

(1) Loan of cash in exchange for a qualified obligation. A loan of cash that is in exchange for a qualified obligation (within the meaning of paragraph (b)(2)(iii) of this section).

(2) Compensated use of trust property—(i) In general. Use of trust property, other than a loan of cash or marketable securities, to the extent that the trust is paid the fair market value of such use within a reasonable period of time from the start of the use of the property. A determination as to the fair market value of the use of such property and as to whether a fair market value payment is made within a reasonable period of time must be based on all the facts and circumstances, including the type of property used and the period of use. In appropriate cases, such as rental of real property,

payments may be made on a periodic basis consistent with arm's length dealings between unrelated parties.

(ii) Safe harbor. For purposes of paragraph (a)(2)(i) of this section, a payment is made within a reasonable period of time if the payment is made within 60 days of the start of the use of trust property.

(3) De minimis use of trust property. Use of trust property, other than a loan of cash or marketable securities, if such use is de minimis. Use of trust property will be considered de minimis if aggregate use by any U.S. beneficiary and any U.S. person related to such U.S. beneficiary does not exceed 14 days during the taxable year of the U.S. beneficiary (or U.S. beneficiaries) who would be treated as receiving a section 643(i) distribution absent this de minimis rule.

(b) Qualified obligations—(1) In general. The rules in this paragraph (b) apply to determine whether a loan of cash is in exchange for a qualified obligation.

(2) Definitions. The following definitions apply for purposes of this section and §§1.643(i)-1 and 1.643(i)-3 through 1.643(i)-5:

(i) Obligor. The term obligor means the person who issues an obligation to a foreign trust in exchange for a loan of cash.

(ii) Obligation. The term obligation means any instrument or contractual arrangement that constitutes indebtedness under general principles of Federal income tax law (for example, a bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other evidence of indebtedness), and any annuity contract that would not otherwise be classified as indebtedness under general principles of Federal income tax law.

(iii) Qualified obligation—(A) General requirements. The term qualified obligation means an obligation that at all times satisfies all of the following requirements:

(1) The obligation is reduced to writing by an express written agreement.

(2) The term of the obligation does not exceed five years. For purposes of determining the term of an obligation, the obligation's maturity date is the last possible date that the obligation can be outstanding under the terms of the obligation.

(3) All payments on the obligation must be in cash in U.S. dollars.

(4) The obligation is issued at par and provides for stated interest at a fixed rate or a qualified floating rate within the meaning of §1.1275-5(b).

(5) The yield to maturity of the obligation is not less than 100 percent of the applicable Federal rate and not greater than 130 percent of the applicable Federal rate. The applicable Federal rate for an obligation is the applicable Federal rate in effect under section 1274(d) for the day on which the obligation is issued, as published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter). The yield to maturity and the applicable Federal rate must be based on the same compounding period. If an obligation is a variable rate debt instrument that provides for stated interest at a qualified floating rate, the equivalent fixed rate debt instrument rules in §1.1274-2(f)(1) or §1.1275-5(e), whichever is applicable, applies to determine the obligation's yield to maturity.

(6) All stated interest on the obligation is qualified stated interest within the meaning of §1.1273-1(c).

(B) Additional requirements to remain a qualified obligation. An obligation will only remain a qualified obligation if, for the first year and each year that the obligation

remains outstanding, the U.S. beneficiary that is the obligor or is related to the obligor fulfills the following requirements:

(1) The U.S. beneficiary timely extends the period for assessment of any income tax attributable to the obligation and any consequent income tax changes for each year that the obligation is outstanding to a date not earlier than three years after the maturity date of the obligation. This extension of the period for assessment is not necessary with respect to the taxable year of the U.S. beneficiary in which the maturity date of the obligation falls, provided that the obligation is paid in cash in U.S. dollars within that year. The period of assessment shall be extended by completing and filing Part III of Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, for every year that the obligation is outstanding. The waiver in Part III of Form 3520 shall also contain such other terms with respect to assessment as may be considered necessary by the IRS to ensure the assessment and collection of the correct tax liability for each year for which the waiver is required. When Part III of Form 3520 is properly executed and filed, the consent to extend the period for assessment of tax will be deemed to be agreed upon and executed by the IRS for purposes of §301.6501(c)-1(d).

(2) The U.S. beneficiary timely reports the status of the obligation, including principal and interest payments, on Part III of Form 3520 for every year that the obligation is outstanding.

(3) The obligor timely makes all payments of principal and interest on the obligation according to the terms of the obligation (including a reasonable grace period of no more than thirty days for a late payment).

(3) Modification of a qualified obligation. If the terms of a qualified obligation are modified and the modification is treated as an exchange under §1.1001-3, the new obligation that is deemed issued in the exchange under §1.1001-3 must satisfy all the requirements in paragraph (b)(2)(iii) of this section to be a qualified obligation. If the modification is not treated as an exchange under §1.1001-3, then the qualified obligation must be retested as of the date of the modification to determine whether the obligation, as modified, continues to satisfy the requirements in paragraph (b)(2)(iii) of this section to be a qualified obligation.

(4) Additional loans. If a qualified obligation is outstanding and the obligor directly or indirectly issues an additional obligation to the foreign trust in exchange for cash, the original outstanding obligation is deemed to have the maturity date of any such subsequent obligation in determining whether the term of the original obligation exceeds the specified 5-year term. The original outstanding obligation must be retested as of the issue date of the additional obligation to determine whether it satisfies all the requirements in paragraph (b)(2)(iii) of this section to be a qualified obligation. The additional obligation must also be separately tested to see if it satisfies the requirements in paragraph (b)(2)(iii) of this section to be a qualified obligation.

(5) Series of obligations. If the IRS determines, based on all of the facts and circumstances, that two or more obligations issued by a U.S. obligor are structured with a principal purpose to avoid the application of section 643(i), the IRS may treat the obligations as a single obligation that is not a qualified obligation.

(6) Obligations that cease to be qualified—(i) In general. If a qualified obligation ceases to be a qualified obligation (for example, because an obligation is modified so

that the term of the obligation exceeds 5 years), the U.S. beneficiary will be treated as receiving a section 643(i) distribution from the trust.

(ii) Amount of section 643(i) distribution. Except as otherwise provided in this paragraph (b)(6)(ii), the amount of the section 643(i) distribution treated as received pursuant to paragraph (b)(6)(i) of this section will be equal to the obligation's outstanding stated principal amount plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273-1(c)) as of the date of the event that causes the obligation to no longer be a qualified obligation. In the case of an obligation that ceases to be a qualified obligation because the obligor issues two or more obligations and the IRS treats the obligations as a single obligation pursuant to paragraph (b)(5) of this section, the amount of the section 643(i) distribution will not exceed the sum of the outstanding stated principal amount plus any accrued but unpaid qualified stated interest for each of the obligations as of the date determined by the IRS under paragraph (b)(6)(iii) of this section.

(iii) Date of section 643(i) distribution. In general, the U.S. beneficiary that is the obligor or that is related to the obligor is treated as receiving a section 643(i) distribution on the date of the event that causes an obligation to no longer be a qualified obligation. However, based on all of the facts and circumstances, if an obligation (or obligations) is structured with a principal purpose to avoid the application of section 643(i), the IRS may deem a section 643(i) distribution to have occurred on any date on or after the issue date of the obligation(s).

(c) Trust property attributable to nongrantor trust portion—(1) In general. A loan or use of trust property from a partial nongrantor trust must be apportioned in a manner that is reasonable in light of all the circumstances of each case, including the terms of the governing instrument, local law, and the practice of the trustee if it is reasonable and consistent.

(2) Specific property. If a loan of cash or marketable securities, or a use of trust property, can be made from only one portion of the trust because the type of property loaned or used is held only by that portion, then the loan or use of property will be deemed to be attributable to that portion.

(d) Reporting. A loan of cash or marketable securities from, or the use of any property of, a foreign grantor or nongrantor trust by a U.S. person will be a distribution for purposes of §1.6048-4(b)(3) or (4), as applicable, and must be reported by such U.S. person, and if the trust is a foreign nongrantor trust, by the U.S. beneficiary, under §1.6048-4(a), irrespective of whether the loan or use of trust property is a section 643(i) distribution.

(e) Examples. The following examples illustrate the rules of paragraphs (b) through (d) of this section:

(1) Example 1: Loan of cash not in exchange for qualified obligation. Y, a nonresident alien, created and funded a foreign nongrantor trust, FT, for the benefit of X, a U.S. person. X is the sole beneficiary of FT. In 2017, FT makes a loan to X in exchange for a demand note that permits FT to require repayment by X at any time. The demand note issued by X is not a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii) because X's obligation to FT could remain outstanding for more

than five years. Accordingly, the qualified obligation exception in §1.643(i)-2(a)(1) does not apply. Under §1.643(i)-1(b) and §1.643(i)-3(a), X is treated as receiving a section 643(i) distribution from FT. X must determine the tax consequences of the distribution under §1.643(i)-3(c). Under §1.6048-4(a), X is required to report the section 643(i) distribution on Part III of Form 3520 for 2017, as a distribution from a foreign trust.

(2) Example 2: Beneficiary fails to extend period of assessment and fails to report loan on Form 3520. Y, a nonresident alien, created and funded a foreign nongrantor trust for the benefit of X, a U.S. person. On June 30, 2017, FT makes a loan to X in exchange for an obligation that satisfies the requirements of §1.643(i)-2(b)(2)(iii). However, X fails to extend the period for assessment of any income tax attributable to the loan through the filing of Form 3520 by its due date as required under §1.643(i)-2(b)(2)(iii)(B)(1). X also fails to report the status of the loan on Form 3520 as required under §1.643(i)-2(b)(2)(iii)(B)(2). Either one of X's failures is sufficient to cause the loan to be treated as a section 643(i) distribution under §1.643(i)-1(b). Because the loan fails to continue to be treated as a qualified obligation, the loan is treated as a section 643(i) distribution from FT as of April 15, 2018, the date that X's 3520 would have been due.

(3) Example 3: Effect of subsequent obligation on original obligation. Y, a nonresident alien, created and funded a foreign nongrantor trust for the benefit of X, a U.S. person. On January 1, 2017, FT makes a loan to X in exchange for Note 1, an obligation with a five-year term that satisfies the requirements of paragraph (b)(2)(iii) of this section. On June 30, 2017, FT makes an additional loan to X in exchange for Note 2, an obligation with the same terms as Note 1, but with its own five-year term. Under paragraph (b)(4) of this section, Note 1 will be deemed to have a maturity of June 30,

2022 (i.e., a greater than five-year term) and will cease to be a qualified obligation. Under paragraph (b)(6)(ii) of this section, X will be treated as receiving a section 643(i) distribution equal to Note 1's outstanding stated principal amount plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273-1(c)) as of June 30, 2017. Note 2 will be separately tested to determine whether it satisfies the requirements of §1.643(i)-2(b)(2)(iii).

(4) Example 4: Series of obligations. Y, a nonresident alien, created and funded a foreign nongrantor trust for the benefit of X, a U.S. person. On January 1, 2017, FT makes a loan to X in exchange for Note 1, an obligation with a five-year term that satisfies the requirements of paragraph (b)(2)(iii) of this section. On January 1, 2018, FT makes an additional loan to X in exchange for Note 2, an obligation with the same terms as Note 1. Under paragraph (b)(5) of this section, the IRS treats Notes 1 and 2 as a single obligation after it determines that Notes 1 and 2 are structured with a principal purpose to avoid the application of section 643(i). Under paragraph (b)(6)(ii) of this section, X is treated as receiving a section 643(i) distribution equal to the combined outstanding stated principal amount of Note 1 and Note 2 plus any accrued but unpaid qualified stated interest. Under paragraph (b)(7) of this section, the failed qualified obligation is treated as a section 643(i) distribution as of January 1, 2018. Note 2 is not separately tested to determine whether it is a qualified obligation.

(5) Example 5: Allocation of trust property attributable to partial grantor trust. In 2016, Y, a nonresident alien, creates and settles a foreign trust, FT, for the benefit of A, a U.S. beneficiary. Y funds the trust with a vacation home valued at $500,000 and $500,000 cash. Under the trust document, Y has the power to revoke the trust as to the

vacation home and any income earned by the vacation home at any time without the consent of any person. This power to revoke results in Y being treated as owning the portion of the trust comprising the vacation home (the grantor trust portion) under section 676 (after application of §1.672(f)-3(a)). Y has no powers that would cause him to be treated as owning the portion of the trust comprising the cash he contributed or any income earned by that cash. A uses the vacation home for 2 months in calendar year 2017 and does not compensate the trust for the use of the vacation home. Under paragraph (c)(2) of this section, the use of the vacation home will be deemed to be attributable to the grantor trust portion and thus will not be treated as a section 643(i) distribution to A. Under paragraph (d) of this section, A must comply with the reporting requirements of §1.6048-4 with respect to the use of the vacation home. Under §1.6048-4(b)(4), A is required to report the use of the vacation home on Part III of Form 3520 for 2017 as a distribution from FT.

§1.643(i)-3 Consequences of section 643(i) distribution.

(a) Amount treated as section 643(i) distribution—(1) Loan of cash. Except to the extent addressed under §1.643(i)-2(b)(6)(ii), in the case of a loan of cash treated as a section 643(i) distribution, the amount of the section 643(i) distribution is the issue price of the loan, as determined under §1.446-2(d)(1), §1.1273-2 or §1.1274-2 (whichever is applicable), as of the date (described in §1.643(i)-2(b)(7)) the loan is treated as a section 643(i) distribution.

(2) Loan of marketable securities. In the case of a loan of marketable securities treated as a section 643(i) distribution, the amount of the section 643(i) distribution is the fair market value of the securities as of the date the loan is treated as a section

643(i) distribution.

(3) Uncompensated use of trust property. In the case of use of trust property treated as a section 643(i) distribution, the amount of the section 643(i) distribution is the fair market value of the use of the property less the amount of any payments made within a reasonable period of time (described in §1.643(i)-2(a)(2)) by a U.S. person for the use of such property. The fair market value of the use of the property will be based on all the facts and circumstances, including the type of property used and the period of use.

(b) Allocation of section 643(i) distribution among more than one U.S. beneficiary. If a U.S. person who is not a U.S. beneficiary of a foreign trust but who is related to more than one U.S. beneficiary of the trust receives a loan of cash or marketable securities, or uses trust property, that is treated as a section 643(i) distribution, then each U.S. beneficiary that is related to the U.S. person receiving the loan or using trust property is treated as receiving an equal share of the section 643(i) distribution.

(c) Tax consequences of a section 643(i) distribution—(1) In general. A U.S. beneficiary who is treated as receiving a section 643(i) distribution must determine the tax consequences of the distribution under either the actual calculation method or the default calculation method. A U.S. beneficiary may not use the actual calculation method unless the U.S. beneficiary has received a Foreign Nongrantor Trust Beneficiary Statement (see §1.6048-4(d)(2)) from the foreign trust. A U.S. beneficiary who has previously used the default calculation method must consistently use the default calculation method to determine the tax consequences of any subsequent

distribution (within the meaning of §1.6048-4(b)) from the same trust in all future years, except in the year in which the trust terminates. See §1.6048-4(d)(3)(iii).

(2) Consequences to foreign trust—(i) Treatment of amount under section 661(a)(2). In the case of a section 643(i) distribution, regardless of whether a U.S. beneficiary uses the default calculation method or the actual calculation method of computing the tax consequences of a distribution, the foreign trust must treat the section 643(i) distribution as an amount properly paid, credited, or required to be distributed by the trust as described in section 661(a)(2).

(ii) Distribution of marketable securities. If the section 643(i) distribution is of marketable securities, the trust will be deemed to have made an election to have section 643(e)(3) apply to such distribution.

(iii) Foreign Nongrantor Trust Beneficiary Statement. The foreign trust may issue a Foreign Nongrantor Trust Beneficiary Statement (as described in §1.6048-4(c)(2)) to each U.S. person who receives a loan of cash or marketable securities or uses trust property other than a loan of cash or marketable securities during the taxable year of the trust, without regard to whether a U.S. person would be required to take the amount of the loan or use of trust property into account as a section 643(i) distribution. If a U.S. person to whom a statement is issued is not a U.S. beneficiary but is related to a U.S. beneficiary, the foreign trust may issue a duplicate statement to the U.S. beneficiary.

(3) Consequences to U.S. beneficiary—(i) Actual calculation method. Under the actual calculation method, a U.S. beneficiary must treat a section 643(i) distribution as an amount properly paid, credited, or required to be distributed by the trust as described in section 662(a)(2) using actual information about the foreign trust as provided in the

Foreign Nongrantor Trust Beneficiary Statement and applying the rules of subparts C and D of part I of subchapter J of chapter 1 of the Internal Revenue Code.

(ii) Default calculation method. Under the default calculation method, the U.S. beneficiary must apply the rules provided in §1.6048-4(d)(3).

(d) Subsequent transactions for loans or use of trust property—(1) In general.. Any subsequent transaction regarding the principal of any loan of cash or marketable securities treated as a section 643(i) distribution (including complete or partial repayment, satisfaction, cancellation, discharge, or otherwise, but not including the payment of interest) or the return of trust property the use of which was treated as a section 643(i) distribution will have the following consequences:

(2) Consequences to foreign trust. Any subsequent transaction regarding the principal of any loan of cash or marketable securities or return of trust property treated as a section 643(i) distribution will have no tax consequences to the trust. However, any payment to the trust other than the repayment of principal of any loan treated as a section 643(i) distribution, including the payment of interest, will be treated as income to the trust.

