# Essential Tax Rules of Cross-Border Gifting

## Planners who serve global clients should have in-depth conversations about personal, financial, and immigration objectives

*By Anthony Malik*

*Anthony "Tony" Malik is principal consultant and owner of Point Square Consulting, an international tax specialty firm, in Atlanta. In addition to tax compliance and planning for international families and businesses, Tony is also a non-attorney taxpayer advocate (enrolled agent) and has successfully represented numerous taxpayers in international tax disputes and offshore amnesty procedures before the IRS and other subnational tax authorities. He can be reached at tony@pointsquaretax.com.*

**Strategic gift planning,** done usually to minimize or eliminate the estate and expatriation[1] taxes, is firmly within the purview of tax and financial advisers. The vast majority of gifting occurs in a purely domestic setting, and most experienced advisers are indeed aware of the essential tax consequences to the parties involved in such gifting. The U.S. gift tax consequences, however, may not necessarily be immediately intuitive or apparent, even to many seasoned advisers, when one party to the transaction is a nonresident.[2] Advisers who specialize in working with international clients are undoubtedly familiar with the plethora of special obligations and penalties for noncompliance imposed on both cross-border gift donors and donees under the Internal Revenue Code (IRC). Considering that we live in an increasingly integrated world wherein global human movement and settlement is the norm, it would be highly beneficial for generalist advisers to also become familiar with at least the essential tax rules of cross-border gifting.

The ensuing sections of this article will provide a general overview of the U.S. tax consequences of cross-border gifting. It should go without saying that the complex nature of U.S. tax law renders an in-depth, comprehensive analysis—which would depend on the completeness of each individual set of facts—of the scenarios considered herein a rank impossibility. For example, to keep things manageable, a very incomplete list of things that this article will not delve into—all of which may or may not have a bearing on either the U.S. or nonresident donor or donee—include the creditability of foreign gift taxes, the impact of an applicable estate and gift tax treaty on the outcome, U.S. state and local tax consequences, gifts of future interests, income tax consequences (e.g., basis determination, recharacterization of an accession to wealth as

taxable income by the IRS), or gifts from business or fiduciary entities. With this important caveat out of the way, let us now turn to some cross-border gifting scenarios that advisers can come across.

> **"The IRS can impose penalties on the U.S. donor for both late filing and payment of gift taxes unless it can be established to the satisfaction of the IRS that there was reasonable cause for the delay."**

### Gifts from U.S. Donors to Nonresident Donees

This is an appropriate starting point for the substance of our discussion because assets held by U.S. donors, irrespective of their situs, gifted to nonresidents are subject to the same general tax rules as gifts in a purely domestic setting. In determining a U.S. donor's taxable gifts, certain statutory exclusions and deductions are permitted. The most commonly availed exclusion is the automatic maximum annual exclusion for the first $15,000[3] of gifts made to each nonresident donee during any single tax year. Gifts of up to the maximum annual exclusion amount can be made every tax year completely tax-free and without reporting consequences to as many nonresident donees as a U.S. donor may desire. However, gifts to any single nonresident donee during a single tax year exceeding the maximum annual exclusion amount generally cannot be made on a tax-free basis. As another example, the law also provides an unlimited exclusion for the payment of qualified tuition or medical expenses of a nonresident donee.[4] So as a tax planning strategy, U.S. donors seeking to aggressively manage their high-net-worth could be advised to fund the entirety of each of their intended nonresident beneficiaries' education and medical costs in addition to gifting each of them up to the maximum annual exclusion amount in cash and other assets each tax year.

Taxable gifts (i.e., gifts exceeding the maximum annual exclusion amount in any single tax year) to any single nonresident donee are reported annually to the IRS on Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return.[5] On Form 709, U.S. donors can claim a generous lifetime unified credit against their resulting gift tax liability, which for the most recently passed tax year (2021) was as high as $4,625,800.[6] Consequently, though a U.S. donor may be responsible for making taxable gifts, he or she may not necessarily owe any tax after utilizing any portion of the available lifetime unified credit. Form 709 is generally due between January 1 and April 15 of the year following the tax year in which the gifts are made.[7] The IRS can impose penalties on the U.S. donor for both late filing and payment of gift taxes unless it can be established to the satisfaction of the IRS that there was reasonable cause for the delay. Compliance-wise, nonresident donees, on the other hand, are outside of the U.S.'s taxing jurisdiction and thus free of any reporting obligations.

