STEP
ADVISING FAMILIES ACROSS GENERATIONS

NEW YORK BRANCH

Edward Devine, Branch Co-chair
edward.devine@bbh.com
(212) 493-8842

Glenn G. Fox, Branch Co-chair
glenn.fox@bakermckenzie.com
(212) 626-4689

Lawrence Lipoff, Notice 97-34 Subcommittee Co-chair
lawrence.lipoff@cohnreznick.com
(646) 601-7791

Magda Szabo, Notice 97-34 Subcommittee Co-chair
mszabo@cscpallc.com
(646) 470-7114

July 13, 2020

Ms. Kinna Brewington
Internal Revenue Service
1111 Constitution Avenue, NW
Room 6526
Washington, DC 20224

Via FedEx

Re: Comments on Notice 97-34

Dear Ms. Brewington:

Enclosed please find comments on Notice 97-34. These comments are submitted on behalf of The Society of Trusts and Estate Practitioners (STEP), New York Branch. They are the result of a committee project of STEP NY and should not necessarily be construed as representing the views of other branches of STEP.

STEP NY would be pleased to discuss these comments with you or your staff.

Sincerely,

Glenn G. Fox
Edward Devine
Lawrence M. Lipoff
Magda Szabo

Cc: Martha Brinson, Internal Revenue Service, Encs.

STEP NEW YORK

COMMENTS ON NOTICE 97-34

These comments are submitted on behalf of the Society of Trusts and Estate Practitioners ("STEP"), New York Branch ("STEP NY"). Accordingly, they should be construed as representing the position of other branches of STEP.

Principal responsibility for the comments submitted herein was exercised by Jenny Longman, Magda Szabo, Jack Brister, David Gershel, Alistair (Sandy) Christopher, Mishkin Santa, Scott Sambur, Eli Akhavan, Ellen Brody, Olga Sanders, Lisa Goldman, C. Jones Perry, James Lynch, Ladidas Lumpkins, Jack Meola, Katarinna McBride, Lawrence M. Lipoff, William Kambas and Gabe Wolosky.

While STEP NY committee participants who were involved in preparing these Comments have clients or matters that may be affected by the matters addressed herein, no participant has been engaged by a client to influence the outcome of any of the matters discussed herein.

Contacts:

Magda Szabo
646-471-7114
mszabo@cscpallc.com

Jenny Longman
212-336-2409
jllongman@pbwt.com

Lawrence M. Lipoff
646-601-7791
Lawrence.Lipoff@CohnReznick.com

Date: July 13, 2020

I. EXECUTIVE SUMMARY

A. IRS Notice 97-34

The Small Business Job Protection Act of 1996 (the "1996 Small Business Act")[1] amended Section 6048 of the Internal Revenue Code of 1986, as amended (the "Code")[2] and expanded the

[1] Pub. L. No. 104-188 (Aug. 20, 1996).
[2] All references to a Section or Sections in this document shall refer to the Code unless otherwise noted.

information reporting requirements for U.S. persons[3] transferring or receiving property from foreign trusts[4] for and U.S. owners of foreign trusts. On June 23, 1997, the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "Service") issued Notice 97-34[5] (the "Notice"). The Notice provided guidance on compliance with the foreign trust and associated information reporting provisions for U.S. persons addressed by the statute on Forms 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts) and 3520-A (Annual Information Return of Foreign Trust with a U.S. Owner).

The Notice was issued with the explicitly stated expectation that Treasury and the Service would issue regulations incorporating the guidance set forth in the Notice. To date, despite the tremendous growth of reportable transactions since 1997 as well as amendments to associated underlying statutes increasing the required reporting, regulations have not been issued, leaving practitioners with numerous questions related to foreign trust reporting. This has not only increased reporting times and taxpayer compliance costs, but has also left taxpayers exposed to unintended and unforeseen penalties.

In general, complying with reporting requirements for Forms 3520 and 3520-A is particularly challenging to taxpayers not only because of the complexity of underlying law, but also because of the interrelationship between foreign trust reporting with and other types of foreign reporting.[6]

For example, many foreign trustees lack a thorough understanding of U.S. concepts involving the calculation of distributable net income ("DNI") and undistributed net income ("UNI") of a foreign trust. It is often the case that information necessary to accurately compute DNI and UNI is not available to a U.S. beneficiary, whether due to the unwillingness of a foreign trustee to cooperate with a U.S. beneficiary or due to the lack of appreciation by the foreign trustee of the relevance of the information requested. Similarly, foreign banks are generally not equipped to provide all U.S. tax-relevant information.

Comment Request for Notice 97-34

---

[3] Section 7701(a)(30) defines a U.S. person as (A) a citizen or resident of the United States, (B) a domestic partnership, (C) a domestic corporation, (D) any estate (other than a foreign estate, within the meaning of paragraph (31)), and (E) any trust if (i) a court within the United States is able to exercise primary supervision over the administration of the trust, and (ii) one or more United States persons have the authority to control all substantial decisions of the trust.

[4] Section 7701(31) defines a foreign trust as essentially any trust other than a trust described in Section 7701(a)(30)(E) cited in the preceding footnote number 3. A foreign estate is also defined by 7701(a)(31) as an estate the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income under subtitle A.

[5] 1997-1 C.B. 422.

[6] Reporting for these forms is interwoven with determinations under other Sections, including but not limited to Sections 1291, 679, 402, 668, and 643.

On May 12, 2020, the IRS published a notice in the Federal Register requesting comments concerning "Information Reporting on Transactions with Foreign Trusts and on Large Foreign Gifts" ..."as part of its continuing effort to reduce paperwork and respondent burden." [7]

Specifically, the IRS is soliciting comments on:

- whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information has practical utility;
- the accuracy of the agency's estimate of the burden of the collection of information;
- ways to enhance the quality, utility, and clarity of the information to be collected;
- ways to minimize the burden of the collection of information on or other forms of information technology; and
- estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.[8]

We commend Treasury and the Service for taking this action. It is our hope that it will yield much needed guidance to facilitate the information-gathering process, especially with regarding the underlying reporting issues that are in need of clarification and have unduly increased the tax reporting complexities and burdens on taxpayers and preparers. Our recommendations are summarized below and discussed in more detail in Section III of this letter.

A. Foreign Trust Beneficiary Statements

- When a U.S. beneficiary is not provided with a Foreign Nongrantor Trust Beneficiary Statement, a U.S. beneficiary reporting a distribution from a foreign nongrantor trust should be permitted to create and attach their own Foreign Nongrantor Trust Beneficiary Statement or its equivalent, or alternatively to attach financial statements from the foreign trust that provide the information necessary for the taxpayer to complete Schedule B of Part III of Form 3520.

