DESCRIPTION OF REVENUE PROVISIONS OF H.R. 3286 RELATING TO TAX CREDIT FOR ADOPTION EXPENSES AND CERTAIN REVENUE OFFSETS

Scheduled for Markup

Before the

HOUSE COMMITTEE ON WAYS AND MEANS

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Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The House Committee on Ways and Means has scheduled a markup on H.R. 3286 ("Adoption Promotion and Stability Act of 1996") on May 1, 1996. H.R. 3286 was introduced on April 23, 1996, by Ms. Molinari, Messrs. Archer and Bunning, Ms. Pryce, and Messrs. Solomon, Tiahrt, and Shaw.

The bill was referred to the Committee on Ways and Means, and in addition, to the Committee on Resources and Economic and Educational Opportunities, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned. Title I of the bill would provide a tax credit for certain adoption expenses and an exclusion for certain adoption expenses. Title II of the bill would remove certain barriers to interethnic adoptions. Title III of the bill would modify child custody proceedings affected by the Indian Child Welfare Act of 1978. Title IV of the bill would provide certain revenue offsets: (1) remove business exclusion for energy subsidies provided by public utilities; and (2) modify treatment of foreign trusts.

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the revenue provisions of the bill (Titles I and IV).

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Revenue Provisions of H.R. 3286 Relating to Tax Credit for Adoption Expenses and Certain Revenue Offsets (JCX-14-96), April 26, 1996.

DESCRIPTION OF REVENUE PROVISIONS OF H.R. 3286

A. Tax Credit for Adoption Expenses; Exclusion for Certain Adoption Expenses (Title I of the Bill)

Present Law

Present law does not provide a tax credit for adoption expenses. Also, present law does not provide an exclusion from gross income for employer-provided adoption assistance. The Federal Adoption Assistance program (a Federal outlay program) provides financial assistance for the adoption of certain special needs children. In general, a special needs child is defined as a child who (1) according to a State determination, could not or should not be returned to the home of the natural parents and (2) on account of a specific factor or condition (such as ethnic background, age, membership in a minority or sibling group, medical condition, or physical, mental or emotional handicap), could not reasonably be expected to be adopted unless adoption assistance is provided. Specifically, the program provides assistance for adoption expenses for those special needs children receiving Federally assisted adoption assistance payments as well as special needs children in private and State-funded programs. The maximum Federal reimbursement is $1,000 per special needs child. Reimbursable expenses include those nonrecurring costs directly associated with the adoption process such as legal costs, social service review, and transportation costs.

Description of Proposal

Tax credit

The proposal would provide taxpayers with a maximum nonrefundable credit against income tax liability of $5,000 per child for qualified adoption expenses paid or incurred by the taxpayer. Any unused adoption credit could be carried forward by the taxpayer for up to five years. Qualified adoption expenses would be reasonable and necessary adoption fees, court costs, attorneys' fees and other expenses that are directly related to the legal adoption of an eligible child. In the case of an international adoption, the credit would not be available unless the adoption is finalized. An eligible child would be an individual (1) who has not attained age 18 as of the time of the adoption, or (2) who is physically or mentally incapable of caring for himself or herself. No credit would be allowed for expenses incurred (1) in violation of State or Federal law, (2) in carrying out any surrogate parenting arrangement, or (3) in connection with the adoption of a child of the taxpayer's spouse. The credit would be phased out ratably for taxpayers with modified adjusted gross income (AGI) above $75,000, and would be fully phased out at $115,000 of modified AGI.

The $5,000 limit would be a per child limit, not an annual limitation. For example, if a taxpayer incurs $3,000 of qualified adoption expenses in year one and $3,000 of qualified adoption expenses in year two, then the taxpayer would receive a $3,000 credit in year one and a $2,000 credit in year two.

To avoid a double benefit, the proposal would deny the credit to taxpayers to the extent the taxpayer may use otherwise qualified adoption expenses as the basis of another credit or deduction. Similarly, the credit would not be allowed for any expenses for which a grant is received under any Federal, State, or local program. This latter limit, however, would not apply in the case of special needs adoptions.