(3) Consequences to U.S. borrower—(i) In general. Except to the extent provided in paragraph (d)(3)(ii) of this section, any subsequent transaction regarding the principal of any loan of cash or marketable securities or return of trust property treated as a section 643(i) distribution will be treated as a transfer that is not a gratuitous transfer by a U.S. person for purposes of §1.671-2(e)(2)(i) and chapter 1 of the Internal Revenue Code, and is not a transfer subject to tax pursuant to chapter 11, chapter 12, and chapter 13 of the Internal Revenue Code.

(ii) Satisfaction of loan through appreciated property. Any transfer of appreciated property to a foreign trust in satisfaction of the principal of a loan of cash or marketable securities treated as a section 643(i) distribution will cause the obligor who transferred the property to recognize as gain or loss the difference between the fair market value of the property transferred and the adjusted basis (for purposes of determining gain) of such property in the hands of the obligor who transferred the property according to the rules of section 1001 and the regulations under section 1001 as contained in 26 CFR part 1.

§1.643(i)-4 Examples.

(a) Scope. The examples in this section illustrate the rules of §§1.643(i)-1 through 1.643(i)-3.

(b) Example 1: Loan to contingent remainder beneficiary treated as loan to U.S. beneficiary. Y, a nonresident alien, created and funded a foreign nongrantor trust within the meaning of §1.643(i)-1(d)(10), FT, for the benefit of his two children from his first marriage, A and B, who are both nonresident aliens. FT's governing trust instrument provides that upon the death of A and B the trust may make a distribution to any of Y's surviving children, in the discretion of the trustee. In 2017, X, a U.S. person who is Y's daughter from his second marriage, receives a loan of $100,000 from FT in exchange for an obligation that is not a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii). Under §1.643(i)-1(d)(5), X is a U.S. beneficiary of FT because X is a U.S. person to whom the trust income or corpus may be paid at the discretion of the trustee. Under §§1.643(i)-1(b)(1) and 1.643(i)-3(a)(1), X is treated as receiving a section 643(i) distribution from FT in the amount of $100,000. X must determine the tax

consequences of the distribution under §1.643(i)-3(c). Under §1.6048-4(a), X is required to report the section 643(i) distribution on Part III of Form 3520 for 2017 as a distribution from a foreign trust.

(c) Example 2: Loan from foreign nongrantor trust to a section 679 trust treated as section 643(i) distribution to U.S. owner. The facts are the same as in paragraph (b) of this section (Example 1), except that, in 2017, FT makes a loan of $100,000 to GT, a foreign grantor trust within the meaning of §1.643(i)-1(d)(9) treated as wholly owned by X, in exchange for an obligation that is not a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii). Under §1.643(i)-1(d)(5), X is treated as a U.S. beneficiary of FT as explained in paragraph (b) of this section (Example 1). Under §§1.643(i)-1(b)(1) and 1.643(i)-3(a)(1), X, as the owner of GT, is treated as receiving a section 643(i) distribution from FT in the amount of $100,000. X must determine the tax consequences of the distribution under §1.643(i)-3(c). Under §1.6048-4(a), X is required to report the section 643(i) distribution on Part III of Form 3520 for 2017 as a distribution from a foreign trust.

(d) Example 3: Loan by a person related to a foreign nongrantor trust treated as a section 643(i) distribution. X is a U.S. beneficiary of FT, a foreign nongrantor trust within the meaning of §1.643(i)-1(d)(10). FT is the sole shareholder of FC, a foreign corporation. On January 1, 2017, FC lends cash to X in exchange for an obligation that is not a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii). FC is related to FT within the meaning of §1.643(i)-1(d)(4). Under §1.643(i)-1(b)(1) and (2), X is treated as receiving a loan from FT on January 1, 2017. Under §1.643(i)-1(b)(2)(ii), the loan is not treated as a section 643(i) distribution if X reports the loan consistent with the

requirements of §1.6038-4 and attaches a statement that demonstrates to the satisfaction of the IRS that the loan would have been made without regard to X's relationship with FT. Otherwise, X is treated as receiving a section 643(i) distribution and must determine the tax consequences of the distribution under §1.643(i)-3(c). Regardless of whether X claims the limitation described in §1.643(i)-1(b)(2)(ii), under §1.6048-4(a), X is required to report the loan on Part III of Form 3520 for 2017 as a distribution from a foreign trust.

(e) Example 4: Loan by an unrelated person treated as a section 643(i) distribution. X is a U.S. beneficiary of FT, a foreign nongrantor trust within the meaning of §1.643(i)-1(d)(10). On January 1, 2017, X borrows $100,000 from Bank in exchange for an obligation that is not a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii), and FT provides a guarantee (within the meaning of §1.679-3(e)(4)) for the loan. Under §1.643(i)-1(b)(1) and (2), X is treated as receiving a loan from FT on January 1, 2017, in the amount of $100,000 because FT guaranteed the loan from Bank to X. On January 1, 2017, X is treated as receiving a section 643(i) distribution. X must determine the tax consequences of the distribution under §1.643(i)-3(c). Under §1.6048-4(a), X is required to report the section 643(i) distribution on Part III of Form 3520 as a distribution from a foreign trust.

(f) Example 5: Loan to a foreign person related to a U.S. beneficiary. X is a U.S. beneficiary of FT, a foreign nongrantor trust within the meaning of §1.643(i)-1(d)(10). X is also the sole shareholder of CFC, a foreign corporation, treated as a controlled foreign corporation under section 957. On January 1, 2017, FT lends $100,000 to CFC in exchange for an obligation that is not a qualified obligation within the meaning of

§1.643(i)-2(b)(2)(iii). CFC is related to X within the meaning of §1.643(i)-1(d)(4). Under §1.643(i)-1(b)(1) and (2), X is treated as receiving a loan from FT on January 1, 2017, in the amount of $100,000 because FT made the loan to CFC, a foreign person related to X, and CFC is not a nonresident alien individual beneficiary of FT. Under §1.643(i)-1(b)(2)(ii), the loan is not treated as a section 643(i) distribution if X reports the loan consistent with the requirements of §1.6038-4 and and attaches a statement that demonstrates to the satisfaction of the IRS that the loan from FT to CFC would have been made without regard to X's relationship with FT. Otherwise, X is treated as receiving a section 643(i) distribution and must determine the tax consequences of the distribution under §1.643(i)-3(c). Regardless of whether X claims the limitation described in §1.643(i)-1(b)(2)(ii), under §1.6048-4(a), X is required to report the loan on Part III of Form 3520 for 2017 as a distribution from a foreign trust.

(g) Example 6: Loan to wholly owned corporation of U.S. beneficiary. Y, a nonresident alien, created and funded a foreign nongrantor trust within the meaning of §1.643(i)-1(d)(10), FT, for the benefit of Y's child, X, a U.S. person. X is a U.S. beneficiary within the meaning of §1.643(i)-1(d)(5). X wholly owns XYZ Corp, a domestic corporation. On July 1, 2017, FT lends $100,000 to XYZ Corp in exchange for an obligation that is not a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii). Under §1.643(i)-1(d)(4) and (7), XYZ Corp is a U.S. person related to X. Under §§1.643(i)-1(b)(1) and §1.643(i)-3(a)(1), X is treated as receiving a section 643(i) distribution from FT in the amount of $100,000. X must determine the tax consequences of the distribution under §1.643(i)-3(c). Under §§1.6048-4(a), X and XYZ Corp are required to report the loan on Part III of Form 3520 for 2017 as a distribution

from a foreign trust.

(h) Example 7: Subsequent transactions with respect to loan treated as a section 643(i) distribution. The facts are the same as in paragraph (g) of this section (Example 6). In 2017, XYZ Corp makes a payment to FT that it characterizes in part as a partial repayment of principal and in part as interest on its obligation to FT. Under §1.643(i)-3(d)(2)(i), the portion of the payment that is characterized as a repayment of principal will be treated as a transfer that is not a gratuitous transfer by a U.S. person for purposes of §1.671-2(e)(2)(i) and chapter 1 of the Internal Revenue Code, and is not a transfer subject to tax pursuant to chapter 11, chapter 12, and chapter 13 of the Internal Revenue Code. Under §1.643(i)-3(d)(1), the transfer of principal will have no tax consequences to FT. Furthermore, under §1.643(i)-3(d)(1), the portion of the payment that is characterized as interest by XYZ Corp will be treated as gross income to FT.

(i) Example 8: Uncompensated use of trust property. Y, a nonresident alien, created and funded a foreign nongrantor trust within the meaning of §1.643(i)-1(d)(10), FT, for the benefit of her daughter, A, a U.S. person. A is a U.S. beneficiary of FT within the meaning of §1.643(i)-1(d)(5). FT owns real property that could be rented to an unrelated person at fair market value for $10,000 a month. During all of 2017, A lives in the property rent-free. Under §§1.643(i)-1(c) and §1.643(i)-3(a)(3), A is treated as receiving a section 643(i) distribution from FT in the amount of $120,000 (12 x $10,000). A must determine the tax consequences of the distribution under §1.643(i)-3(c). Under §1.6048-4(a), A must report the section 643(i) distribution on Part III of Form 3520 for 2017 as a distribution from FT.

(j) Example 9: Partially compensated use of trust property. the facts are the

same as in paragraph (i) of this section (Example 8) except that A pays FT $2,000 on the first of each month for the use of the property. Under §§1.643(i)-1(b), 1.643(i)-2(a)(2), and 1.643(i)-3(a)(3), A is treated as receiving a section 643(i) distribution from FT in the amount of $96,000 (12 x ($10,000 - $2,000)). A must determine the tax consequences of the distribution under §1.643(i)-3(c). Under §§1.6048-4(a), A must report the entire $120,000 on Part III of Form 3520 for 2017 as a distribution from FT even through only a portion of the $120,000 is treated as a section 643(i) distribution.

(k) Example 10: Uncompensated use of trust property treated as distribution from accumulated income. On January 1, 2015, Y, a nonresident alien, creates and funds a foreign nongrantor trust within the meaning of §1.643(i)-1(d)(10), FT, for the benefit of Y's son, X, a U.S. person. X is a U.S. beneficiary of FT within the meaning of §1.643(i)-1(d)(5). FT has $60,000 of DNI, as defined under section 643(a), in 2015, $80,000 of DNI in 2016, and $90,000 of DNI in 2017. FT has never made any distributions. FT owns real property that could be rented to an unrelated person for $10,000 a month. During all of 2017, X occupies the property rent free. Under §1.643(i)-1(c) and §1.643(i)-3(a)(3), X is treated as receiving a section 643(i) distribution from FT in 2017 in the amount of $120,000, the fair market value use of the trust property (12 x $10,000). X receives a Foreign Nongrantor Trust Beneficiary Statement from FT and uses the actual calculation method under §1.643(i)-3(c)(3)(i) to determine the tax consequences of the section 643(i) distribution. The $120,000 is treated as an amount properly paid, credited, or required to be distributed by the trust as described in section 662(a)(2). As a result of X's uncompensated use of FT's property, X's section 643(i) distribution consists of a distribution of DNI of $90,000 (FT's DNI in 2017) and an

accumulation distribution of $30,000 under subpart D of subchapter J of chapter 1 of the Internal Revenue Code.

(l) Example 11: Use of property of partial grantor trust not treated as section 643(i) distribution. X and Y are married. X is a U.S. person and Y is a nonresident alien. X and Y have three children, A, B, and C. A and B are both nonresident aliens. C is a U.S. person. In 2016, X and Y created a foreign trust, FT, for the benefit of A and B to which X contributed a vacation home and Y contributed cash and securities. Neither X nor Y retained any powers described in sections 673 through 677. In 2017, C lived in the vacation home rent free. Under §§1.679-1(a) and 1.679-2(a)(5), X will be treated as the owner of the portion of FT attributable to the vacation home. Under §1.643(i)-2(c)(2), C's use of the vacation home will be treated as the use of property from the grantor trust portion of FT. C will not be treated as receiving a section 643(i) distribution. Under §§1.6048-4(a), C must report the use of the vacation home on Part III of Form 3520 for 2017 as a distribution from FT.

(m) Example 12: Use of trust property by exempt entity not treated as section 643(i) distribution. In 2017, X, a nonresident alien, creates a foreign nongrantor trust, FT, and funds the trust with cash and a valuable painting. In 2017, pursuant to the terms of the trust instrument, FT lends the painting to E, a U.S. entity that is a charity under section 501(c)(3). E has a determination letter from the IRS that has not been revoked recognizing its exemption from federal income tax under section 501(a). E exhibits the painting and does not reimburse FT for the use of the painting. E is not a U.S. person within the meaning of §1.643(i)-1(d)(7) because E is an entity that is exempt from tax under chapter 1 of the Code. Accordingly, E's use of the painting is not

a section 643(i) distribution under §1.643(i)-1(c). Although E's use of the painting is a distribution within the meaning of §1.6048-4(b), under §1.6048-5(b)(3), E is not required to report the use of the painting on Part III of Form 3520 because E is a section 501(c)(3) entity that has received a determination letter from the IRS.

§1.643(i)-5 Applicability date.

The rules of §1.643(i)-1 through 1.643(i)-4 apply to loans of cash or marketable securities from a foreign trust made or the use of any other property of a foreign trust, after the date of publication of the final regulations in the **Federal Register**. However, taxpayers may rely on the rules of §§1.643(i)-1 through 1.643(i)-4 to determine the treatment of a such loans or the use of any other property of a foreign trust prior to this date, provided that they apply the proposed regulations consistently with respect to open tax years ending on or before the date of publication of these regulations as final regulations.

Par. 3. Section 1.679-0 is amended by:

1. Adding new entries for §1.679-1(c)(2) and (c)(2)(i) through (c)(2)(ii)(B).
2. Adding new entries for §1.679-2(a)(5) and (a)(5)(i) through (vi).
3. Redesignating the entry for §1.679-2(b)(3) as the entry for §1.679-2(b)(4).
4. Adding new entries for §1.679-2(b)(3), (d)(1), and (d)(2).
5. Adding new entries for §1.679-2(b)(4)(i) through (vi).
6. Revising the entries for §1.679-4(d)(2) through (6).
7. Adding new entries for §1.679-4(d)(6)(i) through (vii).
8. Removing the entry for §1.679-4(d)(7).
9. Revising the entry for §1.679-7.

The additions and revisions read as follows:

§1.679-0 Outline of major topics.

* * * * *

§1.679-1 U.S. transferor treated as owner of foreign trust.

(c) * * *

(2) U.S. person.

(i) In general.

(ii) Special rules.

(A) Dual resident taxpayers.

(B) Dual status taxpayers.

§1.679-2 Trusts treating as having a U.S. beneficiary.

(a) * * *

(5) Loans or uncompensated use of trust property as paid or accumulated for the benefit of a U.S. person.

(i) In general.

(ii) Indirect loans.

(iii) Exceptions.

(iv) Safe harbors.

(v) Interaction with section 643(i).

(vi) Examples.

(A) Example 1: Loan of cash to U.S. person.

(B) Example 2: Use of trust property by U.S. person.

(C) Example 3: Use of trust property by charitable entity.

(D) Example 4: Indirect loan of cash to a U.S. person.

(E) Example 5: Interaction with section 643(i) and with section 6048(c) information reporting.

* * * * *

(b) * * *

(3) Loans to, or uncompensated use of trust property by, indirect beneficiaries.

(4) Examples.

(i) Example 1. Trust benefitting foreign corporation.

(ii) Example 2. Trust benefitting another trust.

(iii) Example 3. Trust benefitting another trust after transferor's death.

(iv) Example 4. Indirect benefit through use of debit card.

(v) Example 5. Other indirect benefit.

(vi) Example 6. Indirect benefit through an indirect loan.

* * * * *

(d) Presumption that foreign trust has U.S. beneficiary.

(1) In general.

(2) Authority of IRS to request information.

§1.679-4 Exceptions to general rule.

* * * * *

(d) Qualified obligations.
(1) In general.
(i) Requirements of the obligation.
(ii) Additional requirements to remain a qualified obligation.
(2) Modification of a qualified obligation.
(3) Additional loans.
(4) Series of obligations.
(5) Obligations that cease to be qualified.
(i) In general.
(ii) Amount transferred to trust.
(iii) Timing of transfers resulting from failed obligations.
(6) Examples.
(i) Example 1: Demand loan.
(ii) Example 2: Private annuity.
(iii) Example 3: Loan to unrelated foreign trust.
(iv) Example 4: Transfer for an obligation with term in excess of 5 years.
(v) Example 5: Transfer for a qualified obligation.
(vi) Example 6: Effect of modification treated as an exchange.
(vii) Example 7: Effect of modification not treated as an exchange.
* * * * *
§1.679-7 Applicability dates.

Par. 4. Section 1.679-1 is amended by revising paragraphs (c)(2) and (c)(6) to read as follows:

§1.679-1 U.S. transferor treated as owner of foreign trust.

* * * * *

(c) * * *

(2) U.S. person—(i) In general. Subject to paragraph (c)(2)(ii) of this section, the term U.S. person means a United States person as defined in section 7701(a)(30).

(ii) Special rules—(A) Dual resident taxpayers. If a dual resident taxpayer (within the meaning of §301.7701(b)-7(a)(1) of this chapter) computes U.S. income tax liability as a nonresident alien on the last day of the taxable year and complies with the filing requirements of §301.7701(b)-7(b) and (c) of this chapter, such individual will not be treated as a U.S. person with respect to the portion of the taxable year covered by Form

1040NR (or Form 1040NR–EZ).

(B) Dual status taxpayers. If a taxpayer abandons his U.S. citizenship or residence during the tax year or acquires U.S. citizenship or residence during the taxable year as provided in §1.6012-1(b)(2)(ii), such individual will not be treated as a U.S. person for the part of the year when the individual is treated as a nonresident alien for computing the individual's income tax liability, as reflected on the Form 1040NR or other similar schedule attached to such Form 1040.

