

Effective Date

The provision is 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 (secs. 411–417 of the bill and secs. 643, 665, 668(a), 672, 679, 1491, 1494, 6038, 6039G, 6677, 7701(a) and 7872(f) of the Code)**

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 are not subject to 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 provides that if a U.S. beneficiary of an inbound grantor trust transfers property to the foreign grantor by gift, that U.S. beneficiary is treated as the 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 and 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 that 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 transfers that represent sales or exchanges of property at fair market value where gain is recognized to the transferor.

Residence of trusts

A 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 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 that 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 trust or a nongrantor trust. Similarly, any U.S. person that 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, any U.S. person that makes a transfer described in section 1491 is required to report the transfer to the Treasury Department.

Any person that fails to file a required report with respect to the creation of, or a transfer to, a foreign trust may be subject to a penalty of 5 percent of the amount transferred to the foreign trust. Similarly, any person that fails to file a required annual report with respect to a foreign trust with U.S. beneficiaries may be subject 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.

Reasons for Change***Grantor trust rules******Inbound grantor trusts***

The Committee has been informed that the U.S. grantor trust provisions are being used as a vehicle to avoid U.S. tax. If a trust is treated as a grantor trust, only the owner of the trust is taxable on the trust's income and not the trust's beneficiaries. Thus, if a foreign person creates a trust with U.S. beneficiaries that is treated as a grantor trust for U.S. tax purposes and if the foreign person's home country does not tax the income, the income of the trust would not be subject to tax by either the United States or the foreign country. The Committee believes that the income derived through these types of arrangements should be subject to tax by at least one jurisdiction.

Outbound grantor trusts

The Committee understands that taxpayers have avoided the application of the outbound grantor trust rules of section 679. For example, a transfer of property to a foreign trust may be structured as a sale in exchange for a note issued by the trust or a person related to the trust where the note will not be repaid. The Committee believes that it is appropriate to disregard notes that do not reflect arm's-length terms in determining whether the transferor received fair market value for the property transferred.

Foreign nongrantor trust rules

The 6-percent simple interest charge applicable to accumulation distributions has not been updated since 1976. In essence, income earned through a foreign nongrantor trust may be deferred from U.S. taxation, then subjected to a below-market interest rate when distributed to a U.S. beneficiary. The Committee believes that it is appropriate to charge the same rate of interest on accumulation distributions as is applicable to general underpayments of income tax.

Under current law, a U.S. beneficiary of a foreign trust may avoid U.S. tax on the income accumulated through the trust by obtaining a "loan" of cash or marketable securities from the trust in lieu of an actual distribution. The Committee believes that it is appropriate to treat loans that do not reflect arm's-length terms as distributions to the borrower.

Residence of trusts

Because the U.S. tax treatment of a trust (and the beneficiaries of a trust) depends on the residence of the trust, the Committee believes that it is appropriate to provide objective criteria for determining the residence of trusts.

Information reporting requirements and associated penalties

The Committee has been informed that certain U.S. settlors have established foreign trusts, including grantor trusts, in tax haven jurisdictions. Income from such foreign grantor trusts is taxable currently to the U.S. grantor, but the Committee understands that there is noncompliance in this regard. The Committee is concerned that the present-law civil penalties for failure to comply with the reporting requirements applicable to foreign trusts established by U.S. persons have proven to be ineffective. In order to deter noncompliance, the Committee believes that it is appropriate to expand the reporting requirements relating to activities of foreign trusts with U.S. grantors or U.S. beneficiaries and to increase the civil penalties applicable to a failure to comply with such reporting requirements.

The Committee understands that some of the jurisdictions in which U.S. settlors have established foreign trusts have strict secrecy laws. The Committee is concerned that the secrecy laws may effectively preclude the Treasury Department from obtaining information necessary to determine the tax liabilities of the U.S. grantors or U.S. beneficiaries with respect to items related to such foreign trusts. The Committee believes that, it is useful, in the case of a foreign trust with a U.S. grantor, to provide an incentive for

the trust to have a limited U.S. agent to accept service of process in order to improve the administrability of the tax law applicable to taxation of income derived from foreign trusts.

