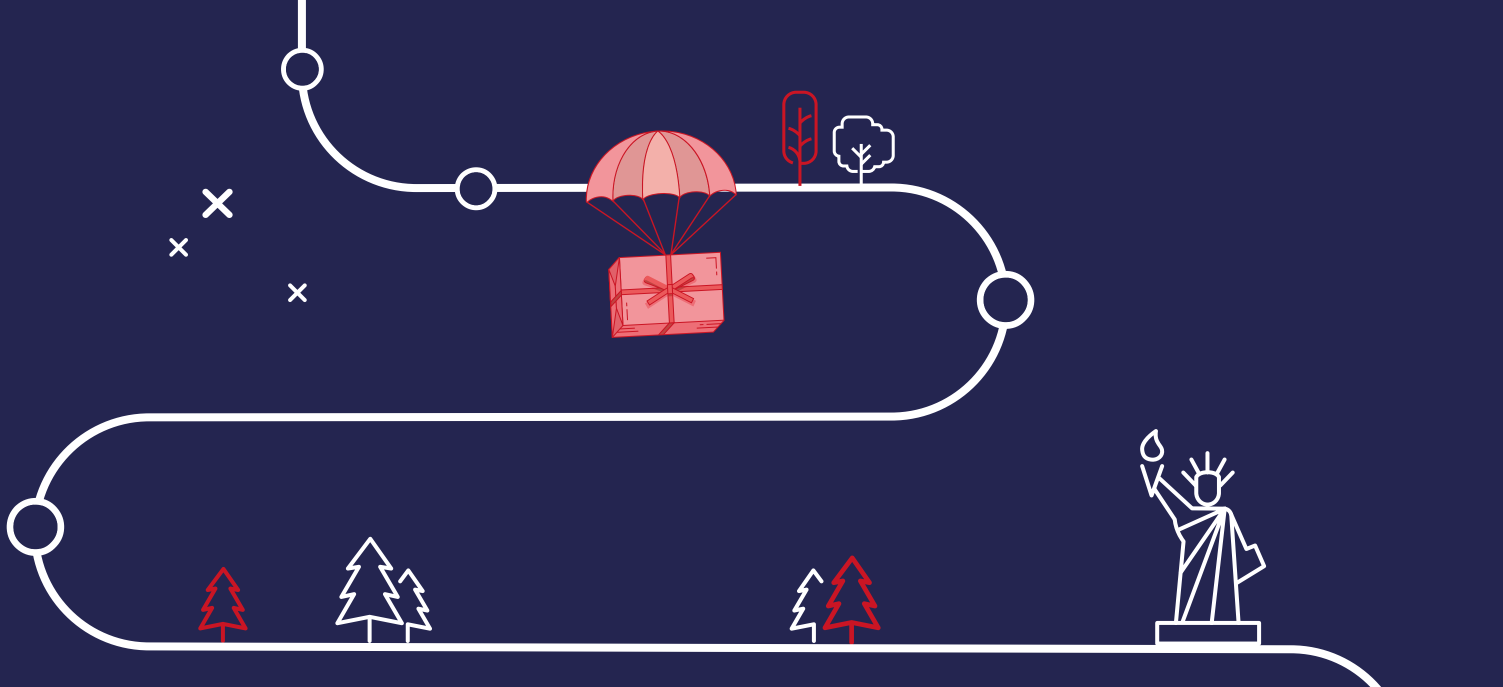
THE PRESENT SITUATION

Hal J Webb and **Sarah B Jacobson** provide a roadmap to federal gift tax for foreign parents gifting money to children in the US



A foreign person[1] who has a child attending school in the US could unintentionally be making a taxable gift when paying for that child's education and living expenses, as there are US federal gift tax issues related to such payments.

Generally speaking, foreign persons are subject to US federal gift tax on gifts of real property situated in the US and tangible personal property situated in the US. Tangible personal property includes items such as money, cars, jewellery, furniture and artwork physically located in the US. There is, however, an exclusion for gifts of tangible property that have an aggregate fair market value of USD14,000[2] or less, per donee, per calendar year.

There is also an exception for payments of certain educational and medical expenses. For example, if a foreign parent pays from their personal financial account for their child's tuition or medical expenses, and such payment is made directly to the provider of those services (e.g. directly to the school or medical facility), those payments would not be subject to federal gift tax, regardless of the source of the funds to make such payments.[3] In fact, those payments are not counted as part of the USD14,000 annual exclusion.

In contrast, gifts of intangible property made by a foreign person are not subject to US federal gift tax even if the intangible property is situated within the US. These federal gift tax rules apply regardless of whether the recipient of the gift is a foreigner or a US citizen or resident. Although these rules may seem relatively straightforward, there are several nuances that can create tax traps for the unwary.

