

Gifts From An Offshore Relative May Have To Be Reported To The IRS

By Patricio A. Suarez

When U.S. citizens or resident aliens (“U.S. persons”) receive sizeable gifts or bequests from friends or relatives living abroad, both parties must be mindful of the potential U.S. tax consequences and reporting requirements. If the gratuitous transfer is of tangible property situated in the U.S., the gift may be taxable to the donor. Moreover, if the gift exceeds a certain amount in value, the recipient may be required to report the gift to the Internal Revenue Service.

Transfers of intangible property, excluding money, from foreign persons to U.S. persons are almost never subject to U.S. gift tax. Transfers of real or tangible property, as well as transfers of money, located in the U.S. almost always are. As a result, foreign donors should consider carefully how they choose to transfer assets. For example, if a nonresident alien father wishes to transfer his New York condominium apartment to his U.S. resident daughter, the father might wish to put the apartment into a foreign corporation and transfer the shares of that corporation rather than the apartment itself — thereby making it a nontaxable transfer of intangible non-U.S. situs

property. Or, if the father wishes to help pay for his daughter’s tuition and/or medical expenses, the father may wish to pay such expenses directly to the providers, because amounts paid as qualified tuition or medical payments on behalf of a U.S. person are not considered gifts.

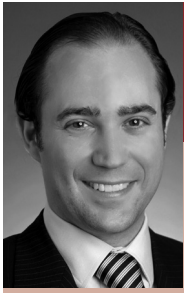
Regarding the recipient, the duty to report a gratuitous transfer from a foreign source applies in the following situations:

“A U.S. person is required to report the receipt of gifts or bequests from a nonresident alien or foreign estate if the aggregate amount exceeds \$100,000 during the taxable year.”

- If a U.S. person receives more than \$100,000 from a nonresident alien individual or a foreign estate in the form of a gift or bequest.
- For 2009, if a U.S. person receives more than \$14,139 from a foreign corporation or a foreign partnership in the form of a gift.
- If a U.S. person receives any amount as a distribution from a foreign trust.

Each of these situations requires that the recipient file a Form 3520 (Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts) with the IRS. The failure to do so can lead to the imposition of substantial penalties by the IRS. What follows is a summary of the particular reporting requirements of each situation and of the penalties and even potential income tax consequences that can arise from failing to file Form 3520.

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who's who

Patricio A. Suarez is an attorney in the New York office of Anderson Kill &

Olick, P.C. Mr. Suarez is a member of the firm's Trusts & Estates practice and has extensive experience providing clients with advice in tax, estate planning and trust and estate administration.

(212) 278-1238
psuarez@andersonkill.com

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Gifts and Bequests from Foreign Individuals and Foreign Estates

A U.S. person is required to report the receipt of gifts or bequests from a nonresident alien or foreign estate if the aggregate amount exceeds \$100,000 during the taxable year. Once the \$100,000 threshold has been met, the donee must separately identify each gift in excess of \$5,000, but not the identity of any donor. If the receipt of a foreign gift or bequest is not timely reported, the IRS can assess a penalty of 5% of the amount of the foreign gift for each month that the gift or bequest is not reported (up to a maximum of 25%). In addition, a recipient who fails to report the gift runs the risk that the IRS may treat the entire transfer as taxable income.

Gifts from Foreign Corporations and Foreign Partnerships

A U.S. person is required to report the receipt of a gift from foreign corporations or foreign partnerships if the aggregate amount exceeds \$14,139 (for 2009) during a taxable year. Once the threshold has been met, all gifts from foreign corporations and foreign partnerships must be separately identified, including the identity of the foreign donor. As is the case with foreign gifts received from individuals, the IRS can assess a penalty of 5% per month of the amount of the foreign gift that is not reported, and gifts from foreign corporations or foreign partnerships may be recharacterized as income if the gift goes unreported.

Distributions from Foreign Trusts

A U.S. beneficiary of a foreign trust must report the amount received as a distribution from the trust, regardless of the amount. Failure to report the distribution can result in the entire distribution being treated as taxable income as well as a 35% penalty on the gross amount of the distribution.

It should be noted that transfers to a foreign trust by a U.S. person may also be a reportable event if the U.S. person is treated as the owner of any part of the assets of the foreign trust under the grantor trust rules during the current tax year.

These rules place the IRS in a win-win situation because they provide that if a gift is not reported, the tax consequences shall be determined by the IRS. Given that the IRS may treat a non-reported gift as taxable income, recipients of such gifts have a strong incentive to determine which gifts are reportable and to report those that are.

As always, we recommend consulting with your tax advisor before entering into any transaction. If the gift has already been made or received, consult with your tax advisor to determine whether it needs to be reported on Form 3520. ▲

IRA Alert: Tax legislation that was signed into law in December 2008 provides that no minimum distributions are required in 2009 from individual retirement plans and employer-provided qualified defined contribution plans. This means that participants and beneficiaries do not have to reduce their account balances by making withdrawals from them in 2009. Anyone who has standing instructions for withdrawals may wish to change them immediately.