Explanation of Provisions

Overview

The bill modifies the tax treatment of trusts as follows:

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

b. Beginning on January 1, 1996, the interest rate applicable to accumulation distributions from foreign nongrantor trusts is the rate imposed on underpayment of tax under section 6621(a)(2), with compounding. The accumulation distribution generally is 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 is 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 is 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, by any grantor or beneficiary of the trust, or by any person related to any grantor or beneficiary generally are not taken into account.

d. The bill authorizes the Secretary of the Treasury to issue regulations to prevent abusive transactions to avoid the purposes of these rules.

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

f. The bill expands 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 bill requires the responsible parties to file information returns with the Treasury Department upon the occurrence of certain events. A failure to comply with the reporting requirements results in increased monetary penalties. Special sanctions apply 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.

g. 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 is required to report the gift to the Treasury Department. Monetary penalties and other sanctions apply to a failure to comply with the reporting requirement.

The provisions are described in more detail below.

a. Inbound grantor trusts with foreign grantors

Foreign grantors not treated as owners

Under the bill, the grantor trust rules generally apply only to the extent that they result, directly or indirectly, in income or other amounts (if any) 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 do not apply to any portion of a trust where their effect is to treat a foreign person as owner of that portion.

The bill provides certain exceptions to the rule described above. Under one exception, the grantor trust rules continue to apply to the portion of a trust where that portion of the trust is revocable by the grantor either without approval of another person or with the consent of a related or subordinate party who is subservient to the grantor (as defined in sec. 672(c)). Under another exception, the grantor trust rules continue to apply to the portion of a trust where the only amounts distributable from that portion during the lifetime of the grantor are to the grantor or the grantor's spouse. The general rule denying grantor trust status does not apply to trusts established to pay compensation, and certain trusts in existence as of September 19, 1995 provided that such trust is treated as owned by the grantor under section 676 or 677 (other than sec. 677(a)(3)).¹ In addition, the grantor trust rules generally apply where the grantor is a controlled foreign corporation (as defined in sec. 957). Finally, the grantor trust rules continue to apply in determining whether a foreign corporation is characterized as a passive foreign investment company ("PFIC"). Thus, a foreign corporation cannot avoid PFIC status by transferring its assets to a grantor trust.

If a U.S. beneficiary, or a family member of such a beneficiary,² of an inbound grantor trust transfers property to the foreign grantor, such beneficiary generally is treated as a grantor of a portion of the trust to the extent of the transfer. This rule applies without regard to whether the foreign grantor is otherwise treated as the owner of any portion of such trust. However, this rule does not apply if the transfer is a sale of the property for full and adequate consideration or if the transfer is a gift that qualifies for the annual exclusion described in section 2503(b).

The bill provides a special rule that allows the Secretary of the Treasury to recharacterize a transfer, directly or indirectly, from a partnership or foreign corporation which the transferee treats as a gift or bequest, to prevent the avoidance of the purpose of section 672(f).³

In a case where a foreign person (that 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, the Committee anticipates that Treasury regulations will provide that, for foreign tax credit purposes, U.S. beneficiaries that are subject to U.S. income tax on the same income will be treated as having paid the foreign taxes

¹ The exception does not apply to the portion of any such trust attributable to any transfers made after September 19, 1995.

² For this purpose, a family member is generally defined as a brother, sister, spouse, ancestor or lineal descendant.

³ See discussion below for reporting requirements under the bill with respect to certain foreign gifts and bequests received by a U.S. person.

that are paid by the foreign grantor. Any resulting foreign tax credits would be subject to applicable foreign tax credit limitations.