* * * * *

(6) Obligation. The term obligation means any instrument or contractual arrangement that constitutes indebtedness under general principles of Federal income tax law (for example, a bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other evidence of indebtedness), and an annuity contract that would not otherwise be classified as indebtedness under general principles of Federal income tax law.

* * * * *

Par. 5. Section 1.679-2 is amended by:

1. Adding paragraph (a)(5).
2. Redesignating paragraph (b)(3) as paragraph (b)(4).
3. In newly redesignated paragraph (b)(4), designating Examples 1 through 5 as paragraphs (b)(4)(i) through (v).
4. Adding paragraph (b)(4)(vi).
5. Adding paragraph (b)(3).
6. Adding paragraphs (d)(1) and (d)(2).

The additions and revisions read as follows:

§1.679-2 Trusts treated as having a U.S. beneficiary.

(a) * * *

(5) Loan or uncompensated use of trust property treated as paid or accumulated for the benefit of a U.S. person—(i) In general. Except as provided in paragraph (a)(5)(iii) of this section, any loan of cash or marketable securities made from a foreign trust or portion of a foreign trust (whether from trust corpus or income) directly or indirectly to, or the use of any other property of a foreign trust or portion of a foreign trust directly or indirectly by, any U.S. person (whether or not a beneficiary under the terms of the trust) will be treated as paid or accumulated for the benefit of a U.S. person for purposes of paragraph (a)(1) of this section. For these purposes, a loan from a foreign trust to, or the use of property of a foreign trust by, a grantor trust (as defined in §1.643(i)-1(d)(9)) or a disregarded entity (as defined in §1.643(i)-1(d)(12)) will be treated as a loan to or use by the owner of the grantor trust or the disregarded entity, respectively. (For example, a loan to a single member LLC treated as a disregard entity will be treated as a loan to the owner of the LLC.)

(ii) Indirect loans. For purposes of paragraph (a)(5)(i) of this section, indirect loans of cash or marketable securities from a foreign trust to a U.S. person include:

(A) Loans made by any person to a U.S. person if the foreign trust provides a guarantee (within the meaning of §1.679-3(e)(4)) for the loan; and

(B) Loans made from a foreign trust to a U.S. person through an intermediary, such as an agent or nominee of the foreign trust, or from a person related (within the meaning of §1.643(i)-1(d)(4)) to the foreign trust.

(iii) Exceptions. Paragraph (a)(5)(i) of this section does not apply if--

(A) The U.S. person who receives the loan of cash or marketable securities, or who receives the use of trust property, is an entity described in section 501(c)(3) (without regard to the requirements of section 508(a)),

(B) The loan of cash received by the U.S. person is in exchange for a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii) (but without regard to §1.643(i)-2(b)(2)(iii)(B)(1) and (2)), or

(C) The U.S. person who uses trust property, other than a loan of cash or marketable securities, pays the trust the fair market value of the use of such property within a reasonable period of time from the date of the start of the use of the property. A determination as to the fair market value of the use of such property and as to whether a fair market value payment is made within a reasonable period of time will be based on all the facts and circumstances, including the type of property used and the period of use. In appropriate cases, such as rental of real property, payments may be made on a periodic basis, if doing so would be consistent with arm's-length dealings between unrelated parties.

(iv) Safe harbors. The following safe harbors apply for purposes of paragraph (a)(5)(iii)(C) of this section.

(A) Reasonable time period. A payment will be considered paid within a reasonable period of time if the payment is made within 60 days of the start of the use of trust property.

(B) De minimis use. Use of trust property will be disregarded if the aggregate use by all U.S. persons (within the meaning of §1.679-1(c)(2)) does not exceed an

aggregate of 14 days during the U.S. persons' taxable year.

(v) Interaction with section 643(i). If a foreign trust or a portion of a foreign trust is treated as having a U.S. beneficiary pursuant to the rules of this paragraph (a)(5) and a U.S. transferor is thus treated as the owner of that foreign trust or a portion of the foreign trust under section 679, section 643(i) does not apply.

(vi) Examples. The following examples illustrate the rules of paragraph (a)(5) of this section. In these examples, X, Y, and E are U.S. persons (within the meaning of §1.679-1(c)(2)), and FT is a foreign trust. The examples are as follows:

(A) Example 1: Loan of cash to U.S. person. In 2015, X transfers cash and real property to FT. X is not treated as the owner of any portion of FT under sections 673 through 679. In 2017, Y receives a loan of cash from FT that is not in exchange for a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii) and does not qualify for the exception under paragraph (a)(5)(iii)(B) of this section. Y is not an entity described in section 501(c)(3) and does not qualify for the exception under paragraph (a)(5)(iii)(A) of this section. Under paragraph (a)(5) of this section, the loan is treated as paid or accumulated for the benefit of a U.S. person for purposes of paragraph (a)(1) of this section, and under §1.679-1(a), X is treated as the owner of FT. Under paragraph (c)(1) of this section, FT is treated as acquiring a U.S. beneficiary in 2017 such that X is treated as receiving an accumulation distribution from FT in 2017 and immediately transferring it back to FT.

(B) Example 2: Use of trust property by U.S. person. The facts are the same as in paragraph (a)(5)(vi)(A) of this section (Example 1) except that instead of receiving a loan of cash in 2017, Y occupies real property owned by FT in exchange for monthly

payments of $2,000. FT could rent the property to an unrelated party at fair market value for $10,000 a month. Under paragraph (a)(5) of this section, Y's use of FT's property is treated as paid or accumulated for the benefit of a U.S. person for purposes of paragraph (a)(1) of this section because Y has not paid fair market value for the use of the real property. Under §1.679-1(a), X is treated as the owner of FT. Under paragraph (c)(1) of this section, FT is treated as acquiring a U.S. beneficiary such that X is treated as receiving an accumulation distribution from FT in 2017 and immediately transferring it back to FT.

(C) Example 3: Use of trust property by charitable entity. In 2015, X transfers cash and a valuable painting to FT. X is not treated as the owner of any portion of FT under sections 673 through 679. In 2017, FT lends the painting to E, a U.S. entity described in section 501(c)(3). E's use of the painting is not treated as paid or accumulated for the benefit of a U.S. person for purposes of paragraph (a)(1) of this section because the exception in paragraph (a)(5)(iii)(A) of this section applies.

(D) Example 4: Indirect loan of cash to a U.S. person. In 2015, X transfers property to FT. FT's trust instrument provides that no U.S. person can benefit either as to income or corpus of FT. In 2017, Y borrows $100,000 from Bank in exchange for an obligation that is not a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii) and does not qualify for the exception under paragraph (a)(5)(iii)(B) of this section. FT provides a guarantee (within the meaning of §1.679-3(e)(4)) for the loan. Under paragraph (a)(5)(ii)(A) of this section, Y is treated as receiving a loan from FT because FT guaranteed the loan from Bank to Y. Under paragraph (a)(5) of this section, the loan is treated as paid or accumulated for the benefit of a U.S. person for purposes of

paragraph (a)(1) of this section. Under §1.679-1(a), X is treated as the owner of FT. Under paragraph (c)(1) of this section, FT is treated as acquiring a U.S. beneficiary such that X is treated as receiving an accumulation distribution from FT in 2017 and immediately transferring it back to FT.

(E) Example 5: Interaction with section 643(i) and with section 6048(c) information reporting. In 2015, X created and funded a foreign nongrantor trust, FT. During 2015 and 2016, FT accumulates income in the amount of $110,000. Before 2017, neither X nor any other person is treated as owning FT under the rules of sections 673 through 679. In 2017, Y, who is related to X within the meaning of §1.643(i)-1(d)(4), receives a loan of $100,000 cash from FT that is not in exchange for a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii) and does not qualify for the exception under paragraph (a)(5)(iii)(B) of this section. Under paragraph (a)(5) of this section, the loan to Y is treated as paid for the benefit of a U.S. person for purposes of paragraph (a)(1) of this section. Under §1.679-1(a), X is treated as the owner of FT. Under paragraph (a)(5)(v) of this section, section 643(i) does not apply to the loan from FT to Y. Under paragraph (c)(1) of this section, FT is treated as acquiring a U.S. beneficiary such that X is treated as receiving an accumulation distribution in the amount of $110,000 in 2017 and immediately transferring that amount back to the trust. Pursuant to §1.6048-4(b)(3), Y is treated as receiving a distribution from FT and must comply with the reporting requirements in §1.6048-4 with respect to the loan.

(b) * * *

(3) Loans to, or uncompensated use of trust property by, indirect beneficiaries. For purposes of paragraphs (a)(1) and (a)(5) of this section, a loan of cash or

marketable securities or the use of trust property shall be treated as paid or accumulated for the benefit of a U.S. person if—

(i) The loan is made to, or the trust property is used by, a foreign entity described in paragraph (b)(1) of this section; or

(ii) The loan is made through, or the use of trust property is made available to, an intermediary described in paragraph (b)(2) of this section, or such loan or use of trust property is made by any other means where a U.S. person may obtain an actual or constructive benefit.

(4) * * *

(vi) Example 6. Indirect benefit through an indirect loan. A transfers property to FT. The trust instrument provides that no U.S. person can benefit either as to income or corpus. However, FT maintains an account with FB, a foreign bank, and FB issues a loan to B against the account maintained by FT. Under paragraphs (a)(1), (a)(5), and (b)(3) of this section, FT is treated as having a U.S. beneficiary.

* * * * *

(d) Presumption that foreign trust has U.S. beneficiary—(1) In general. If a U.S. person directly or indirectly transfers property to a foreign trust other than a trust described in §1.679-4(a)(2) or (3), the IRS may treat the trust as having a U.S. beneficiary for purposes of §1.679-1(a), unless the U.S. person—

(i) Satisfies the reporting requirements of §1.6048-2 with respect to the transfer;

(ii) Attaches a copy of the Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, filed pursuant to §1.6048-2, to the U.S. person's federal income tax return for the tax year in which the transfer was

made), and

(iii) Includes an explanatory statement attached to the U.S. person's federal income tax return that demonstrates to the satisfaction of the IRS that the trust satisfies the requirements of paragraph (a)(1) of this section immediately after the transfer.

(2) Authority of IRS to request information. The IRS may request information related to the trust described in paragraph (d)(1) of this section and its potential beneficiaries in order to determine whether the trust satisfies the requirements of paragraph (a)(1) of this section. Unless such additional information is provided upon the IRS's written notice and request to the U.S. person, the trust will be presumed to have a U.S. beneficiary. The U.S. person will have 60 days (90 days if the notice is addressed to a person outside the United States) to respond to the notice and request.

Par. 6. Section 1.679-4 is amended by revising paragraph (d) to read as follows:

§1.679-4 Exceptions to general rule.

* * * * *

(d) Qualified obligations—(1) In general—(i) Requirements of the obligation. For purposes of this section, an obligation is treated as a qualified obligation only if the obligation at all times satisfies all of the following requirements—

(A) The obligation is reduced to writing by an express written agreement;

(B) The term of the obligation does not exceed five years. For purposes of determining the term of an obligation, the obligation's maturity date is the last possible date that the obligation can be outstanding under the terms of the obligation;

(C) All payments on the obligation must be made in cash in U.S. dollars;

(D) The obligation is issued at par and provides for stated interest at a fixed rate

or a qualified floating rate within the meaning of §1.1275-5(b);

(E) The yield to maturity of the obligation is not less than 100 percent of the applicable Federal rate and not greater than 130 percent of the applicable Federal rate. The applicable Federal rate for an obligation is the applicable Federal rate in effect under section 1274(d) for the day on which the obligation is issued, as published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter). The yield to maturity and the applicable Federal rate must be based on the same compounding period. If an obligation is a variable rate debt instrument that provides for stated interest at a qualified floating rate, the equivalent fixed rate debt instrument rules in §1.1274-2(f)(1) or §1.1275-5(e), whichever is applicable, apply to determine the obligation's yield to maturity; and

(F) All stated interest on the obligation is qualified stated interest within the meaning of §1.1273-1(c).

(ii) Additional requirements to remain a qualified obligation. An obligation will remain a qualified obligation if, for the first year and each year that the obligation remains outstanding, the U.S. transferor fulfills the requirements of this paragraph (d)(1)(ii):

(A) The U.S. transferor timely extends the period for assessment of any income tax attributable to the obligation and any consequent income tax changes for each year that the obligation is outstanding to a date not earlier than three years after the maturity date of the obligation. This extension of the period for assessment is not necessary with respect to the taxable year of the U.S. transferor in which the maturity date of the obligation falls, provided that the obligation is paid in cash in U.S. dollars within that

year. The period of assessment is extended by completing and filing Part I of Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, for every year that the obligation is outstanding. Part I of Form 3520 may also contain such other terms with respect to assessment as may be considered necessary by the IRS to ensure the assessment and collection of the correct tax liability for each year for which the extension of the period of assessment is required. When Part I of Form 3520 is properly executed and filed, the consent to extend the period for assessment of tax will be deemed to be agreed upon and executed by the IRS for purposes of §301.6501(c)-1(d);

(B) The U.S. transferor timely reports the status of the obligation, including principal and interest payments, on Part I of Form 3520 for every year that the obligation is outstanding; and

(C) The U.S. transferor timely makes all payments of principal and interest on the obligation according to the terms of the obligation (including a reasonable grace period of no more than thirty days for a late payment).

(2) Modification of a qualified obligation. If the terms of a qualified obligation are modified and the modification is treated as an exchange under §1.1001-3, the new obligation that is deemed issued in the exchange under §1.1001-3 must satisfy the requirements in paragraph (d)(1) of this section to be a qualified obligation. If the modification is not treated as an exchange under §1.1001-3, then the qualified obligation must be retested as of the date of the modification to determine whether the obligation, as modified, continues to satisfy the requirements in paragraph (d)(1) of this section to be a qualified obligation.

(3) Additional loans. If a qualified obligation is outstanding and the U.S. transferor or a related person directly or indirectly obtains an additional obligation issued by the trust in exchange for cash, or if the U.S. transferor directly or indirectly obtains an additional obligation issued by a person related to the trust, the original outstanding obligation is deemed to have the maturity date of any such subsequent obligation in determining whether the term of the original obligation exceeds the specified 5-year term. The original outstanding obligation must be retested as of the issue date of the additional obligation to determine whether it satisfies all the requirements in paragraph (d)(1) of this section to be a qualified obligation. The additional obligation must also be separately tested to see if it satisfies the requirements of (d)(1) of this section to be a qualified obligation.

(4) Series of obligations. If the IRS determines that two or more obligations issued by a trust or a person related to the trust are structured with a principal purpose to avoid the application of section 679, the IRS may treat the obligations as a single obligation that is not a qualified obligation within the meaning of paragraph (d)(1) of this section.

(5) Obligations that cease to be qualified—(i) In general. A qualified obligation that ceases to be a qualified obligation (for example, because a modification causes the term of the obligation to exceed 5 years) will cause the U.S. transferor to be treated as making a transfer to the trust.

(ii) Amount transferred to the trust. The amount that the U.S. transferor will be treated as having transferred to the trust will be equal to the obligation's outstanding stated principal amount plus any accrued but unpaid qualified stated interest (within the

meaning of §1.1273-1(c)) as of the date of the event that causes the obligation to no longer be a qualified obligation. In the case of an obligation that ceases to be a qualified obligation because the U.S. transferor issues two or more obligations and the IRS treats the obligations as a single obligation pursuant to paragraph (d)(4) of this section, the U.S. transferor will be treated as making a transfer to the trust in an amount not to exceed the sum of the outstanding stated principal amount of the obligations plus any accrued but unpaid qualified stated interest for each of the obligations as of the date determined under paragraph (d)(5)(iii) of this section.

(iii) Timing of transfers resulting from failed qualified obligations. In general, a U.S. transferor is treated as making a transfer to the trust on the date of the event that causes the obligation to no longer be a qualified obligation. However, based on all of the facts and circumstances, if an obligation (or obligations) is structured with a principal purpose to avoid the application of section 679, the IRS may deem a transfer to have occurred on any date on or after the issue date of the obligation(s).

(6) Examples. The following example illustrates the rules of this paragraph (d). In these examples, A and B are U.S. residents and FT is a foreign trust.

(i) Example 1: Demand loan. A transfers $50,000 to FT in exchange for a demand note that permits A to require repayment by FT at any time. A is a related person (as defined in §1.679-1(c)(5)) with respect to FT. Because FT's obligation to A could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether A's transfer is eligible for the fair market value exception of paragraph (a)(4) of

this section. Accordingly, §1.679-1 applies with respect to the full $50,000 transfer to FT.

(ii) Example 2: Private annuity. A transfers $40,000 to FT in exchange for an annuity from FT that will pay A $100x per year for the rest of A's life. A is a related person (as defined in §1.679-1(c)(5)) with respect to FT. Because FT's obligation to A could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether A's transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679-1 applies with respect to the full $40,000 transfer to FT.

(iii) Example 3: Loan to unrelated foreign trust. B transfers $10,000 to FT in exchange for an obligation of the trust. The term of the obligation is fifteen years. B is not a related person (as defined in §1.679-1(c)(5)) with respect to FT. Because B is not a related person with respect to FT, paragraph (c) of this section does not apply. The fair market value of the obligation received by B is taken into account for purposes of the fair market value exception of paragraph (a)(4) of this section even though the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section.

(iv) Example 4: Transfer for an obligation with term in excess of 5 years. A transfers property that has a fair market value of $50,000 to FT in exchange for an obligation of FT. The term of the obligation is ten years. A is a related person (as defined in §1.679-1(c)(5)) with respect to FT. Because the term of the obligation is

greater than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether A's transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679-1 applies with respect to the full $50,000 transfer to FT.