The proposal would provide that individuals who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart from each other for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the child for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. Further, the proposal would provide that an individual legally separated from his spouse under a decree of divorce or separate maintenance would not be considered married for purposes of this provision.

Exclusion from income

The proposal would provide a maximum $5,000 exclusion from the gross income of an employee for specified certain adoption expenses be paid by the employer. The $5,000 limit would be a per child limit, not an annual limitation. In order for the exclusion to apply, the expenses would have to be paid under an adoption assistance program in connection with an adoption of an eligible child (as described above) by an employee. An adoption assistance program would be a nondiscriminatory plan of an employer under which the employer provides employees with adoption assistance. Also, not more than five percent of the benefits under the program for any year could benefit a class of individuals consisting of more than five percent owners of the employee or their spouses or dependents. An adoption assistance program would not have to be funded. An adoption reimbursement program operated under section 1052 of title 10 of the U.S. Code (relating to the armed forces) or section 514 of title 14 of the U.S. Code (relating to members of the Coast Guard) would be treated as an adoption assistance program for these purposes. Adoption assistance would be a qualified benefit under a cafeteria plan. The exclusion would be phased out ratably for taxpayers with modified AGI above $75,000 and would be fully phased out at $115,000 of modified AGI. No credit would be allowed for adoption expenses paid or reimbursed under an adoption assistance program.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 1996.

B. Revenue Offsets
(Title IV of the Bill)

1. Remove business exclusion for energy subsidies provided by public utilities

Present Law

Internal Revenue Code section 136, as added by the Energy Policy Act of 1992, provides an exclusion from the gross income of a customer of a public utility for the value of any subsidy provided by the utility for the purchase or installation of an energy conservation measure with respect to a dwelling unit (as defined by sec. 280A(f)(1)). In addition, for subsidies received after 1994, section 136 provides a partial exclusion from gross income for the value of any subsidy provided by a utility for the purchase or installation of an energy conservation measure with respect to property that is not a dwelling unit. The amount of the exclusion is 40 percent of the value for subsidies received in 1995, 50 percent of the value for subsidies received in 1996, and 65 percent of the value for subsidies received after 1996.

For this purpose, an energy conservation measure is any installation or modification primarily designed to reduce consumption of electricity or natural gas or to improve the management of energy demand with respect to property. With respect to property other than a dwelling unit, an energy conservation measure includes "specially defined energy property" (generally, property described in sec. 48(l)(5) of the Code as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990).

The exclusion does not apply to payments made to or from a qualified cogeneration facility or a qualifying small power production facility pursuant to section 210 of the Public Utility Regulatory Policy Act of 1978.

Section 136 denies a deduction or credit to a taxpayer (or in appropriate cases requires a reduction in the adjusted basis of property of a taxpayer) for any expenditure to the extent that a subsidy related to the expenditure was excluded from the gross income of the taxpayer.

Description of Proposal

The proposal would repeal the partial exclusion for any subsidy provided by a utility for the purchase or installation of an energy conservation measure with respect to property that is not a dwelling unit.

Effective Date

The proposal would be effective for subsidies received after December 31, 1996, unless received pursuant to a binding written contract in effect on September 13, 1995, and all times thereafter.

2. Modify treatment of foreign trusts

Present Law

Inbound grantor trusts with foreign grantors

Under the grantor trust rules (secs. 671-679), a grantor that retains certain rights or powers generally is treated as the owner of the trust's assets without regard to whether the grantor is a domestic or foreign person. Under these rules, U.S. trust beneficiaries can avoid U.S. tax on distributions from a trust where a foreign grantor is treated as owner of the trust, even though no tax may be imposed on the trust income by any jurisdiction. In addition, a special rule treats a U.S. beneficiary of an inbound grantor trust who transferred property to the foreign grantor by gift of a portion of the trust as a grantor of the trust to the extent of the transfer.

