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

Notice 97–34

This notice provides guidance regarding the new foreign trust and foreign gift reporting provisions contained in the Small Business Job Protection Act of 1996 (the "Act"). The Act expands information reporting requirements under section 6048 of the Internal Revenue Code (the "Code") for U.S. persons who make transfers to foreign trusts and for U.S. owners of foreign trusts. In addition, the Act adds new reporting requirements for U.S. beneficiaries of foreign trusts, extensively revises the civil penalties for failure to file information with respect to foreign trusts, and adds civil penalties for failure to report certain transfers to foreign entities. See sections 6048(c), 6677, and 1494(c). The Act also adds section 6039F to the Code, creating reporting requirements for U.S. persons who receive large gifts from foreign persons.

Notice 96–60, 1996–49 I.R.B. 7, provided that taxpayers would not be required to file information statements under section 6048(a) or be subject to associated penalties under section 6677 until further guidance was issued. Section VII of this notice sets forth this further guidance.

This notice has eight sections. Section I explains the expected revisions to Forms 3520 and 3520–A. Section II provides certain definitions of terms used in this notice. Section III provides guidance on reporting of transfers to foreign trusts. Section IV explains the reporting responsibilities of U.S. owners of foreign trusts, including the information returns to be filed by these foreign trusts and the procedures for foreign trusts to appoint U.S. agents. Section V provides guidance regarding the new reporting requirements for U.S. beneficiaries of foreign trusts. Section VI explains the new reporting rules for U.S. persons who receive large gifts from foreign persons. Section VII provides guidance on the new penalties for failure to comply with these reporting requirements. Finally, Section VIII provides special transition rules.

Treasury and the Service expect to issue regulations incorporating the guidance set forth in this notice. Until such regulations are issued, taxpayers must comply with the guidance set forth in this notice.

Section I. Revisions to Forms 3520 and 3520–A

Prior to the Act, a U.S. person who transferred property to a foreign trust was required to report the transfer on Form 3520, "Creation of or Transfers to Certain Foreign Trusts," within 90 days of the transfer. In addition, U.S. owners of foreign trusts were required to file annually Form 3520–A, "Annual Return of Foreign Trust with U.S. Beneficiaries." No reporting was required of U.S. beneficiaries of foreign trusts or of U.S. persons who received gifts from foreign persons.

In order to facilitate taxpayer compliance and reduce duplicative reporting requirements, the Service is developing a revised Form 3520 ("Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts") that generally will allow U.S. persons to use a single form to comply with all of the new reporting requirements of the Act pertaining to transactions with foreign trusts and the receipt of foreign gifts. In addition, Form 3520–A will be revised so that foreign trusts will be able to use that form to meet the new information reporting requirements of section 6048(b). U.S. owners of foreign trusts will no longer be required to file Form 3520–A.

Section II. Definitions

For purposes of this notice, the terms "grantor," "beneficiary," and "obligation" are defined as follows.

A "grantor" includes any person who creates a trust as well as any person who directly or indirectly makes a gratuitous transfer of money or other property to a trust. A grantor includes a person who acquires an interest in a trust in a nongratuitous transfer from a person who is a grantor of the trust. A grantor also includes an investor who acquires an interest in a fixed investment trust from a grantor of the trust. If one person creates or funds any portion of a trust primarily as an accommodation for another person, the other person will be treated as the grantor with respect to such portion of the trust. Gratuitous transfers are described below in Section III.

A "beneficiary" includes any person that could possibly benefit (directly or indirectly) from the trust at any time (including any person who could benefit if the trust were amended), whether or not the person is named in the trust instrument as a beneficiary and whether or not the person can receive a distribution from the trust in the current year. Sections 679(c), 643(a)(7). *See also* H.R. Rep. No. 658, 94th Cong., 1st Sess. 210 (1975), 1976–3 (vol. 2) C.B. 902. However, for purposes of sections 643(i), 679(a)(3)(C) and 1494, a person will not be considered a beneficiary if, based on all relevant facts and circumstances, it could not be reasonably anticipated that the person could possibly benefit from the trust. For example, for this purpose a publicly-traded corporation would generally not be treated as a beneficiary of a family's trust even if the trustee is given complete discretion to distribute trust income to anyone. However, friends and business associates of the family would be considered beneficiaries of such a trust because it could be reasonably anticipated that the trust could possibly benefit such persons.

An "obligation" includes any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other evidence of indebtedness, and, to the extent not previously described, any annuity contract.

Section III. Transfers to Foreign Trusts

This section of the notice provides guidance for the reporting of transfers to foreign trusts. As more fully described below, gratuitous transfers are reportable under section 6048(a). For this purpose, a gratuitous transfer is any transfer other than: (a) a transfer for fair market value, or (b) a corporate or partnership distribution. In addition, as more fully described below, nongratuitous transfers (all transfers other than gratuitous transfers) to a foreign trust are reportable

[1] There are currently two provisions of the Internal Revenue Code designated as section 6039F. The second provision was added by the Health Insurance Portability and Accountability Act of 1996 (HIPAA). Treasury intends to seek a technical correction to HIPAA to redesignate section 6039F as added by HIPAA as section 6039G. All subsequent references to section 6039F in this Notice relate to section 6039F as contained in the Small Business Job Protection Act of 1996.

under section 1494 if: (a) the U.S. transferor does not immediately recognize all of the gain on the transfer (or recognizes gain solely by reason of an election under section 1057), or (b) the U.S. transferor is related to the trust. If a transfer is gratuitous in part and nongratuitous in part, the gratuitous portion of the transfer must be reported under section 6048 and the nongratuitous portion of the transfer must be reported under section 1494.

A. Background

Section 6048(a) generally provides that any U.S. person who directly or indirectly transfers money or other property to a foreign trust (including a transfer by reason of death) must report such transfer at the time and in the manner prescribed by the Secretary. Section 6048(a)(2). Transfers to foreign trusts described in sections 402(b), 404(a)(4), or 404A, or trusts determined by the Secretary to be described in section 501(c)(3) are not reportable under these requirements. Section 6048(a)(3)(B)(ii). Transfers involving fair market value sales are also not reportable. Section 6048(a)(3)(B)(i). The Secretary may exempt other types of transfers from being reported if the United States does not have a significant interest in obtaining the required information. Section 6048(d)(4). A person who fails to comply with the reporting requirements of section 6048(a) with respect to a transfer occurring after August 20, 1996, will be subject to a 35 percent penalty on the gross value of the property transferred. Section 6677(a).

One of the purposes of the reporting requirements in section 6048(a) is to ensure that U.S. transferors comply with section 679. Section 679 generally treats a U.S. person as the owner of a foreign trust if the U.S. person transfers property to the foreign trust and the trust could benefit a U.S. person. However, a U.S. person will not be treated as the owner of the trust under section 679 if, in exchange for the property transferred to the trust, the U.S. person receives property whose value is at least equal to the fair market value of the property transferred. Section 679(a)(2)(B).

Certain transfers of property by U.S. persons to foreign trusts may be described in section 1491 as well as section 6048(a). Section 1491 generally provides that a U.S. person who transfers property to a foreign trust is subject to a 35 percent excise tax on any unrecognized gain in the transferred property. Section 1494 generally provides that transfers described in section 1491 to certain foreign entities (including foreign trusts) must be reported. Notice 97–18, 1997–10 I.R.B. 35, provided that in the case of transfers to foreign trusts, reporting obligations under section 1494 may be satisfied if the U.S. transferor complies with its reporting obligations under section 6048(a) and the U.S. transferor does not owe excise tax under section 1491.

