AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
ORAL STATEMENT
PRESENTED TO
Internal Revenue Service
PUBLIC HEARING:
Proposed Regulations Regarding Transactions With Foreign Trusts and Information Reporting on Transactions With Foreign Trusts and Large Foreign Gifts Proposed Regulations (REG-124850-08, Docket IRS-2024-0022, RIN 1545-B104)
August 21, 2024

INTRODUCTION

Good morning. I am Henry Alden a CPA and the Managing Member of Everest International Group LLC. I am the current Chair of the American Institute of CPAs (AICPA) Form 3520 Penalties Task Force. I am joined by Karen Brodsky, a tax partner at Deloitte Tax LLP and a current member and the immediate past Chair of the Task Force. Our testimony today is on behalf of the AICPA, the world's largest member association representing the CPA profession, with more than 400,000 members in the United States and worldwide.

Because of the extreme importance of the proposed regulations regarding transactions with foreign trusts and information reporting on transactions with foreign trusts and large foreign gifts, the AICPA submitted detailed comments to the Internal Revenue Service (IRS or "the Service") on July 5, 2024. In our comments today, we will focus only on several key areas.

As an initial comment, we appreciate the enormous amount of time that the Service has dedicated to drafting the proposed regulations that we are discussing today. We all recognize the need for additional guidance and clarity in this area, and we at the AICPA fully support the Service's efforts.

One of the primary objectives of the AICPA Form 3520 Penalties Task Force is to limit the number of individuals that we will refer to as "rank and file" taxpayers from being subject to the complex and costly information reporting requirements under sections 6048 and 6039F. Another key focus for the AICPA is avoiding traps for the unwary. Unfortunately, the penalties that are imposed for noncompliance with foreign trust and gift reporting are among the highest in the Code. In cases where taxpayers cannot obtain full relief from penalties, the results can be financially ruinous, especially considering that in the case of foreign pensions, these funds often cannot be reached by the taxpayer in order to satisfy their U.S. tax liability.

1. NON-U.S. PENSIONS

The first topic that we would like to address is the reporting required for non-U.S. pensions. Perhaps no aspect of the proposed regulations affects more U.S. individuals than those involving pension arrangements outside the U.S.

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The need for broad relief from the burdens and perils of information reporting under section 6048 for foreign pension trusts clearly is recognized and accepted by the Service as evidenced by the exception for participation in a Canadian Registered Retirement Savings Plan, or "RRSP." While Revenue Procedure 2020-17 and the proposed regulations offer expanded reporting exceptions, we believe the relief needs to be expanded even further.

Provide an exception for certain treaty eligible pension plans.

We recommend that the reporting exception for "tax-favored foreign retirement trusts" be expanded to include as a separate category pension plans that are located in certain treaty countries. We believe that where a tax treaty provides for a tax exemption or tax deferral for a particular item, a similar reporting exemption should be allowed under section 6048. Before these types of provisions are included in a tax treaty, the U.S. Treasury becomes fully familiar with the various forms of pension arrangements in the other jurisdiction and agrees to the relief included in the treaty.

Eliminate the required link for contributions to earned income.

Next, I want to address our recommendation that the Service eliminate the requirement in -5(b)(2)(iii) that a foreign retirement plan may only permit contributions to be made with respect to earned income. This requirement severely limits the number of plans that will qualify for the exception to reporting under section 6048, and it would fall harshly on numerous rank-and-file participants.

Many foreign plans permit modest additional contributions to be made to a plan by a participant. Provisions such as this are not oriented towards highly-paid employees, but are usually motivated by an effort to encourage rank-and-file employees to set aside additional amounts towards their retirement. As an example, the U.S. allows tax-favored contributions to be made to an Individual Retirement Account by a non-working spouse who has no earned income.

We believe that any concerns that the Service may have about removing the earned income requirement should be alleviated when the limiting effects on funding and benefits provided in -5(b)(2)(iv) are considered.

Restrict application of the requirements in -5(b)(2).

We also wish to address a significant exposure — a trap for the unwary — posed by the list of requirements in the -5(b)(2) regulations that a foreign pension plan must satisfy under the laws established in the jurisdiction governing the trust. As presently drafted, those requirements must all be satisfied in every year that the individual participates in the plan, requiring a participant to monitor changes in the governing law. We recommend that this rule not be applied in years where there are no contributions to the plan by or for a particular participant.

2. REPORTING BY U.S. PERSONS RECEIVING GIFTS OR BEQUESTS FROM NON-U.S. PERSONS

A. The current $100,000 filing threshold for reporting such gifts was established with Notice 97-34 (in 1997). We urge the Service to increase the threshold to at least $1,000,000 and to index it for inflation.