Foreign trusts that are not grantor trusts

Under the accumulation distribution rules (which generally apply to distributions from a trust in excess of the trust's distributable net income for the taxable year), a distribution by a foreign nongrantor trust of previously accumulated income generally is taxed at the U.S. beneficiary's average marginal rate for the prior 5 years, plus interest (secs. 666, 667). Interest is computed at a fixed annual rate of 6 percent, with no compounding (sec. 668). If adequate records of the trust are not available to determine the proper application of the rules relating to accumulation distributions to any distribution from a trust, the distribution is treated as an accumulation distribution out of income earned during the first year of the trust (sec. 666(d)).

If a foreign nongrantor trust makes a loan to one of its beneficiaries, the principal of such a loan generally is not taxable as income to the beneficiary.

Outbound foreign grantor trusts with U.S. grantors

Under the grantor trust rules, a U.S. person who transfers property to a foreign trust generally is treated as the owner of the portion of the trust comprising that property for any taxable year in which there is a U.S. beneficiary of any portion of the trust (sec. 679(a)). This treatment generally does not apply, however, to transfers by reason of death, to transfers made before the transferor became a U.S. person, or to sales or exchanges of property at fair market value where gain is recognized to the transferor.

Residence of estates and trusts

An estate or trust is treated as foreign if it is not subject to U.S. income taxation on its income that is neither derived from U.S. sources nor effectively connected with the conduct of a U.S. trade or business. Thus, if a trust is taxed in a manner similar to a nonresident alien individual, it is considered to be a foreign trust. Any other estate or trust is treated as domestic.

Section 1491 generally imposes a 35-percent excise tax on a U.S. person that transfers appreciated property to certain foreign entities, including a foreign trust. In the case of a domestic trust that changes its situs and becomes a foreign trust, it is unclear whether property has been transferred from a U.S. person to a foreign entity, and, thus, whether the transfer is subject to the excise tax.

Information reporting and penalties related to foreign trusts

Any U.S. person who creates a foreign trust or transfers money or property to a foreign trust is required to report that event to the Treasury Department without regard to whether the trust is a grantor or a nongrantor trust. Similarly, any U.S. person who transfers property to a foreign trust that has one or more U.S. beneficiaries is required to report annually to the Treasury Department. In addition, if the transfer of any appreciated property by a U.S. person is subject to section 1491, the transferor is required to report the transfer to the Treasury Department.

Any person who fails to file a required report with respect to the creation of, or a transfer to, a foreign trust may be subjected to a penalty of 5 percent of the amount transferred to the foreign trust. Similarly, any person who fails to file a required annual report with respect to a foreign trust with U.S. beneficiaries may be subjected to a penalty of 5 percent of the value of the corpus of the trust at the close of the taxable year. The maximum amount of the penalty imposed under either case may not exceed $1,000. A reasonable cause exception is available.

Reporting of foreign gifts

There is no requirement to report gifts or bequests from foreign sources.

Description of Proposal

Overview

The proposal would modify certain aspects of the tax treatment of foreign trusts with U.S. beneficiaries as follows:

a. The grantor trust rules generally would apply only to the extent that they result, directly or indirectly, in amounts being currently taken into account in computing the income of a U.S. person. Certain exceptions would apply.

b. Beginning on January 1, 1996, the interest rate applicable to accumulation distributions from foreign nongrantor trusts would be the rate imposed on underpayment of tax under section 6621(a)(2), with compounding. The accumulation distribution generally would be allocated proportionately to prior trust years in which the trust had undistributed net income. The full amount of a loan of cash or marketable securities by a foreign nongrantor trust to a U.S. grantor or a U.S. beneficiary (or a U.S. person related to such a grantor or beneficiary) generally would be treated as a distribution to the grantor or beneficiary.