The bill provides a transition rule for any domestic trust that has a foreign grantor that is treated as the owner of the trust under present law, but becomes a nongrantor trust under the bill. 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 is exempt from the excise tax on transfers to a foreign trust otherwise imposed by section 1491. However, the bill's new reporting requirements and penalties are applicable to such a trust and its beneficiaries. In addition, the assets of such a trust will be treated as if they were recontributed to a nongrantor trust by the foreign grantor, with no recognition of gain or loss, on the date the trust ceases to be treated as a grantor trust. The nongrantor trust will have the same basis in such assets as did the grantor on the date the trust ceases to be treated as a grantor trust.

Distributions by foreign trusts through nominees

The bill generally treats any amount paid to a U.S. person, where the amount was derived (directly or indirectly) from a foreign trust, as if paid by the foreign trust directly to the U.S. person. This rule disregards 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 applies whether or not the trust was created by a U.S. person. The rule does 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 provisions discussed in this part are effective on the date of enactment.

b. Foreign trusts that are not grantor trusts

Interest charge on accumulation distributions

The bill changes 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 same manner as interest imposed on underpayments of tax under section 6621(a)(2). Simple interest is accrued at the rate of 6 percent through 1995. Beginning on January 1, 1996, however, compound interest based on the underpayment rate is 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 is allocated proportionately to prior trust years in which the trust has 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 is treated as reducing proportionately the undistributed net income from prior years.

The bill includes a formula to determine the period for which interest is charged using the underpayment rates under section

6621(a)(2). Under the formula, for example, if a foreign nongrantor trust had \$100 of undistributed net income each year in years 1 through 3 and the trust distributes \$100 of accumulated income to its U.S. beneficiary in year 4, the taxpayer has to pay interest using the section 6621(a)(2) interest rates as if the income accrued for 2 years.⁴ In addition, the \$100 accumulation distribution reduces the trust's undistributed net income by \$33 each year for years 1 through 3.⁵

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 beneficiary⁶), except to the extent provided by Treasury regulations, the bill treats the full amount of the loan as distributed to the grantor or beneficiary. The Committee expects that the Treasury regulations will provide an exception from this treatment for loans with arm's-length terms. In applying this exception, the Committee further expects consideration to be given to whether there is a reasonable expectation that a loan will be repaid. In addition, any subsequent transaction between the trust and the original borrower regarding the principal of the loan (e.g., repayment) is disregarded for all purposes of the Code. This provision does not apply to loans made to persons that are exempt from U.S. income tax.

Effective date

The provision to modify the interest charge on accumulation distributions applies to distributions after the date of enactment. The provision with respect to loans to U.S. grantors, U.S. beneficiaries or a related U.S. person related to such a grantor or beneficiary applies to loans made after September 19, 1995.

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

The bill makes several modifications to the general rule of section 679(a)(1) under which 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 the trust. The bill also contains an amendment to conform the definition of certain foreign corporations the income of which is deemed to be accumulated for the benefit of a U.S. beneficiary to the definition of controlled foreign corporations (as defined in sec. 957(a)).

Sale or exchange at market value

Present law contains several exceptions to grantor trust treatment under section 679(a)(1) described above. Under one of the exceptions, grantor trust treatment does not result from a transfer of

⁴The number of years is determined as a weighted average as follows: $(\$100 \times 3 \text{ years}) + (\$100 \times 2 \text{ years}) + (\$100 \times 1 \text{ year}) \div \$300 = 2$

⁵That is, one-third of the \$100 of distribution reduces the \$100 of undistributed net income for each of years 1, 2 and 3.

⁶For 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), except that in applying section 267(c)(4) an individual's family includes the spouses of the members of the family.

property 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 bill provides that obligations issued (or, to the extent provided by regulations, guaranteed) by the trust, by any grantor or beneficiary of the trust, or by any person related to any grantor or beneficiary⁷ (referred to as “trust obligations”) generally are not taken into account except as provided in Treasury regulations. The Committee expects that the Treasury regulations will provide an exception from this treatment for loans with arm’s-length terms. In applying this exception, the Committee further expects consideration to be given to whether there is a reasonable expectation that a loan will be repaid. Principal payments by the trust on any such trust obligations generally will reduce the portion of the trust attributable to the property transferred (i.e., the portion of which the transferor is treated as the grantor).