B. Section 6048(a) Information Reporting

Except as otherwise provided in Section III.E., a U.S. person must report under section 6048(a) any gratuitous transfer to a foreign trust. Although nongratuitous transfers generally are not reportable under section 6048(a), any transfer in exchange for an obligation that is treated as a qualified obligation (as defined in section III.C.2) must also be reported under section 6048(a). In the event of a reportable transfer occurring by reason of death, the executor, as defined in section 2203, is responsible for reporting the transfer.

A gratuitous transfer is any transfer other than (i) a transfer for fair market value, or (ii) a corporate or partnership distribution. A transfer of property to a trust may be considered a gratuitous transfer without regard to whether the transfer is a gift for gift tax purposes (see Chapter 12 of Subtitle B of the Code). A gratuitous transfer to a foreign trust must be reported on Form 3520.

For purposes of this notice, a transfer for fair market value includes only transfers in consideration for property received from the trust, services rendered by the trust, or the right to use property of the trust. A transfer is for fair market value only to the extent that the value of the property received, services rendered, or the right to use the property is equal to the fair market value of the property transferred. For example, rents, royalties, and compensation paid to a trust are transfers for fair market value only if the payments reflect an arm's length price for the use of the property of, or services rendered by, the trust.

For purposes of this determination, if a U.S. person contributes property to a trust in exchange for any type of interest in the trust, such interest in the trust will be disregarded in determining whether fair market value has been received. In addition, a U.S. person will not be treated as making a transfer for fair market value merely because the transferor recognizes gain on the transaction. For example, if a taxpayer elects to treat a transfer of appreciated property to a foreign trust as a deemed sale under section 1057, such a transfer will not be treated as a transfer for fair market value because the transferor did not receive actual fair market value consideration pursuant to the deemed sale. For special rules regarding obligations issued by related foreign trusts, see Section III.C. below.

For purposes of this notice, a transfer to a foreign trust is a corporate distribution, and therefore not a gratuitous transfer, only if it is a distribution described in sections 301, 302, 305, 355, or 356. Similarly, for purposes of this notice, a transfer to a foreign trust is a partnership distribution, and therefore not a gratuitous transfer, only if it is described in section 731. A distribution from one trust to another trust that is a beneficiary of the first trust is a gratuitous transfer. Moreover, a domestic trust that becomes a foreign trust is deemed to have made a gratuitous transfer of all its assets immediately before becoming a foreign trust. *See* section 1491.

Notwithstanding any other guidance provided by this notice, a gratuitous transfer also includes any direct or indirect transfer that is structured with a principal purpose of avoiding the application of sections 679 or 6048. *See* sections 643(a)(7), 679(d), and 6048(a).

C. Trust Obligations

1. Background

Congress was concerned that certain taxpayers may have attempted to avoid the application of sections 679 and 6048(a) by transferring property to a foreign trust in exchange for obligations issued by the trust. H.R. Rep. No. 542, 104th Cong., 2d Sess., pt. 2 at 25 (1996). Thus, the Act provides that if a U.S. person transfers money or other property to a related foreign trust, any obligation issued by the trust (or any obligation of a person related to the trust) will not be taken into account in determining if the U.S. person received fair market value, except to the extent provided by regulations. Sections 679(a)(3)(A)(i), 6048(a)(3)(B)(i). For

[2] As explained in Notice 97–18, Treasury and the Service are studying whether distributions by domestic corporations and partnerships should be reportable under section 1494. This notice does not affect the reporting of such corporate or partnership distributions.

purposes of determining whether an obligation is disregarded, a person is related to a trust if, without regard to the transfer, the person is a grantor of the trust, a beneficiary of the trust, or a person who is related (within the meaning of section 643(i)(2)(B)) to any grantor or beneficiary of the trust. Section 679(a)(3)(C).

Congress nevertheless intended that Treasury and the Service would exercise regulatory authority to allow certain trust obligations to be taken into account in determining whether such a transferor has received fair market value. In exercising this regulatory authority, Congress expected that Treasury and the Service would give consideration to whether there is a reasonable expectation that an obligation of the trust would be repaid. H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 335 (1996).

2. Qualified Obligations

Where a U.S. person transfers money or other property to a related foreign trust in exchange for an obligation from that trust (or an obligation of a person related to such trust), regulations will provide that the obligation will be taken into account for purposes of section 679 in determining whether the U.S. transferor received fair market value from the foreign trust only if the obligation is a ''qualified obligation.''

An obligation is a qualified obligation only if:

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

(ii) 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);

(iii) All payments on the obligation are denominated in U.S. dollars;

(iv) 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);

(v) The U.S. transferor extends the period for assessment of any income or transfer tax attributable to the transfer and any consequential 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 is not necessary if the maturity date of the obligation does not extend beyond the end of the U.S. person's taxable year and is paid within such period); when properly executed and filed, such an agreement will be deemed to be consented to by the Service Center Director or the Assistant Commissioner (International) for purposes of § 301.6501(c)–1(d); and

(vi) The U.S. transferor reports the status of the obligation, including principal and interest payments, on Form 3520 for each year that the obligation is outstanding.

If, while the original obligation is outstanding, the U.S. transferor or a person related to the trust directly or indirectly obtains another obligation issued by the trust, or if the U.S. transferor directly or indirectly obtains another obligation issued by a person related to the trust, the original obligation will be 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. In addition, a series of obligations issued and repaid by the trust (or a person related to the trust) will be treated as a single obligation if the transactions giving rise to the obligations are structured with a principal purpose to avoid the application of this provision.

If an obligation treated as a qualified obligation subsequently fails to be a qualified obligation (e.g., a renegotiation of the terms of the obligation causes the term of the obligation to exceed five years), the U.S. transferor will be treated as making a gratuitous transfer to the trust in an amount equal to the original obligation's adjusted issue price (within the meaning of § 1.1275–1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of § 1.1273–1(c)) as of the date of the subsequent event that causes the obligation to no longer be a qualified obligation. If the maturity date is extended beyond five years by reason of the issuance of a subsequent obligation by the trust (or person related to the trust), the amount of the gratuitous transfer will not exceed the issue price of the subsequent obligation. The subsequent obligation will be separately tested to determine if it is a qualified obligation.

Generally, as discussed above, a gratuitous transfer resulting from a failed qualified obligation will be deemed to occur on the date of the subsequent event that causes the obligation to no longer be a qualified obligation. However, based on all facts and circumstances, the district director may deem a gratuitous transfer to have occurred on any date on or after the issue date of the original obligation. For example, if at the time the original obligation was issued the transferor knew or had reason to know that the obligation would not be repaid, the district director could deem the transfer to have occurred on the issue date of the original obligation. A demand loan does not have a specified term and, therefore, cannot be a ''qualified obligation.'' In addition, an annuity contract cannot be a ''qualified obligation.''

The rules for qualified obligations apply to an obligation of a related foreign trust (or of a person related to the trust) issued after February 6, 1995, whether or not in accordance with a preexisting arrangement or understanding. For purposes of these rules, if an obligation issued on or before February 6, 1995, is modified after that date, and the modification is a significant modification within the meaning of § 1.1001–3, the obligation is treated as if it were issued on the date of the modification. However, the penalty contained in revised section 6677 will only apply to the failure to report transfers in exchange for obligations issued after August 20, 1996.