c. A nonresident alien who transfers property to a foreign trust and then becomes a U.S. resident within 5 years after the transfer would be treated as making a transfer to the foreign trust on his residency starting date. In determining whether a foreign trust paid fair market value to the transferor for property transferred to the trust, obligations issued by the trust, any person related to any grantor or beneficiary generally would not be taken into account.

d. A two-part objective test would be established for determining whether a trust is foreign or domestic for tax purposes.

e. The proposal would expand the reporting requirements with respect to foreign trusts if there is a U.S. grantor of the foreign trust or a distribution from the foreign trust to a U.S. person. The proposal would require the responsible parties to file the designated information reports with the Treasury Department upon the occurrence of certain events. A failure to comply with the reporting requirements would result in increased monetary penalties under the proposal. Unless a U.S. owner of any portion of a foreign trust appoints a limited agent to accept service of process with respect to requests and summons by the Treasury Department in connection with the tax treatment of items relating to the trust, special sanctions would apply.

f. Any U.S. person (other than certain tax-exempt organizations) that receives purported gifts or bequests from foreign sources totaling more than $10,000 during the year would be required to report the gift to the Treasury Department. Monetary penalties and certain sanctions would apply to a failure to comply with the reporting requirement.

The proposal is described in more detail below.

a. Inbound grantor trusts with foreign grantors

Foreign grantors not treated as owners

Under the proposal, the grantor trust rules generally would apply only to the extent that they result, directly or indirectly, in amounts being currently taken into account in computing the income of a U.S. citizen or resident or a domestic corporation. Thus, the grantor trust rules generally would not apply to any portion of a trust where their effect would be to treat a foreign person as owner of that portion. The proposal would provide certain exceptions to this general rule. The grantor trust rules would continue to apply to any trust that is revocable by the grantor. In addition, the grantor trust rules would continue to apply to any trust where the only amounts distributable during the lifetime of the grantor are to the grantor or the grantor's spouse. These exceptions would not apply to the extent of gifts made by a U.S. beneficiary of the trust to the foreign grantor. The proposal also would not apply to trusts established to pay compensation, and certain trusts in existence as of September 19, 1995.[2] In addition, the proposal generally

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[2] The exception would not apply to the portion of any such trust attributable to any transfers made after September 19, 1995.

would not apply where the grantor is a controlled foreign corporation. Under the proposal, the grantor trust rules would apply in determining whether a foreign corporation is characterized as a passive foreign investment company ("PFIC"). Thus, a foreign corporation could not avoid PFIC status by transferring its assets to a grantor trust.

If a U.S. beneficiary of an inbound grantor trust transfers property to the foreign grantor by gift, such beneficary would be treated as a grantor of a portion of the trust to the extent of the transfer. This rule would apply without regard to whether the foreign grantor would otherwise be treated as the owner of any portion of such trust.

In a case where a foreign grantor, who would be treated as the owner of a trust but for the above rule, actually pays tax on the income of the trust to a foreign country, it is anticipated that Treasury regulations would provide that, for foreign tax credit purposes, U.S. beneficiaries who are subject to U.S. income tax on the same income would be treated as having paid the foreign taxes that were paid by the foreign grantor. Any resulting foreign tax credits would be subject to applicable foreign tax credit limitations.

The proposal would provide a transition rule for any domestic trust that has a foreign grantor who is treated as the owner of the trust under present law. If such a trust becomes a foreign trust before January 1, 1997, or if the assets of such a trust are transferred to a foreign trust before that date, such trust would be exempt from the excise tax on transfers to a foreign trust otherwise imposed by section 1491. However, the proposal's new reporting requirements and penalties would be applicable.

Distributions by foreign trusts through nominees

The proposal would treat any amount paid to a U.S. person, where the amount was derived (directly or indirectly) from a foreign trust of which the payor is not the grantor, as if paid by the foreign trust directly to the U.S. person. This rule would disregard the role of an intermediary or nominee that may be interposed between a foreign trust and a U.S. beneficiary. Unlike present law, however, the rule would apply whether or not the trust was created by a U.S. person. The rule would not apply to a withdrawal from a foreign trust by its grantor, with a subsequent gift or other payment to a U.S. person.