(v) Example 5: Transfer for a qualified obligation. The facts are the same as in paragraph (d)(6)(iv) of this section (Example 4), except that the term of the obligation is three years. Assuming the other requirements of paragraph (d)(1) of this section are satisfied, the obligation is a qualified obligation and its stated principal amount is taken into account for purposes of determining whether A's transfer is eligible for the fair market value exception of paragraph (a)(4) of this section.

(vi) Example 6: Effect of modification treated as an exchange. A transfers property that has a fair market value of $10,000 to FT in exchange for an obligation that satisfies the requirements of paragraph (d)(1) of this section. A is a related person (as defined in §1.679-1(c)(5)) with respect to FT. Two years later, the terms of the obligation are modified and the modification is treated as an exchange under §1.1001-3. The new obligation that is deemed issued in the exchange under §1.1001-3 must satisfy the requirements of paragraph (d)(1) of this section to be a qualified obligation.

(vii) Example 7: Effect of modification not treated as an exchange. The facts are the same as in paragraph (d)(6)(vi) of this section (Example 6), except that the modification is not treated as an exchange under §1.1001-3. The obligation must be retested as of the date of the modification to determine whether the obligation, as modified, continues to satisfy the requirements in paragraph (d)(1) to be a qualified

obligation.

Par. 7. Section 1.679-7 is amended by:

1. Revising the section heading.

2. Adding paragraphs (b)(4) through (b)(7).

The revision and additions reads as follows:

§1.679-7 Applicability dates.

* * * * *

(b) * * *

(4) The amendments to §§1.679-1(c)(2) and 1.679-1(c)(6) apply for taxable years beginning after the date of publication of the final regulations in the **Federal Register**.

(5) The rules of §1.679-2(a)(5) apply to loans and the use of trust property after the date of publication of the final regulations in the **Federal Register**.

(6) The rules of §1.679-2(d) apply to transfers of property after the date of publication of the final regulations in the **Federal Register**.

(7) Section 1.679-4(d) applies to obligations issued or modified after the date of publication of the final regulations in the **Federal Register**. If an obligation issued on or before the date of publication of the final regulations in the **Federal Register** is modified after that date, and the modification is a significant modification under §1.1001-3, the new obligation that is deemed issued in the exchange is treated as issued after the date of publication of the final regulations. If the modification is not a significant modification under §1.1001-3, then the original obligation must be retested as of the date of the modification to determine whether the obligation, as modified, satisfies the requirements in paragraph (d)(1), as amended, to be a qualified obligation.

Par. 8. Section 1.6039F-1 is added to read as follows:

§1.6039F-1 U.S. recipients of foreign gifts.

(a) Reporting of foreign gifts—(1) In general. Except as provided in paragraphs (a)(2) and (c) of this section, each U.S. person (within the meaning of section 7701(a)(30)) who receives a foreign gift (within the meaning of paragraph (b) of this section) during a taxable year must report such gift on Part IV of Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, by the fifteenth day of the fourth month after the close of the U.S. person's taxable year. In the case of a U.S. person who has been granted an extension of time to file its income tax return pursuant to section 6081, an extension of time for filing Form 3520 is granted to the fifteenth day of the tenth month following the close of the U.S. person's taxable year. Pursuant to §1.6081-1, no additional extension of time to file a tax return will be allowed beyond the fifteenth day of the tenth month following the close of the U.S. person's taxable year, and therefore no further extension of time to file Form 3520 will be allowed. In the case of a U.S. person who is a calendar year filer, the due date for filing the Form 3520 is April 15, with a maximum extension for a 6-month period ending on October 15. For special rules concerning the treatment of dual resident taxpayers (within the meaning of §301.7701(b)-7(a)(1) of this chapter) and dual status taxpayers (described in §1.6012-1(b)(2)(ii)) as U.S. persons for purposes of this section, see paragraph (f) of this section.

(2) Reporting for decedents. In the case of a U.S. person who is an individual and who died during the calendar year, the executor of the decedent's estate must report foreign gifts received by the decedent during the taxable year on Part IV of Form

3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, by the fifteenth day of the fourth month after the close of the U.S. person decedent's taxable year. In the case of an executor who has been granted an extension of time to file the decedent's income tax return for the decedent's year of death pursuant to section 6081, an extension of time for filing Form 3520 is granted to the fifteenth day of the tenth month following the close of the decedent's taxable year. No additional extension of time to file Form 3520 will be allowed beyond the fifteenth day of the tenth month following the close of the filer's taxable year.

(b) Definition of foreign gift—(1) In general. The term foreign gift means any amount received from a non-U.S. person that the recipient treats as a gift or bequest for income tax purposes, but does not include any qualified transfer within the meaning of section 2503(e)(2) (relating to certain transfers for educational or medical expenses) or any transfer of an amount from a foreign trust that is treated as a distribution (within the meaning of §1.6048-4(b)) from the foreign trust and reported on a return under §1.6048-4. The fact that a transfer is a covered gift or covered bequest under section 2801(e) has no impact on the application of this definition for purposes of this section. A U.S. person who receives a transfer from a foreign trust must treat that transfer as a distribution from the trust that is reportable under §1.6048-4, rather than as a foreign gift that is reportable under paragraph (a) of this section even if the U.S. person treats the transfer as a gift for another purpose, such as computing the person's federal income tax liability.

(2) Purported transfers. The term foreign gift includes any amount received by a U.S. person from a non-U.S. person that the recipient does not treat as a gift or bequest

for income tax purposes (such as a purported loan), but that, based on all the facts and circumstances, the IRS determines was in substance a gift.

(c) Exceptions—(1) Section 501(c) recipient. Paragraph (a) of this section does not apply if the recipient of the foreign gift is an organization described in section 501(c) and exempt from tax under section 501(a).

(2) De minimis rules—(i) Foreign gifts from foreign individuals or foreign estates—(A) De minimis amount. Paragraph (a) of this section does not apply to a foreign gift received by a U.S. person from a foreign individual (i.e., an individual who is not a U.S. person) or a foreign estate (within the meaning of section 7701(a)(31)(A)) if the aggregate amount of foreign gifts received, directly or indirectly, from any particular such individual or estate (the transferor) does not exceed $100,000 during the U.S. person's taxable year. The de minimis rule of this paragraph (c)(2)(i) does not apply to covered gifts or covered bequests described in section 2801(e) that are received by U.S. persons. A U.S. person's receipt of covered gifts or covered bequests is instead addressed in paragraph (c)(2)(ii) of this section.

(B) Aggregation rule. To determine whether paragraph (c)(2)(i) of this section applies to foreign gifts received from the transferor, each U.S. person must aggregate foreign gifts received, directly or indirectly, from all foreign individuals, foreign estates, and any other foreign persons (such as corporations or partnerships) that the U.S. person knows or has reason to know are related to the transferor within the meaning of §1.643(i)-1(d)(4). If the aggregate amount of all these foreign gifts exceeds the $100,000 de minimis amount, the U.S. person must separately identify the aggregate amount of all foreign gifts received from the transferor and each foreign person related

to the transferor in excess of $5,000 and provide identifying information about the transferor and each such foreign person other than a foreign individual (for example, name and address).

(ii) Covered gifts or covered bequests. Paragraph (a) of this section does not apply to a covered gift or covered bequest described in section 2801(e) that is received by a U.S. person. Rather, reporting is required if the aggregate amount of covered gifts or covered bequests received by the U.S. person during the calendar year exceeds the section 2801(c) amount, which is the dollar amount of the per-donee exclusion in effect under section 2503(b) for that calendar year. For these purposes, the aggregate amount of covered gifts or covered bequests received by the U.S. person during the calendar year shall not include transfers from a foreign trust (as described in paragraph (b)(1) of this section) that are considered covered gifts or covered bequests described in section 2801(e), as such transfers are reportable as distributions (within the meaning of §1.6048-4(b)) under §1.6048-4.

(iii) Other foreign gifts—(A) De minimis amount. Paragraph (a) of this section does not apply to a foreign gift received by a U.S. person from a foreign corporation or a foreign partnership if the aggregate amount of such transfers from any particular corporation or partnership (the transferor) does not exceed $10,000 during the U.S. person's taxable year, as modified by cost-of-living adjustments pursuant to paragraph (c)(2)(iii)(B) of this section.

(B) Cost-of-living adjustments. The de minimis amount for purposes of paragraph (c)(2)(iii)(A) of this section is increased by an amount equal to the product of the amount specified in paragraph (c)(2)(iii)(A) of this section and the cost-of-living

adjustment for the taxable year of the gift under section 1(f)(3), except that paragraph (B) thereof is applied by substituting “1995” for “1992.”

(C) Aggregation rule. To determine whether paragraph (c)(2)(iii) of this section applies to foreign gifts from the transferor, the U.S. person must aggregate foreign gifts received from all foreign corporations, foreign partnerships, and any other foreign persons that the U.S. person knows or has reason to know are related to the transferor within the meaning of §1.643(i)-1(d)(4). If the aggregate amount of these foreign gifts exceeds the de minimis amount, the U.S. person must separately identify the aggregate amount of all foreign gifts from the transferor and each foreign person related to the transferor and provide identifying information about the transferor and each such foreign person other than a foreign individual (for example, name and address).

(iv) Joint returns. In the case of spouses who file joint returns under section 6013, the de minimis amount under paragraph (c)(2)(i)(A) of this section applies separately to each individual. Thus, spouses who file a joint return will not be subject to paragraph (a) of this section if the aggregate amount of foreign gifts received by each spouse, directly or indirectly from any particular individual or estate, taking into account the aggregation rule of paragraph (c)(2)(i)(B) of this section does not exceed $100,000 during the taxable year.

(d) Valuation principles. The amount of a foreign gift is the value of the property at the time of the transfer. The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts. Accordingly, the value of the property is determined in accordance with the

federal gift tax valuation principles of section 2512 and sections 2701 through 2704 (chapter 14 of the Internal Revenue Code) and the regulations under section 2512 and sections 2701 through 2704 as contained in 26 CFR part 1.

(e) Penalty for failure to file information—(1) In general. If a U.S. person fails to furnish the information required under paragraph (a) of this section with respect to any foreign gift within the time prescribed therefore (including extensions)—

(i) The tax consequences of the receipt of such foreign gift will be determined by the IRS based on all facts and circumstances, and

(ii) Notwithstanding the tax consequences under paragraph (e)(1)(i) of this section, such U.S. person must pay (upon notice and demand by the IRS and in the same manner as tax) an amount equal to 5 percent of the amount of such foreign gift for each month (or portion thereof) for which the failure to report the foreign gift as a gift on Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, continues (not to exceed 25 percent of such amount in the aggregate).

(2) Reasonable cause exception. Paragraph (e)(1) of this section will not apply to any failure to report a foreign gift if the U.S. person demonstrates to the satisfaction of the IRS that the failure is due to reasonable cause and not due to willful neglect. The determination of whether a taxpayer acted with reasonable cause and not with willful neglect is made under the principles set out in §1.6664-4 and §301.6651-1(c). This determination is made on a case-by-case basis, taking into account all pertinent facts and circumstances.

(f) Special rules—(1) Dual resident taxpayers. If a dual resident taxpayer (within

the meaning of §301.7701(b)-7(a)(1) of this chapter) computes U.S. income tax liability as a nonresident alien on the last day of the taxable year and complies with the filing requirements of §301.7701(b)-7(b) and (c) of this chapter, such individual will not be treated as a U.S. person with respect to the portion of the taxable year covered by Form 1040NR (or Form 1040NR–EZ).

(2) Dual status taxpayers. If a taxpayer abandons his U.S. citizenship or residence during the tax year or acquires U.S. citizenship or residence during the taxable year as provided in §1.6012-1(b)(2)(ii), such individual will not be treated as a U.S. person for the part of the year when the individual is treated as a nonresident alien for computing the individual's income tax liability, as reflected on the Form 1040NR or other similar schedule attached to such Form 1040.

(g) Examples. The following examples illustrate the rules of this section:

(1) Example 1: Qualified transfer exception. X, a U.S. person, attends Private University, an accredited college in the United States. X's grandparents, who are not U.S. persons, pay X's tuition directly to Private University. The tuition payment is a qualified transfer within the meaning of section 2503(e)(2). Under paragraph (b)(1) of this section, X will not be treated as receiving a foreign gift from his grandparents. Accordingly, X will not be required to report the tuition payment under paragraph (a) of this section.

(2) Example 2: Charitable donee. XYZ, a U.S. person, is an organization described in section 501(c) and exempt from tax under section 501(a). XYZ receives a bequest of $100,000 from a foreign estate. Because XYZ meets the exception under paragraph (c)(1) of this section for organizations described in section 501, XYZ is not

required to report the bequest under paragraph (a) of this section.

(3) Example 3: Gift from dual resident taxpayer. X is a lawful permanent resident of the United States within the meaning of §301.7701(b)-1(b) of this chapter and a resident of Country F under the domestic law of Country F. X is a resident of Country F under the residence article of the U.S.-Country F income tax treaty and notifies the United States by taking such a position on a Form 1040NR and a Form 8833 for the 2017 tax year. Pursuant to §301.7701(b)-7 of this chapter, X is treated as a nonresident alien for purposes of computing his U.S. income tax liability for 2017. During 2017, X makes a gift of $150,000 to Y, a U.S. citizen. Under paragraph (f)(1) of this section, X is not treated as a U.S. person for purposes of this section. Because X is not treated as a U.S. person for 2017, the gift is a foreign gift within the meaning of paragraph (b) of this section. Y must report receipt of the foreign gift under paragraph (a) of this section.

(4) Example 4: Gifts from related foreign individuals. X, a U.S. citizen, is married to Y, a nonresident alien. Y has three brothers, A, B, and C, who also are nonresident alien individuals. In 2017, Y makes a gift of $90,000 to X, A makes a gift of $40,000 to X, B makes two gifts to X (one of $4,000 and one of $3,000), and C makes a gift of $4,000 to X. X treats all five transfers as gifts. Under paragraphs (c)(2)(i)(A) and (B) of this section, to calculate the $100,000 de minimis amount, X must aggregate foreign gifts from Y, A, B, and C because X knows or has reason to know that A, B, and C are related to Y within the meaning of §1.643(i)-1(d)(4). For 2017, X must report the receipt of $141,000 in foreign gifts. In addition, under paragraph (c)(2)(i)(B) of this section, X must separately identify the $90,000 foreign gift from Y, the $40,000 foreign gift from A, and the aggregated $7,000 foreign gift from B because each person’s foreign gift for

2017 was in excess of $5,000. X is not required to identify the $4,000 gift from C separately because it was not in excess of $5,000. Because Y, A, and B are individuals, X need not identify these donors when reporting the transactions.

(5) Example 5: Covered gift within meaning of section 2801(e). Z is a resident of Country F and relinquished his U.S. citizenship on July 1, 2008, becoming a covered expatriate within the meaning of section 877A(g)(1). On December 31, 2017, Z gives $50,000 to his son, X, who is a U.S. person. The transfer is a covered gift within the meaning of section 2801(e) and a foreign gift within the meaning of paragraph (b) of this section. Because the value of the foreign gift exceeds the threshold specified in paragraph (c)(2)(ii) of this section ($14,000 for calendar year 2017), X must report receipt of the foreign gift under paragraph (a) of this section. X may also be subject to tax under section 2801.

(6) Example 6: Gifts from foreign individual and related corporation. X, a U.S. citizen, is married to Y, a nonresident alien. Y is the sole shareholder of FC, a foreign corporation. During 2017, Y made a gift of $7,000 to X, and FC made a purported gift of $9,000 to X. Because X knows or has reason to know that Y and FC are related, X must aggregate the gifts from Y and FC ($16,000). Although the $16,000 aggregate amount deemed received from Y does not exceed the $100,000 threshold with respect to foreign gifts from foreign individuals, the $16,000 aggregate amount deemed received from FC exceeds the applicable de minimis threshold for foreign gifts from foreign corporations under paragraph (c)(2)(iii) of this section for 2017. Accordingly, X must separately identify each foreign gift from Y and FC and must provide identifying information about FC because it is a foreign corporation.

(7) Example 7: Penalties for failure to report information. The facts are the same as in paragraph (g)(6) of this section (Example 6). X fails to report the amounts received from Y and FC on Form 3520 and does not demonstrate to the satisfaction of the IRS that such failure is due to reasonable cause and not due to willful neglect. Under paragraph (e)(1)(i) of this section and §1.672(f)-4(a)(2), the IRS may require X to include the purported gift of $9,000 from FC in X's gross income as if it were a dividend from FC. Under paragraph (e)(1)(i) of this section, the IRS may also determine that there are no tax consequences to X upon receiving the gift of $7,000 from Y. Without regard to the tax consequences determined under paragraph (e)(1)(i) of this section, under paragraph (e)(1)(ii) of this section, X must pay $800, an amount equal to 5 percent of the aggregate amount of $16,000 for each month for which the failure to disclose the foreign gifts on Form 3520 continues (not to exceed $4,000, an amount equal to 25 percent of the aggregate amount of $16,000).

(8) Example 8: Distribution from a foreign trust. X, a U.S. person, receives a distribution of $500,000 from a foreign trust that X treats as a distribution that is not subject to tax for purposes of computing X's income tax liability. Under paragraph (b) of this section, X is required to report the amount as a distribution under §1.6048-4 and not as a foreign gift under paragraph (a) of this section. Based on the advice of his tax advisor, X reports the distribution under paragraph (a) of this section as a foreign gift and not as a distribution under §1.6048-4. X's failure to report the distribution under §1.6048-4 is subject to penalties under §1.6677-1(a) unless X can demonstrate to the satisfaction of the IRS that such failure is due to reasonable cause and not due to willful neglect. The fact that X reported the distribution under paragraph (a) of this section

based on the advice of his tax advisor is one factor that may be taken into account in determining whether X's failure to report the distribution under §1.6048-4 was due to reasonable cause.