B. We request an exception to Form 3520 reporting of gifts and bequests between spouses, especially where the recipient spouse is a U.S. citizen.

C. We suggest that final guidance regarding reporting requirements for gifts and bequests from covered expatriates on Form 3520 be paused, pending the issuance of final regulations under section 2801, which we understand are scheduled for release later this year.

D. Our final point on this topic is to encourage the creation of a new stand-alone form for reporting gifts and bequests from non-U.S. persons, to replace the current reporting requirements on Part IV of Form 3520; since Form 3520 is otherwise used to report transactions with foreign trusts, the requirement to report gifts on the same form creates confusion and may lead to missed filings.

3. PENALTY ADMINISTRATION

Our written comments include requests to incorporate into the regulations, or into administrative procedures elsewhere, specific rules for addressing taxpayers who believe that they have reasonable cause to avoid the imposition of penalties. Our requests include:

- Instituting a required review of the facts prior to the assessment of penalties, and
- Adoption of a First Time Abatement or waiver.

We believe that our suggestions, if adopted, will substantially reduce the time and often considerable expense that taxpayers must incur in order to seek a waiver of penalties, as well as a reduction of the time that IRS personnel need to devote to specific cases where abatements are requested for penalties that are imposed prior to a review of the facts.

We also recommend alignment between various due dates to alleviate the problem of missed filing deadlines. In particular, the due date for Form 3520 should be aligned with the due date of the filer's income tax return in all cases, including for individual taxpayers with an original due date of June 15, and an extended due date of December 15 for their income tax returns.

4. PROPOSED REGULATIONS UNDER SECTION 643(i) AND LOANS FROM FOREIGN TRUSTS

Our written comments include a number of suggestions on this topic, including the following:

A. Non-qualified obligation loans from a foreign trust that remain outstanding on the U.S. residency starting date of a beneficiary should be treated as a distribution as of the date the loan was made, rather than on the first day that the individual becomes a resident alien.

B. Loans made by a beneficiary of a foreign trust or by the foreign trust itself to a non-beneficiary should not be imputed to a beneficiary of the trust who happens to be related to the borrower, at least not without substantial limitations.

- The proposed regulations assume an unreasonable level of knowledge and/or information sharing between trust beneficiaries, or between a trustee and a beneficiary regarding transactions that the beneficiary was not party to.
- The proposed regulations may result in a deemed distribution in situations where the trustee had no involvement in, or knowledge of, a particular transaction.

C. The proposed regulations address the application of previously taxed earnings and profits (or PTEP) rules where a loan is made to a trust beneficiary by a foreign corporation that is subject to the controlled foreign corporation (CFC) or passive foreign investment company (PFIC) rules.

This was an area of considerable uncertainty, and we are pleased that this is addressed in the proposed regulations. However, there remains uncertainty regarding the taxation of actual distributions, and we recommend that PTEP be addressed in this context as well.

For example, if a U.S. beneficiary of a foreign trust which owns shares in a CFC has an income inclusion under the Subpart F or Global Intangible Low-Tax Income (GILTI) rules as a result of being a US shareholder via their beneficial interest in the trust, and the same U.S. beneficiary later receives a distribution from the foreign trust that derives from the underlying CFC, it is unclear how to apply the PTEP rules.

5. METHODS USED TO COMPUTE U.S. INCOME TAX ON DISTRIBUTIONS FROM FOREIGN TRUSTS

Our written comments on this topic should be read in the context of our view that a U.S. beneficiary receiving and reporting a distribution from a foreign trust should be able to utilize the actual method in as many cases as possible.

6. CLASSIFICATION OF FOREIGN ENTITIES

Our final point today is a request for the Service to provide definitive guidance on how certain types of widely-used non-U.S. entities should be classified for U.S. tax purposes. Some years ago, the Service was able to classify incorporated entities on a country-by-country basis as “per se” or

not per se corporations. Thus, it should be possible for the Service to undertake this project in order to assist taxpayers, their advisors, and IRS examining agents, to properly classify at least the most common types of non-U.S. entities that have the attributes of a trust for U.S. tax and information reporting purposes. Clarity with respect to properly classifying an entity will provide certainty regarding the related reporting requirements and will encourage compliance.

CONCLUSION

Thank you again for the IRS efforts in this area, and for the opportunity for us to testify today. We hope that IRS will consider these thoughts as it considers what to do next with the regulations. The AICPA Form 3520 Penalties Task Force looks forward to working with IRS and is available to continue our dialogue on any of these issues.