Effective date

The proposal would be effective on the date of enactment.

b. Foreign trusts that are not grantor trusts

Interest charge on accumulation distributions

The proposal would change the interest rate applicable to accumulation distributions from foreign trusts from simple interest at a fixed rate of 6 percent to compound interest

determined in the manner of the interest imposed on underpayments of tax under section 6621(a)(2). Simple interest would be accrued at the rate of 6 percent through 1995. Beginning on January 1, 1996, however, compound interest based on the underpayment rate would be imposed not only on tax amounts determined under the accumulation distribution rules but also on the total simple interest for pre-1996 periods, if any. For purposes of computing the interest charge, the accumulation distribution would be allocated proportionately to prior trust years in which the trust had undistributed net income (and the beneficiary receiving the distribution was a U.S. citizen or resident), rather than to the earliest of such years. An accumulation distribution would be treated as reducing proportionately the undistributed net income from prior years.

Anti-abuse regulations authority

The proposal would include an anti-abuse rule which authorizes the Secretary of the Treasury to issue regulations, on or after the date of enactment, that may be necessary or appropriate to carry out the purposes of the rules applicable to estates, trusts and beneficiaries, including regulations to prevent the avoidance of those purposes.

Loans to grantors or beneficiaries

In the case of a loan of cash or marketable securities by the foreign trust to a U.S. grantor or a U.S. beneficiary (or a U.S. person related to such grantor or beneficiary[3]), except to the extent provided by Treasury regulations, the proposal would treat the full amount of the loan as distributed to the grantor or beneficiary. It is expected that the regulations would provide an exception from this treatment for loans with arm's-length terms. It is further expected that whether there is a reasonable expectation that a loan will be repaid would be taken into account in applying the exception from this treatment to such loan. In addition, any subsequent transaction between the trust and the original borrower regarding the principal of the loan (e.g., repayment) would be disregarded for all purposes of the Code.

Effective date

The proposal to modify the interest charge on accumulation distributions would apply to distributions after the date of enactment. The proposal with respect to loans to U.S. grantors or U.S. beneficiaries would apply to loans made after September 19, 1995.

c. Outbound foreign grantor trusts with U.S. grantors

The proposal would make several modifications to the rules of section 679 under which foreign trusts with U.S. grantors and U.S. beneficiaries are treated as grantor trusts.

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[3] For this purpose, a person generally would be treated as related to the grantor or beneficiary if the relationship between such person and the grantor or beneficiary would result in a disallowance of losses under section 267 or 707(b).

Sale or exchange at market value

Present law contains an exception from grantor trust treatment for property transferred by a U.S. person to a foreign trust in the form of a sale or exchange at fair market value where gain is recognized to the transferor. In determining whether the trust paid fair market value to the transferor, the proposal generally would not, except as provided by regulations, take into account obligations issued by the trust, by any grantor or beneficiary of the trust, or by any person related to a grantor or beneficiary. In addition, to the extent provided by regulations, obligations guaranteed by the trust, by any grantor or beneficiary of the trust, or by any person related to a grantor or beneficiary also would not be taken into account.

Other transfers

Under the proposal, a transfer of property to certain charitable trusts would be exempt from the application of the rules treating foreign trusts with U.S. grantors and U.S. beneficiaries as grantor trusts.

Transferors or beneficiaries who become U.S. persons

The proposal would apply the rules of section 679 to certain foreign persons who transfer property to a foreign trust and subsequently become U.S. persons. A nonresident alien individual who transfers property, directly or indirectly, to a foreign trust and then becomes a resident of the United States within 5 years after the transfer generally would be treated as making a transfer to the foreign trust at the time the individual becomes a U.S. resident. The amount of the deemed transfer would be the portion of the trust (including undistributed earnings) attributable to the property previously transferred. Consequently, the individual generally would be treated under the rules of section 679 as the owner of that portion of the trust in any taxable year in which the trust has U.S. beneficiaries. The proposal's new reporting requirements and penalties (discussed below) also would be applicable.