- When a U.S. beneficiary is not provided with a Foreign Grantor Trust Beneficiary Statement with respect to distributions from a foreign grantor trust, the statement should not be required if the necessary information has already been provided by the grantor with a Form 3520-A. If a Form 3520-A is not required, (because the grantor is not a U.S. person), the U.S. beneficiary should instead be required to certify that the distribution was from a foreign grantor trust and provide information relevant to the trust's classification as such.

[7] FR Doc. 2020-10236 Filed: 5/12/2020 8:45 am; Publication Date: 5/13/2020.
[8] Id.

B. Competing Anti-Deferral Regimes

- Clearer guidance is needed regarding the application of the Passive Foreign Investment Company ("PFIC") regime to U.S. beneficiaries of foreign discretionary nongrantor trusts.

C. Duplicative Reporting Issues

- Where reported assets are duplicative based on filing requirements on both Forms 3520 and 3520-A, certain reporting requirements should be eliminated.

- Consideration should be given to consolidating Forms 3520 and 3520-A to eliminate duplication of reporting and information.

D. Late or Amended Filing of Form 3520 and Associated Penalties Involving: (1) Qualified Obligations; and (2) Foreign Nongrantor Trust Beneficiary Statements.

- Clarify whether reporting requirements for "Qualified Obligations" and "Foreign Nongrantor Trust Beneficiary Statements" are satisfied by incorporating or attaching necessary information on a late or amended Form 3520.

- Eliminate the requirement involving a separate filing agreeing to extend the statute of limitations in connection with a Qualified Obligation.

E. Electronic Filing

- Given the efficiencies and encouragement by Congress for the use of electronic filing, and especially the difficulties posed by the COVID-19, we recommend electronic filing be extended for all filings of Forms 3520 and 3520-A.

F. Notice 97-34 and Foreign Retirement Plans.

- Expand eligibility for exemption from filing for foreign retirement plans and provide reporting alternatives to taxpayers that are more understandable and easier to comply with.

G. U.S. Exempt Organizations' Receipt of Donations from Foreign Trusts.

- Exempt all Section 501(c) organizations from reporting under Section 6048(c), similar to the exemption available for Section 501(c) organizations under Section 6039F.
- Alternatively, clarify that the exception to the reporting of distributions from foreign trusts under Section 6048(c) applies to all organizations described in

Section 501(c)(3) with a determination letter from the IRS and not just domestic trusts.

H. Issues related to Section 643(i):

- Loans received by beneficiaries of foreign grantor trusts should not be reportable on Form 3520; or in the alternative, the Commissioner should clarify that only the amount and date of the loan should be reported.

- Provide guidance in relation to the use of foreign trust property for purposes of Section 643(i).

I. Due Date for Form 3520-A

- Change the filing date for Form 3520-A from three and half months after the close of the year, to four and a half months, to make it consistent with the filing date for domestic trusts.

II. BACKGROUND

A. Overview

The 1996 Small Business Act contained several anti-abuse provisions applicable to U.S. persons with foreign interests. The 1996 Small Business Act amended Section 6048 and expanded foreign trust and foreign gift reporting. The legislation also added Sections 643(i) and 6039F with the following consequences:[9]

- Section 643(i) generally treats loans from a foreign trust to a U.S. grantor or beneficiary – and to their related parties – as distributions.[10]
- Section 6039F requires U.S. persons to disclose receipt of certain gifts from foreign persons.[11]

These information reporting rules are part of a sustained and far-reaching effort by Congress and the Treasury to curtail tax evasion and to discourage offshore tax abuses.

The Notice provides additional guidance on compliance with the foreign trust and foreign gift information reporting provisions contained in Section 6048.[12] As noted above, regulations have not yet been issued.

---

[9] Section 6038D, requiring specified disclosure of all foreign financial assets, was added under the HIRE Act in 2010 along with expansion of reportable provisions under Section 643(i), discussed in greater detail herein.

[10] I.R.C. § 643(i).

[11] I.R.C. § 6039F(a).

[12] *Id*. Although the Treasury and the Service expected to issue regulations incorporating the guidance set forth in the Notice, none so far have been promulgated.

The Foreign Account Tax Compliance Act ("FATCA") enacted on March 18, 2010 as part of the HIRE Act[13] is a large and complex set of rules also designed to promote global transparency and to discourage international tax evasion. The HIRE Act expanded Section 6048 reporting requirements but did not provide additional guidance.[14] The HIRE Act also added Section 6038D, which requires U.S. individuals and certain domestic entities disclose to the Service interests in "specified foreign financial assets".[15]

Notice 97-34 instructs that Form 3520 shall be used by U.S. persons to comply with Section 6048 and the reporting requirements pertaining to foreign trusts and receipts of foreign gifts.

The Notice also specifies that Form 3520-A must be filed by a foreign trust to enable the U.S. owner of the foreign trust to meet the information reporting requirements of Section 6048(b). If the foreign trust fails to provide the U.S. owner with Form 3520-A, then according to the Form 3520 Instructions, the U.S. owner must complete and submit to the Service a substitute Form 3520-A.

B. Form 3520

Section 6048(a) states that a "responsible party"[16] must provide written notice of any "reportable event" to the Secretary.[17] Notice 97-34 clarifies that this requirement is met by timely submitting an accurate and complete Form 3520 with an annual income tax return. Section 6048(a)(3) defines a reportable event as:[18]

- the creation of a trust by a U.S. person
- any gratuitous transfer of money or property by a U.S. person to a foreign trust (directly or indirectly), including transfer by reason of death, and
- the death of a U.S. citizen or resident if a) the decedent was treated as owner of any portion of a foreign trust or b) any portion of a foreign trust was included in the decedent's gross estate.[19]

Section 6048(c) requires that a U.S. person file Form 3520 to report any distributions that U.S. person receives from a foreign trust during any taxable year. Form 3520 is also used by a U.S. person to report the receipt of certain large gifts or bequests from a foreign person as described in Section 6039F.

Finally, loans from a foreign trust to a U.S. grantor or beneficiary, or to a U.S. related party, are reported on Form 3520 in accordance with Sections 643(i) and 6048(a). Section V.A.2 of the

---

[13] Pub. L. No. 111-147 (March 18, 2010).
[14] I.R.C. § 6048(b)
[15] I.R.C. § 6038D(a).
[16] I.R.C. § 6048 "responsible party" means (A) the grantor in the case of the creation of an inter vivos trust, (B) the transferor in the case of a reportable event described in paragraph (3)(A)(ii) other than a transfer by reason of death, and (C) the executor of the decedent's estate in any other case.
[17] I.R.C. § 6048(a)(1).
[18] I.R.C. § 6048(a)(3)(B) provides reporting exceptions for transfers of property to a trust at fair market value and deferred compensation and charitable trusts.
[19] I.R.C. § 6048(a)(3)(A).