D. Section 1494 Information Reporting

Notwithstanding that nongratuitous transfers of property generally are not reportable under section 6048(a), fair market value transfers must nevertheless be reported on Form 3520 pursuant to section 1494 if:

(i) The U.S. transferor (other than a person described in Part II.A.1.i. through iii. of Notice 97–18, 1997–10 I.R.B. 35) makes a nongratuitous transfer of appreciated property to a foreign trust and does not immediately recognize all of the gain on the property transferred (or recognizes gain only by reason of an election described in section 1057); or

(ii) The U.S. transferor is related to the trust. A transferor is considered related to the trust if the transferor is the grantor of the trust, a beneficiary of the trust, or a person related to a grantor or beneficiary (applying the principles of section 643(i)(2)(B), as modified by Section II.A.2. of Notice 97–18, 1997–10 I.R.B. 35).

If such a nongratuitous transfer to a foreign trust is reportable under section 1494, the transfer must be reported on Form 3520 in a manner comparable to the manner for reporting transactions with other foreign entities on Form 926 (''Return by a U.S. Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership''). *See* Notice 97–18, Section III.C. Thus, if a U.S. person transfers appreciated property to a foreign trust and does not immediately recognize the entire amount of gain on the transfer (or recognizes gain only by reason of an election described in section 1057), the transferor must separately identify the property transferred. However, if the transferor recognizes the gain (if any) on the property transferred, but the transferor is related to the foreign trust, the transferor may aggregate the amounts transferred to the trust during the year, using the categories set forth in Section III.C. of Notice 97–18.

The transferor will not be required to file a separate Form 926 in addition to Form 3520 unless the transferor owes excise tax under section 1491 with respect to a transfer. Elections under section 1057 to avoid the section 1491 excise tax can be made on Form 3520.

E. Deferred Compensation and Charitable Trusts

Without regard to whether a transfer to a foreign trust is gratuitous or nongratuitous, transfers to foreign trusts described in sections 402(b), 404(a)(4), 404A, or 501(c)(3) are exempt from reporting under section 6048(a). Section 6048(a)(3)(B)(ii). For purposes of this provision, a trust will be considered described in section 501(c)(3) only if it has a determination letter from the Service that has not been revoked recognizing its status as exempt from income taxation under section 501(a).

Section 6048(d)(4) authorizes the Secretary to suspend requirements of section 6048 as appropriate. Based on this authority, no reporting will be required under section 6048(a) on transfers to Canadian Registered Retirement Savings Plans (RRSPs) if the trust would qualify for treaty benefits at the time of the transfer under the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital. Any U.S. person relying on a tax treaty with Canada to avoid information reporting must, however, disclose this position under section 6114.

Furthermore, the Secretary has determined that, if a foreign trust is described in sections 402(b), 404(a)(4), 404A or 501(c)(3), or is an RRSP, and a transfer to such trust would be exempt from reporting under section 6048(a) pursuant to this notice, no reporting is required with respect to any transfer to that trust under section 1494. Thus, no penalty will apply under sections 6677 or 1494(c) with respect to the failure to report any transfer to such a trust.

Comments are solicited concerning whether other categories of transfers to foreign trusts should be exempt from reporting under sections 6048(a) and 1494.

F. Examples

The following examples illustrate the rules in this Section II. In these examples, A is a U.S. citizen, DC is a domestic corporation, DT is a domestic trust that is not treated as owned by any other person, and FT is a foreign trust.

Example 1. Contribution to FT. A contributes cash to FT, through a broker, in exchange for units in FT. The value of the units in FT is disregarded in determining whether A has received fair market value. Therefore, the contribution by A is a gratuitous transfer and A must report the contribution to FT under section 6048(a).

Example 2. Interest payment to FT. A borrows cash from FT, an unrelated foreign trust. Arm's-length interest payments by A will not be treated as gratuitous transfers. Thus, A is not required to report the payments under section 6048(a). In addition, A is not required to report the payments under section 1494, since A is not related to the trust.

Example 3. Trust distribution to FT. A created and funded DT. After A's death, DT distributes cash to FT, which is a beneficiary of DT. The trust distribution by DT is a gratuitous transfer. DT must report the distribution under section 6048(a).

Example 4. Dividend payment to FT. A creates and funds FT. FT owns stock of DC, a publicly traded company, which pays a dividend to FT. The dividend paid by DC is not a gratuitous transfer. Thus, DC is not required to report the dividend to FT under section 6048(a).

Example 5. Right to withdraw. F, a foreign individual, creates FT and contributes $10,000 to FT. In addition, A transfers $10,000,000 to FT. A retains no power over FT. F has the right to withdraw all of FT's property. A must report the transfer of $10,000,000 to FT under section 6048(a).

Example 6. Anti-abuse rule. FT is created by a foreign person to benefit B, A's child, who is a U.S. citizen. FT is not treated as owned by any other person. On December 1, 1998, A creates a limited partnership and contributes property worth $1,000,000 to the limited partnership. On March 1, 1999, with a principal purpose to avoid the application of section 679, A sells a 25 percent interest in the limited partnership to the trust in exchange for $185,000 (A takes the position that $185,000 reflects the fair market value of the 25 percent interest because of a discount for the minority interest.) Even if the fair market value of the minority interest in the limited partnership was only $185,000 at the time of the transfer, the $65,000 minority discount will be treated as a gratuitous transfer as of March 1, 1999, for purposes of section 679 and 6048 because the transaction was designed to avoid section 679. Therefore, A must report the $65,000 minority discount under section 6048(a) in 1999. A must also report the $185,000 under section 1494 in 1999, since A is related to the foreign trust.

Example 7. Nonqualified obligation. A, the father of a U.S. beneficiary of FT, sells property worth $1,000,000 to FT in exchange for an obligation issued by FT. The obligation is not a ''qualified obligation.'' Thus, A's sale to FT will be treated as a gratuitous transfer and A must report the transfer under section 6048(a). A will also be treated as owning for purposes of section 679 the portion of the trust attributable to the property worth $1,000,000 that he transferred to the trust.

Example 8. Qualified obligation. A, a beneficiary of FT, sells property on January 1, 1998, worth $1,000,000 to FT in exchange for an obligation issued by FT due on January 1, 2001, with a stated interest rate equal to 100 percent of the applicable Federal rate. FT is not treated as owned by any other person. To ensure that the obligation is a qualified obligation, A must report the transfer for purposes of section 6048(a), properly extend the statute of limitations for each year in which the obligation is outstanding, and report annually on the status of the obligation. Provided A complies with these requirements, the obligation is a qualified obligation and A has not made a gratuitous transfer to the trust in 1998 for purposes of section 6048.

Example 9. Subsequent transfer while qualified obligation is outstanding. Assume the same facts as *Example 8*, except that A's father, C, who is not a U.S. person, also loaned FT $900,000 on December 1, 2000, when the adjusted issue price on FT's original obligation to A is $800,000, plus accrued but unpaid interest of $10,000. FT's obligation to C has a maturity date of December 1, 2004, more than five years after the issue date of A's original obligation. Because A is related to C, A's original obligation is treated as having a maturity date of December 1, 2004. Thus, A will be treated as having made a gratuitous transfer to FT of $810,000 as of December 1, 2000. A must report this transfer on Form 3520 for the year 2000. However, if as of the date of A's original transfer A knew or had reason to know that the obligation would not be repaid, the district director could determine that A made a gratuitous transfer to FT of $1,000,000 as of January 1, 1998.