### Gifts from U.S. Donors to Their Nonresident Spouses

Married couples, in a purely domestic context, generally need not be concerned with gift taxation due to the unlimited interspousal gift tax deduction afforded to them by the law.[8] However, this cardinal benefit is not extended to gifts from U.S. donors to their nonresident spouses.[9] Gifts to nonresident spouses instead have an annual inflation-adjusted deduction, which for the most recently passed tax year (2021) totaled $159,000.[10] The apparent rationale for imposing limits on the nontaxability of asset transfers from a U.S. donor to their nonresident spouse is that

in the absence of such a remedial provision, taxpayers could, under a number of different scenarios, freely transfer highly appreciated assets outside of the U.S.'s taxing jurisdiction and have the accompanying realized capital gains escape U.S. taxation altogether.

Gifts valued at more than the maximum annual exclusion amount to a nonresident spouse in any single tax year incur a tax cost and are required to be reported on Form 709 to the IRS by the applicable due date. As in the previous scenario, the U.S. spouse can utilize any portion of their available lifetime unified credit amount against the resulting gift tax liability. The nonresident donee spouse, on the other hand, is not subject to reporting under the Code.

## Gifts from Nonresident Donors to U.S. Donees

U.S. donees are required to report to the IRS on Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts, their receipt of gifts from nonresidents if the aggregate value of such gifts from any single nonresident donor during any single tax year exceeds $100,000.[11] The filing deadline for Form 3520 is pegged to the filing deadline of the donee's U.S. income tax return (i.e., Form 1040, U.S. Individual Income Tax Return).[12] Once the $100,000 threshold is exceeded, each gift in excess of $5,000 received during the year must be separately reported to the IRS.[13] It is particularly with such inbound gifts that U.S. taxpayers must be very vigilant about their federal tax reporting duties because noncompliance in this area is cause for draconian penalties. To wit, a U.S. donee who does not properly report an inbound gift on Form 3520 by their filing deadline, or who fails to include all of the required information, or includes incorrect information is subject to a penalty equal to 5 percent of the total value of the gift for each month, or fraction thereof, that the failure continues, up to a maximum penalty of 25 percent.[14]

An interesting consideration with respect to inbound gifts is that gifts from multiple nonresident donors can be treated, depending on the facts, as having been made by a single nonresident donor. The U.S. donee, in determining whether they received gifts in excess of $100,000 from a single nonresident during a single tax year, must aggregate gifts from foreign persons that the U.S. donee knows, or has reason to know, are related within the meaning of Code Section 643(i)(2)(B).[15] Notice here that no such aggregation rule exists with respect to gifts from a U.S. donor to nonresident donees. In effect, when determining whether a U.S. donor makes taxable gifts to any single nonresident donee during any single tax year, they are not required to aggregate gifts to foreign persons that such U.S. donor knows, or has reason to know, are related. The aggregation rule, inapplicable to outbound gifts, is a unique feature of inbound gifts.

For the aggregation rules to apply, the stipulation is that the nonresident donors themselves must be related to one another and not necessarily related to the U.S. donee. The following example provided by the IRS is very helpful in concretizing the guidance on this matter:

> "A is a U.S. citizen who is married to B. B and all of B's brothers, C, D, and E, are not U.S. persons. In a single taxable year, B makes a gift of $90,000 to A, C makes a gift of $40,000 to A, D makes two gifts to A (one of $4,000 and one of $3,000), and E makes a gift of $4,000 to A. For that taxable year, A must report the receipt of $141,000 in gifts from foreign persons. A must separately identify the $90,000 gift from B because B and his brothers gave gifts in excess of $100,000. A must also separately identify the $40,000 gift from C because C and his brothers gave gifts in excess of $100,000. A must identify the receipt

of $7,000 in total gifts from D because D and his brothers gave gifts in excess of $100,000, but is not required to separately list information about each transaction because no gift is in excess of $5,000. A is not required to separately identify transaction information about E's gifts because gifts from foreign individuals of less than $5,000 are not required to be separately identified."[16]

On the other hand, gifts valued at under $100,000 received from multiple unrelated nonresident donors in a single tax year are not subject to reporting even if the aggregate value of all such gifts exceeds $100,000. Along the same vein, it should be mentioned that in the case of having received gifts in excess of $100,000 from multiple unrelated nonresident donors in a single tax year, the guidance is suggestive, but not determinative, that the U.S. donee should file a separate Form 3520 with respect to reportable gifts from each nonresident.[17]