(h) Applicability date—(1) In general. Except as provided in paragraph (h)(2) of this section, the rules of this section apply to amounts received after the date of publication of the final regulations in the **Federal Register**.

(2) Covered expatriates. The last sentence of paragraph (c)(2)(i)(A) and paragraph (c)(2)(ii) of this section, related to covered gifts or covered bequests, are effective on the date final regulations relating to section 2801 are published in the **Federal Register** and apply to covered gifts or covered bequests received on or after that date. Prior to the date final regulations relating to section 2801 are published in the **Federal Register**, paragraph (c)(2)(i)(A) applies to covered gifts or covered bequests received on or after the date of publication of final regulations under section 6039F in the **Federal Register**.

Par. 9. Sections 1.6048-1, 1.6048-2, 1.6048-3, 1.6048-4, 1.6048-5, 1.6048-6, and 1.6048-7 are added to read as follows:

§1.6048-1 Scope.

(a) In general. Sections 1.6048-1 through 1.6048-7 provide rules concerning information that must be reported under section 6048 with respect to foreign trusts. This section provides general definitions for purposes of section 6048. Section 1.6048-2 provides rules concerning the obligation of a responsible party to provide notice of a reportable event that occurs during the responsible party's taxable year with respect to a foreign trust. Section 1.6048-3 provides rules concerning the obligation of a U.S.

owner of a foreign trust to report information about the ownership of the foreign trust and to ensure that the trust provides certain information about the trust's activities and operations for the year to the IRS and to any U.S. person (within the meaning of section 7701(a)(30)) who is treated as the owner of the trust or who receives a distribution from the trust. Section 1.6048-4 provides rules concerning the reporting obligation of a U.S. person who receives a distribution from a foreign trust during the U.S. person's taxable year. Section 1.6048-5 provides exceptions to the rules of §§1.6048-2 through 1.6048-4. Section 1.6048-6 provides certain special rules, including rules concerning dual resident taxpayers (within the meaning of §301.7701(b)-7(a)(1) of this chapter) and dual status taxpayers (described in §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. Section 1.6048-7 provides applicability dates. For civil penalties that apply for failure to comply with the requirements of §§1.6048-2 through 1.6048-4, see §1.6677-1. For penalties that apply to understatements of tax that are attributable to transactions involving undisclosed foreign financial assets, including assets with respect to which information was required to be provided under section 6048 but was not provided, see section 6662(b)(7) and (j). For suspension of the statute of limitations when required information has not been provided under section 6048, see section 6501(c)(8).

(b) Definitions. The following definitions apply for purposes of this section and §§1.6048-2 through 1.6048-7:

(1) Foreign person. The term foreign person means any person who is not a U.S. person within the meaning of section 7701(a)(30).

(2) Grantor trust. The term grantor trust means a trust or any portion of a trust

that is treated as owned by any person under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code.

(3) Nongrantor trust. The term nongrantor trust means a trust or any portion of a trust that is not treated as owned by any person under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code.

§1.6048-2 Notice of certain events.

(a) In general—(1) Filing requirement. A responsible party (as defined in paragraph (c) of this section) must provide written notice of any reportable event (as defined in paragraph (b) of this section) that occurs during the responsible party's taxable year on Part I of Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, unless an exception in §1.6048-5 applies. If a responsible party has a reportable event with more than one foreign trust during the taxable year, the responsible party must file a separate Form 3520 for each such foreign trust. For special rules concerning the treatment of dual resident taxpayers (within the meaning of §301.7701(b)-7(a)(1) of this chapter) and dual status taxpayers (described in §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, see §1.6048-6. See §§1.679-1 and 1.684-1 for additional rules regarding transfers to foreign trusts by U.S. persons.

(2) Due dates—(i) General rule. If the responsible party is a grantor or transferor described in paragraph (c)(1) or (c)(2) of this section, Form 3520 must be filed by the fifteenth day of the fourth month after the close of the responsible party's taxable year. In the case of a responsible party who has been granted an extension of time to file its income tax return pursuant to section 6081, an extension of time for filing Form 3520 is

granted to the fifteenth day of the tenth month following the close of the responsible party's taxable year. No additional extension of time to file Form 3520 will be allowed beyond the fifteenth day of the tenth month following the close of the responsible party's taxable year.

(ii) Filing by executor of decedent's estate. If the responsible party is described in paragraph (c)(3) of this section, Form 3520 must be filed by the fifteenth day of the fourth month after the close of the decedent's taxable year. In the case of an executor who has been granted an extension of time to file the decedent's income tax return for the decedent's year of death pursuant to section 6081, an extension of time for filing Form 3520 is granted to the fifteenth day of the tenth month following the close of the decedent's taxable year which includes the date of decedent's death. No additional extension of time to file Form 3520 will be allowed beyond the fifteenth day of the tenth month following the close of the decedent's taxable year which includes the date of the decedent's death.

(b) Reportable event. Subject to §1.6048-5 (Exceptions), for purposes of this section, the term reportable event means any of the following:

(1) The creation of any foreign trust (within the meaning of §301.7701-7 of this chapter) by any U.S. person.

(2) Any direct, indirect, or constructive transfer, within the meaning of §1.679-3 or §1.684-2, of property (including cash) to a foreign trust by a U.S. person, including a transfer by reason of death. In addition, a reportable event includes a U.S. person's transfer of property to a domestic trust that becomes foreign trust, as described in §1.684-4 (Outbound migrations of domestic trusts), and a U.S. person's transfer of

property in exchange for any obligation of the trust or a related person, as described in §1.679-4, without regard to whether the obligation is a qualified obligation.

(3) The death of a citizen or resident of the United States if—

(i) The decedent was treated as the owner of any portion of a foreign trust under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code, or

(ii) Any portion of a foreign trust was included in the gross estate of the decedent.

(c) Responsible party. For purposes of this section, the term responsible party means any of the following:

(1) The grantor (within the meaning of §1.671-2(e)) in the case of the creation of an inter vivos trust.

(2) The transferor in the case of a reportable event described in paragraph (b)(2) of this section other than a transfer by reason of death.

(3) The executor of the decedent's estate in any other case (whether or not the executor is a U.S. person).

(d) Examples. The following examples illustrate the rules of this section. References to the grantor trust rules means subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code.

(1) Example 1: Creation of foreign trust. A, an attorney, creates a foreign trust, FT, on behalf of B, A's client, and transfers $100 to FT out of A's funds. A and B are both U.S. persons. A and B are both treated as grantors of FT under §1.671-2(e). B reimburses A for the $100 transferred to FT. Under paragraph (b)(1) of this section, the creation of FT is a reportable event, and under paragraph (c)(1) of this section, A and B are responsible parties. Under paragraph (b)(2) of this section, the funding of FT is a

reportable event, and under paragraph (c)(2) of this section, B is the responsible party. Accordingly, under paragraph (a) of this section, A and B are both required to report the creation of FT and B is also required to report the transfer to FT. A must report the creation of FT and B must report the creation and the funding of FT, respectively, on Part I of Form 3520.

(2) Example 2: Transfers to two foreign trusts. The facts are the same as in paragraph (d)(1) of this section (Example 1). B also transfers $100 to a second foreign trust, FT2, during the same taxable year. Under paragraph (a)(1) of this section, B must file two Forms 3520, one for FT and one for FT2.

(3) Example 3: Transfer by domestic trust to foreign trust. Under the grantor trust rules, B is treated as the owner of a domestic trust, DT. B is a U.S. person and funds DT with $1,000X. Subsequently, B causes DT to transfer $600X to FT, an existing foreign trust. Under §1.679-3(b), B is treated as transferring $600X to FT. Under paragraph (b)(2) of this section, the transfer is a reportable event. Under paragraph (c)(2) of this section, B is a responsible party. Accordingly, under paragraph (a) of this section, B is required to report the transfer on Part I of Form 3520.

(4) Example 4: Transfer by reason of death. C, a U.S. person, is treated as the owner of a domestic trust, DT, under the grantor trust rules. The trust instrument provides that upon C's death, DT will terminate and the trustee must distribute the trust corpus to a foreign trust for the benefit of C's children. C dies in 2017. The trustee of DT distributes the trust corpus to a foreign trust, FT. The transfer to FT is a reportable event under paragraph (b)(2) of this section. Under paragraph (c)(3) of this section, the executor of C's estate is a responsible party. Accordingly, under paragraph (a) of this

section, the executor of C's estate is required to report the transfer on Part I of Form 3520 by April 15, 2017, four months and 15 days after the close of C's 2017 tax year, the year that includes the date of C's death, as described in paragraph (a)(2)(ii) of this section. If C's executor is granted an extension of time to file C's final income tax return for the year of decedent's death, then C's Form 3520 will have a 6-month extension and be due by October 15, 2018.

(5) Example 5: Death of U.S. citizen who was the owner of a foreign trust. The facts are the same as in paragraph (d)(4) of this section (Example 4). C dies in 2017 while he is treated as the owner of FT. Under paragraph (b)(3)(i) of this section, C's death is a reportable event. Under paragraph (c)(3) of this section, the executor of C's estate is a responsible party. Accordingly, under paragraph (a) of this section, the executor of C's estate is required to report C's death on Form 3520 by April 15, 2018, four months and 15 days after the close of C's 2017 tax year, the year that includes C's death, as described in paragraph (a)(2)(ii) of this section. If C's executor is granted an extension of time to file C's final income tax return for the year of decedent's death, then C's Form 3520 will also have an extension and be due by October 15, 2018.

(6) Example 6: Transfer in exchange for less than fair market value. X, a U.S. person, sells property worth $1,000X to a foreign trust, FT, in exchange for $100X in cash. Under §1.671-2(e)(2)(ii), the $900X excess amount is a gratuitous transfer by X to FT. Under §1.679-3(a), X is treated as making a transfer of $900X to FT. Under paragraph (b)(2) of this section, the transfer is a reportable event. Under paragraph (c)(2) of this section, X is a responsible party. Accordingly, under paragraph (a) of this section, X is required to report the $900X transfer to FT on Part I of Form 3520.

(7) Example 7: Creation and funding of trust in Puerto Rico by U.S. citizen. X is a U.S. citizen and a bona fide resident of Puerto Rico. X creates and funds a trust, T, in Puerto Rico. T is subject to the primary jurisdiction of the Puerto Rican courts. Because T fails the court test of §301.7701-7(a)(i), it is classified as a foreign trust under §301.7701-7. Under paragraph (b)(1) and (2) of this section, the creation and funding of T are reportable events. Under paragraph (c)(1) and (2) of this section, X is a responsible party. Accordingly, under paragraph (a) of this section, X is required to report the creation and funding of T on Part I of Form 3520.

(8) Example 8: Indirect transfer. X, a U.S. person, creates FT, a foreign trust, for the benefit of his children, who are U.S. citizens. On July 1, 2017, X transfers ABC stock to his uncle, Y, a nonresident alien, for no consideration. Y immediately sells the ABC stock and uses the proceeds to purchase DEF stock. On January 1, 2018, Y transfers the DEF stock to FT. X is related to Y within the meaning of §1.679-3(c)(4). X cannot demonstrate to the satisfaction of the IRS that Y has a relationship with the beneficiaries of the trust that establishes a reasonable basis for concluding that the intermediary would make a transfer to FT, that Y acted independently of X, or that Y is not an agent of X. Thus, the transfer is deemed to be for the principal purpose of tax avoidance under §1.679-3(c)(2). Under §1.679-3(c)(1), X is treated as having made an indirect transfer of the DEF stock to FT on January 1, 2018. Under §1.679-3(c)(3), Y is treated as an agent of X, and the DEF stock is treated as transferred to FT by X. Under paragraph (b)(2) of this section, the transfer is a reportable event. Under paragraph (c)(2) of this section, X is a responsible party. Accordingly, under paragraph (a) of this section, X is required to report the transfer on Part I of Form 3520.

(9) Example 9: Constructive transfer. FT, a foreign trust, owes $100X to F Corp, an unrelated foreign corporation, for the performance of services by F Corp for the benefit of FT. In satisfaction of FT's liability to F Corp, X, a U.S. person, transfers to F Corp property with a fair market value of $100X. Under §1.679-3(d)(1), X is treated as having made a constructive transfer of the property to FT. Under paragraph (b)(2) of this section, the transfer is a reportable event. Under paragraph (c)(2) of this section, X is a responsible party. Accordingly, under paragraph (a) of this section, X is required to report the transfer on Part I of Form 3520.

(10) Example 10: Guarantee of foreign trust obligations. F Corp, a foreign corporation, lends $100X to FT, a foreign trust, in exchange for FT's obligation to repay the loan. X, a U.S. person, guarantees the repayment of $60X of FT's obligation. Under §1.679-3(e)(1) and (2), X is treated as having transferred $60X to FT. Under paragraph (b)(2) of this section, the transfer is a reportable event. Under paragraph (c)(2) of this section, X is a responsible party. Accordingly, under paragraph (a) of this section, X is required to report the transfer on Part I of Form 3520.

(11) Example 11: Dual resident taxpayer. The facts are the same as in paragraph (d)(10) of this section (Example 10) except that X is a dual resident taxpayer (within the meaning of §301.7701(b)-7(a)(1) of this chapter) who computes his U.S. tax liability as a nonresident alien for the taxable year during which he is treated as making the transfer. Pursuant to §1.6048-6(a)(1), X is not treated as a U.S. person for that taxable year and is not required to report the transfer on Part I of Form 3520.

(12) Example 12: Outbound migration of domestic nongrantor trust with no U.S. beneficiaries. X, a U.S. person, transfers property to an irrevocable domestic trust, DT,

for the sole benefit of X's daughter, a nonresident alien. DT is not treated as owned by X or any other person under the grantor trust rules. DB, a domestic bank, resigns as trustee when X dies, and FB, a foreign bank, becomes the replacement trustee under the terms of the trust. Pursuant to §301.7701-7(d) of this chapter, DT becomes a foreign trust, FT. Under §1.684-4(a), DT is treated as having transferred all of its assets to FT and is required to recognize gain on the transfer under §1.684-1(a). Under paragraph (b)(2) of this section, the transfer is a reportable event. Under paragraph (c)(2) of this section, DT is the responsible party. Accordingly, under paragraph (a) of this section, DT is required to report the transfer on Part I of a Form 3520 filed on behalf of DT with respect to FT.

(13) Example 13: Outbound migration of domestic grantor trust. On January 1, 2017, X, a U.S. person, transfers property to a revocable domestic trust, DT, for the benefit of A, a U.S. person. X is treated as the owner of DT under the grantor trust rules. On January 15, 2018, DT acquires a foreign trustee who has the power to determine whether and when distributions will be made to A. Under sections 7701(a)(30)(E) and 7701(a)(31)(B) and §301.7701-7(d)(1)(ii)(A) and (d)(2)(i) of this chapter, DT becomes a foreign trust on January 15, 2018. Under paragraph (a) of this section, X is treated as transferring property to a foreign trust on January 15, 2018. Under paragraph (a) of this section, X is required to report the transfer on Part I of Form 3520.

§1.6048-3 U.S. owners of foreign trusts.

(a) Information to be provided by a foreign grantor trust—(1) In general. Unless an exception in §1.6048-5 applies, any U.S. person (within the meaning of section 7701(a)(30)) who is treated as an owner (U.S. owner) of a foreign trust or any portion of

a foreign trust (within the meaning of §301.7701(b)-7 of this chapter) under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code during any taxable year is responsible for ensuring that by the fifteenth day of the third month after the end of the foreign trust's taxable year, with a maximum extension of a 6-month period beginning on such day, the foreign trust —

(i) Files Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner (Under section 6048(b)), with the IRS, to which are attached copies of the statements required by paragraphs (a)(1)(ii) and (iii) of this section,

(ii) Furnishes a Foreign Grantor Trust Owner Statement in accordance with the instructions for Form 3520-A for the taxable year to each U.S. owner; and

(iii) Furnishes a Foreign Grantor Trust Beneficiary Statement in accordance with the instructions for Form 3520-A for the taxable year to each U.S. person other than the U.S. owner to whom the trust has made a distribution (within the meaning of §1.6048-4(b)), either directly or indirectly, during the trust's taxable year (each a U.S. beneficiary).

(2) Substitute Form 3520-A. If the foreign trust does not file and report all the information required by paragraph (b)(1) of this section, the U.S. owner must--

(i) Complete and file Part II of Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, by the due date of the U.S. owner's Form 3520, as described in §1.6048-2(a)(2) except that "U.S. owner" replaces a "responsible party;" and

(ii) Complete Form 3520-A and related statements on behalf of the foreign trust and file them with the U.S. owner's Part II of Form 3520 by the due date of the U.S.

owner's Form 3520 as provided in paragraph (a)(2)(i) of this section. Further, the U.S. owner must furnish the Foreign Grantor Trust Beneficiary Statement to each U.S. beneficiary by the due date of the U.S. owner's Form 3520.

(3) Filing by executor of decedent's estate. If the U.S. person described in paragraph (a)(2) of this section dies in the year that such person is treated as the owner of a foreign trust, Form 3520 must be filed by the executor of the decedent's estate by the fifteenth day of the fourth month after the close of the U.S. person decedent's taxable year. In the case of an executor who has been granted an extension of time to file the decedent's income tax return for the decedent's year of death pursuant to paragraph 6081, an extension of time for filing Form 3520 is granted to the fifteenth day of the tenth month following the close of the decedent's taxable year which includes the decedent's death. No additional extension of time to file Form 3520 will be allowed beyond the fifteenth day of the tenth month following the close of the decedent's taxable year including the decedent's death.

(4) Certain fixed investment trusts. A U.S. owner who is subject to the rules of this section will not be required to provide information about the other persons who are treated as owners of the foreign trust if the foreign trust meets all requirements to qualify as a widely held fixed investment trust within the meaning of §1.671-5(b)(22) other than the requirement that it be a U.S. person under section 7701(a)(30)(E).