Example 10. Nongratuitous bank loan to FT. A funds FT with a contribution of $1,000,000. A's grandchildren, who are U.S. citizens, are the only possible beneficiaries of FT. A is treated as the owner of FT under section 679. FT borrows money from an unrelated U.S. bank at arm's length terms to purchase U.S. real property. U.S. bank has made a nongratuitous transfer to FT, and is not required to report the transfer for purposes of section 6048(a).

Example 11. Non-arm's length sale to related FT. FT is created by a foreign person to benefit B, A's spouse, who is a U.S. citizen. FT is not treated as owned by any other person. A sells property worth $1,000,000 to FT in exchange for $100,000 in cash. The $900,000 excess is a

gratuitous transfer by A. A must report this excess under section 6048(a). A must also report the $100,000 under section 1494, since A is related to FT.

Example 12. Nongratuitous transfer to related FT. FT is created by a foreign person to benefit B, A's spouse, who is a U.S. citizen. FT is not treated as owned by any other person. The office building in which A conducts his U.S. business is owned by FT. A makes fair market value rental payments to FT. A's rental payments are not gratuitous transfers. Thus, A is not required to report the rental payments under section 6048(a). However, A must report the aggregate amount of the rental payments on an annual basis under section 1494 since A is related to FT.

Example 13. Transfer that is gratuitous in part and nongratuitous in part. Assume the same facts as *Example 12,* except that A's rental payments to FT are in excess of fair market value. The portion of each of A's rental payments that is in excess of fair market value is a gratuitous transfer. Thus, A must report the excess portion of each payment under section 6048(a). In addition, A must report the fair market value portion of the payments under section 1494.

Section IV. U.S. Owners of Foreign Trusts.

Each U.S. person treated as an owner of a foreign trust under sections 671 through 679 is responsible for ensuring that the foreign trust files an annual return setting forth a full and complete accounting of all trust activities, trust operations and other relevant information. Section 6048(b)(1). In addition, the U.S. owner is responsible for ensuring that the trust annually furnishes such information as the Secretary prescribes to U.S. owners and U.S. beneficiaries of the trust. Section 6048(b)(1)(B). If the trust does not furnish this information, the U.S. owner is subject to a penalty equal to 5 percent of the gross value of the portion of the trust's assets treated as owned by that person. Section 6677(b) and (c)(2). The penalty applies to taxable years of U.S. owners beginning after December 31, 1995.

A. Annual Return

The Service plans to revise Form 3520–A to allow that form to be used by foreign trusts to satisfy their annual information reporting requirements. Until the revised Form 3520–A is available, the U.S. owner must ensure that a trustee who is authorized to sign Form 3520–A: (1) files the unrevised Form 3520–A, (2) writes ''FOREIGN GRANTOR TRUST'' at the top of the form, (3) completes the identifying information on the form as if the foreign trust were the U.S. owner required to file the form, (4) signs the form, (5) attaches a Foreign Grantor Trust Information Statement to the form, (6) sends a Foreign Grantor Trust Owner Statement (see part 4 of the Foreign Grantor Trust Information Statement) to each U.S. owner of a portion of the trust, and (7) sends a copy of a Foreign Grantor Trust Beneficiary Statement (see part 5 of the Foreign Grantor Trust Information Statement) to each U.S. beneficiary who received a distribution from the trust during the taxable year. Except as provided in Section VIII, Form 3520–A must be filed and the required statements furnished to the U.S. grantors and U.S. beneficiaries by the fifteenth day of the third month after the end of the trust's taxable year (or later, if pursuant to an extension of time to file). See Section VIII for special filing deadlines for filing Form 3520–A for 1996.

The Foreign Grantor Trust Information Statement should be submitted in substantially the following format:

FOREIGN GRANTOR TRUST INFORMATION STATEMENT

1. Foreign Trust Background Information
   - A. Name, address and employer identification number (''EIN'') of trust
   - B. Name, address and taxpayer identification number (''TIN'') of the U.S. agent (if any)
   - C. Name, address and TIN (if any) of the trustee who signed Form 3520–A
   - D. Method of accounting used by the trust (cash or accrual)
   - E. The taxable year of the foreign trust to which the statement applies
2. Foreign Trust Balance Sheet. The foreign trust balance sheet should contain both beginning and end of year balances. Amounts may be aggregated within each category listed below and should be stated at their approximate fair market value. A good faith estimate of fair market value is satisfactory.
   - A. Assets
     1. Cash
     2. Accounts receivable
     3. Inventory
     4. Government obligations
     5. Other marketable securities
     6. Other non-marketable securities
     7. Depreciable (depletable) assets
     8. Real property
     9. Other assets (attach summary schedule)
     10. Total assets
   - B. Liabilities
     1. Accounts payable
     2. Contributions, gifts, grants, etc. payable
     3. Mortgages and notes payable
     4. Other liabilities (attach summary schedule)
     5. Total liabilities
   - C. Retained Earnings
     1. Contributions
     2. Accumulated trust income
     3. Other (state nature)
     4. Total net worth
3. Foreign Trust Income Statement. Use U.S. tax principles to determine the trust's income.
   - A. Income
     1. Interest
     2. Dividends
     3. Rents, royalties, distributive share of partnership income, etc.
     4. Capital gains
        a. Net short-term capital gain
        b. Net long-term capital gain
     5. Other (state nature)
     6. Total income
   - B. Deductions
     1. Interest
     2. Foreign taxes
     3. State and local taxes
     4. Trustee and advisor fees
     5. Amortization and depreciation
     6. Other (state nature)
     7. Total deductions
   - C. Net Income or loss (A.6. less B.7.)
   - D. Distributions to beneficiaries (separately state for each U.S. beneficiary)
   - E. Tax credits (attach summary schedule)
4. The Foreign Grantor Trust Owner Statement
   - A. Foreign Trust Background Information
     1. Name, address and EIN of trust
     2. Name, address and TIN of U.S. agent (if any)
     3. Name, address and TIN (if any) of the trustee who signed Form 3520–A
     4. Method of accounting used by the trust (cash or accrual)
     5. The taxable year of the foreign trust to which the statement applies
     6. Name, address and TIN of the U.S. owner
     7. A good faith estimate of the U.S. owner's gross reportable amount (the fair market value of the trust's assets treated as owned by the U.S. person)

B. Statement of Net Income Attributable to the Owner. Use U.S. tax principles to determine the owner's income.

1. Income attributable to the owner
   a. Interest
   b. Dividends
   c. Rents, royalties, distributive share of partnership income, etc.
   d. Capital gains
      1. Net short-term capital gain
      2. Net long-term capital gain
   e. Other (state nature)
   f. Total income
2. Deductions attributable to the owner
   a. Interest
   b. Foreign taxes
   c. State and local taxes
   d. Trustee and advisor fees
   e. Amortization and depreciation
   f. Other (state nature)
   g. Total deductions
3. Net Income or loss attributable to the owner (B.1.f. less B.2.g.)
4. Tax credits attributable to the owner (attach summary schedule)

5. The Foreign Grantor Trust Beneficiary Statement

A. Foreign Trust Background Information

1. Name, address and EIN of trust
2. Name, address and TIN of U.S. agent (if any)
3. Name, address and TIN (if any) of the trustee who signed Form 3520–A
4. The taxable year of the foreign trust to which the statement applies

B. U.S. Beneficiary Information

1. Name, address and TIN of U.S. Beneficiary
2. A description of the property (including cash) distributed or treated as distributed to the U.S. person during the taxable year, and the fair market value of the property distributed.