Insofar as the nonresident donor's obligations under the Code are concerned, the determination of the situs of the gifted assets is an essential component. Nonresident donors are not subject to U.S. gift taxation under Code Section 2501 unless the gift consists of U.S. situs real or tangible personal property.[18] Gifts of intangible properties, even of U.S. situs, from nonresident donors to U.S., or for that matter nonresident, donees do not trigger U.S. gift taxation.[19] While at first mention, foreign ownership of valuable U.S. situs assets may seem like a curious concept, experienced U.S. cross-border advisers can affirm that it is not uncommon for high-net-worth nonresidents to educate their children at U.S. universities, spend a considerable amount of leisure time in the U.S., invest in the U.S. financial and real estate markets, and own expensive U.S. situs tangible personal property (e.g., cars and boats). Once subject to U.S. gift taxation, in 2021, similar to U.S. donors, nonresidents also enjoy an exclusion of the first $15,000 of gifts.[20] Gifts of U.S. situs exceeding $15,000 made to any single U.S. or nonresident donee in a single tax year are reportable on Form 709.

An extremely important point to note is that unlike U.S. donors, who can benefit from utilizing any portion of their available lifetime unified credit against their gift tax liability, nonresidents cannot utilize any such credit against their gift tax liabilities.[21] Nonresident donors' taxable gifts are instead taxed cumulatively over their lifetime at graduated rates ranging from 18 percent to 40 percent for gifts made after 2012.[22] The comparatively more immediate gift tax consequences to nonresidents make considerations such as asset selection, donee identification, and disciplined timing very important elements of their overall gift-giving strategy.

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### Gifts from Nonresident Donors to Their U.S. Spouses

The available guidance on gifts from nonresident donors does not make any special mention, modification, exemption, or exclusion for gifts from nonresident spouses of U.S. donees. Thus, the aforementioned general rules of inbound gift taxation are applicable in full force to U.S. recipients of gifts from their nonresident spouses thereby making them subject to the same reporting requirements as are U.S. recipients of gifts from any other nonresident donors.

The gift taxation of the nonresident spouse, on the other hand, is altogether different from that of the generic nonresident donor under the immediately preceding heading in this paper. During the course of a given tax year, a nonresident spouse may gift U.S. or non-U.S. situs assets of an unlimited value to their U.S. spouse on a completely tax-free basis without creating a concomitant Form 709 filing requirement for oneself. It is tempting to postulate that the reason for such tax treatment, at least insofar as the nonresident spouse's U.S. situs assets are concerned, is that appreciated assets remain in the hands of a taxpayer who is subject to U.S. taxation. However, should that be the case, then it is not at all clear as to why nonresident donors are subject to harsh taxation upon gifting U.S. situs assets to U.S. donees other than their spouse.[23]

In the consideration of this topic, it is also useful to contrast the gift tax treatment of the nonresident-spouse donor with that of a U.S. counterpart. While gifts going from a U.S. donor to their nonresident spouse do not qualify for the unlimited marital deduction, as we have just discussed, gifts flowing in the opposite direction do.

## Gifts from Former U.S. Persons to U.S. Donees

In a stark departure from customary U.S. gift tax law (i.e., the donor is primarily liable for the payment of gift taxes[24]), Congress, on June 17, 2008, added Code Section 2801 to the Code to legislatively shift the gift tax burden to U.S. donees in the case of receipt of gifts from certain former U.S. persons who either previously renounced their U.S. citizenship or relinquished their green cards. In addition, the Code Section 2801 gift tax is imposed on the U.S. donee more onerously than how the gift tax is generally imposed on donors in most cases; to wit, the lifetime unified credit is unavailable to the U.S. donee to eliminate—or at the very least mitigate—their gift tax liability.[25] Resultantly, gifts in excess of the maximum annual exclusion amount are subject to U.S. gift taxation at the highest prevailing marginal gift and estate tax rate.[26]

Very interestingly, though the Code Section 2801 gift tax was statutorily codified almost a decade and a half ago, the U.S. Department of the Treasury never issued finalized regulations providing guidance as to the administration of, and compliance with, this newly enacted gift tax. The IRS, for its part, has announced that it intends to release new Form 708, U.S. Return of Gifts or Bequests From Covered Expatriates, once final regulations are promulgated. U.S. donees can, until such time that Form 708 is released, enjoy both tax-deferral and a reporting exemption courtesy of the IRS.[27] Notwithstanding, to the Treasury Department's credit, it has issued proposed regulations that provide interim guidance.[28] However, since proposed regulations are subject to change, even to substantial change, prior to final promulgation, the time and effort required to divine their detailed meanings for purposes of our discussion is not warranted.