Under the proposal, a beneficiary would not be treated as a U.S. person for purposes of determining whether the transferor of property to a foreign trust would be taxed as a grantor with respect to any portion of a foreign trust if such beneficiary first became a U.S. resident more than 5 years after the transfer.

Outbound trust migrations

The proposal would apply the rules of section 679 to a U.S. person that transferred property to a domestic trust if the trust subsequently became a foreign trust while the transferor was still alive. Such a person would be deemed to make a transfer to the foreign trust on the date of the migration. The amount of the deemed transfer would be the portion of the trust (including undistributed earnings) attributable to the property previously transferred. Consequently, the individual generally would be treated under the rules of section 679 as the owner of that portion of the trust in any taxable year in which the trust has U.S. beneficiaries. The proposal's reporting

requirements and penalties (discussed below) also would be applicable.

Effective date

The rules described in this part would apply to transfers of property after February 6, 1995.

d. Residence of estates and trusts

Treatment as U.S. person

The proposal would establish a two-part objective test for determining for tax purposes whether a trust is foreign or domestic. If both parts of the test are satisfied, the trust would be treated as domestic. Only the first part of the test would apply to estates.

Under the first part of the proposed test, in order for an estate or trust to be treated as domestic, a U.S. court (i.e., Federal, State, or local) must be able to exercise primary supervision over the administration of the estate or trust. It is expected that this test would be satisfied by any trust instrument that specifies that it is to be governed by the laws of any State.

Under the second part of the proposed test, in order for a trust to be treated as domestic, one or more U.S. fiduciaries must have the authority to control all substantial decisions of the trust. It is expected that this test would be satisfied in any case where fiduciaries who are U.S. persons hold a majority of the fiduciary power (whether by vote or otherwise), and where no foreign fiduciary, such as a "trust protector" or other trust advisor, has the power to veto important decisions of the U.S. fiduciaries. It is further expected that, in applying this test, a reasonable period of time would be allowed for a trust to replace a U.S. fiduciary who resigns or dies before the trust would be treated as foreign.

Under the proposal, a foreign estate would be defined as an estate other than an estate that is determined to be domestic under the court-supervision test. A foreign trust would be defined as a trust other than a trust that is determined to be domestic under both the court-supervision test and the U.S. fiduciary test.

Outbound migration of domestic trusts

Under the proposal, if a domestic trust changes its situs and becomes a foreign trust, the trust would be treated as having made a transfer of its assets to the foreign trust and would be subject to the 35-percent excise tax imposed by present-law section 1491 unless one of the exceptions to this excise tax were applicable. The U.S. grantor also would be required to report the transfer under the reporting requirements described below. Failure to report such a transfer would result in penalties (discussed below).

Effective date

The proposal to modify the treatment of a trust or estate as a U.S. person would apply to taxable years beginning after December 31, 1996. In addition, if the trustee of a trust so elects, the proposal would apply to taxable years ending after the date of enactment. The proposed amendment to section 1491 would be effective on the date of enactment.

e. Information reporting and penalties relating to foreign trusts

The proposal would expand the reporting requirements with respect to foreign trusts if there is a U.S. grantor of the foreign trust or a distribution from the foreign trust to a U.S. person. The proposal would require the responsible parties to file the designated information reports with the Treasury Department upon the occurrence of certain events. A failure to comply with the reporting requirements would result in increased monetary penalties under the proposal.

Information reporting requirements

First, the proposal would require the grantor, transferor or executor (i.e., the "responsible party") to notify the Treasury Department upon the occurrence of certain reportable events. The reportable events include direct and indirect transfers of property to a foreign trust, other than a nonexempt employees' trust described in section 402(b), and the death of a U.S. citizen or resident if any portion of a foreign trust was included in the gross estate of the decedent. The required notice would identify the money or other property transferred and report information regarding the trustee and beneficiaries of the foreign trust.

