



Tax Planning for Sexual Harassment Claims - US Taxpayers - Foreign Gifts

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Gary S. Wolfe has over 34 years of experience, specializing in IRS Tax Audits and International Tax Matters including: International Tax Planning/Tax Compliance, and International Asset Protection.

As of July 2016, Gary Wolfe has internationally published 15 books and 28 articles. Gary has received 14 international tax awards from five different Global expert societies in LONDON/UK including being voted one of the 100 leading world's law firms with votes from over 150,000 voters in over 160 countries with the following award: Global 100 (2016) (KMH Media Group) - CA/US International Tax Planning Law Firm of the Year.

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Tax Planning for Sexual Harassment Claims: US Taxpayer/Foreign Gifts

When the parties involve a payor who is an international (i.e. non-US person) intricate tax reporting rules may arise under IRS Form 3520 which requires an annual report be filed for US taxpayers who receive foreign gifts from foreign persons (i.e. Non-Resident Aliens "NRAs"/Foreign Estates or through a nominee for a foreign donor) if the gift or aggregate gift was for more than \$100k in any tax year, or over \$15,601 if received from a foreign corporation or partnership.

The penalties for failure to report include: up to 25% of the amount of the gift, and up to 40% of the amount of the underpayment of tax attributable to any "undisclosed foreign financial asset.

In the case of any transfer directly from a foreign partnership or foreign corporation which the recipient treats as a gift the Secretary of the Treasury (IRS) may recharacterize such transfer (as income) to avoid tax evasion. The IRS may also impose an accuracy-related penalty of 20% for the underpayment of tax required to be shown on the tax return.

If the gift is received and held in an off-shore (i.e. Non-US situs) bank account and is over \$10,000 in any one tax year, the recipient may be required to disclose the offshore gift (on their Form 1040/Schedule B/Part III/Line 7) and to file Fincen Form 114 (FBAR filing) to report the foreign gift or be subject to a 50% per year civil penalty and a maximum 10 years in jail if willful failure to file the FBAR form.

The test for triggering the tax compliance is whether the US person "knew or had reason to know the gift was from a foreign person/estate/entity.

Penalties may not apply if the US person failure to report a foreign gift was due to reasonable cause and not willful neglect.

For US taxpayers who receive gifts in settlement of sexual harassment claims the intricate tax rules for US Taxpayers to report foreign gifts is summarized below.

US Tax Law (Foreign Gifts)

US Taxpayers who receive Foreign Gifts from Foreign Persons More than \$100,000 (from Non-Resident Alien ("NRA") or Foreign Estate, which includes foreign persons related to NRA or Foreign Persons related to Foreign Estate) or more than \$15,601 (as gifts from foreign corporation/partnerships) must file Form 3520 and declare those gifts annually or be subject to penalties.

The penalty for failure to report the gifts are 5% of the amount of the foreign gifts for each month for which the failure to report the gift continues (not to exceed a total of 25% of the gift).

To calculate the over \$100,000/\$15,601 threshold the US Taxpayer must aggregate the gifts from the NRAs/Foreign Estates (Partnerships/Corporations). The test is whether the US Taxpayer gift recipient "knew or had reason to know the gift was from a foreign person/estate/entity).

The US Taxpayer test includes do they know or have any reason to know that the foreign donor in making any gift was acting as a nominee or intermediary for any other person.

The penalty for Foreign Gifts is imposed if IRS Form 3520 is not timely filed. The Form 3520 filing is due with the income tax returns due for taxpayer (subject to extensions). If the complete Form 3520 is not timely filed by the due date (including extensions), the time for "assessment of any tax imposed with respect to any event or period will not expire before the date that is 3 years after the due date on which the required information is reported" (IRC 6501(c)(8)).

This tax rule enacted as part of the Foreign Account Tax Compliance Act (March 2010, enacted as part of the HIRE ACT (Hiring Incentives to Restore Employment Act), amended the prior law and made the entire income tax return (not just the Form 3520) suspended until 3 years after the due date on which the required information for Form 3520 due for the foreign gift is reported.

IRC 6039 F governs the reporting of large gifts received from foreign persons. Under IRC 6039 F (a) a "foreign gift" means any amount received from a person other than a US person which the recipient treats as a foreign gift. Under 6039 F (c) (1) (A) (B): If the US person fails to furnish the information required (by the Secy of the Treasury)

(A) the tax consequences of the receipt of such gift shall be determined by the Secy of the Treasury.

(B) such US person shall pay (upon notice and demand by the Secy and in the same manner as tax) an amount equal to 5% of the amount of such foreign gift for each month for which the failure continues (not to exceed 25% of such amount in the aggregate).

Under 6039 F (c) (2), the penalty shall not apply "to any failure to report a foreign gift if the US person shows that the failure is due to reasonable cause and not due to willful neglect."

Foreign gifts do not include a gift to a US person for any payment made for qualified tuition or medical payments on behalf of a US person.

Under IRC 672 (f) (4), in the case of any transfer directly (or indirectly) from a partnership or foreign corporation which the transferee treats as a gift, the Secy of Treasury may recharacterize such transfer to prevent avoidance of the purposes of this subsection.

Under IRC 6662 (j) there is an accuracy-related penalty imposed for underpayment of tax required to be shown on a tax return. There shall be added to the tax an amount equal to 20% of the portion of the underpayment of tax.

Under IRC Sec. 6662(j) if there is an undisclosed foreign financial understatement i.e. Under IRC 6662 (j)(1) an understatement for such taxable year which is attributable to any transaction involving an undisclosed foreign financial asset, the penalty is 40% (not 20%) of the underpayment of tax attributable to any "undisclosed foreign financial asset".

If the gift is received in an offshore bank account and is over \$10,000 the recipient may be required to file Fincen Form 114 (FBAR filing) to report the foreign gift or be subject to a 50% per year civil penalty (based on the highest value for the off-shore account for the tax year) and a maximum 10 years in jail as a criminal penalty for each year not filed.