Notice provides that a loan from a foreign trust that is a "Qualified Obligation," (and therefore treated as a loan and not a distribution from a foreign trust), must still be disclosed on Form 3520 each year the obligation is outstanding.[20]

C. Form 3520-A

A U.S. person treated as an owner[21] of a foreign trust must use Form 3520-A to meet the information reporting requirements of Section 6048(b). If the foreign trust does not complete Form 3520-A, the U.S. owner must complete and attach a substitute Form 3520-A or be subject to penalties. [22]

D. Penalties

1. Forms 3520 and 3520-A

The penalty structure for failure to timely file complete and accurate Forms 3520 and 3520-A is contained in Section 6677.

No penalty will be imposed under Section 6677 for a failure due to reasonable cause and not due to willful neglect.[23]

If a gift is not reported on Form 3520, the recipient is subject to penalties under Section 6039F(c).

2. Form 8938 (Statement of Specified Foreign Financial Assets)

A specified person who holds any interest above a certain aggregated value in a specified foreign financial asset must disclose that asset on Form 8938. The specified person must attach Form 8938 to their annual income tax return.[24] Regulation 1.6038D-7 outlines exceptions from filing Form 8938 when the specified person has duly disclosed the financial asset on Forms 3520 and 3520-A, if required. Penalties for failure to disclose on Form 8938 are outlined in Regulation Section 1.6038D-8.

---

[20] Among other requirements, the Notice stipulates that in order for a loan from a foreign trust to be treated as a Qualified Obligation, the recipient must agree to extend "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."

[21] As determined under the grantor trust rules of I.R.C. §§ 671-679.

[22] *See* I.R.C. § 6677(b).

[23] I.R.C § 6677(d).

[24] I.R.C.§ 6038D(a).

III. COMMENTS

A. FOREIGN TRUST BENEFICIARY STATEMENTS

Background

Part V.B. of the Notice requires that a U.S. beneficiary receiving a distribution from a foreign trust must attach a beneficiary statement to Form 3520 that provides, *inter alia*, the following information:

1. Sufficient information to permit the U.S. beneficiary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes; and

2. Either:
   (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.

Question 30 of Part III of Form 3520 asks whether the U.S. beneficiary received a Foreign Non-Grantor Trust Beneficiary Statement from the foreign trust with respect to a distribution from a foreign non-grantor trust. If the answer is no, the U.S. beneficiary is required to use the "Default Calculation" [25] under Schedule A of Part III to calculate the portion of the distribution that is ordinary income and the portion that is an accumulation distribution under the Sections 665-668 accumulation distribution rules. If the answer is yes, the U.S. beneficiary can, subject to certain limitations, choose whether to use the Default Calculation or the Actual Calculation of trust distributions under Schedule B of Part III.

Similarly, Question 29 of Part III of Form 3520 asks whether the U.S. beneficiary received a Foreign Grantor Trust Beneficiary Statement from the foreign trust with respect to a distribution from a foreign grantor trust. If the answer is no, the U.S. beneficiary is required to use the Default Calculation and fill out Schedule A of Part III to calculate the portion of the distribution that is ordinary income reportable by the U.S. beneficiary and the portion that is treated as an

[25] The default calculation taxes the portion of the trust distribution that exceeds 125% of the average distribution received during the prior three years and making that component the base for the interest charge computation. As discussed, it allows U.S. persons who do not have records as to trust activity a method to calculate the liability. If adopted in any year, the U.S. person must continue to utilize this method.

accumulation distribution. If the answer is yes, the U.S. beneficiary is required to attach the statement, but is otherwise not required to provide any information about the distribution.

Information Gathering Obstacles

The requirement to provide a Foreign Grantor or Nongrantor Trust Beneficiary Statement creates several challenges for the U.S. beneficiary. The first requirement denoted above of obtaining sufficient information requires the trustee to provide information that would permit the U.S. beneficiary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes. This may be difficult or impossible for a foreign trustee, as it would effectively force the trustee, which may have little knowledge of the U.S. tax system, to make determinations under U.S. law that it is not qualified to make. Furthermore, the second requirement of access to books and records may directly conflict with bank secrecy rules in the jurisdiction in which the trustee is located or under the law under which the trust is governed.

It is sensible to require use of the Default Calculation by a U.S. beneficiary reporting a distribution from a foreign nongrantor trust if the U.S. beneficiary has not obtained the necessary information to permit the U.S. beneficiary to accurately complete Schedule B of Part III, since without that information, it is impossible for the U.S. beneficiary to accurately report the character of the income received and pay the correct tax. However, the U.S. beneficiary may have access to the necessary information in the absence of a beneficiary statement. For example, the U.S. beneficiary may have received financial statements from the trustee regarding the trust's activity for the year. It is inequitable to penalize the U.S. beneficiary by forcing the U.S. beneficiary to report a distribution using the Default Calculation in the absence of a Foreign Nongrantor Trust Beneficiary Statement from a foreign trust when the U.S. beneficiary might otherwise have access to the information necessary to accurately complete Schedule B. Indeed, the U.S. beneficiary would likely have better access than the foreign trustee to U.S. tax counsel that would permit the U.S. beneficiary to accurately interpret the financial statements and determine the appropriate characterization of the income under U.S. tax law.

With respect to a foreign grantor trust, it is inequitable to penalize the U.S. beneficiary for not providing a Foreign Grantor Trust Beneficiary Statement if the U.S. beneficiary is not the grantor. Under normal circumstances, a U.S. beneficiary receiving a distribution from a grantor trust is not subject to tax on the distribution. If the Grantor is a U.S. person, it is particularly inequitable, since the Grantor has presumably already been taxed on the income in the foreign grantor trust. Under the current rules, in the absence of a Foreign Grantor Trust Beneficiary Statement, the U.S. beneficiary has to use the Default Calculation and accordingly pay tax on the distribution. This can result in the same income being taxed to both the Grantor and the taxpayer. Furthermore, in such circumstances, the Service would already have the information they are seeking, in the form of a Form 3520-A filed by the Grantor.