C. Owner Information.

1. An explanation of the facts and law (including the section of the Internal Revenue Code) that establishes that the foreign trust (or the portion of the foreign trust from which the beneficiary received a distribution) is treated for U.S. tax purposes as owned by another person.
2. A statement identifying whether the owner of the foreign trust (or the portion of the foreign trust from which the beneficiary received a distribution) is an individual, trust, corporation or partnership, and whether that person is a U.S. or foreign person. If the owner is a U.S. person, a foreign partnership, a foreign corporation, or a foreign trust, attach the name, address and TIN (if any) of the owner.

B. Appointment of U.S. Agent.

If a foreign trust with a U.S. owner does not have a U.S. agent, the Secretary may determine the amounts required to be taken into account with respect to the foreign trust by the U.S. owner. Section 6048(b)(2). In order to avoid this result, a U.S. owner of a foreign trust should ensure that the foreign trust appoints a U.S. person to act as the foreign trust's limited agent for purposes of applying sections 7602, 7603, and 7604 with respect to a request by the Secretary to examine records or produce testimony, or a summons by the Secretary for such records or testimony. Any U.S. citizen, resident alien, or domestic corporation (including a U.S. grantor or U.S. beneficiary of a foreign trust) may act as the U.S. agent of the trust.

In order to authorize a U.S. person to act as an agent under section 6048(b), the trust and the agent must enter into a binding agreement substantially in the form that follows:

AUTHORIZATION OF AGENT

[Name of foreign trust] hereby expressly authorizes [name of U.S. agent] to act as its agent solely for purposes of sections 7602, 7603, and 7604 of the Internal Revenue Code with respect to any request to examine records or produce testimony related to the proper treatment of amounts required to be taken into account under the rules of section 6048(b)(1)(A) or to any summons for such records or testimony. I certify that I have the authority to execute this authorization of agent to act on behalf of [name of foreign trust].

_____ ____ ____

Signature of trustee (or other authorized person) (title) (date)

Type or print your name below

_____

_____

TIN (if any)

_____

Address

[Name of agent] accepts this appointment to act as agent for [name of foreign trust] for the above purpose. I certify that I have the authority to execute this authorization of agent to act on behalf of [name of foreign trust] and agree to accept service of process for the above purposes

_____ ____ ____

Signature of agent (title) (date)

Type or print your name below

_____

_____

TIN (if any)

_____

Address

The authorization of agent agreement must be executed by the foreign trust and the U.S. agent prior to the due date of the U.S. owner's Form 3520 for the taxable year that he or she is considered the owner of the trust. The authorization must remain in effect for as long as the statute of limitations remains open for the U.S. owner's relevant taxable year. If the agent resigns, liquidates or its responsibility as an agent of the trust is terminated, the U.S. owner of the foreign trust must ensure that the foreign trust notifies the Commissioner within 90 days, by filing an amended Form 3520–A with the Philadelphia Service Center. This notification must contain the name, address and TIN of the new U.S. agent (if any).

A foreign trust will not be treated as having a U.S. agent unless the foreign trust identifies the name, address and taxpayer identification number of the U.S. agent on Form 3520–A. Even if the foreign trust identifies a U.S. agent on Form 3520–A, however, the foreign trust may be treated as providing incorrect information and, therefore, the U.S. owner may be subject to the penalty described in section 6677(a) and (b) if either the U.S. agent or the foreign trust does not comply with its obligations under the agreement (e.g., the foreign trust fails to produce records requested by the Service in reliance on the bank secrecy laws of the country where the trust's bank accounts are located).

Section V. U.S. Beneficiaries of Foreign Trusts

Generally, a U.S. person who receives a distribution, directly or indirectly, from a foreign trust after August 20, 1996, is required to report on Form 3520 the name of the trust, the aggregate amount of distributions received from the trust during the taxable year, and such other information as the Secretary may prescribe. Section 6048(c). Reporting is required under section 6048(c) only if the U.S. person knows or has reason to know that the trust is a foreign trust. A U.S. beneficiary who fails to report a distribution received after August 20, 1996, will be subject to a 35 percent penalty on the gross amount of the distribution. Section 6677(a).

Except as otherwise provided below, a distribution from a foreign trust includes any gratuitous transfer of money or property from a foreign trust, whether or not the trust is owned by another person. A distribution from a foreign trust includes the receipt of trust corpus and the receipt of a gift or bequest described in section 663(a). In addition, a distribution is reportable if it is either actually or constructively received. For example, if a U.S. beneficiary uses a credit card, and charges on that credit card are paid or otherwise satisfied by a foreign trust or guaranteed or secured by the assets of a foreign trust, the amount charged on that credit card will be treated as a distribution to the U.S. beneficiary that must be reported under section 6048(c) for the year in which the charge occurs. If a beneficiary writes a check on the foreign trust's bank or brokerage account or otherwise incurs a debt charged to the foreign trust, the amount incurred will be treated as a distribution to the U.S. beneficiary that must be reported under section 6048(c). Also, if a beneficiary receives a payment from a foreign trust in exchange for property transferred to the trust or services rendered to the trust, and the fair market value of the payment received exceeds the fair market value of the property transferred or services rendered, such excess will be treated as a distribution to the U.S. beneficiary that must be reported under section 6048(c). For example, if a U.S. beneficiary receives a payment from a foreign trust purportedly in exchange for the beneficiary's performance of services as a trustee of the trust, and the payment exceeds the fair market value of the services actually performed by the beneficiary, the excess will be treated as a distribution to the beneficiary.

The Secretary may suspend or modify any requirement of this section. Section 6048(d)(4). Reporting is not required under section 6048(c) with respect to distributions from trusts that are taxable as compensation for services rendered, within the meaning of section 672(f)(2)(B) and the regulations thereunder, so long as the recipient of a distribution from such a trust reports the distribution as compensation income on its applicable federal income tax return. Section 6048(d)(4). Reporting is also not required under section 6048(c) with respect to distributions from foreign trusts received by domestic organizations described in section 501(c)(3), provided the organization has a determination letter from the Service that has not been revoked recognizing its status as exempt from income taxation under section 501(a).

A. Loans to U.S. Grantors and U.S. Beneficiaries

Section 643(i) provides that, except as provided in regulations, if a foreign trust directly or indirectly makes a loan of cash or marketable securities to a U.S. grantor or U.S. beneficiary of the trust, the amount of the loan will be treated as a distribution to that grantor or beneficiary. If such a loan is made to a U.S. person who is related to a U.S. grantor or U.S. beneficiary (within the meaning of section 643(i)(2)(B)), the amount of the loan will be treated as a distribution to the related grantor or beneficiary. The amount of a loan is its issue price, as determined under § 1.446–2(d)(1), § 1.1273–2 or § 1.1274–2 (whichever is applicable).

For purposes of section 643(i), a loan of cash will be considered to include an extension of credit to a person related to the trust upon the purchase of property from the trust. Sections 643(i) and 643(a)(7); Rev. Rul. 85–13, 1985–1 C.B. 184, 185. If a trust makes a loan to a grantor that causes the grantor to be treated as the owner of a portion of the trust under section 675(3), the loan will not be treated as a distribution under section 643(i), and will not be reportable under section 6048(c).

Congress intended that Treasury and the Service would exercise regulatory authority to create an exception to this treatment for certain loans. In exercising this regulatory authority, Congress expected that Treasury and the Service 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. 334 (1996).

This notice announces that regulations will treat such a loan as a distribution unless the loan is in consideration for a ''qualified obligation'' from the grantor, beneficiary or a related person. An obligation is a qualified obligation only if:

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

(ii) 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);

(iii) All payments on the obligation are denominated in U.S. dollars;

(iv) 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);

(v) The U.S. person extends the period for assessment of any income tax attributable to the loan and any consequential 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 (this extension is not necessary if the maturity date of the obligation does not extend beyond the end of the U.S. person's taxable year and is paid within such period); when properly executed and filed, such an agreement will be deemed to be consented to by the Service Center Director or the Assistant Commissioner (International) for purposes of § 301.6501(c)–1(d); and

(vi) The U.S. person reports the status of the obligation, including principal and interest payments, on Form 3520 for each year that the obligation is outstanding.

If, while the original obligation is outstanding, the U.S. grantor or U.S. beneficiary (or a person related to the U.S. grantor or U.S. beneficiary) directly or indirectly issues another obligation to the trust the original obligation will be 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. In addition, a series of obligations issued and repaid by the U.S. grantor or U.S. beneficiary (or a person related to the U.S. grantor or U.S. beneficiary) will be treated as a single obligation of the U.S. grantor or U.S. beneficiary if the transactions giving rise to the obligations are structured with a principal purpose to avoid the application of this provision.

If an obligation treated as a qualified obligation subsequently fails to be a qualified obligation (e.g., a renegotiation of the terms of the obligation causes the term of the obligation to exceed five years), the U.S. grantor or U.S. beneficiary (or related person) will be treated as receiving a distribution from the trust in an amount equal to the original obligation's adjusted issue price (within the meaning of § 1.1275–1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of § 1.1273–1(c)) as of the date of the subsequent event that causes the obligation to no longer be a qualified obligation. If the maturity date is extended beyond five years by reason of the issuance of a subsequent obligation by the U.S. grantor or U.S. beneficiary (or related person), the amount of the distribution will not exceed the issue price of the subsequent obligation. The subsequent obligation will be separately tested to determine if it is a qualified obligation.

Generally, as discussed above, a distribution resulting from a failed qualified obligation will be deemed to occur on the date of the subsequent event that causes the obligation to no longer be a qualified obligation. However, based on all facts and circumstances, the district director may deem the distribution to have occurred on any date on or after the issue date of the original obligation. For example, if at the time the original obligation was issued the transferor knew or had reason to know that the obligation would not be repaid, the district director could deem the distribution to have occurred on the issue date of the original obligation. A demand loan does not have a specified term and, therefore, cannot be a ''qualified obligation.'' In addition, an annuity contract cannot be a ''qualified obligation.''

Section 643(i) applies to any loan of cash or marketable securities issued by a foreign trust after September 19, 1995, whether or not in accordance with a preexisting arrangement or understanding. For purposes of section 643(i), if an obligation issued on or before September 19, 1995, is modified after that date, and the modification is a significant modification within the meaning of § 1.1001–3, the obligation is treated as if it were issued on the date of the modification. However, the penalty contained in revised section 6677 will only apply to the failure to report loan in consideration for an obligation issued after August 20, 1996.

B. Beneficiary Statements.

Section 6048(c)(2) provides that any distribution from a foreign trust, whether from income or corpus, to a U.S. beneficiary will be treated as an accumulation distribution includible in the gross income of the distributee if adequate records are not provided to the Secretary to determine the proper treatment of the distribution. An accumulation distribution from a foreign trust is generally taxed pursuant to sections 665 through 668. Section 668, as amended by the Act, generally imposes an interest charge on distributions of accumulated income at the rate applicable to general underpayments of income tax.

A U.S. beneficiary will not be required to treat the entire distribution as an accumulation distribution if the beneficiary obtains from the foreign trust either a Foreign Grantor Trust Beneficiary Statement (see part 5 of the Foreign Grantor Trust Information Statement as described in Section IV.A. of this notice) or a Foreign Nongrantor Trust Beneficiary Statement (described below) with respect to the distribution. If a U.S. beneficiary cannot obtain such a beneficiary statement from the trust, it is expected that Form 3520 will allow the U.S. beneficiary to avoid treating the entire amount as an accumulation distribution if the U.S. beneficiary can provide certain information regarding actual distributions from the trust for the prior three years. Under this ''default treatment,'' the U.S. beneficiary will be allowed to treat a portion of the distribution as a distribution of current income based on the average of distributions from the prior three years, with only the excess amount of the distribution treated as an accumulation distribution (and therefore subject to the interest charge of section 668). Form 3520 will describe this default treatment option in greater detail. A U.S. beneficiary's use of this default treatment will not affect calculations by the trust (e.g., calculations of the trust's distributable net income under section 643(a)).

To completely avoid default treatment, a beneficiary receiving a distribution from a trust must obtain either a Foreign Grantor Trust Beneficiary Statement or a Foreign Nongrantor Trust Beneficiary Statement with respect to the portion of the trust from which the beneficiary received the distribution. The beneficiary must attach a copy of the relevant beneficiary statement(s) to his or her Form 3520.

If a U.S. beneficiary receives a complete Foreign Grantor Trust Beneficiary Statement with respect to a distribution during the taxable year, the beneficiary should treat the distribution as a gift from the owner of the trust, and therefore, generally as nontaxable. If a U.S. beneficiary receives a complete Foreign Nongrantor Trust Beneficiary Statement that provides adequate information to determine the U.S. tax consequences of the distribution from the foreign trust, the beneficiary may determine the tax consequences of the distribution on an actual basis and avoid the default treatment. The U.S. beneficiary may determine the tax consequences of the distribution in accordance with the information in the beneficiary statement only if the beneficiary has a copy of the relevant beneficiary statement(s) at the time he or she files his or her income tax return. A U.S. beneficiary may not rely on a beneficiary statement if he or she knows or has reason to know that the information contained in the statement is incorrect.

A Foreign Nongrantor Trust Beneficiary Statement must contain the following information and be set forth in substantially the following format:

FOREIGN NONGRANTOR TRUST BENEFICIARY STATEMENT

1. Foreign Trust Background Information
   - A. Name, address and employer identification number (''EIN'') of the trust
   - B. Name, address and taxpayer identification number (''TIN'') (if any) of the trustee furnishing this statement
   - C. Method of accounting used by the trust (cash or accrual)
   - D. The taxable year of the foreign trust to which the statement applies
   - E. A statement identifying whether any grantor of the trust was a partnership or foreign corporation. If so, attach an explanation of the relevant facts.

2. U.S. Beneficiary Information
   A. Name, address and TIN of U.S. Beneficiary
   B. A description of the property (including cash) distributed or deemed distributed to the U.S. person during the taxable year, and the fair market value of the property distributed.
3. Sufficient information to enable the U.S. beneficiary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes. Normally, information similar to the information required by Schedule K–1 of Form 1041 would be adequate for this purpose. If relevant, the trust must also provide the beneficiary with adequate information for the beneficiary to complete Forms 4970, 5471, and 8621.
4. Representation on Access to Books and Records
   A. A statement that, upon request, the trust will permit either the Service or the U.S. beneficiary to inspect and copy the trust's permanent books of account, records, and such other documents that are necessary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes; or
   B. The name, address and EIN of the trust's U.S. agent.

Regarding the procedures for the foreign trust to appoint a U.S. agent, see Section IV.B. of this notice.

Section VI. U.S. Recipients of Foreign Gifts.

The Act creates new reporting requirements under section 6039F for U.S. persons (other than an organization described in section 501(c) and exempt from tax under section 501(a)) that receive large gifts (including bequests) from foreign persons after August 20, 1996. Generally, if the value of the aggregate foreign gifts received by a U.S. person during any taxable year exceeds $10,000, the U.S. recipient must provide such information as the Secretary prescribes. Section 6039F(a). The term ''foreign gift'' means any amount received from a person other than a United States person that the recipient treats as a gift or bequest, 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 distribution properly reported under section 6048(c). Section 6039F(b).

Reporting under section 6039F will be required on an annual basis on Form 3520. It is expected that Form 3520 will only require the reporting of general information necessary to determine whether a purported gift is properly classified as a gift or income. For example, limited information will be required regarding whether the foreign donor is an individual, corporation, partnership, or estate, and whether the foreign donor was acting as a nominee or intermediary for another person. Also, a brief description of the property received will be required. It is expected that the form will not require information on the identity of the foreign donor unless the foreign donor is a partnership or foreign corporation, or is acting as a nominee or intermediary for such an entity. However, the U.S. donee may be required to provide additional information, including the identity of the donor, to the IRS upon request.

If a gift is not reported on Form 3520, the tax consequences of the receipt of the gift shall be determined by the Secretary. Section 6039F(c)(1)(A). In addition, the recipient is subject to a penalty equal to 5 percent of the value of the gift for each month in which the gift is not reported (not to exceed 25 percent). Section 6039F(c)(1)(B). Reporting is only required under section 6039F for gifts actually or constructively received by a U.S. person. Furthermore, reporting is required under section 6039F only if the U.S. person knows or has reason to know that the donor is a foreign person.

A. Application of section 6039F to distributions from and contributions to trusts

If a foreign trust makes a distribution to a U.S. beneficiary, the beneficiary should report the amount as a distribution from the trust under section 6048(c), rather than as a gift under section 6039F. Contributions of property by foreign persons to domestic or foreign trusts that have U.S. beneficiaries are not reportable by the U.S. beneficiaries under section 6039F unless the U.S. persons are treated as receiving the contribution in the year of the transfer (e.g., the beneficiary is an owner of that portion of the trust under section 678). A domestic trust that is not treated as owned by another person is required to report the receipt of a contribution to the trust from a foreign person as a gift under section 6039F. A domestic trust that is treated as owned by a foreign person is not required to report the receipt of a contribution to the trust from a foreign person. However, a U.S. person should report the receipt of a distribution from such a trust as a gift from a foreign person under section 6039F.

B. Reporting thresholds

For purposes of determining whether the receipt of a gift from a foreign person is reportable, Treasury and the Service have determined that different reporting thresholds are warranted for gifts received from nonresident alien individuals, foreign estates, foreign partnerships, and foreign corporations. Accordingly, it is expected that Form 3520 will apply the following reporting thresholds and requirements:

1. Gifts from foreign individuals and foreign estates.

A U.S. person is required to report the receipt of 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 taxable year. Once the $100,000 threshold has been met, it is expected that Form 3520 will require the donee to separately identify each gift in excess of $5,000, but will not require the identification of the donor.

2. Purported gifts from foreign corporations or foreign partnerships

A U.S. person is required to report the receipt of purported gifts from foreign corporations and foreign partnerships if the aggregate amount of purported gifts from all such entities exceeds $10,000 (as modified by cost-of-living adjustments under section 6039F(d)) during the taxable year.

Once the $10,000 threshold has been met, it is expected that Form 3520 will require the donee to separately identify all purported gifts from a foreign corporation or foreign partnership, including the identity of the donor entity. Purported gifts from foreign corporations or foreign partnerships are subject to recharacterization under new section 672(f)(4).

3. Aggregation rules

To calculate if a U.S. person has received gifts during the taxable year from a particular foreign person in excess of the relevant threshold, the U.S. person must aggregate gifts from foreign persons that he knows or has reason to

know are related, within the meaning of section 643(i)(2)(B), whether or not the gifts from a related person would independently exceed the threshold for reporting of gifts from that person. If the relevant reporting threshold is exceeded, it is expected that Form 3520 will require the donee to separately identify each aggregated gift in excess of $5,000 from a nonresident alien or foreign estate, but will not require the identification of such a donor, and to separately identify each aggregated purported gift from a foreign corporation or foreign partnership, including the identity of the donor entity.

Example 14. Gifts from related foreign individuals. A is a U.S. citizen who is married to B. B and all of B's brothers, C, D, and E, are not U.S. persons. In a single taxable year, B makes a gift of $90,000 to A, C makes a gift of $40,000 to A, D makes two gifts to A (one of $4,000 and one of $3,000), and E makes a gift of $4,000 to A. For that taxable year, A must report the receipt of $141,000 in gifts from foreign persons. A must separately identify the $90,000 gift from B, because B and his brothers gave gifts in excess of $100,000. A must also separately identify the $40,000 gift from C, because C and his brothers gave gifts in excess of $100,000. A must identify the receipt of $7,000 in total gifts from D because D and his brothers gave gifts in excess of $100,000, but is not required to separately list information about each transaction because no gift is in excess of $5,000. A is not required to separately identify transaction information about E's gifts, because gifts from foreign individuals of less than $5,000 are not required to be separately identified. Because B, C, and D are individuals, A need not identify these donors when reporting the transactions.

Example 15. Gifts from related foreign individual and corporation. A is a U.S. citizen who is married to B. B is the sole shareholder of FC, a foreign corporation. B is not a U.S. person. In a taxable year, B makes a gift of $6,000 to A, and FC makes a purported gift of $8,000 to A. Because A knows or has reason to know that B and FC are related, A must aggregate gifts from B and FC ($14,000). Although the $14,000 aggregate amount deemed received from B does not exceed the $100,000 threshold with respect to gifts from nonresident aliens, the $14,000 aggregate amount deemed received from FC exceeds the $10,000 threshold with respect to gifts from foreign corporations. Accordingly, A must separately identify each gift from B and FC, and must provide identifying information about FC because it is a foreign corporation.

Section VII. Penalties for Failure to Provide Information

Substantial penalties under section 6677 and 6039F(c) apply if information required by section 6048 or section 6039F is not reported or is reported inaccurately. Generally, the penalty depends on the ''gross value'' or ''gross amount'' of the property involved.

In determining the gross value or gross amount of property, the valuation principles of section 2512 and the regulations thereunder must be used, without regard to any prohibitions or restrictions on a person's interest in the property.

Penalties under sections 6677(a) and 6039F will not be imposed if the failure to file was due to reasonable cause and not willful neglect. A taxpayer will not have reasonable cause merely because a foreign country would impose a civil or criminal penalty on the trustee (or other person) for disclosing the required information. Section 6677(d). Also, refusal on the part of a foreign trustee to provide information for any other reason, including difficulty in producing the required information or provisions in the trust instrument that prevent the disclosure of required information, will not be considered reasonable cause.

The penalties under section 6677 apply only to the extent that the transaction is not reported or is reported inaccurately. Thus, if a U.S. person transfers property worth $1,000,000 to a foreign trust, but reports only $400,000 of that amount, penalties may be imposed only on the unreported $600,000.

Moreover, if the penalties under both sections 6677 and 1494(c) could apply to the failure to report the transfer of property to a foreign trust, the penalty under section 6677 will be assessed and will reduce any penalty otherwise imposed under section 1494(c).

If the penalties under both sections 6039F and section 6677 could apply to the failure to report a distribution from a foreign trust treated as a gift, the penalty under section 6677 will be assessed, and will reduce any penalty otherwise imposed under section 6039F.

Section VIII. Transition Rules

A. Filing dates

Generally, to avoid penalties under sections 1494(c), 6039F, or 6677, Form 3520 must be filed as an attachment to the taxpayer's income tax return by the due date (including extensions) of the taxpayer's income tax return. In addition, unless otherwise provided, a copy of Form 3520 must be sent to the Philadelphia Service Center by the same date. However, with respect to Form 3520 for the taxable year that includes August 20, 1996 (the ''1996 Form 3520''), no such penalties will be imposed if the taxpayer files the 1996 Form 3520 on or before November 15, 1997, with the Philadelphia Service Center. Alternatively, no section 1494(c), 6039F, or 6677 penalties will be imposed for a failure to file Form 3520 if the taxpayer files the 1996 Form 3520 by the due date (including extensions) for the taxpayer's income tax return for the first taxable year beginning on or after January 1, 1997, provided the taxpayer's income tax return for the tax year that includes August 20, 1996, reflects the information contained in the 1996 Form 3520. Taxpayers who file a Form 3520 that is not revised as described herein will not be considered to have complied with the information reporting requirements of revised sections 1494 and 6048.

Generally, no section 6677 penalty will be assessed on the U.S. owner of a foreign trust for a failure to file Form 3520–A if the foreign trust files Form 3520–A with the Philadelphia Service Center by the fifteenth day of the third month following the end of the trust's taxable year (or later, if pursuant to an extension of time to file). However, with respect to Form 3520–A for the taxable year that includes August 20, 1996 (the ''1996 Form 3520–A''), no such penalty will be imposed if the foreign trust files the 1996 Form 3520–A on or before October 15, 1997. Alternatively, no section 6677 penalty will be imposed if the foreign trust files the 1996 Form 3520–A by the due date (including extensions) for the Form 3520–A for the first taxable year beginning on or after January 1, 1997, provided the U.S. owner reflects the information contained in the 1996 Form 3520–A on the owner's income tax return for the tax year that includes August 20, 1996.

Example 16. Time to report receipt of 1996 trust distributions. A, a U.S. citizen whose taxable year is the calendar year, receives a distribution from a foreign trust on November 1, 1996. A reports the distribution as ordinary income (without an interest charge under section 668) on his 1996 income tax return, which is filed on June 15, 1997. No section 6677 penalty will be imposed if A files a 1996 Form 3520 by November 15, 1997. Alternatively, A will be allowed to delay filing his 1996 Form 3520 until he files his 1997 income tax return (by April 15, 1998, or a later date if the date for filing the return is extended), but only if A reflects the correct information contained in the Form 3520 on his 1996 income tax return. Thus, if the 1996 Form 3520 indicates that the distribution should be treated as ordinary income without an interest charge under section 668, A may file the 1996 Form 3520 by April 15, 1998, and need not amend his 1996 income tax return. However, if the Form 3520 indicates that the distribution is subject to an interest charge under section 668, and A files the 1996 Form 3520 on April 15, 1998, A will be liable

for the section 6677 penalty unless A also amends his 1996 income tax return to reflect the interest charge.

B. Interaction with Notice 96–65

As described in Notice 96–65, 1996–52 I.R.B. 28, the Act amended section 7701(a)(30) and (31) to set forth new criteria that must be met for a trust to qualify as a domestic trust. Certain domestic trusts will be treated as making section 1491 transfers on January 1, 1997, as a result of becoming foreign trusts under the new law. If a domestic trust relies in good faith on Notice 96–65 to continue to file tax returns as a domestic trust, but is unable to meet the new domestic trust criteria by the end of the two-year period set forth in the notice, no U.S. person (transferor, owner, or beneficiary) will be required to treat the trust as a foreign trust and thereby report transfers to or distributions from that trust on Form 3520 during the two-year period. Further, the trust will not be required to file Form 3520-A for that two-year period. Finally, no penalty will be imposed under sections 1494(c), 6039F, or 6677 for failure to report transactions with the trust during that period, or for the trust failing to file Form 3520–A for that period. However, if the trust has not successfully met the new domestic trust criteria by the expiration of the two-year period, penalties under sections 1494(c), 6039F, or 6677 will be imposed unless the relevant Forms 3520 and 3520–A reporting all transactions during that two-year period are filed within 90 days after the expiration of the two-year period.

C. Domestic Trusts with Foreign Activities

Section 6048(d)(2) provides that, to the extent provided in regulations, a domestic trust may 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. Treasury and the Service are studying the appropriate scope of section 6048(d)(2). Until further guidance is issued, domestic trusts will not be treated as foreign trusts pursuant to that section.

EFFECT ON OTHER GUIDANCE

Section II.B.4. of Notice 97–18, 1997–10 I.R.B. 35, which provides that a U.S. person who makes a transfer to a foreign trust may satisfy that person's reporting requirements under section 1494 solely by complying with the reporting requirements of section 6048(a), is hereby modified.

PUBLIC COMMENT INVITED

Treasury and the Service invite comments on the guidance provided by this notice. Written comments should be submitted by August 1, 1997 to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Attention: CC:CORP:ER:
(Notice 97–34)
Room 5228
Washington, DC 20044

or, alternatively, via the internet at:

http://www.irs.ustreas.gov/prod/taxregs/comments.html.

The comments submitted will be available for public inspection and copying.

PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget for review in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1538.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information in this notice are in the sections III, IV, V, and VI. This information is required by the IRS to assure compliance with the new provisions of the Small Business Job Protection Act of 1996. The likely respondents are individuals, business or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting burden is 11,000 hours. The estimated average annual burden per respondent varies from .50 hours to 2 hours, depending on individual circumstances, with an estimated average of 1 hour and 3 minutes. The estimated number of respondents is 10,500. The estimated annual frequency of responses is annually.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this notice is Leslie Cracraft, formerly of the Office of Associate Chief Counsel (International). For further information regarding sections 1491, 1494, 6039F, 6048 and 6677, contact Michael Kirsch on (202) 622–3860. For further information on section 679, contact Willard Yates on (202) 622–3870. For further information regarding sections 7701(a)(30) and (31), contact James Quinn on (202) 622–3060. For further information regarding section 672(f), contact Grace Fleeman on (202) 622–3850. These contact numbers are not toll-free calls.