(b) Consistency rule. U.S. owners or U.S. beneficiaries who receive a Foreign Grantor Trust Owner Statement or Foreign Grantor Trust Beneficiary Statement from a foreign trust must treat any item reported by the trust to such U.S. person in a manner that is consistent with the trust's treatment of such item on the Foreign Grantor Trust

Owner Statement or Foreign Grantor Trust Beneficiary Statement, unless they notify the IRS about the inconsistent treatment. The notification of inconsistent treatment may be made on a Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR). If a U.S. owner or U.S. beneficiary takes an inconsistent position and fails to notify the IRS about the inconsistent treatment, or if the U.S. owner or U.S. beneficiary receives incorrect information from the foreign trust, then rules similar to the rules of section 6034A(c) (generally requiring beneficiaries of estates or trusts to file their returns in a manner that is consistent with information received from the estate or trust) will apply.

(c) Determinations with respect to trusts not having U.S. agents. Unless a foreign trust to which this section applies authorizes a U.S. agent as described in paragraph (d) of this section, or if otherwise provided pursuant to paragraph (d)(4) of this section, the determination of amounts required to be taken into account with respect to the trust by a U.S. person under the grantor trust rules will be determined by the IRS based on all the facts and circumstances.

(d) Authorization of a U.S. agent—(1) In general. The rules of this paragraph (d) apply to any foreign trust to which this section applies if the trustee of the foreign trust authorizes a U.S. person to act as the trust's limited agent solely for purposes of sections 7602, 7603, and 7604 with respect to—

(i) Any request by the Secretary to examine records or produce testimony related to the proper treatment of amounts required to be taken into account under the grantor trust rules, or

(ii) Any summons by the Secretary for such records or testimony.

(2) Limitations. The appearance of persons or production of records by reason of a U.S. person being an agent described in paragraph (d)(1) of this section will not subject such persons or records to legal process for any purpose other than determining the correct treatment of the amounts to be taken into account pursuant to paragraph (c) of this section.

(3) No office, permanent establishment, or trade or business. A foreign trust that appoints a U.S. agent described in paragraph (d)(1) of this section will not be considered to have an office or a permanent establishment in the United States, or to be engaged in a trade or business in the United States, solely because of the agent's activities as an agent pursuant to this section.

(4) Summons issued to a U.S. agent—(i) In general. Paragraph (c) of this section applies if a summons is issued to a U.S. person (either directly or as a limited agent of a foreign trust who was appointed pursuant to paragraph (d)(1) of this section) or to a foreign trust (where service of the summons can be effectuated) to produce any records or testimony in order to determine the amounts required to be taken into account under the grantor trust rules; and if—

(A) The summons is not quashed in a proceeding, if any, begun not later than the 90th day after such summons was issued and is not determined to be invalid in a proceeding, if any, begun under section 7604 to enforce such summons; and

(B) The IRS has sent by certified or registered mail a notice to the U.S. person or foreign trust of its determination that such U.S. person or foreign trust has not substantially and timely complied with the summons, and a proceeding to review such determination is not begun any later than 90 days after such notice is mailed. If such a

proceeding is not begun on or before such 90th day, the determination by the IRS shall be binding.

(ii) Coordination with treaties or tax information exchange agreements. Where records of a foreign trust are obtainable on a timely and efficient basis under information exchange procedures provided under a tax treaty or tax information exchange agreement (TIEA) with a foreign country, the IRS generally will make use of such procedures before issuing a summons. The absence or pendency of a treaty or TIEA request may not be asserted as grounds for refusing to comply with a summons or as a defense against the determination under paragraph (c) of this section of amounts required to be taken into account under the grantor trust rules. For purposes of this paragraph, information is available on a timely and efficient basis if it can be obtained within 180 days of the request.

(iii) Enforcement proceeding not required. The IRS is not required to begin an enforcement proceeding to enforce the summons in order to apply the rules of paragraph (d)(4) of this section.

(iv) Suspension of statute of limitations. If the U.S. person or foreign trust to which a summons is issued brings a proceeding to quash such summons not later than the 90th day after such summons was issued or begins a proceeding to review a determination under paragraph (d)(4)(i)(B) of this section not later than the 90th day after the day on which the notice referred to in paragraph (d)(4)(i)(B) of this section was mailed, the running of any period of limitation under section 6501 (relating to assessment and collection of tax) or under section 6531 (relating to criminal prosecutions) for the taxable year or years to which the summons that is the subject of

such proceeding relates shall be suspended for the period during which such proceeding, and appeals therein, are pending. In no event shall any such period expire before the 90th day after the day on which there is a final determination in such proceeding.

(e) Examples. The following examples illustrate the rules of this section:

(1) Example 1: Fixed investment trust. X, a U.S. person, is treated as an owner of a foreign trust, FT, that would be a widely held fixed investment trust within the meaning of §1.671-5(b)(22) if it were a domestic trust. Under paragraph (a)(4) of this section, X is required to complete and file Part II of Form 3520, except that X is not required to provide information about the other owners of FT.

(2) Example 2: Substitute Form 3520-A. X, a U.S. person, is treated as the owner of a foreign trust, FT. FT's taxable year ends on June 30. On May 1, 2017, FT made a distribution to Y, a U.S. beneficiary of the trust. FT fails to comply with the requirements of paragraph (a)(1) of this section for its taxable year ending June 30, 2017. Under paragraph (a)(2)(i) of this section, X is required to complete and file Part II of Form 3520 by the due date for X's 2017 Form 3520. In addition, under paragraph (a)(2)(ii) of this section, X is required to complete a substitute Form 3520-A and related statements and file them with X's 2017 Form 3520. X must furnish a Foreign Grantor Trust Beneficiary Statement to Y by the due date for X's 2017 Form 3520.

(3) Example 3: Failures to appoint U.S. agent and to respond to summons. X, a U.S. person, is treated as the owner of a foreign trust, FT. FT does not appoint a U.S. agent described in paragraph (d)(1) of this section. The IRS issues a summons to X for the production of records of FT related to the proper treatment of amounts required to

be taken into account by X under the grantor trust rules. Neither X nor FT responds to the summons. Under paragraph (c) of this section, the IRS may determine the amount that X must take into account based on all the facts and circumstances.

(4) Example 4: Multiple trusts. X, a U.S. person, is treated as the owner of two foreign trusts, FT1 and FT2. During 2017, X transfers cash to FT1 and receives a distribution from FT2. X must report his transfer to and ownership of FT1 on one Form 3520, and he must report his ownership of and distribution from FT2 on a second Form 3520.

(5) Example 5: Dual resident taxpayer. (i) X is a lawful permanent resident of the United States within the meaning of §301.7701(b)-1(b) of this chapter and a resident of Country F under the domestic law of Country F. X is treated as a resident of Country F under the residence article of the U.S.-Country F income tax treaty (the treaty). Pursuant to §301.7701(b)-7 of this chapter, X is treated as a nonresident alien for purposes of computing his U.S. income tax liability for 2017. During 2017, X transfers $100X to a foreign trust, FT, for the benefit of his children, who are U.S. citizens. Under §1.6048-6(a), X is not treated as a U.S. person and is not required to report the transfer on a Form 3520 for 2017.

(ii) In 2018, X waives any benefits to which he would have been entitled under the treaty and computes his U.S. income tax liability as a resident alien. Under §1.679-5(a), X is treated as having transferred $100X to FT on January 1, 2018, together with any undistributed net income of the trust attributable to the $100X. Under §1.679-1(a), X is treated as the owner of FT as of January 1, 2018. Under §1.6048-2(a) and paragraph (a) of this section, X is required to file a Form 3520 for 2018 on which he

reports the transfer to FT on Part I and his ownership of FT on Part II. If FT fails to comply with the requirements of paragraph (a)(1) of this section, under paragraph (a)(2) of this section, X also is required to complete and file a substitute Form 3520-A with a Foreign Grantor Trust Owner Statement attached and furnish a Foreign Grantor Trust Beneficiary Statement to his children.

§1.6048-4 Reporting by U.S. beneficiaries of foreign trusts.

(a) Reporting of trust distributions—(1) In general. Unless an exception in §1.6048-5 applies, any U.S. person (within the meaning of section 7701(a)(30)) who receives a distribution from any foreign trust (without regard to whether the U.S. person is treated as the owner of the foreign trust) must file Part III of Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, by the due date of the U.S. person's Form 3520, as described in §1.6048-2(a)(2) except that "U.S. person" replaces a "responsible party."

(2) Filing by executor of decedent's estate. If the U.S. person described in paragraph (a)(1) of this section dies in the year of receipt of a trust distribution, Form 3520 must be filed by the executor of the U.S. person's estate by the fifteenth day of the fourth month after the close of the U.S. person decedent's taxable year. In the case of an executor who has been granted an extension of time to file the decedent's income tax return for the decedent's year of death pursuant to section 6081, an extension of time for filing Form 3520 is granted to the fifteenth day of the tenth month following the close of the decedent's taxable year which includes the decedent's death. No additional extension of time to file Form 3520 will be allowed beyond the fifteenth day of the tenth month following the close of the decedent's taxable year which includes the date of the

decedent's death.

(b) Distribution—(1) In general. Except as provided in paragraphs (b)(3)(ii) and (b)(4)(ii) of this section, a distribution means any transfer of property from a foreign trust received directly or indirectly by a U.S. person to the extent such property exceeds the fair market value of any property or services, if any, received by the foreign trust in exchange for property transferred, without regard to whether any portion of the trust is treated as owned by the grantor or another person under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code, and without regard to whether the recipient is designated as a beneficiary by the terms of the trust or the distribution has any income tax consequences. For these purposes, a transfer of property to a grantor trust or to a disregarded entity (as defined in §1.643(i)-1(d)(12)) will be treated as a transfer to the owner of the grantor trust or the disregarded entity, respectively. (For example, a loan to a single member LLC treated as a disregard entity will be treated as a loan to the owner of the LLC.) A distribution includes any amount actually or constructively received, and includes the receipt of trust corpus and the receipt of a gift or bequest described in section 663(a). For distributions through intermediaries see paragraph (b)(2) of this section; for loans of cash or marketable securities see paragraph (b)(3) of this section; for use of trust property see paragraph (b)(4) of this section; and for the receipt of covered gifts or bequests received from a foreign trust see paragraph (b)(5) of this section.

(2) Distributions from foreign trusts through intermediaries—(i) In general. A distribution includes any indirect transfer of property from a foreign trust received by a U.S. person through an intermediary, nominee or agent. In such a case, except as

otherwise provided in paragraph (b)(2)(ii) of this section, the intermediary, nominee or agent is treated as an agent of the foreign trust and the property is treated as distributed to the U.S. person in the year the property is transferred to the U.S. person or made available by the intermediary, nominee or agent to the U.S. person.

(ii) Special rule. If the Commissioner determines that the intermediary, nominee or agent is an agent of the U.S. person under generally applicable U.S. agency principles, the property will be treated as transferred to the U.S. person on the date of the transfer from the foreign trust to the intermediary.

(iii) Effect on intermediary. If the transfer of property is treated as a transfer of property to the U.S. person on the date of the transfer from the foreign trust to the intermediary under paragraph (b)(2)(ii) of this section, the intermediary is not treated as having transferred the property to the U.S. person.

(iv) Reporting indirect transfers of property. An indirect transfer of property from a foreign trust must be reported on Part III of Form 3520 without regard to whether the receipt of such property would be treated as having any income tax consequences to the U.S. person receiving such property or to a U.S. beneficiary of the foreign trust.

(3) Loans of cash or marketable securities—(i) In general. A distribution includes any loan of cash or marketable securities from a foreign trust (whether from trust corpus or income) directly or indirectly to a U.S. person. For these purposes, a loan to a grantor trust or to a disregarded entity (as defined in §1.643(i)-1(d)(12) will be treated as a loan to the owner of the grantor trust or the disregarded entity, respectively. (Ror example, a loan to a single member LLC treated as a disregard entity will be treated as a loan to the owner of the LLC.) Loans from a foreign trust include:

(A) Loans made by any person to a U.S. person if the foreign trust provides a guarantee (within the meaning of §1.679-3(e)(4)) for the loan, and

(B) Loans made to a U.S. person by any intermediary, nominee or agent.

(ii) Section 643(i) loans of cash or marketable securities. A distribution includes a loan of cash or marketable securities from a foreign nongrantor trust directly or indirectly to any U.S. beneficiary (within the meaning of §1.643(i)-1(d)(5)) or a U.S. person related (within the meaning of §1.643(i)-1(d)(4)) to a U.S. beneficiary without regard to whether the loan was made in exchange for a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii) . For these purposes, indirect loans include loans described in §1.643(i)-1(b)(2).

(iii) Reporting loans of cash or marketable securities. A loan of cash or marketable securities from a foreign trust must be reported by the U.S. person described under paragraph (b)(3)(i) of this section and the U.S. beneficiary described under paragraph (b)(3)(ii) of this section on Part III of Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, without regard to whether the loan would be treated as having any income tax consequences to a U.S. beneficiary (within the meaning of §1.643(i)-1(d)(5)) of the foreign trust.

(4) Use of trust property—(i) In general. A distribution includes the fair market value of the use of any property of a foreign trust directly or indirectly by a U.S. person. For these purposes, use of property of a foreign trust by a grantor trust or by a disregarded entity (as defined in §1.643(i)-1(d)(12)) will be treated as the use of trust property by the owner of the grantor trust or the disregarded entity, respectively. (For example, use of trust property by a single member LLC treated as a disregard entity will

be treated as use of trust property by the owner of the LLC.)

(ii) Section 643(i) use of trust property. A distribution includes the fair market value of the use of any property of a foreign nongrantor trust directly or indirectly by a U.S. beneficiary (within the meaning of §1.643(i)-1(d)(5)) or a U.S. person related (within the meaning of §1.643(i)-1(d)(4)) to a U.S. beneficiary without regard to whether the foreign trust is paid the fair market value for such use. For these purposes, indirect use of trust property include the use described in §1.643(i)-1(c)(2).

(iii) Reporting use of trust property. The use of trust property must be reported by the U.S. person described under paragraph (b)(4)(i) of this section and the U.S. beneficiary described under paragraph (b)(4)(ii) of this section on Part III of Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, without regard to whether the use of trust property would be treated as having any income tax consequences to a U.S. beneficiary (within the meaning of §1.643(i)-1(d)(5)) of the foreign trust.

(5) Certain covered gifts or covered bequests. The term distribution includes any covered gift or covered bequest (described in section 2801(e)) that is received as a transfer from a foreign trust.

(c) Statements provided by foreign trust—(1) Foreign grantor trust with U.S. owner--(i) Owner statement. Pursuant to §1.6048-3(b)(1)(ii), a U.S. person who receives a distribution, including a loan of cash or marketable securities or the use of other trust property, from a foreign trust (or portion of a foreign trust) that the U.S. person is treated as owning under the grantor trust rules should receive a Foreign Grantor Trust Owner Statement.

(ii) Statement for U.S. person receiving a distribution. Pursuant to §1.6048-3(b)(1)(iii), a U.S. person who receives a distribution, including a loan of cash or marketable securities or the use of other trust property, from a foreign trust (or portion of a foreign trust) that is treated as owned by another U.S. person under the grantor trust rules should receive a Foreign Grantor Trust Beneficiary Statement.

(2) Foreign nongrantor trust. A foreign nongrantor trust may issue, by the fifteenth day of the third month after the end of the trust's taxable year, a Foreign Nongrantor Trust Beneficiary Statement to a U.S. person who receives a distribution, including, pursuant to §1.643(i)-3(c)(2)(iii), to a U.S. person who receives a loan of cash or marketable securities or the use of other trust property (without regard to whether such loan or use of trust property is a section 643(i) distribution under §1.643(i)-1(a)), from the foreign trust during the trust's taxable year.

(3) Foreign grantor trust with foreign owner. A foreign trust that is treated as owned by a foreign person under the grantor trust rules may issue, by the fifteenth day of the third month after the end of the trust's taxable year, a Foreign-Owner Grantor Trust Beneficiary Statement to a U.S. person who receives a distribution, including a loan of cash or marketable securities or the use of other trust property (without regard to whether such loan or use of trust property is a section 643(i) distribution under §1.643(i)-1(a)).

(d) Tax consequences of distributions—(1) In general. A U.S. person (other than a U.S. person described in §1.6048-4(c)(1)) who receives a distribution from a foreign trust, but who does not receive a statement described in §1.6048-4(c), must determine the tax consequences of the distribution under the default calculation method described

in paragraph (d)(3) of this section. A U.S. person who receives a Foreign Grantor Trust Beneficiary Statement or a Foreign-Owned Grantor Trust Beneficiary Statement must determine the income tax consequences of the distribution as if the distribution came directly from the owner of the trust. Unless the U.S. person used the default calculation method described in paragraph (d)(3) of this section for distributions from a foreign trust, a U.S. person who receives a Foreign Nongrantor Trust Beneficiary Statement from the foreign trust may determine the income tax consequences of the distribution under either the actual calculation method described in paragraph (d)(2) of this section or the default calculation method. If the U.S. person used the default calculation method with respect to distributions from the same foreign trust, it must continue to use the default calculation method for all subsequent distributions from the trust. For rules determining the tax consequences of a distribution in the year a foreign trust terminates, see paragraphs (b)(3)(i)(B) and (b)(3)(iii) of this section.

(2) Actual calculation method. Under the actual calculation method, the tax consequences of the distribution are determined by using actual information about the foreign trust as provided in the applicable statement described in §1.6048-4(c) and applying the rules of subparts C and D of Part I of subchapter J of chapter 1 of the Internal Revenue Code.

