



FOREIGN GIFTS TO US PERSONS: IRS Reporting Requirements and Associated Penalties



Issue 8

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Gifts From a Foreign Person

(as brought to you originally by the International Tax Gap Series from the IRS

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Monies received from foreign sources are always a point of curiosity when it comes to determining US tax consequences. (Gifts received by US persons from other US persons are simply subject to US gifting rules on Form 706 and/or Form 709). If you are a foreigner in the US, you have little to worry about as far as receiving monies from abroad. Monies received in commerce and trade are usually exempt, however, it is when US persons receive money from abroad for nonbusiness purposes is when the monkey seems to be an ever-present scoundrel.

There are many things to be aware of, such as: the residency of the person receiving the money, the one providing the money, the use of the funds, and the amount in question. This article will attempt to provide a basic understanding as to what a foreign gift of money is and when to report it.

WHO IS A US PERSON? First and foremost, we must understand who a US person is, and who a foreigner is. A US person by the definition of the Internal Revenue Code Section 7701(b) is either a US Citizen, a US Permanent Resident holding a Green Card from the Department of Homeland Security, or, a person who passes the Substantial Presence Test (and consequently elects US residency status by filing a US 1040). US persons are also domestic partnerships, domestic corporations, domestic trusts, and any estate (other than a foreign estate, within the meaning of section 7701(a)(31(A)). In other words, if you are an individual person, and if you are NOT a US citizen or Green Card Holder, you may STILL be construed a US resident due to you having passed the substantial presence test and you then filing a 1040 instead of a 1040NR. If you are on a work or business visa, you would have to 'elect' your foreign status (for e.g., if you are on a work visa such as an H1B, or L1, etc.) by filing the correct form during tax filing time (i.e., a 1040NR). That way, you would be a declaring yourself as a foreigner. Foreigners are exempt, after filing such a 1040NR, from worldwide income and gift reporting requirements. Of course if one has no income to report, then no 1040 nor 1040NR would be filed.

However, if one falls into one of the categories of a US person mentioned above, then worldwide income would be reported on the 1040 and any gifts received would also be reported on a separate form (mentioned below).

GENERAL RULE FOR GIFTING TO US PERSONS: For those US persons, the general rule for reporting foreign gifts is quite simple. But what exactly is a "gift?" The IRS defines a gift as that of "money or other property received by a US person from a foreign person that the recipient treats as a gift or bequest and excludes from gross income. A 'foreign person' is a nonresident alien individual or foreign corporation, partnership or estate." What does this mean? Well, it means if you, the US person as defined earlier, receive from any foreign person any monies or property worldwide, for which you did not provide any services or products, and which you did not report as compensation on your US 1040 tax return, you have essentially declared yourself as having received a gift. (Caveat: gifts from foreign trusts are subject to highly complex and very different rules than gifts from foreign persons. This information is listed in the instruction set of Form 3520).

Many US persons (such as students studying in the USA) receive gifts for tuition or medical payments from foreign persons. These are not gifts and not income, as mentioned in most income



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tax treaties between the US and the country of origin of the international student. And of course, if one is an international student, then that international student is definitely not a US person (F1 visa holders for the first five years, are foreign persons. After that first five year period of the F1 visa, all F1 visa holders are automatically US persons, unless they continue to elect their foreign status by filing a 1040NR and accompanying 8833 if they have income, or form 8843 every year if they do not have income).

FORM TO USE FOR REPORTING: Once a US person has received such a gift from a foreign person, the [Annual Return to Report Transactions with Foreign Trusts & Receipt of Certain Foreign Gifts, form 3520](#) is required to be reported by the same due date as the income tax return, or by the normal tax filing extension date, if the valid extension for the tax filing is taken, usually by October 15th. This form must be filed separately from the tax return. (FYI, a complementary form, [Form 3520-A, Annual Information Return of Foreign Trust With a US Owner](#) may also be filed if you are a beneficiary, owner, or can be treated as an owner due to new HIRE act rules).

Any US person having received either:

1. Gifts or bequests valued at more than \$100,000 from a nonresident alien individual or foreign estate (including foreign persons related to that nonresident alien individual or foreign estate);

or

2. Gifts valued at more than \$14,165 (adjusted annually for inflation) from foreign corporations or foreign partnerships (including foreign persons related to the foreign corporations or foreign partnerships). (This amount was for the 2010 year);

is required to report such gifts on the 3520.

AGGREGATION RULE: Gifts from different foreign persons who are related, are to be aggregated on the form if the summation of those foreign persons' gifts add up to be more than \$100,000. For e.g., if a person gifts you \$99,000, then NO reporting requirement would exist. However, if that person's sibling, or that person's company he/she owns or has an interest in, for e.g., gifts you \$1,001, you now have a 3520 reporting requirement.

If however, US persons receive gifts from foreign persons who were once US persons after June 17th, 2008, a whole different rule-set applies. Line 57 must be marked yes. The IRS likes to keep a track of gifts coming from ex-patriates.

It is imperative to know that this particular reporting requirement is just that: a reporting requirement per US Treasury Regs and Code. Therefore, there is no tax which would result from reporting everything as required on a timely basis.

3520 Foreign Personal Gift Penalties: However, if you are a US person who has received a reportable gift and failed to report it, then you could possibly be subject to a penalty of 5% of the amount of the gift for each month the form is not filed, up to a total of 25%, PLUS statutory interest on the penalty which the IRS charges. This penalty is according to Section 6039F, for failure to report foreign gifts of persons not involving trusts.

3520 Trust Gift Penalties: If you fail to report gifts to or from a foreign trust, the penalty is: the GREATER of \$10,000, 35% of the gross value of any property transferred to a foreign trust, 35% of the gross value of any property received by a US person from a foreign trust, or 5% of the gross value of the portion of the trust's assets treated as owned by a US person.

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Keep in mind, that the 3520 reporting is also a part of the [Offshore Voluntary Disclosure Initiative \("OVDI"\)](#) which the IRS has launched in 2011, which would close on August 31st, 2011. In other words, if you know that you have received gifts from foreign persons (or foreign trusts, or transferred monies to foreign trusts) in the past and have not adequately nor accurately reported such gifts, you can utilize the OVDI program for 2011 set up by the IRS for this year and include these gifts as part of that program. The OVDI program (which is usually thought of as for those persons who have not reported foreign income and assets) is also for those people who have not reported foreign gifts. [See the full FAQ here.](#) (Keep in mind, a few states have set up OVDI programs on their own, independently of the IRS's OVDI, and their rules and deadlines can vary - California for one).

If you have not yet applied for the OVDI, you still have plenty of time before the August 31st deadline to simply get approved for this program. However, the IRS has allowed a 90 day extension request to be filed. See question 25 from the FAQ link in the last paragraph.

Needless to say, these are complicated rules for reporting foreign gifts, assets, and income. There are treaty rules, trust rules, as well as state and foreign country rules to navigate when attempting to report things the correct way without the consequence of costly penalties.

So be sure to call and discuss these matters with your CPA / tax consultant early enough so that you do not run into these things last second come tax filing time. Our office does assist with the federal and state OVDI programs, as well as other foreign income, asset, gift, and reporting requirements.

Have a safe and tax-free summer!

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