GIFTS OF MONEY

Gifts of money made to children living in the US are particularly susceptible to being subject to federal gift tax because they can be made in a variety of ways, such as by cheque, physical currency, wire transfer, automated teller machine, automated clearing house, journal entry or other money-transfer services. In addition, such gifts can be made from or to financial accounts located in the US or outside the US, and from accounts owned by the foreign parent or by an entity owned, controlled or funded by such parent. Further, such gifts can be made directly to the child or paid to a third party for the benefit of the child. Sometimes children even use credit cards or debit cards linked to a financial account owned, controlled or funded by the foreign parent.

Although not entirely free from doubt, case law and guidance from the Internal Revenue Service (IRS) suggests that money is tangible property.[4] Based upon that proposition, the transfer of money by a foreign person is subject to federal gift tax if such money is situated within the US. Thus, a foreign parent must be careful when making gifts of money to or for the benefit of their child living in the US.

CHEQUE

The IRS has also ruled that a transfer of money by a cheque is complete when it is paid, certified or accepted by the drawee bank.[5] Certain guidance from the IRS further suggests that, when the cheque is cashed, it is the location of the donor's account that is relevant for the purposes of determining whether the gift is subject to US federal gift tax. In particular, the IRS has ruled that a gift made by a foreign person by a cheque that was drawn on their personal financial account located outside the US is not treated as property situated in the US for federal gift tax purposes, even if such a cheque is deposited in a financial account located in the US that is owned by the donee.[6]

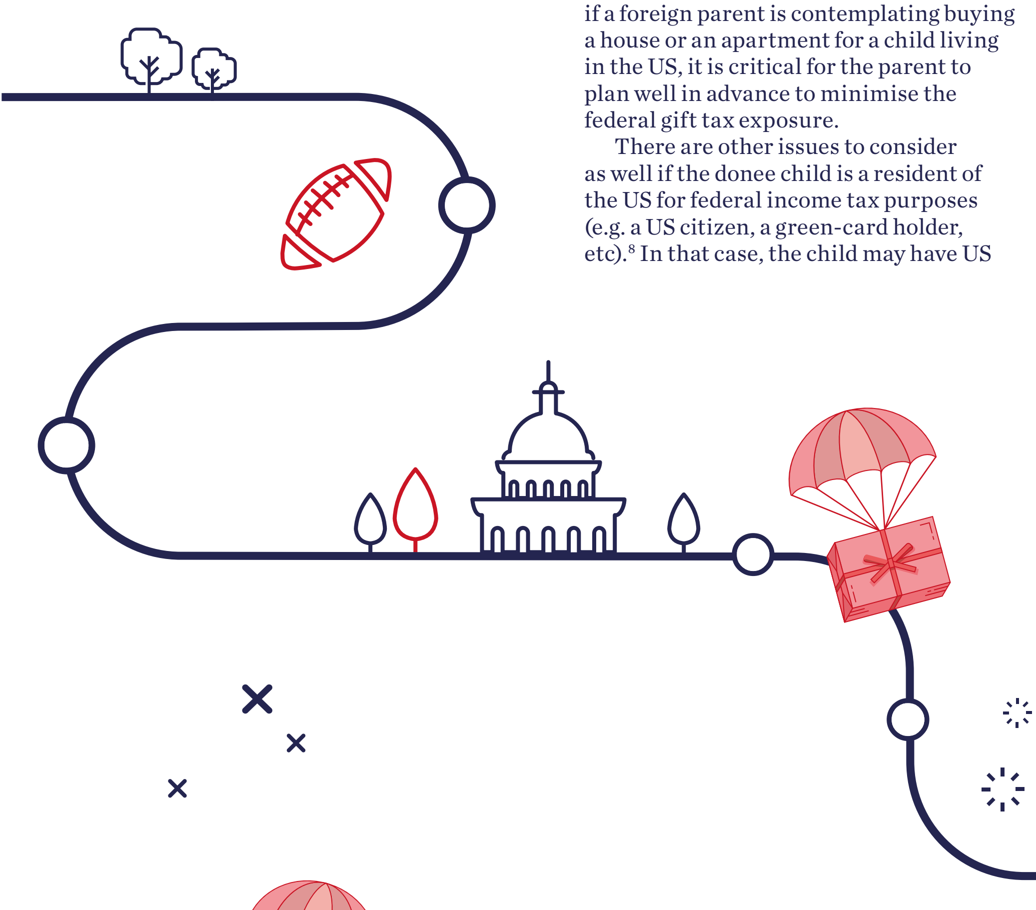
Based on this logic, it is also reasonable to conclude that a gift by a cheque drawn on the foreign parent's personal financial account located in the US may be problematic, while a cheque drawn on the foreign parent's personal financial account located outside the US would not be. Similarly, a foreign parent may have exposure to US federal gift tax by allowing their child in the US to use a debit or credit card that is linked to a US financial account owned or controlled by themselves.