## Closing Thoughts

The preceding discussion is meant to provide readers with a fundamental conceptual understanding of, and an appreciation for, the U.S. rules of cross-border gift taxation. In practice, the more complicated one's client's set of facts as they pertain to cross-border gifting, the deeper one must delve into the devilish details to ascertain the proper treatment. As a general rule of thumb, advisers should, when helping international clients plan their gifting strategy, obtain as much relevant background information possible. Some of the items for which information from clients should be requested include the constitution of their net worth, situs of their assets, applicable foreign transfer taxes, and long-term residence/domicile

intentions as they relate to the United States, etc. It is only after a reasonably comprehensive understanding of a client's long-term personal, financial, immigration, and business goals can an optimal gift-giving strategy be crafted. ■

## Endnotes

1. The expatriation tax is a net-worth-based exit tax that is imposed on certain U.S. citizens and long-term permanent legal residents upon the renunciation of their U.S. citizenship or relinquishment of their green cards. See IRC §§ 877 and 877A.
2. In very simple terms, a nonresident for U.S. estate and gift tax purposes is a non-U.S. citizen domiciled abroad. See Treas. Reg. §§ 20.0-1(b) and 25.2501-1(b).
3. Inflation-adjusted by IRC § 2503(b)(2), the exclusion for the most recently passed tax year (2021) was $15,000. (Rev. Proc. 2020-45; Instructions, Form 709 (August 26, 2021), pg. 2.
4. IRC § 2503(e).
5. IRC § 6019.
6. IRC § 2505. The lifetime exemption of $11,700,000, using the blended estate and gift tax rate, yields a credit of $4,625,800.
7. Treas. Reg. § 25.6075-1.
8. IRC § 2523(a).
9. IRC § 2523(i).
10. Rev. Proc. 2020-45.
11. IRC § 6039F(a); Notice 97-34, 1997-1 C.B. 422.
12. "In general, a U.S. person's Form 3520 is due on the 15th day of the fourth month following the end of such person's tax year for income tax purposes, which, for individuals, is April 15 . . . " See the text under the heading "When and Where to File," Instructions, Form 3520 (November 30, 2021), pg. 2.
13. Instructions, Form 3520 (November 30, 2021), pg. 12.
14. IRC § 6039F(c)(1)(B).
15. Notice 97-34, 1997-1 C.B. 422, § VI(B)(3). Ascertaining "related parties" under the Code for various tax purposes can be a wondrously complex exercise. For purposes of our discussion, suffice it to say that family members (i.e., siblings, half siblings, spouses, ancestors, descendants, and the spouses of any of these) constitute relatives. See IRC § 267(c)(4).
16. Ibid.
17. See the verbiage in Notice 97-34, 1997-1 C.B. 422, § VI(B)(1).
18. *Burnet v. Brooks*, 288 U.S.378 (1933); Treas. Reg. § 25.2511-3(a)(1)(i).
19. However, a nonresident's U.S. situs intangible property is subject to U.S. estate taxation. IRC §§ 2031, 2103, and 2106. Therefore, for estate tax planning purposes, nonresidents may be advised to reduce their net worth by making inter vivos gifts of U.S. situs intangible property.
20. Ibid.
21. A nonresident can, however, claim a meager estate tax credit worth $13,000. See IRC § 2102(b). Technically, the effect of this credit is to shelter the first $60,000 of the nonresident's gross U.S. taxable estate from the federal estate tax.
22. IRC §§ 2001(c) and 2502(a) (amended by the American Taxpayer Relief Act of 2012, P.L. 112-240, § 101(c)).
23. Along the same vein, also consider gifts in a purely domestic setting wherein the gift tax is indeed applicable.
24. IRC § 1619.
25. On the other hand, had the former U.S. person gifted assets to the same U.S. donee prior to expatriating, the donor would be allowed to utilize a lifetime unified credit worth as much as $4,625,800 against any potential U.S. gift tax liability, and the U.S. donee could enjoy a tax-free accession to wealth.
26. In 2021, the highest marginal estate and gift tax rate was 40 percent. See IRC §§ 2001(c) and 2502(a).
27. Preamble to REG-112997-10; Announcement 2009-57, 2009-29 I.R.B. 158.
28. Prop. Treas. Reg. §§ 28.2801-0 through 28.2801-7.