(3) Default calculation method—(i) Consequences to U.S. person who receives a distribution from a foreign trust—(A) In general. Under the default calculation method, the tax consequences of the distribution are determined by allocating the distribution between a distribution of current income and a distribution of accumulated income under the rules of this paragraph (d)(3) and in accordance with the Instructions for Form

3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, for the applicable taxable year. The portion of the distribution that is treated as a distribution of current income is 125% of the average distribution that the U.S. person received from the foreign trust during the immediately preceding three taxable years (or the number of years during which the trust has been a foreign trust if fewer than three years). The remainder of the distribution, if any, is treated as an accumulation distribution within the meaning of section 665(b) that is subject to an interest charge under section 668. For purposes of computing the interest charge (in the absence of actual information provided on a statement described in §1.6048-4(c)), the U.S. person must assume that the applicable number of years the 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 had been made and tax under section 665(d) had been imposed).

(B) In year of trust termination. Unless paragraph (d)(3)(iii) of this section applies, the tax consequences of a distribution in the year a foreign trust terminates are determined by treating the distribution as an accumulation distribution within the meaning of section 665(b) that is subject to an interest charge under section 668 for any amount in excess of the portion of the distribution that is treated as a distribution of current income described in paragraph (d)(3)(i)(A) of this section.

(ii) Consequences to trust. A foreign trust must determine the income tax consequences of distributions to U.S. persons by applying the applicable rules of part I of subchapter J of chapter 1 of the Internal Revenue Code.

(iii) Actual calculation method in year of foreign trust termination after using the

default calculation method. A U.S. person who has previously used the default calculation method with respect to distributions from a foreign trust may, in the year in which the foreign trust terminates, determine the tax consequences of a distribution from the same trust by using the actual calculation method provided that the trust provides to the U.S. person accurate information on the applicable statement described in §1.6048-4(c)). The U.S. person must recalculate the tax effect of previous distributions from such foreign trust under the actual calculation method in order to determine the portion attributable to current income, accumulated income, and principal in the year that the foreign trust terminates.

(iv) Example. The following example illustrates the rules of paragraph (d)(3)(i) of this section. B, a U.S. person, is a beneficiary of a foreign nongrantor trust, FT, that was established in 2013. In 2014, 2015, and 2016, B received distributions from FT of $100X, $200X, and $300X respectively. In 2017, B receives a $400X distribution from FT. To determine the tax consequences of the 2017 distribution, B applies the default calculation method. Under the default calculation method, the average distribution that B received from FT during the preceding three years is $200X and 125% of such average distribution is $250X. Therefore, $250X of the 2017 distribution is treated as a distribution of current income and the remaining $150X is treated as an accumulation distribution. The $150X that is treated as an accumulation distribution is subject to an interest charge under section 668. B must report the distribution and the default calculation on Part III of Form 3520 for 2017.

(e) Authorization of a U.S. agent and failure to respond to summons. The trustee of a foreign trust may authorize a U.S. person to act as the trust's limited agent under

rules prescribed in §1.6048-3(e). If a U.S. person who receives a distribution from the foreign trust (within the meaning of paragraph (b) of this section) other than a loan or use of trust property that is not treated as a section 643(i) distribution under §1.643(i)-1 does not receive a Foreign Grantor Trust Beneficiary Statement, Foreign-Owned Grantor Trust Beneficiary Statement, or Foreign Nongrantor Trust Beneficiary Statement from the foreign trust, and if the trustee does not authorize a U.S. agent and if a U.S. person to whom a summons is issued fails to respond to the summons, then the U.S. person must determine the tax consequences of the distribution under the default calculation method described in paragraph (d)(3) of this section.

(f) Interaction with §1.6039F-1. If a U.S. person receives a distribution from a foreign trust, the U.S. person must report the distribution under paragraph (a) of this section and not under §1.6039F-1(a), regardless of whether the distribution is taxable to the U.S. person receiving the distribution. See §1.6039F-1(b).

(g) Examples. The following examples illustrate the rules of this section. In each example, X is a U.S. citizen and FT is a foreign trust.

(1) Example 1: Payment of debt treated as distribution. X owes $1,000X to Y for services that Y performed for X. In satisfaction of X's liability to Y, FT transfers to Y property with a fair market value of $1,000x. Under paragraph (b)(1) of this section, FT's transfer of property to Y is constructively received by X from FT, and is a distribution in the amount of $1,000x to X for purposes of this section. Under paragraph (a) of this section, X must report the distribution on Part III of Form 3520.

(2) Example 2: Assumption of liability treated as distribution. The facts are the same as in paragraph (g)(1) of this section (Example 1) except that FT assumes X's

liability to pay Y. The result is the same as in paragraph (g)(1) of this section (Example 1).

(3) Example 3: Trust guarantee of U.S. person's obligation treated as distribution from foreign trust. Y lends $1,000x of cash to X in exchange for X's obligation to repay the loan. FT guarantees the repayment of $600x of X's obligation. Under paragraph (b)(3)(i)(A) of this section, FT's guarantee of X's obligation is a distribution from FT to X in the amount of $600x. Under paragraph (a) of this section, X must report the distribution on Part III of Form 3520.

(4) Example 4: Section 643(i) loan not in exchange for qualified obligation. X's sister, A, and A's husband, B, are both U.S. citizens. X, A, and B are U.S. persons within the meaning of §1.643(i)-1(d)(7), and X is related to B under §1.643(i)-1(d)(4). B is a beneficiary of FT, a nongrantor trust. In 2017, FT lends $100x to X in exchange for a demand note that permits FT to require repayment by X at any time. The demand note issued by X is not a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii) because X's obligation to FT could remain outstanding for more than five years. Accordingly, the loan from FT to X is treated as a section 643(i) distribution of $100x to B under §1.643(i)-1(a). The loan is a distribution from FT to X and B under paragraph (b)(3)(ii) of this section. Under paragraphs (a) and (b)(3)(iii) of this section, X and B must each report the distribution on Part III of Form 3520.

(5) Example 5: Section 643(i) loan in exchange for qualified obligation. The facts are the same as in paragraph (g)(4) of this section (Example 4) except that the loan cannot remain outstanding for more than five years and it is a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii). Although the loan is not a section 643(i)

distribution within the meaning of §1.643(i)-1(a), the loan is nevertheless a distribution from FT to X and B under paragraph (b)(3)(ii) of this section. Under paragraphs (a) and (b)(3)(iii) of this section, X and B must each report the distribution on Part III of Form 3520.

(6) Example 6: Distribution through intermediary. X's grandfather, Y, a nonresident alien, created FT in 1980 for the benefit of his children and their descendants. FT's trustee, T, determines that $100x of accumulated income should be distributed to X. Pursuant to a plan with a principal purpose of avoiding the interest charge that would be imposed on an accumulation distribution from a foreign trust by section 668, T causes FT to make a gratuitous transfer of $100x to N, a foreign person. N subsequently makes a gratuitous transfer of $100x to X. Under §1.643(h)-1(a)(1), FT is deemed to have made an accumulation distribution of $100x to X. The distribution through N as the intermediary is treated as a distribution under paragraph (b)(2)(i) of this section. Under paragraphs (a) and (b)(2)(iv) of this section, X must report the distribution on Part III of Form 3520.

(7) Example 7: Excess payment in exchange for property. X transfers to FT property with a fair market value of $200x in exchange for a payment of $500x. Under paragraph (b)(1) of this section, the excess amount of $300x is treated as a distribution from FT to X. Under paragraph (a) of this section, X must report the distribution of $300x on Part III of Form 3520.

(8) Example 8: Excess payment in exchange for services. X receives a payment of $100x from FT purportedly in exchange for X's performance of services as a trustee of FT. The fair market value of the services performed is $20x. Under paragraph (b)(1)

of this section, X is treated as receiving a distribution of $80x from FT. Under paragraph (a) of this section, X must report the distribution of $80X on Part III of Form 3520.

(9) Example 9: Distribution received by U.S. owner. X is treated as the owner of FT under section 679. X receives a distribution from FT. Under paragraph (a) of this section, X is required to report the distribution on Part III of Form 3520.

(10) Example 10: Distribution from trust owned by another person. X receives a distribution from FT. Y, a nonresident alien, is treated as the owner of FT under the grantor trust rules. X receives a completed Foreign-Owned Grantor Trust Beneficiary Statement. Under paragraph (a) of this section and §1.6048-6(b), X is required to file Form 3520 for the year of the distribution.

(11) Example 11: Inclusion in income where records not provided. The facts are the same as in paragraph (g)(10) (Example 10) except that X does not receive a Foreign-Owned Grantor Trust Beneficiary Statement from FT. After failing to respond to a summons for information, X does not provide adequate records to the IRS to determine the proper treatment of the distribution. Because of X's failure to respond to the request for information, pursuant to §1.6048-4(e), X must determine the tax consequences of the distribution using the default calculation method. Under the default calculation method, X must include the distribution in gross income as an accumulation distribution in accordance with rules prescribed in paragraph (d)(3) of this section and in the Instructions for Form 3520 for the applicable taxable year.

(12) Example 12: Distribution attributable to covered gift. Z relinquishes his U.S. citizenship on September 15, 2008. Z is a covered expatriate within the meaning of

section 877A(g)(1). On August 1, 2016, Z creates and transfers $300x to a foreign trust, FT, for the benefit of his son, S, a U.S. citizen. On December 30, 2017, S receives a $40x distribution from FT. Assume that the entire amount of the distribution is a covered gift within the meaning of section 2801(e). Under paragraph (b)(5) of this section, the covered gift is a distribution. Under paragraph (a) of this section, S must report the distribution on Part III of Form 3520. S may have additional reporting requirements for the covered gift.

§1.6048-5 Exceptions.

(a) Exceptions under section 6048(a)(3)(B). For purposes of §1.6048-2, a reportable event does not include any of the following:

(1) Any transfer of property to a foreign trust to the extent the transfer is a transfer for fair market value within the meaning of §1.679-4(b) other than a transfer by a U.S. transferor that is a related person (as defined in §1.679-1(c)(5)) with respect to the foreign trust in exchange for any obligation of the trust or a related person (without regard to whether such obligation is a qualified obligation described in §1.679-4(d));

(2) Any transfer of property to a foreign trust described in section 402(b), 404(a)(4), or 404A; and

(3) Any transfer of property to a foreign trust described in section 501(c)(3) provided that the trust has received a determination letter from the Service that has not been revoked recognizing the foreign trust's exemption from federal income tax under section 501(a) as an organization described in section 501(c)(3).

(b) Exceptions for certain tax-favored foreign trusts—(1) In general. Sections 6048(a) through 6048(c) and §§1.6048-2 through -4 do not apply to any eligible

individual's transactions with, or ownership of, a tax-favored foreign retirement trust as defined under paragraph (b)(2) of this section or a tax-favored foreign non-retirement savings trust as defined under paragraph (b)(3) of this section. For purposes of this §1.6048-5(b), an eligible individual means an individual who is, or at any time was, a U.S. citizen or resident (within the meaning of section 7701(a)(30)(A)) and who, for any period during which an amount of tax may be assessed under section 6501 (without regard to section 6501(c)(8)), is compliant (or comes into compliance) with all requirements for filing a U.S. federal income tax return (or returns) covering the period such individual was a U.S. citizen or resident, and to the extent required under U.S. tax law, has reported as income any contributions to, earnings of, or distributions from, an applicable tax-favored foreign trust on the applicable return (including on an amended return).

(2) Tax-favored foreign retirement trust. For purposes of this section, a tax-favored foreign retirement trust means a foreign trust for U.S. tax purposes that is created, organized, or otherwise established under the laws of a foreign jurisdiction (the trust's jurisdiction) as a trust, plan, fund, scheme, or other arrangement (collectively, a trust) to operate exclusively or almost exclusively to provide, or to earn income for the provision of, pension or retirement benefits and ancillary or incidental benefits, and that meets the following requirements established by the laws of the trust's jurisdiction:

(i) The trust is generally exempt from income tax or is otherwise tax-favored under the laws of the trust's jurisdiction. For purposes of this section, a trust is tax-favored under the laws of the trust's jurisdiction if it meets any one or more of the following conditions:

(A) Contributions to the trust that would otherwise be subject to tax are deductible or excluded from income, are taxed at a reduced rate, give rise to a tax credit, or are otherwise eligible for another tax benefit (such as a government subsidy or contribution); and

(B) Taxation of investment income earned by the trust is deferred until distribution or the investment income is taxed at a reduced rate.

(ii) Annual information reporting with respect to the trust (or of its participants or beneficiaries) is provided, or is otherwise available, to the relevant tax authorities in the trust's jurisdiction.

(iii) Only contributions with respect to income earned from the performance of personal services are permitted.

(iv) Contributions to the trust are limited by a percentage of earned income of the participant, are subject to an annual limit of $50,000 or less to the trust, or are subject to a lifetime limit of $1,000,000 or less to the trust. These contribution limits are determined using the U.S. Treasury Bureau of Fiscal Service foreign currency conversion rate on the last day of the tax year (available at https://www.fiscal.treasury.gov/reports-statements/treasury-reporting-rates-exchange).

(v) Withdrawals, distributions, or payments from the trust are conditioned upon reaching a specified retirement age, disability, or death, or penalties apply to withdrawals, distributions, or payments made before such conditions are met. A trust that otherwise meets the requirements of this paragraph (b)(1)(v), but that allows withdrawals, distributions, or payments for in-service loans or for reasons such as

hardship, educational purposes, or the purchase of a primary residence, will be treated as meeting the requirements of this paragraph.

(vi) In the case of an employer-maintained trust:

(A) The trust is nondiscriminatory insofar as a wide range of employees, including rank and file employees, must be eligible to make or receive contributions or accrue benefits under the terms of the trust (alone or in combination with other comparable plans);

(B) The trust (alone or in combination with other comparable plans) actually provides significant benefits for a substantial majority of eligible employees; and

(C) The benefits actually provided under the trust to eligible employees are nondiscriminatory.

(3) Tax-favored foreign non-retirement savings trust. For purposes of this section, a tax-favored foreign non-retirement savings trust means a foreign trust for U.S. tax purposes that is created, organized, or otherwise established under the laws of a foreign jurisdiction (the trust's jurisdiction) as a trust, plan, fund, scheme, or other arrangement (collectively, a trust) to operate exclusively or almost exclusively to provide, or to earn income for the provision of, medical, disability, or educational benefits, and that meets the following requirements established by the laws of the trust's jurisdiction:

(i) The trust is generally exempt from income tax or is otherwise tax-favored under the laws of the trust's jurisdiction as defined in paragraph (b)(1)(i) of this section.

(ii) Annual information reporting with respect to the trust (or of its participants or beneficiaries) is provided, or is otherwise available, to the relevant tax authorities in the trust's jurisdiction.

(iii) Contributions to the trust are limited to $10,000 or less annually or $200,000 or less on a lifetime basis, determined using the U.S. Treasury Bureau of Fiscal Service foreign currency conversion rate on the last day of the tax year (available at https://www.fiscal.treasury.gov/reports-statements/treasury-reporting-rates-exchange).

(iv) Withdrawals, distributions, or payments from the trust are conditioned upon the provision of medical, disability, or educational benefits, or apply penalties to withdrawals, distributions, or payments made before such conditions are met.

(4) Certain rollovers and transfers. A trust that otherwise meets the requirements of paragraphs (b)(2) or (b)(3) of this section will not fail to be treated as a tax-favored foreign retirement or non-retirement savings trust within the meaning of this paragraph (b) solely because it may receive a rollover of assets or funds transferred from another tax-favored foreign retirement or non-retirement savings trust established and operated under the laws of the same jurisdiction, provided that the trust transferring assets or funds also meets the requirements of this paragraph (b)(2) or (b)(3), as applicable (this paragraph does not apply to transfers between tax-favored retirement trusts and non-retirement savings trusts).

(c) Exception for distributions from certain foreign compensatory trusts. Section 6048(c) and §1.6048-4 do not apply to a distribution received by a U.S. person from a foreign trust described §1.672(f)-3(c)(1) provided that the U.S. person includes in income any amounts accumulated on behalf of, or distributed by the trust, to the U.S.

person to the extent such amounts are required to be included in gross income (other than amounts that are exempt from federal income tax under a bilateral income tax treaty or any other bilateral agreement to which the United States is a party) of the U.S. person, including pursuant to section 409A(b).

(d) Exception for certain distributions received by domestic section 501(c)(3) organizations. Section 6048(c) does not apply to a distribution from a foreign trust received by a domestic organization described in section 501(c)(3) provided that the organization has received a determination letter from the IRS that has not been revoked recognizing the domestic organization's exemption from federal income tax under section 501(a) as an organization described in section 501(c)(3).

(e) Exception for certain mirror code possession trusts. Sections 6048(a) through 6048(c) do not apply to a trust located in a mirror code possession to the extent the responsible party (within the meaning of section 6048(a)(4)), U.S. owner, or U.S. recipient is a bona fide resident (within the meaning of §1.937-1(b)) of such mirror code possession. For purposes of this paragraph (b)(4), a mirror code possession is a possession that administers income tax laws that are identical (except for the substitution of the name of the possession for the term "United States" where appropriate) to those in force in the United States, and a trust is located in a mirror code possession if a court within the mirror code possession is able to exercise primary supervision over the administration of the trust and one or more bona fide residents of the mirror code possession have the authority to control all substantial decisions of the trust.

(f) Exceptions pursuant to subsequent guidance. Sections 6048(a) through

6048(c) will not apply to any additional category of foreign trust that the IRS may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

§1.6048-6 Special rules

(a) Special rules—(1) Dual resident taxpayers. If a dual resident taxpayer (within the meaning of §301.7701(b)-7(a)(1) of this chapter) computes U.S. income tax liability as a nonresident alien on the last day of the taxable year and complies with the filing requirements of §301.7701(b)-7(b) and (c) of this chapter, such individual will not be treated as a U.S. person for purposes of §§1.6048-2 through 1.6048-4 with respect to the portion of the taxable year covered by Form 1040NR (or Form 1040NR–EZ).