WIRE TRANSFER

There is also uncertainty as to the proper classification of a wire transfer as tangible or intangible for federal gift tax purposes. Using the logic that applies to gifts made by a cheque, a wire transfer sent from a financial account located outside the US, and owned personally by the foreign parent, to a financial account located in the US and owned by the foreign parent's child should not trigger federal gift tax exposure for the foreign parent. On the other hand, a wire transfer sent from a financial account located in the US and owned personally by the foreign parent generates potential exposure to federal gift tax – unless the total amount gifted in the relevant calendar year is less than the federal gift tax annual exclusion.

By far the most conservative approach for gifts of money would be for the foreign parent to wire funds (or give a cheque) from their personal foreign financial account to be deposited in a personal foreign financial account owned by their child. The next best approach would be for the foreign parent to wire funds (or give a cheque) from their personal foreign financial account to a personal financial account located in the US that is owned by their child.

Rather than making gifts of money to a child who is living in the US, it may be preferable for the foreign parent to purchase short-term US Treasury bills (T-Bills) or other publicly traded securities, and transfer those to the child instead. T-Bills are considered intangible property and therefore are not subject to federal gift tax.[7] Plus, the cost to purchase or liquidate short-term T-Bills is typically nominal. This approach would remove the uncertainty concerning the US gift tax treatment of gifts of money.



COMMON MISTAKES

A typical mistake occurs when a foreign parent purchases items such as furniture, artwork or a car located in the US for the child, allowing the child to take title to such property directly in their own name. Such outright gifts are subject to federal gift tax because those items constitute tangible property located in the US. Items of tangible property that can easily be moved from the US should be physically removed from the US before the gift is made. Otherwise, careful planning in advance of the gift is advisable, because various planning techniques can typically be implemented to eliminate the imposition of federal gift tax.

Purchases of US real estate for a child also must be carefully planned, because a gift by a foreign parent of US real property would be subject to federal gift tax. Likewise, if a foreign parent makes a gift of money to their child, with the intention that such money is to be used to purchase US real property, such a gift could be treated as a gift of US real property rather than a gift of money. Thus, if a foreign parent is contemplating buying a house or an apartment for a child living in the US, it is critical for the parent to plan well in advance to minimise the federal gift tax exposure.

There are other issues to consider as well if the donee child is a resident of the US for federal income tax purposes (e.g. a US citizen, a green-card holder, etc.).[8] In that case, the child may have US informational reporting requirements if they were to receive gifts in excess of USD100,000 in the aggregate during a calendar year. Additionally, if the foreign parent were to transfer money from an account owned by a trust, foreign corporation or foreign partnership, rather than transferring money from their personal financial account, the gift could be treated for federal tax purposes as taxable income to the child rather than the receipt of a gift.

Proper planning can provide a foreign parent with the ability to financially support a child living in the US without the risk of being subject to US federal gift tax. Thus, a foreign person who has a child studying in the US should plan carefully before making any gifts or paying any expenses to, or for the benefit of, such child.

1 For this purpose, a 'foreign' person or a 'foreigner' refers to someone who is neither a citizen of the US nor domiciled in the US for US federal transfer tax (e.g. estate and gift tax) purposes. Domicile requires physical presence in the US and intent to remain in the US indefinitely. An individual's subjective intent to remain in the US indefinitely is determined by weighing a number of objective factors

2 The amount of the annual exclusion is indexed for inflation each calendar year. If the donee is the foreign spouse of the donor, then the annual exclusion is USD149,000 for 2017 instead of USD14,000, except that, if such spouse is a US citizen, then an unlimited gift tax deduction would apply. Issues related to gifts made to a spouse are outside the scope of this article

3 *Internal Revenue Code*, s2503(e)

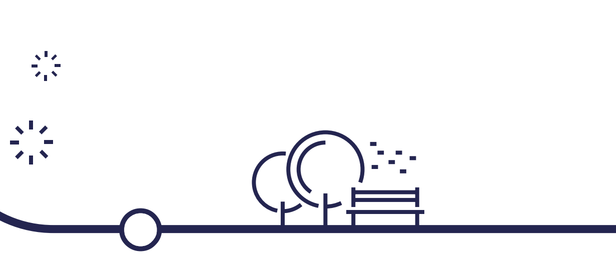
4 *IRS General Counsel Memorandum 36860* (1976)

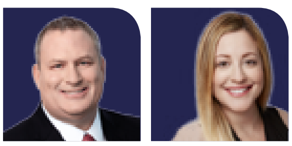
5 *IRS General Counsel Memorandum 34845* (1972)

6 Private Letter Ruling (PLR) 8138103; reaffirmed by PLR 8210055 on this issue only

7 PLR 8210055

8 Issues that are not related to gifts of money are outside the scope of this article. Such issues include, but are not limited to, (a) when a student may become a US resident for federal income tax purposes; (b) when a student may be subject to US federal capital gains tax; (c) informational return reporting for foreign students or for US citizens or residents; (d) the taxation of scholarships and grants; and (e) the taxation of compensation earned when working in the US for a school or otherwise





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