Second, a U.S. person that is treated as the owner of any portion of a foreign trust would be required to ensure that the trust files an annual report to provide full accounting of all the trust activities for the taxable year, the name of the U.S. agent for the trust, and other information as prescribed by the Secretary of the Treasury.[4] In addition, unless a U.S. person is authorized to accept service of process as the trust's limited agent with respect to any request by the Treasury Department to examine records or to take testimony and any summons for such records or testimony in connection with the tax treatment of any items related to the trust, the Treasury Secretary would be entitled to determine the amount to be taken into account under the grantor trust rules (secs. 671 through 679). This limited agency relationship would not constitute an agency relationship for any other purpose under Federal or State law.

Third, any U.S. person who receives (directly or indirectly) any distribution from a foreign trust would be required to file a notice to report the name of the trust, the aggregate

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[4] It is intended that the regulations would require the trust to furnish information to U.S. grantors and beneficiaries concerning income reportable by such persons in a manner similar to that used to report the items on schedule K-1 of Form 1041.

amount of the distributions received, and other information that the Secretary of the Treasury may prescribe. In cases where adequate records are not provided to the Secretary of Treasury to determine that proper treatment of any distributions from a foreign trust, the distribution includible in the gross income of the U.S. distributee would be treated as an accumulation distribution from the mid year of a foreign trust (i.e., the number of years that the trust has been in existence divided by 2) for purposes of computing the interest charge applicable to such distribution.

Monetary penalties for failure to report

Under the proposal, a person who fails to provide the required notice in cases involving the transfer of property to a new or existing foreign trust, or a distribution by a foreign trust to a U.S. person, would be subject to an initial penalty equal to 35 percent of the gross reportable amount. A failure to provide an annual reporting of trust activities would result in an initial penalty equal to 5 percent of the gross reportable amount. In cases involving a transfer of property to a foreign trust, the gross reportable amount would be the gross value of the property transferred. In cases involving the death of a U.S. citizen or resident whose estate includes any portion of a foreign trust, the gross amount would be the greater of: (a) the amount the decedent is treated as owning under the grantor trust rules or (b) the value of the property includible in the gross estate of the decedent. In cases where annual reporting of trust activities is required, the gross reportable amount would be the gross value of the portion of the foreign trust's assets treated as owned by the U.S. grantor at the close of the year, and in cases involving a distribution to a U.S. beneficiary of a foreign trust, the gross reportable amount would be the amount of the distribution to the beneficiary. An additional $10,000 penalty would be imposed for continued failure for each 30-day period (or fraction thereof) beginning 90 days after the Treasury Department notifies the responsible party of such failure. Such penalties would be subject to a reasonable cause exception. In no event would the total amount of penalties exceed the gross reportable amount.

Effective date

The reporting requirements and applicable penalties generally would apply to reportable events occurring or distributions received after the date of enactment. The annual reporting requirement and penalties applicable to U.S. grantors would apply to taxable years of such persons beginning after the date of enactment.

f. Reporting of foreign gifts

The proposal generally would require any U.S. person (other than certain tax-exempt organizations) that receives purported gifts or bequests from foreign sources totaling more than $10,000 during the taxable year to report them to the Treasury Department. The threshold for this reporting requirement would be indexed for inflation. The definition of a gift to a U.S. person for this purpose would exclude amounts that are qualified tuition or medical payments made on behalf of the U.S. person, as defined for gift tax purposes (sec. 2503(e)(2)). If the U.S.

person fails, without reasonable cause, to report foreign gifts as required, the Treasury Secretary would be authorized to determine, in its sole discretion, the tax treatment of the unreported gifts. In addition, the U.S. person would be subject to a penalty equal to 5 percent of the amount of the gift for each month that the failure continues, with the total penalty not to exceed 25 percent of such amount.

Effective date

The proposal would apply to amounts received after the date of enactment.