(2) Dual status taxpayers. If a taxpayer abandons his U.S. citizenship or residence during the tax year or acquires U.S. citizenship or residence during the taxable year as provided in §1.6012-1(b)(2)(ii), such individual will not be treated as a U.S. person for purposes of §§1.6048-2 through 1.6048-4 for the part of the year when the individual is treated as a nonresident alien for computing the individual's income tax liability, as reflected on the Form 1040NR or other similar schedule attached to such Form 1040.

(b) Effect of ownership by another person. For purposes of this section and §§1.6048-2 through 1.6048-4, in determining whether a U.S. person makes a transfer to, or receives a distribution from, a foreign trust, the fact that a portion of such trust is treated as owned by another person under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code is disregarded. See §1.6048-4(g)(10).

(c) [Reserved]

(d) Married individuals filing a joint annual income tax return. Married individuals who file a joint annual income tax return under section 6013 and who are both transferors, grantors, or owners of the same foreign trust, or who are both beneficiaries of the same foreign trust, may file one Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, at the time and in the manner described in §1.6048-2 through §1.6048-6. See § 1.6677-1(f) with respect to liability for penalties.

§1.6048-7 Applicability dates

(a) In general. The rules of §§1.6048-0 through 1.6048-4 and §1.6048-6 apply as follows:

(1) Section 1.6048-0 and §1.6048-1 apply after the date of final regulations in the **Federal Register**.

(2) To the extent related to §1.6048-2, including the relevant portions of §1.6048-6, the rules apply to reportable events occurring after the date of publication of the final regulations in the **Federal Register**.

(3) To the extent related to §1.6048-3, including the relevant portions of §1.6048-6, the rules apply to taxable years of U.S. persons beginning after the date of publication of the final regulations in the **Federal Register**.

(4) To the extent related to §1.6048-4, including the relevant portions of §1.6048-6, the rules apply to distributions received after the date of publication of the final regulations in the **Federal Register**

(b) Special rule for §1.6048-5. Section 1.6048-5 applies as follows--

(1) To the extent related to reportable events under section 6048(a) and the

regulations under section 6048 as contained in 26 CFR part 1, the rules apply to reportable events occurring after the date that final regulations are published in the **Federal Register**.

(2) To the extent related to ownership of a foreign trust under section 6048(b) and the regulations under section 6048 as contained in 26 CFR part 1, the rules apply to taxable years of U.S. owners beginning the date that final regulations are published in the **Federal Register**; and

(3) To the extent related to distributions from a foreign trust under section 6048(c) and the regulations under section 6048 as contained in 26 CFR part 1, the rules apply to distributions received after the date that final regulations are published in the **Federal Register**.

Par. 10. Section 1.6677-1 is added to read as follows:

§1.6677-1 Failure to file information with respect to certain foreign trusts

(a) Civil penalty—(1) In general. In addition to any criminal penalty provided by law, and subject to the rules of paragraph (b) of this section (concerning reporting required under §1.6048-3), if any notice or return required to be filed by §§1.6048-2 through 1.6048-4 is not timely filed, or contains incomplete or incorrect information, then with respect to each such failure, the person required to file such notice or return must pay a penalty equal to the greater of $10,000 or 35 percent of the gross reportable amount (within the meaning of paragraph (c) of this section), subject to the limits imposed under paragraph (a)(3) of this section. If an amount that is less than the full gross reportable amount is reported, the penalty equals the greater of $10,000 or 35 percent of the amount that is unreported, subject to the limits imposed under paragraph

(a)(3) of this section.

(2) Penalty for continuing failure. If any failure described in paragraph (a)(1) of this section continues for more than 90 days after the day on which the IRS mails notice of such failure to the person required to pay such penalty, such person must pay an additional penalty (in addition to the amount determined under paragraph (a)(1) of this section) of $10,000 for each 30-day period (or fraction thereof) during which such failure continues after the expiration of such 90-day period.

(3) Maximum penalty—(i) Limited to gross reportable amount. In no event will the aggregate amount of the penalty imposed under paragraphs (a)(1) and (2) of this section with respect to any one failure exceed the gross reportable amount with respect to that failure. At such time as the gross reportable amount with respect to any failure can be determined by the IRS, any subsequent penalty imposed under paragraphs (a)(1) and (2) of this section will be reduced as necessary to ensure that the aggregate amount of the penalties imposed under paragraphs (a)(1) and (2) of this section does not exceed the gross reportable amount with respect to that failure (and to the extent that such aggregate amount already collected exceeds the gross reportable amount, the IRS will refund the excess amount pursuant to section 6402).

(ii) Period of limitations on refund of excess amounts. The limitations provided for claims for refund under section 6511(a) and (b) apply to the refund of any excess amount.

(b) Special rules for returns under §1.6048-3. In the case of a Form 3520-A (including a substitute Form 3520-A) that is required to be filed under §1.6048-3(a)—

(1) The U.S. person who is treated as the owner of the foreign trust (or a portion

of the foreign trust) will be liable for the penalty imposed by paragraph (a) of this section for failure to comply with §1.6048-3(a), and

(2) Paragraph (a) of this section will be applied by substituting “5 percent” for “35 percent.”

(c) Gross reportable amount—(1) In general. For purposes of paragraph (a) of this section, the term gross reportable amount means—

(i) The gross value of the property involved in the reportable event (determined as of the date of the event) in the case of a failure relating to §1.6048-2,

(ii) The gross value of the portion of the trust’s assets at the close of the trust’s taxable year treated as owned by the U.S. person in the case of each applicable failure relating to §1.6048-3, and

(iii) The gross amount of the distribution in the case of a failure relating to §1.6048-4.

(2) Gross value and gross amount. The gross value or gross amount of property is determined in accordance with the valuation principles of sections 2512 and 2031 and the regulations under sections 2512 and 2031 as contained in 26 CFR part 1, though, in all events, without regard to any taxes, expenses, liabilities, or restrictions on the sale or use of the property.

(d) Reasonable cause exception—(1) In general. Paragraph (a) of this section will not apply to any failure to file information with respect to a foreign trust if the person required to file such information demonstrates to the satisfaction of the IRS that the failure is due to reasonable cause and not due to willful neglect. The determination of whether a taxpayer acted with reasonable cause and not with willful neglect is made

under the principles set out in §1.6664-4 and §301.6651-1(c) of this chapter. This determination is made on a case-by-case basis, taking into account all pertinent facts and circumstances.

(2) Examples of situations that do not satisfy the reasonable cause exception. Examples of facts that do not constitute reasonable cause for purposes of this paragraph (d) include but are not limited to the following:

(i) The fact that a foreign jurisdiction would impose a civil or criminal penalty on such person (or any other person) for disclosing the required information.

(ii) Refusal on the part of a foreign trustee to provide information for any reason, including difficulty in producing the required information or the existence of provisions in the trust instrument that prevent the disclosure of required information.

(e) Deficiency procedures not to apply. Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) will not apply in respect of the assessment or collection of any penalty imposed under this section.

(f) Married individuals filing a joint annual income tax return. Married U.S. individuals who file a joint annual income tax return under section 6013 are treated, for purposes of this section, as if they are a single person. Married individuals who file a joint annual income tax return under section 6013 will not be treated as a single person for purposes of this section if one of the married individuals can prove to the satisfaction of the IRS that they did not have an interest in the underlying property giving rise to a reporting requirement under sections 6048(a) through (c) and §1.6048-2 through §1.6048-4. The liability of married individuals who file a joint annual income tax return and who are both transferors, grantors, or owners of the same foreign trust, or who both

receive a distribution from the same foreign trust, with respect to any penalties under this section is joint and several.

(g) Examples. The following examples illustrate the rules of this section. In each example, X is a U.S. person and FT is a foreign trust.

(1) Example 1: Partial reporting. X transfers property worth $1,000x to FT but reports only $400x of that amount on Part I of Form 3520 pursuant to §1.6048-2. X does not demonstrate to the satisfaction of the IRS that X's failure to report the correct amount was due to reasonable cause and not due to willful neglect. Under paragraph (a)(1) of this section, penalties will be imposed only on the unreported $600x.

(2) Example 2: Maximum penalty limited to gross reportable amount. X receives a distribution of $100,000 from FT in 2011 but fails to report the distribution as required by §1.6048-4(a). The IRS learns about the distribution but does not have enough information to determine the gross reportable amount. On January 2, 2017, the IRS mails notice of the failure to X and assesses a penalty of $10,000 under paragraph (a)(1) of this section. X does not comply with his reporting requirement within 90 days after the day that the IRS mailed the notice (by April 2, 2017), so the IRS begins to assess additional penalties of $10,000 under paragraph (a)(2) of this section for each 30-day period (or fraction thereof) during which the failure continues. By the time X complies with his reporting requirement, the aggregate penalties assessed with respect to his failure to report the distribution total $150,000. Under paragraph (a)(3)(i) of this section, the maximum penalty that the IRS may collect with respect to this failure is $100,000 (the applicable gross reportable amount determined under paragraph (c)(1)(iii) of this section).

(3) Example 3: Multiple failures over multiple years. X created FT in 2013 and is treated as the owner of FT under the grantor trust rules. The trustee of FT fails to file a Form 3520-A with respect to FT for 2015 through 2017 as required by §1.6048-3(b), and X fails to file a substitute Form 3520-A (as required by §1.6048-3(b)) and a Form 3520 (as required by §1.6048-3(a)) for the same time period. (In 2018, X replaces the trustee and the new trustee files a Form 3520-A for 2018.) Under paragraphs (a)(1) and (b) of this section, X is subject to a penalty for failure to comply with §1.6048-3(a) and another penalty for failure to comply with §1.6048-3(b) for 2015, 2016, and 2017.

(4) Example 4: Distribution from foreign-owned grantor trust through an intermediary. Y, a nonresident alien, is treated as the owner of FT under section 676, after the application of section 672(f). X receives a distribution from FT through an intermediary as described in §1.6048-4(b)(2)(i). X does not include the distribution in gross income and does not report the distribution on Part III of Form 3520 as required by §1.6048-4(a). Even if the IRS agrees that X was not required to include the distribution in gross income, X is liable for penalties imposed by paragraph (a)(1) of this section based on the gross reportable amount determined under paragraph (c)(1)(iii) of this section as a result of the application of §1.6048-4(b)(2)(iv).

(5) Example 5: Multiple failures in multiple years. (i) Facts. On December 31, 2015, X creates FT and makes a gratuitous transfer of property with a value of $100,000 to FT. X is treated as the sole owner of FT under the grantor trust rules. During 2016, X makes no transfers to FT and receives no distributions from FT. At the end of 2016, the value of FT's assets is $110,000. During 2017, X makes no transfers to FT, but X receives a distribution of $30,000. At the end of 2017, the value

of FT's assets is $85,000. X does not file any Forms 3520 or substitute Forms 3520-A for 2015, 2016, or 2017. The Trustee of FT does not file any Forms 3520-A for 2015, 2016, or 2017.

(ii) Analysis–(A) 2015. For 2015, X is subject to two penalties under paragraphs (a)(1) and (b) of this section: a $35,000 penalty (the greater of $10,000 or $35,000 (35% of $100,000)) for failure to comply with §1.6048-2(a) and a $10,000 penalty (the greater of $10,000 or $5,000 (5% of $100,000)) for failure to comply with §1.6048-3(a). If X does not comply with his reporting requirements for 2015 within 90 days after the day on which the IRS mails notice of his failures to X, X will be subject to additional penalties under paragraph (a)(2) of this section of $10,000 per failure per 30-day period (or fraction thereof) ($20,000 in the aggregate per 30-day period (or fraction thereof)) during which the failure continues. Under paragraph (a)(3)(i) of this section, the aggregate amount of the penalty imposed under paragraphs (a)(1) and (2) of this section with respect to each failure shall not exceed the gross reportable amount for that failure.

(B) 2016. For 2016, X is subject to one penalty under paragraphs (a)(1) and (b) of this section: a $10,000 penalty (the greater of $10,000 or $5,500 (5% of $110,000)) for failure to comply with §1.6048-3(a). If X does not comply with his reporting requirements for 2016 within 90 days after the day on which the IRS mails notice of his failures to X, X will be subject to additional penalties under paragraph (a)(2) of this section of $10,000 per failure per 30-day period (or fraction thereof) ($10,000 per 30-day period (or fraction thereof)) during which the failure continues. Under paragraph (a)(3)(i) of this section, the aggregate amount of the penalty imposed under paragraphs

(a)(1) and (2) of this section with respect to each failure shall not exceed the gross reportable amount for that failure.

(C) 2017. For 2017, X is subject to two penalties under paragraphs (a)(1) and (b) of this section: a $10,000 penalty (the greater of $10,000 or 4,250 (5% of $85,000)) for failure to comply with §1.6048-3(a), and a penalty of $10,500 (the greater of $10,000 or $10,500 (35% of $30,000)) for failure to comply with §1.6048-4. If X does not comply with his reporting requirements for 2017 within 90 days after the day on which the IRS mails notice of his failures to X, X will be subject to additional penalties under paragraph (a)(2) of this section of $10,000 per failure per 30-day period (or fraction thereof) ($20,000 in the aggregate per 30-day period (or fraction thereof)) during which the failure continues. Under paragraph (a)(3)(i) of this section, the aggregate amount of the penalty imposed under paragraphs (a)(1) and (2) of this section with respect to each failure shall not exceed the gross reportable amount for that failure.

(iii) Conclusion. X is subject to aggregate penalties of $75,500 under paragraphs (a)(1) and (b) of this section: $45,000 for 2015, $10,000 for 2016, and $20,500 for 2017. X may be subject to additional penalties under paragraph (a)(2) of this section if he fails to comply with his reporting requirements within 90 days after the day on which the IRS mails notice of each failure to X. Under paragraph (a)(3)(i) of this section, the aggregate amount of the penalty imposed under paragraphs (a)(1) and (2) of this section with respect to each failure shall not exceed the gross reportable amount for that failure.

(6) Example 6: Interaction with §1.6039F-1. In 2015, X receives $500,000 from FT that X treats as a gift. Under §1.6048-4(d) and §1.6039F-1(b), X is required to report

the amount as a distribution under §1.6048-4 and not as a foreign gift under §1.6039F-1(a). However, based on the advice of her tax advisor, X reports the distribution under §1.6039F-1(a) and not under §1.6048-4. X's failure to report the distribution under §1.6048-4 is subject to penalties under §1.6677-1(a) unless X demonstrates to the satisfaction of the IRS that such failure is due to reasonable cause and not due to willful neglect. The fact that X reported the distribution under §1.6039F-1(a) based on the advice of her tax advisor is a factor that may be taken into account in determining whether X's failure to report the distribution under §1.6048-4 was due to reasonable cause. X's reliance on her tax advisor's advice can only constitute reasonable cause, however, if, under all the circumstances, the reliance was reasonable within the meaning of §1.6664-4(c).

(7) Example 7: Presumption that FT has a U.S. owner. X created FT in 2012 and transferred $100,000 to FT. X reported the transfer to FT on Part I of Form 3520 for 2012, but did not complete the other parts of the Form 3520. X did not file any Forms 3520 with respect to FT in 2013 or subsequent years. FT has not filed any Forms 3520-A with respect to FT (and X has not filed any substitute Forms 3520-A). Pursuant to §1.679-2(d)(2), the IRS sends a written notice to X requesting additional information related to the trust and its potential beneficiaries. X does not respond. Under §1.679-2(d)(1), FT is treated as having a U.S. beneficiary. Under §1.679-1(a), X is treated as the owner of FT. Under paragraphs (a) and (b) of this section, X is subject to penalties for 2012 and subsequent years for failure to comply with §1.6048-3(a). X also is subject to penalties for 2012 and subsequent years for failure to comply with §1.6048-3(b).

(8) Example 8: Penalty for failure to report loan that is not treated as a section

643(i) distribution. FT is not treated as being owned by X or any other person under the grantor trust rules. X receives a loan of cash from FT and in exchange issues an obligation to FT that is a qualified obligation within the meaning of §1.643(i)-2(b)(2)(iii). Provided the obligation does not cease to be a qualified obligation, the loan will not be a section 643(i) distribution under §1.643(i)-1(a) and therefore will not be taxable to X. However, the loan is a distribution within the meaning of §1.6048-4(b)(3) that must be reported on Part III of Form 3520 under §1.6048-4(a). X fails to report the loan. X is subject to penalties under §1.6677-1(a) unless X demonstrates to the satisfaction of the IRS that such failure is due to reasonable cause and not due to willful neglect.

(9) Example 9: Joint and several penalties. X and Y, are married U.S. persons who file a joint income tax return under section 6013. In 2017, X and Y create FT and fund the trust with $100,000 for the benefit of their U.S. children. X and Y jointly file their income tax return for the 2017 tax year, but fail to file a Form 3520 reporting the transfer of assets to a foreign trust pursuant to section 6048(a) as well as their ownership of a foreign trust pursuant to section 6048(b). For the 2017 tax year, X and Y are jointly and severally liable for penalties under §1.6677-1(a) pursuant to §1.6677-1(f).

(h) Applicability dates—(1) Reportable events. To the extent related to §1.6048-2, this section applies to reportable events occurring after the date of publication of the final regulations in the **Federal Register**.

(2) Grantor trust reporting. To the extent related to §1.6048-3, this section applies to taxable years of U.S. persons beginning after the date of publication of the final regulations in the **Federal Register**.

(3) Reporting by U.S. beneficiaries. To the extent related to §1.6048-4, this section applies to distributions received after the date of publication of the final regulations in the **Federal Register**.

Deputy Commissioner for Services and Enforcement.