Other transfers

The bill adds a new exception to the general rule of section 679(a)(1) described above. Under the bill, a transfer of property to certain charitable trusts is 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 bill applies the rule of section 679(a)(1) 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 is treated as making a transfer to the foreign trust on the individual’s U.S. residency starting date (as defined in sec. 7701(b)(2)(A)). The amount of the deemed transfer is the portion of the trust (including undistributed earnings) attributable to the property previously transferred. Consequently, the individual generally is treated under section 679(a)(1) as the owner of that portion of the trust in any taxable year in which the trust has U.S. beneficiaries. The bill’s reporting requirements and penalties (discussed below) also are applicable.

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

Outbound trust migrations

The bill applies the rules of section 679(a)(1) to a U.S. person that transferred property to a domestic trust if the trust subsequently becomes a foreign trust while the transferor is still alive. Such a person is deemed to make a transfer to the foreign trust

⁷For this purpose, a person is 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), except that in applying section 267(c)(4) an individual’s family includes the spouses of the members of the family.

on the date of the migration. The amount of the deemed transfer is the portion of the trust (including undistributed earnings) attributable to the property previously transferred. Consequently, the individual generally is treated under the rules of section 679(a)(1) as the owner of that portion of the trust in any taxable year in which the trust has U.S. beneficiaries. The bill's reporting requirements and penalties (discussed below) also are applicable.

Effective date

The provisions to amend section 679 apply to transfers of property after February 6, 1995.

d. Anti-abuse regulatory authority

In general

The bill includes 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.

Effective date

The provision is effective on the date of enactment.

e. Residence of trusts

Treatment as U.S. person

The bill establishes 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 is treated as domestic.

Under the first part of the proposed test, in order for a 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 trust. The Committee expects that this test generally will 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. The Committee expects that this test will be satisfied in any case where fiduciaries that 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. The Committee further expects that, in applying this test, a reasonable period of time will be allowed for a trust to replace a U.S. fiduciary that resigns or dies before the trust is treated as foreign.

Under the bill, a foreign trust is 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 bill, if a domestic trust changes its situs and becomes a foreign trust, the trust is treated as having made a transfer of its assets to a foreign trust and is subject to the 35-percent excise

tax imposed by present-law section 1491 unless one of the exceptions to this excise tax is applicable. The U.S. grantor also is 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 provision to modify the treatment of a trust as a U.S. person applies to taxable years beginning after December 31, 1996. In addition, if the trustee of a trust so elects, the provision would apply to taxable years ending after the date of enactment. The amendment to section 1491 is effective on the date of enactment.

f. Information reporting and penalties relating to foreign trusts

The bill expands 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 bill requires the responsible parties to file information returns with the Treasury Department upon the occurrence of certain events. A failure to comply with the reporting requirements will result in increased monetary penalties.

Information reporting requirements

First, the bill requires the grantor, transferor or executor (i.e., the “responsible party”) to notify the Treasury Department upon the occurrence of certain reportable events. The term “reportable event” means the creation of any foreign trust by a U.S. person, the direct and indirect transfer of any money or property to a foreign trust, including a transfer by reason of death, 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. A reportable event does not include any transfer of property to a foreign trust in exchange for consideration of at least the fair market value of the property.⁸ Also excluded are transfers to certain pension trusts, nonexempt employees’ trusts described in section 402(b), and charitable trusts. The required return provides information regarding the amount of money or other property transferred to the trust, the identities of the trustee and beneficiaries of the foreign trust, and other items as prescribed by the Secretary of the Treasury.