Recommendations

We therefore recommend that guidance be issued and Form 3520 be revised to specifically permit a U.S. beneficiary reporting a distribution from a foreign nongrantor trust to create and attach their own Foreign Nongrantor Trust Beneficiary Statement or its equivalent, or alternatively to attach financial statements from the foreign trust that provide the information necessary for the taxpayer to complete Schedule B. The U.S. beneficiary, having obtained the necessary financial information to complete such a statement, would be able to directly provide this information to the Service upon request. Therefore, the statement described in item #2 of the list above would not be necessary.

In addition, if the necessary information has already been provided by the grantor pursuant to a Form 3520-A, we recommend guidance be issued and Form 3520 be revised to not require any Foreign Grantor Trust Beneficiary Statement with respect to distributions from a foreign grantor trust. If a Form 3520-A is not required, (because the grantor is not a U.S. person), the U.S. beneficiary should instead be required to certify that the distribution was from a foreign grantor trust and provide information sufficient to support that determination.

B. COMPETING ANTI-DEFERRAL REGIMES

PFIC Excess Distribution and Foreign Trust Accumulation Distribution Regimes

Indirect shareholders of a passive foreign investment company ("PFIC")[26] are taxed under the PFIC regime on indirect distributions and dispositions with respect to their indirectly-held PFIC stock. Unless eligible for exception, PFIC shareholders are subject to an interest charge[27] on "excess distributions" or distributions that exceed 125% of the average distributions received in the three previous years of ownership. If such PFIC shareholders are also beneficiaries of a foreign nongrantor trust, they are also subject to tax under the accumulation distribution rules of Subchapter J (commonly referred to as the "Throwback Tax").

Sections 665 through 668 impose an "accumulation distribution tax" on a distribution by a foreign nongrantor trust to a U.S. beneficiary out of UNI. This tax is dealt with in Part III of Form 3520, as well as Form 4970 (Tax On Accumulation Distribution of Trusts), which is to be attached to Form 3520 where these rules apply. Since a foreign trust is not subject to tax on any PFIC inclusions, any income that it earns with respect to PFIC stock will be treated as UNI unless currently distributed. When the foreign trust does make a later distribution, the accumulation distribution tax is imposed at ordinary income rates (even if all of the trust's income consists of capital gains), with the rate representing an average of the highest marginal rates in effect over the

[26] See Sections 1291 through 1297. PFICS are defined in Section 1297(a). A foreign corporation qualifies as a PFIC if (a) 75% or more of the foreign corporation's gross income for the taxable year is passive (e.g., generates portfolio type income) or (b) average percentage of assets held during the taxable year that produce passive income is at least 50%.

[27] We note exceptions for QEF elections and mark to market treatment. See Sections 1293 and 1296.

preceding five-year period. In addition, the UNI is allocated over the period during which it accumulated with an interest charge imposed on the tax allocated in each such year.

In that both regimes eliminate the benefit of tax deferral, the accumulation distribution tax regime operates similarly to the PFIC rules. Unfortunately, where a foreign nongrantor trust owns PFIC shares, the two regimes have not been coordinated. Therefore, under current law, both the accumulation distribution regime and the PFIC regime can apply U.S. beneficiaries of foreign nongrantor trusts. As a result, the same income could be subject both to the PFIC regime without direct distributions to U.S. beneficiaries, and, if accumulated, treated as UNI when subsequently distributed out to those same U.S. beneficiaries.[28]

Potential for Double Taxation

This lack of coordination seems both to penalize U.S. beneficiaries and undermine the government's interest in having a rational and predictable taxing system. If a foreign nongrantor trust receives distributions from a PFIC, or sells PFIC shares, and distributes the resulting income in the same year, the trust will not have UNI. There is no rule requiring that PFIC accumulations over the trust's holding period for the PFIC stock be treated as UNI. There is no clear rule that sets forth a coherent methodology for a U.S. beneficiary of a foreign nongrantor trust to take into account its share of a PFIC distribution; the preamble to the proposed regulations[29] merely requires the use of a reasonable manner that triggers or preserves the interest charge.

However, it is unclear how any Section 1291 inclusion would be allocated over the trust's holding period where the interests of different beneficiaries change over time or are not fixed. It is also unclear if a U.S. beneficiary would be entitled to the benefit of the rule excluding previously taxed income if income is imputed to one beneficiary, but distributions are made to another (or are retained by the trust). This could result can be double taxation of PFIC income.

Recommendations

We recommend that (i) clearer guidance be given regarding the application of the PFIC regime to discretionary trusts, and/or (ii) a decision should be made to apply only the Throwback Tax regime to such trusts. While there are several potential bases for clearer guidance (such as only looking to actual distributions to beneficiaries in a given year, or using a pattern of distributions to beneficiaries over a period of years, similar to the three-year 125% excess distribution rule for PFICs), all would still seem to be difficult in their application. It would perhaps be more straightforward to take the position that only the Throwback Tax regime applies to foreign complex trusts. This has the benefit of being a more straightforward and practical application while still meeting the intention of the anti-deferral regime. These anti-deferral

---

[28] Though more limited in application, we note that shareholders with direct or indirect ownership in excess of 50% of vote or value of a foreign corporation are also subject to Subpart F income and Global Intangibles Low Taxed Income (GILTI) tax regimes which, where applicable, prevails over the PFIC regime. See Sections 951 through 960 generally. While we believe that further coordination between the CFC regime and the Throwback Tax is necessary, we note that the CFC anti-deferral approach is somewhat different in that it involves an annual inclusion of income and not an imposition of an interest surcharge on distribution similar to excess distributions from a PFIC or accumulation distributions from a foreign trust.

[29] See 84 FR 33120.

regimes (Throwback, and PFIC) are all intended to ensure similar tax results for both onshore and offshore investments. Therefore, only one anti-deferral regime need apply and the one which is most practical for the IRS, taxpayers and practitioners alike is the Throwback rules.

C. DUPLICATIVE REPORTING ISSUES AND FORM RECOMMENDATIONS

Forms 3520 and 3520-A are required to be filed in connection with foreign trusts with U.S. owners. Both Form 3520 and Form 3520-A are intended to provide the Service with information about the U.S. owner of a foreign trust and the trust itself. However, the forms require largely overlapping information, and due dates for these forms are not the same.[30]

In addition to Forms 3520 and 3520-A, U.S. persons who are beneficiaries or owners of a foreign trusts face multiple filing and reporting requirements typically also involving Form 8938, Form 114 and further disclosure on Part III of Schedule B, Form 1040. Treas. Reg. Section 1.6038D-7(a) highlights Treasury and the Service's intent to eliminate or reduce "duplicative reporting" specifically stating that "a specified person is not required to report a specified foreign financial asset on Form 8938 …if the specified person reports the asset on… Form 3520." We note the foregoing as further underscoring the overriding intention on the part of Treasury and the Service to avoid the duplication of reporting information on tax forms.[31]

The table below illustrates duplicative information reporting requirements among Forms 3520 and 3520-A.

1. Table Reflecting Duplication

General description and stated purpose	Form 3520	Form 3520-A

[30] The anomalous due date for Form 3520-A is discussed in greater detail in Section J below. In addition, at times, there is a lack of consistency or sufficient clarity as to required reporting. See the following footnote.

[31] Treas. Reg. Section 1.6038D-2(a)(6) provides that the value of such assets reported in another form or format nevertheless count toward the threshold triggering Form 8938 reporting. This can create unnecessary complications especially in cases where specified foreign financial assets transition during the year resulting in reporting the same asset not just on Forms 3520 & 3520, but also on Form 8938 with a double counting of assets as well as double reporting. For example, assume married U.S. citizens who file jointly reside overseas. Assume further that a balance in an exempt reporting employer pension plan is rolled over during the year to a reportable private pension plan that triggers 3520-A and 3520 reporting. The same retirement plan would be counted twice to determine if a taxpayer meets the filing threshold of IRC Section 6038D as a result of the same asset being treated as a reportable foreign financial asset and as a foreign grantor trust in the same year. Further, it would also seem that the asset should not need to be reported in both Parts IV and VI of Form 8938, but rather in one or the other. However, there is no specific guidance on point. Further guidance on this related FATCA reporting matter is needed. We recommend that in such situations where the financial asset undergoes changes in nature and kind only need to be counted once in determining a taxpayer's filing requirements and if said filing requirements are met that the asset be reported based on the character of the asset at the end of the year.

Primary intent of Form and information required	U.S. persons' transactions with foreign trusts, U.S. ownership of foreign trusts, and identification of U.S. beneficiaries	Identify U.S. owners and beneficiaries (i.e., transactions between foreign trust and U.S. persons); qualification as foreign trust
U.S. Agent	Line 3	Part I, Line 3a
Trust instrument, operational and financial statement information	Part I, line 18	Part I, line 2
Trust financial statements/information	Part I, line 18	Part II, lines 1 through 16; and Part III, lines 1 through 21
Distribution information	Part II, line 24	Part II, line 17
Foreign grantor trust owner statement	Part II, line 22	Page 3
Trust income attributable to U.S. owner	Part III, line 24 (notes)	Page 4
Foreign grantor trust beneficiary statement	Part III, line 29	Page 5

Section 6048(b)(1)(A) states that a U.S. person treated as the owner of any portion of a foreign trust is required to ensure the *trust* files a return for the taxable year. Under Section 6677(b)(1), penalties for failure to file the trust return are assessed solely against the U.S. person deemed to be the owner or grantor of the foreign trust.

Since the U.S. person deemed to be the owner of a foreign trust is ultimately responsible for ensuring that the foreign trust tax return is filed and he or she is liable for penalties for failure to file, the impetus behind the required filing of both Forms 3520 and 3520-A for such trusts seems unduly burdensome when (a) information reporting could be combined and satisfied on a single expanded Form that provides all necessary information and (b) significant components of these Forms require reporting of the same information.

If the primary purpose of Forms 3520 and 3520-A is to identify and report certain specified transactions between foreign trusts and U.S. persons, then combining the two forms into one would create efficiencies and encourage compliance.

We are further recommending the following specific areas of revision to Form 3520:

(i) Part I, line 18 requires specified trust financial statements (balance sheet and a profit and loss statement) on an annual basis and other information such as the trust instrument and other required documents that dictate the operation of the trust when there are any changes to such instruments. This information provides the Service sufficient information for related reporting including FATCA, DNI and UNI. We recommend this be weighed against the elimination of current Notice 97-34 requirements to attach grantor and nongrantor beneficiary statements when such information should be sufficient to ascertain DNI and UNI for U.S. tax reporting purposes; and

(ii) Part II, line 22 which requires either a copy of Form 3520-A's foreign grantor trust statement or a substitute. We recommend the Form 3520-A filing requirement should be eliminated and a substitute Foreign Grantor Trust Statement be attached to Form 3520 with instructions on Form 3520 detailing required reporting information for the Statement.

D. ELECTRONIC FILING

The Service began e-filing with a pilot project in 1996. Since then, electronic filing has become common practice for taxpayers and preparers. Section 6011(f) explicitly provides that electronic filing should be encourages stating as follows:

> Promotion of electronic filing.
> (1) In general.
> The Secretary is authorized to promote the benefits of and encourage the use of electronic tax administration programs, as they become available, through the use of mass communications and other means.
> (2) Incentives.
> The Secretary may implement procedures to provide for the payment of appropriate incentives for electronically filed returns.

Although income tax returns for trusts and individuals, including nonresident alien individuals, can be filed electronically, there is no provision allowing for electronic filing of Forms 3520-A and 3520 on a stand-alone basis. This creates a significant inconvenience to both taxpayers and preparers given that original signatures must be obtained from parties located abroad, which difficulty has been exacerbated by the COVID-19 pandemic.

There does not appear to a rationale for precluding e-filing of Forms 3520 and 3520-A and given the very severe penalties imposed for late filing of these forms, a continued requirement for paper filing of these returns imposes an increasingly undue burden to taxpayers. We note further that Section 6011(f) referenced above, in effect, endorses and encourages the implementation of e-filing. For the foregoing reasons, it is recommended that e-filing for these Forms by the Service be permitted and effectuated as soon as possible.

E. LATE OR AMENDED FILING OF FORM 3520 AND ASSOCIATED PENALTIES INVOLVING (1) QUALIFIED OBLIGATIONS; AND (2) NONGRANTOR BENEFICIARY STATEMENTS

Section 6048(c) provides that U.S. beneficiaries are required to report information in connection with the receipt of a distribution from a foreign trust. Section 6048(c)(2)(A) provides that "if adequate records are not provided to the Secretary to determine the proper treatment of any distribution from a foreign trust, such distribution shall be treated as an accumulation distribution includible in the gross income of the distributee."

Section 6677(a) imposes a penalty of the greater of $10,000 or 35% of the reportable amount in the case where the information is not reported timely or the information is false or incomplete.[32] However, Section 6048(d)(4) provides that the requirements of the statute can be modified if "no significant tax interest" exists on the part of the government in obtaining the required information. Section 6677(d) provides that no penalty shall be imposed on any failure which is shown to be due to reasonable cause and not due to willful neglect.

In a similar vein, the underlying statutory period of limitations delineated in Section 6501(c)(8) for Form 3520 filings prior to the HIRE Act provided for the suspension of the statute of limitations for tax assessment. It was amended and limited under the HIRE Act, to expire for filings under Section 6048 under the regular statutory time where the "failure to furnish" is due to "reasonable cause and not willful neglect" such that only items "related to such failure" are subject to the extended statute of limitations under the statute.

Qualified Obligations

Background

[32] Penalties are reduced to 5% for foreign grantor trusts per § 6677(b).

Part V.A. of the Notice addresses loans between U.S. grantors and U.S. beneficiaries and states that "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."

Such a "loan", recharacterized as a deemed distribution under the provision, would therefore also be subject to the reporting requirements for Foreign Nongrantor Trust Beneficiary Statements. As discussed further in the following paragraphs, in addition to Section 6677 penalties, noncompliance with this requirement further triggers application of the Default Method under the accumulation distribution rules. If such a loan meets the requirements of a "Qualified Obligation," it will not be treated as a distribution. The Notice provides six detailed requirements for Qualified Obligation status which are not fully included in the instructions to Form 3520.[33] All of the requirements must be satisfied for distribution treatment to be avoided.

The requirements for non-distribution treatment include: (1) a written obligation; (2) a maximum term of 5 years; (3) denomination in USD; (4) a yield to maturity of not less than 100% and not more than 130% of the AFR on the date of issue; and (5) extension of the statute of limitations (for both income and transfer tax) in certain cases. In addition, the reporting must be incorporated on a Form 3520 for each year that the obligation is outstanding. The proper classification of a loan is therefore critical since a mistake in belief relative to classification of a loan triggers significant penalties.

Extension of Statute of Limitations

The fifth reporting requirement requires extension of the period of assessment to a date not earlier than three years before maturity of 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 the obligation is paid within such period. This requirement to extend the statute of limitations is particularly burdensome, and accomplished on a separate filing. Given the very material penalty provisions that are triggered for failure to comply, we recommend that consideration be given to eliminating this requirement entirely, as it goes well beyond statutory requirements. It does not appear to serve any significant tax interest on the part of the government[34] and creates a significant trap for the unwary.

Amended or Late Filed Forms

We further note the timing of such reporting is not provided. Should such a requirement remain, we recommend in the alternative that clarification be provided whether such filing can be effectuated with an amended Form 3520. In other words, if an agreement extending the statute of

[33] Reference is made to the Notice, but unlike other provisions such as for Beneficiary Statements, no greater detail is provided.

[34] See Section 6048(d)(4).

limitations is filed after Form 3520 is due or with a late filed or amended Form 3520, the loan should remain eligible for Qualified Obligation status. In this regard, we would also note the 2010 HIRE Act amendment to the statute of limitations, Section 6501(c)(8)(B), which, as noted previously, reduced in both scope and time the period for assessment in situations involving reasonable cause.

Turning to the sixth requirement for Qualified Obligations, which involves reporting the Qualified Obligation on a Form 3520 for each year it is outstanding, and assuming all the other requirements are satisfied, there is no explicit requirement that the reporting is effectuated on a timely filed Form 3520. It simply requires the reporting on this Form.

The lack of explicit reference, however, leaves uncertainty as to the treatment of Qualified Obligations especially for reasonable cause filing exceptions. Hence, we recommend that explicit language addressing reasonable cause filing exceptions be incorporated in IRS guidance in the case where a loan otherwise satisfying all the criteria for a Qualified Obligation is properly reported on a late or amended Form 3520 pursuant to a reasonable cause filing.

Foreign Nongrantor Trust Beneficiary Statement

Current Filing Requirements

Part V.B. of Notice 97-34 details various pieces of information that must be contained in a Foreign Nongrantor Trust Beneficiary Statement. This includes basic identifying information about the foreign trust, method of accounting used, name, address and applicable TIN (if any) of the trustee furnishing the statement, taxable year of the foreign trust and a statement identifying whether any grantor of the trust was a partnership or foreign corporation, and if this is the case, an explanation of relevant facts.

In addition to identifying information noted above, the statement must provide information concerning the U.S. beneficiary. This includes basic identifying information, description of the property distributed or deemed distributed, and sufficient information to enable the U.S. beneficiary to establish the appropriate treatment for U.S. tax purposes. Further, the Foreign Nongrantor Trust Beneficiary Statement must include 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 and records to establish the appropriate treatment of any actual or deemed distribution if the foreign

trust has not properly designated a U.S. agent.[35] Failure to comply with all requirements essentially results in the amount being treated as an accumulation distribution.[36]

Amended or Late Filed Forms

However, as is the case with qualified obligations, the Notice does not make clear whether the filing of this information with a late or amended Form 3520 or filing under "reasonable cause" circumstances can satisfy the reporting requirements, and thereby avoid, for example, "accumulation distribution" treatment.

Notice 97-34 was issued primarily to provide guidance to 1996 tax law changes. In subsequent years, especially for unintended omissions by taxpayers who were reasonably unaware of the nuances of U.S. foreign information return reporting, programs such as the Streamlined Filing Compliance Procedures and the Delinquent International Information Return Procedures have greatly increased the focus on filing delinquent returns and amending returns to include foreign information returns.

Recommendation

Consistent with the foregoing, we therefore recommend explicit guidance be issued that addresses situations involving especially reasonable cause exceptions for late-filed or amended Forms 3520 requiring Foreign Nongrantor Trust Beneficiary Statements. Such guidance should make clear that amounts properly reported on such late or amended Forms 3520 do not result in accumulation distribution characterization.

F. NOTICE 97-34 AND FOREIGN RETIREMENT PLANS

Reporting for Foreign Retirement Plans

Tax reporting of foreign retirement plans by U.S. taxpayers is not specifically addressed by the Notice. However, the classification and treatment of foreign pensions as foreign trusts or foreign grantor trusts places such vehicles within the scope of Section 6048 reporting.

---

[35] Turning to the instructions to Form 3520, they do not readily parallel these detailed attachment requirements. For example, there is no detailed reference to all items viz., 1.B of Form 97-34 Part V.B. Relative to the general reference of "an explanation of the appropriate U.S. tax treatment of any distribution or deemed distribution for U.S. tax purposes, or sufficient information to enable the U.S. beneficiary to establish the appropriate treatment of any distribution or deemed distribution for U.S. tax purposes", the instructions would have greater clarity if they included the exact language of the entire paragraph such as specific reference to e.g., Schedule K-1 and "sufficient information to complete Form 4970, 5471, and 8621" which technically involves more than treatment but also very detailed and specific information given that any such omission implicitly leads to penalties.

[36] As noted, it also triggers penalties under Section 6677 of the greater of $10,000 or 35% of the amount of the distribution (before any applicable interest).

Section 6048(a)(3)(B)(ii) provides an exception from reporting with respect to transfers to certain foreign compensatory trusts meeting the requirements of the deferred compensation agreements described in Section 402(b),[37] Section 404(a)(4),[38] or Section 404A.[39]

As may be apparent, the exceptions provided are very limited in scope. Given the variety of approaches both treaty and nontreaty countries have taken toward incentivizing retirement savings and providing retirement plans, the ability of a plan participant to either obtain the information required to analyze a given plan for conformity to the foregoing Sections presents a very significant challenge to taxpayers and practitioners. This is further complicated by the potential of change in offshore plans based on a variety of circumstances including plan participants.[40]

As noted, if the government has no significant tax interest in obtaining the required information, Section 6048(d)(4) authorizes the Secretary to modify or even suspend any reporting requirement created by this Code Section. Based on the foregoing, the Service issued Revenue Procedure 2014-55 which aimed at such simplification of reporting and in broad terms eliminated the reporting requirements imposed by Section 6048 (Form 3520), and as to custodians, Form 3520-A with respect to Canadian retirement plans.[41]

Revenue Procedure 2020-17

Most recently, the Service issued Revenue Procedure 2020-17, which exempts tax-favored foreign retirement trusts meeting the six requirements delineated therein from Section 6048 reporting requirements. These requirements include annual information reporting, limitations to earned income, contribution limitations to annual limits of $50,000 or less or lifetime limits to $1 million, impositions of penalties for withdrawals outside of specified conditions, and, for employer-maintained trusts, nondiscrimination rules.

While this is a step in a positive direction, many of the same issues that existed prior to the issuance of Revenue Procedure 2020-17 remain unresolved. As a practical matter, Revenue Procedure 2020-17 provides little relief. Specifically, many taxpayers for whom practitioners are preparing returns or to whom practitioners are providing advice are not able to easily obtain information about a plan. Often, either the taxpayer or plan sponsor have severed their

---

[37] Generally, this section addresses the taxation of certain funded nonqualified deferred compensation arrangements that are not tax exempt under 501(a) and generally defers income recognition until there is no longer a substantial risk of forfeiture or the interests become transferable.

[38] This Section addresses stock bonus, pension or profit-sharing trusts that would qualify for exemption under Section 501(a) except for the fact that the trust is created or organized outside the U.S.

[39] Section 404A addresses qualified foreign plans which involve, in addition to meeting the requirements set forth therein, a formal election to have the section apply to the plan.

[40] We note that this complexity extends not only to reporting on Form 3520-A but also to reporting on other forms, such as FBAR, and to the reporting of income on a Form 1040. We are, in this comment letter, only dealing with reporting on Forms 3520 and Form 3520-A.

[41] Specifically, Canadian Registered Retirement Savings Plans or RRSPs.

relationship, in some cases many years ago, or plan sponsors may have no obligation to provide information to plan participants. The requirement in Revenue Procedure 2020-17 concerning contribution limitation thresholds also poses significant challenges in many cases.[42]

Recommendations

We believe that for many, if not most taxpayers, it remains difficult, if not impossible, to either obtain the information necessary for the taxpayer to be able to assert that the plan meets the standards set forth or actually be in a plan that satisfies the parameters detailed. Therefore, we recommend that a different set of criteria be used that involves information taxpayers can obtain and such criteria be incorporated in updated guidance missing from Notice 97-34.

We recommend for tax treaty countries, the referenced treaty definition of pension be accepted as the benchmark for Section 6048 exceptions. If it does, the treaty provisions should govern as in the case with Canadian RRSPs. Alternatively, or with non-treaty countries, perhaps the account value should govern. Only if the account value exceeds a certain threshold (which should be of sufficient size so as to justify governmental interest under Section 6048(d)(4)), should reporting be required. Another approach might involve looking at factors that would indicate effective control by the U.S. person, such as if the taxpayer has a direct or indirect interest in or control over the foreign entity sponsoring the plan that is over a certain threshold, such as 50%, or if the taxpayer was an officer, then Section 6048 reporting would be triggered. This approach would also limit reporting to those taxpayers who could, in most cases, obtain the necessary information about a foreign retirement plan to properly report it.

G. U.S. EXEMPT ORGANIZATIONS' RECEIPT OF DONATIONS FROM FOREIGN TRUSTS

Notice Provisions Regarding Exempt Organizations

Section V of IRS Notice 97-34, citing Section 6048(c), provides that if any U.S. person receives (directly or indirectly) during any taxable year of such person any distribution from a foreign trust, such person shall make a return with respect to such trust for such year which includes (A) the name of such trust, (B) the aggregate amount of the distributions so received from such trust during such taxable year, and (C) such other information as the Secretary may prescribe. The reporting requirements set forth in Section 6048(c) correspond with Part III of Form 3520.

The IRS has not yet issued regulations governing the types of reporting required by the above Code Sections, but has provided form instructions, in addition to the guidance found in the Notice. Unfortunately, the Notice and the form instructions are inconsistent insofar as reporting by U.S. charities in Part III is concerned, as described below.

[42] For example, cash benefit plans have a much higher threshold as they are premised on targeted distributions and allow for contributions well in excess of $50,000 per year and $1 million.

Anomalous Exceptions

The Notice provides that reporting is 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).[43] (emphasis added).

However, under "Exceptions to Filing" in the 2019 Form 3520 Instructions, the exception described above in the Notice is described more narrowly (prior year form instructions have been similarly phrased). That exception covers "distributions from foreign trusts to domestic *trusts* that have a current determination letter from the IRS recognizing their status as exempt from income taxation under Section 501(c)(3)." (emphasis added).

Thus, under the Notice, a domestic Section 501(c)(3) organization classified as a corporation would be excused from filing Form 3520 to report a grant from a foreign trust, whereas it would *not* be excepted under the narrower form instructions exception. It is unclear why the Form instructions limit the exception to domestic charitable trusts, as opposed to all domestic Section 501(c)(3) organizations. Furthermore, as they are all generally exempt from federal income tax, there doesn't appear to be a rationale for distinctions between organizations described in Section 501(c)(3) and other Section 501(c) organizations.

It should be noted Section 6039F has a broader carve-out for exempt organizations for purposes of reporting foreign gifts. If the value of the aggregate foreign gifts received by a U.S. person (*other than an organization described in Section 501(c) and exempt from tax under Section 501(a)*) during any taxable year exceeds $10,000, such U.S. person shall furnish certain information to the IRS (emphasis added).

In the case of both Sections 6048(c) and 6039F, excepting all organizations described in Section 501(c) from the reporting requirements is sensible, as the concern of the IRS that a trust distribution or gift might actually constitute income should not be present in the case of a tax-exempt organization. As Form 3520 requires various forms of documentation from the foreign trust, and a U.S. exempt organization would not normally be in a position to obtain that documentation, reporting foreign trust distributions is particularly burdensome for a U.S. exempt organization.

Recommendation

Treasury regulations should clarify the exception to reporting trust distributions under Section 6048(c) applies equally to all organizations described in Section 501(c). Limiting the exception to Section 501(c)(3) organizations with a determination letter would not exempt

[43] See Part V.

churches, for example, that are entitled to "self-declare" and without a determination letter from the IRS claim exemption under Section 501(c)(3).

H. ISSUES IN RELATION TO SECTION 643(i)

Application of Section 643(i) to Grantor Trusts

Section 6048(c) requires reporting of distributions from foreign trusts to beneficiaries that are U.S. persons. Unless per guidance issued under Notice 97-34 they satisfy the criteria set forth therein for "qualified obligations," loans from nongrantor trusts are effectively treated as distributions under the provisions of Section 643(i)[44] Effective Mach 18, 2010, Section 643(i)was expanded under the HIRE Act amendments, to include the use of foreign trust property.

Section 643(i) explicitly limits its application to "Subparts B, C, and D." However, the grantor trust rules are contained in subpart E, and therefore by its terms, Section 643(i) technically does not apply to foreign grantor trusts,[45] with the result, for example, the uncompensated use of property held by a U.S. grantor trust should not be treated as a reportable constructive distribution under Section 643.[46] Section 6048(d)(1) provides in determining whether a U.S. person receives a distribution from a foreign trust, the fact that a portion of such trust is a grantor trust shall be disregarded. Thus, Congress intended distributions from foreign grantor trusts be reportable. However, Section 6048(d)(1) does not further provide the definition of "distribution" in the context of foreign non-grantor trusts should apply to reporting applicable to foreign grantor trusts. Neither the plain language of Section 6048 nor the legislative history of the Small Business Job Protection Act of 1996 - warrants such an interpretation or indicates loans from foreign grantor trusts are reportable.

Despite the absence of clear statutory mandate, Form 3520 requires reporting of both loans and uncompensated use of trust property held by foreign grantor trusts. Accordingly, in upcoming guidance, the Commissioner should clarify that loans of foreign grantor trusts and uncompensated use of foreign grantor trust property are either not required to be reported on Form 3520, or alternatively, should the Commissioner interpret Section 6048 as requiring reporting of loans from foreign grantor trusts, the Commissioner should clarify in the instructions to Form 3520 that only the amount and date of such loans on Line 25 of Form 3520 should be reported and the remainder of Line 25 and Line 26 is inapplicable. Given this reporting issue, when a trust changes status from grantor to nongrantor such as on death of a grantor as a distribution from a grantor trust, further guidance should also be provided as to the treatment of loan forgiveness.

---

[44] The absence of guidance regarding use of trust property is discussed in the following paragraphs.

[45] Specifically, Section 643(i) references only grantors or beneficiaries of foreign trusts.

[46] We note the provisions of Section 679(c)(6) separately provide, unless repayment is made within a reasonable time, a fair rate of interest applies or reasonable payment for use of trust property is made, for purposes of that subsection the uncompensated use of trust property by means of a loan or use of trust property indirectly or directly by a U.S. person whether or not a beneficiary under the terms of the trust shall be treated as paid or accumulated for the benefit of a U.S. person.

Reporting Use of Foreign Trust Property

Section V of the Notice explains pursuant to Section 6048(c), any U.S. person who receives a distribution, directly or indirectly, from a foreign trust after August 20, 1996, must report on Form 3520 the name of the trust, the aggregate amount of distributions received from the trust during the year, and any other information as required by the Secretary. Under Section 6677(a), failure by the beneficiary to properly report a distribution(s) on his or her Form 3520 and/or individual income tax return for the applicable tax year subjects the beneficiary to a tax penalty equal to the greater of $10,000 or 35% of the gross reportable amount. Section 643(i) states a loan of cash or marketable securities from a foreign trust to a grantor or beneficiary is considered to a distribution to such grantor or beneficiary.

When the Notice was first issued, this was relatively simple to comply with. The beneficiary would look at the fair market value of the cash and/or property considered to be distributed under Section 643(i) and report on Form 3520.

In 2010, Section 553 of Pub. Law 111-147 amended Section 643(i) to include the use of trust property in the definition of a loan from the foreign trust. Unless the grantor or beneficiary compensated the trust in an amount equal to the fair market value of such use within a reasonable time period, it required the fair market value of the use of the trust property be reported on Form 3520 as a distribution. Neither the amended statute nor the Committee Reports issued on Pub. Law 111-147 provided any specific guidance on uncompensated use, such as defining a "reasonable period of time" after use for consideration to be paid or explaining how to measure the fair market value of the use of the trust property.

Practitioners expected the Service to formulate regulations or issue guidance on these questions, but ten years later, no further clarification has been provided. Examples of trust assets that are used by a grantor or beneficiary include real property owned by the trust and used by a grantor or beneficiary as a primary residence or vacation home, as well as personal property, which is often located in the grantor or beneficiary's primary residence or vacation home. If guidance was provided on this issue, it would facilitate the ability of taxpayers and practitioners to comply as well as enhance the quality and clarity of the information reported by grantors and beneficiaries on Form 3520.

I. DUE DATE FOR FORM 3520-A

Section 6071(a) states that "when not otherwise provided for by this title, the Secretary shall by regulations prescribe the time for filing any return, statement, or other document required by this title or by regulations." Form 3520-A must be filed annually for foreign trusts with at least one U.S. owner.

For returns for tax years beginning after December 31, 2015, Congress[47] directed that IRS modify appropriate Regulations to provide the due date as the fifteenth day of the third month after the close of the trust's tax year (subject to a 6-month extension of time if timely made). However, the due date for domestic trusts, as with individual returns, has remained as April 15th.

This filing date inconsistency created a significant trap for the unwary and even knowledgeable practitioners have found themselves missing this date and thereby triggering the very severe penalties for late filing discussed previously. As the agency implementing and providing guidance to Congress, the Treasury and the Service should recommend to Congress a change in filing date so that foreign trust reporting be in conformity with the filing date for domestic trust reporting.

[47] See Section 2006(b)(9), PL 114-41. 7/31/2015.