Second, a U.S. person that is treated as the owner of any portion of a foreign trust is required to ensure that the trust files an annual return 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.⁹ 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

⁸For this purpose, consideration other than cash is taken into account at its fair market value and the rules of section 679(a)(3), as modified by the bill, apply (see earlier discussion).

⁹The Committee intends that the Treasury 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.

the tax treatment of any items related to the trust, the Treasury Secretary is entitled to determine the tax consequences of amounts to be taken into account under the grantor trust rules (secs. 671 through 679). This limited agency relationship does not constitute an agency relationship for any other purpose under Federal or State law. The Committee intends that the Treasury Secretary's exercise of its authority to make such a determination will be subject to judicial review under an arbitrary or capricious standard, which provides a high degree of deference to such determination. For this purpose, rules similar to the rules of sections 6038A(e)(2) and (4) with respect to enforcement of requests for certain records apply.

Third, any U.S. person that receives (directly or indirectly) any distribution from a foreign trust is required to file a return to report the name of the trust, the aggregate 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 the proper treatment of any distributions from a foreign trust, the distribution is includable in the gross income of the U.S. distributee and is treated as an accumulation distribution from the middle year of a foreign trust (i.e., computed by taking 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, unless the foreign trust elects to have a U.S. agent for the limited purpose of accepting service of process (as described above).

Monetary penalties for failure to report

Under the bill, a person that fails to provide the required notice or return 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, is subject to an initial penalty equal to 35 percent of the gross reportable amount. A failure to provide an annual reporting of trust activities will 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 is 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 is the greater of: (a) the amount the decedent is treated as owning under the grantor trust rules or (b) the value of the property includable in the gross estate of the decedent. In cases where annual reporting of trust activities is required, the gross reportable amount is 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 is the amount of the distribution to the beneficiary. An additional \$10,000 penalty is 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. The same penalties are applicable to a failure to report (as required by present law) certain transfers to other foreign entities. Such penalties are subject to a reasonable cause exception. The Committee intends that the reasonable cause

standard will be satisfied upon the showing of reasonable efforts to comply with the reporting requirements. In no event will the total amount of penalties exceed the gross reportable amount.

Effective date

The reporting requirements and applicable penalties generally apply to reportable events occurring or distributions received after the date of enactment. The annual reporting requirement and penalties applicable to U.S. grantors apply to taxable years of such persons beginning after December 31, 1995.

g. Reporting of foreign gifts

The bill generally requires any U.S. person (other than certain tax-exempt organizations) that receives purported gifts or bequests from foreign sources total more than \$10,000 during the taxable year to report them to the Treasury Department. The threshold for this reporting requirement is indexed for inflation. The definition of a gift to a U.S. person for this purpose excludes 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)), and amounts that are distributions to a U.S. beneficiary of a foreign trust if such amounts are properly disclosed under the reporting requirements of the bill. If the U.S. person fails, without reasonable cause, to report foreign gifts as required, the Treasury Secretary is authorized to determine the tax treatment of the unreported gifts. The Committee intends that the Treasury Secretary's exercise of its authority to make such a determination will be subject to judicial review under an arbitrary or capricious standard, which provides a high degree of deference to such determination. In addition, the U.S. person is 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 provision applies to amounts received after the date of enactment.

III. VOTES OF THE COMMITTEE

In compliance with clause 2(1)(2)(B) of rule XI of the Rules of the House of Representatives, the following statement is made concerning the votes of the Committee in its consideration of the bill:

Motion to report the bill

The bill, H.R. 3286, was ordered favorably reported, as amended, on May 1, 1996, by voice vote, with a quorum present.

Roll call vote on amendment

An amendment by Mr. Rangel, as amended by Mr. Jacobs, to Title II to restore current law language regarding the use of cultural, ethnic or racial considerations in placement of children into foster care or adoptive homes was defeated by a roll call vote of 15 yeas to 22 nays. The vote was as follows: