

January 2015

## Tax Reform Proposals on a Gift Tax on the Transfer of Property by Nonresidents

Daze Swift Lee

Follow this and additional works at: <http://scholarship.law.umassd.edu/umlr>

 Part of the [Taxation-Federal Estate and Gift Commons](#), and the [Tax Law Commons](#)

---

### Recommended Citation

Lee, Daze Swift (2015) "Tax Reform Proposals on a Gift Tax on the Transfer of Property by Nonresidents," *University of Massachusetts Law Review*: Vol. 10: Iss. 1, Article 6.

Available at: <http://scholarship.law.umassd.edu/umlr/vol10/iss1/6>

This Note is brought to you for free and open access by Scholarship Repository @ University of Massachusetts School of Law. It has been accepted for inclusion in University of Massachusetts Law Review by an authorized administrator of Scholarship Repository @ University of Massachusetts School of Law.

# **Tax Reform Proposals on a Gift Tax on the Transfer of Property by Nonresidents**

Daze Swift Lee

10. U. MASS. L. REV. 194

## **ABSTRACT**

This Note raises taxation issues pertaining to a gift tax on the transfer of property by nonresidents under current United States tax rules. It further illustrates patterns and trends to evade a gift tax using transaction maneuvers. These issues are defined in three categories: a gift tax on the transfer of property situated only within the United States by a nonresident, no gift tax on the transfer of intangible assets, and transferee liability. In response to such issues, this Note calls for corresponding proposals to resolve gift taxation problems. It proposes that a gift tax should be imposed on the transfer of property by a nonresident whether the property is situated inside or outside of the United States. It also proposes that intangible assets transferred by a nonresident should not be exempt from gift taxation. Lastly, this Note proposes that in a gift transaction made by a nonresident, a U.S. donee should be required to withhold a tentative amount of gift tax from the nonresident donor to enhance taxpayer compliance with tax regulations.

## **AUTHOR NOTE**

Daze Swift Lee, CPA, CMA, CGMA, MBA is an associate professor in taxation and accounting at Bunker Hill Community College, adjunct professor at Bay State College, managing shareholder of a local accounting firm, and board member at numerous non-profit organizations including Santa's Magic, Inc. in greater Boston. His teaching and research interests are in tax law, trust, estate, GAAP standards, forensic accounting, and audit methodology. His professional services and memberships include the American Institute of Certified Public Accountants, the Massachusetts Society of Certified Public Accountants, the Institute of Certified Management Accountants, and the Chartered Institute of Management Accountants. He is also a Juris Doctor Candidate (2015) at the University of Massachusetts School of Law and a member of the University of Massachusetts Law Review.

I.	INTRODUCTION .....	196
II.	CURRENT GIFT TAX RULES AND ADMINISTRATION .....	197
A.	Gift Tax on the Transfer of Property Situated Only Within the United States by a Nonresident.....	199
B.	No Gift Tax on the Transfer of Intangible Assets.....	199
C.	Transferee Liability.....	200
III.	REFORM PROPOSALS ON GIFT TAX RULES.....	202
A.	Gift Tax on the Transfer of Property Situated Only Within the United States by a Nonresident; Taxing on the Transfer of Property by a Nonresident Whether the Property Was Situated Within or Outside the United States. ....	202
1.	Double Taxation .....	203
2.	Constitutional Considerations.....	204
3.	Administrative Technicalities .....	205
4.	Benefits of Gift Tax Reform.....	206
B.	No Gift Tax on the Transfer of Intangible Assets; Taxing on the Transfer of Property by a Nonresident Regardless of Its Form Whether It Is Tangible or Intangible.....	207
1.	Inconsistency .....	208
2.	Inequity.....	208
C.	Improving Effectiveness in Requiring Nonresidents to Comply with a Gift Tax Return Proposal; Withholding From Nonresident Donors .....	209
1.	Defending the U.S. Tax Base .....	210
2.	Burden-Shifting .....	210
3.	Withholding the Burden on a U.S. Donee.....	211
IV.	CONCLUSION .....	211

## I. INTRODUCTION

A tax professional is having a conversation with one of his foreign clients. She confides to him that she has a substantial piece of property in the United States that she is interested in giving to her son, an American citizen. She questions whether there are any gift tax consequences of this gift because she is neither an American citizen nor a permanent resident. Ultimately, this is no longer an unusual question.

In our globalized world, people who live outside the United States are raising these types of concerns involving property, taxes, and other issues that affect one's financial circumstances. In the past, United States laws addressed interstate issues, but not international issues.<sup>1</sup> Global patterns pertaining to lifestyle changes trigger tax issues<sup>2</sup> and call for new financial reporting requirements.<sup>3</sup>

This Note discusses deeply rooted issues regarding gift taxes on transfers by nonresidents and offers proposals to resolve those issues. Unlike a gift transferred by a resident, a gift transferred by a nonresident to a U.S. citizen is classified into two different categories: (1) taxable and (2) nontaxable.<sup>4</sup> When a gift is tangible personal or real property situated in the United States, it is taxable.<sup>5</sup> Otherwise, a gift, such as a wire-transfer of funds by a nonresident, is nontaxable.<sup>6</sup> This creates a huge loophole in tax administration, leaving the following questions to consider:

1. Today, when technology is extremely advanced, should we allow nonresidents to make a tax-free gift to American donees by converting their U.S. property to cash?<sup>7</sup>

2. Should the transfer of intangible assets by nonresidents remain exempt from the current law's gift tax?

---

<sup>1</sup> Michael Danilack, *The Impact of Globalization on Tax Administration*, 3, 6, 10 (IRS, 2010), <http://www.irs.gov/pub/irs-soi/10rpdiscussdanilack.pdf>.

<sup>2</sup> *Id.* at 7.

<sup>3</sup> Amendments to the Bank Secrecy Act Regulations-Reports of Foreign Financial Accounts, 76 Fed. Reg. 10234-01 (proposed Feb. 26, 2010) (to be codified at 31 C.F.R. pt. 1010).

<sup>4</sup> I.R.C. § 2501 (2013); I.R.C. § 2511; Treas. Reg. § 25.2511-3 (2013).

<sup>5</sup> Treas. Reg. § 25.2511-3(a)(1).

<sup>6</sup> I.R.C. § 2501(a)(2); I.R.C. § 2511(b); Treas. Reg. § 25.2511-3(a)(1).

<sup>7</sup> I.R.C. § 2104.

3. How can the IRS improve its effectiveness with respect to requiring nonresidents to file and pay a gift tax return?

This Note answers the above questions. It is designed to shed light on current gift tax rules for property transferred by nonresidents, and associated problems, and provide reform proposals to resolve those problems. Part II lays out a general understanding of gift tax rules. Part III explains the depth of the problems arising from our current gift tax rules by illustrating examples and cases. In addition, this Note provides gift tax reform proposals to close tax loopholes and prevent evasive tax tactics and transaction maneuvers. The proposals show why it is important to implement new rules and a new system, to effectively and efficiently discourage tax evasion, and to eventually raise our tax revenue.

## II. CURRENT GIFT TAX RULES AND ADMINISTRATION

A gift tax is a wealth transfer tax that applies when a person transfers property while alive.<sup>8</sup> It is similar to an estate tax, which applies to transfers associated with death.<sup>9</sup> Both the gift tax and the estate tax are part of the unified tax system<sup>10</sup> that subjects gratuitous transfers<sup>11</sup> of property between persons to taxation.<sup>12</sup> Under the current Internal Revenue Code, a tax is imposed on the transfer of property in the form of a gift by any individual, resident or nonresident.<sup>13</sup> The gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal,

---

<sup>8</sup> PRENTICE HALL, FEDERAL TAX'N, Corporations 12-2 (Timothy J. Rupert et al., 2014); *See* Treas. Reg. § 25.2511-2(a) (“The gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer, nor is it conditioned upon ability to identify the donee at the time of the transfer. On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.”).

<sup>9</sup> I.R.C. § 2001.

<sup>10</sup> *See Id.* § 2010; *Id.* § 2505.

<sup>11</sup> *Comm’r v. Duberstein*, 363 U.S. 278, 285 (1960) (A gift in the statutory sense proceeds from a detached and disinterested generosity out of affection, respect, admiration, charity or like impulses).

<sup>12</sup> PRENTICE HALL, *supra* note 8, at 12-2.

<sup>13</sup> I.R.C. § 2501.

tangible or intangible.<sup>14</sup> The term “taxable gift” means the total amount of gifts made during the calendar year, less certain deductions.<sup>15</sup>

To one’s surprise, a gift tax is paid by the donor.<sup>16</sup> This is contrary to the beneficiary-carrying-the-burden principle and the ability-to-pay principle. Under U.S. tax law, if a father makes a gift to his son, it is the father who is responsible for the gift tax, which is counter-intuitive to the fact that the economic benefit has been transferred to the son who received the gift and is more capable of paying the gift tax. This rule of tax law creates a few issues<sup>17</sup> to be addressed later in this Note.

The scope of taxable gifts in the case of the transfer of property varies depending on whether the transferor is a resident or a nonresident. For residents,<sup>18</sup> the gift tax applies to all gift transfers of property, regardless of where the property is situated. For nonresidents,<sup>19</sup> however, application of the gift tax is limited to property<sup>20</sup> situated within the United States.<sup>21</sup> For instance, if an American father gives his American son real property in France, such transferred property is subject to a gift tax. But if a French father gives his American son the same real property in France, that property escapes the United States gift tax.<sup>22</sup> First, this Note discusses a gift tax on the transfer of property situated only within the United States by a nonresident.

---

<sup>14</sup> *Id.* § 2511.

<sup>15</sup> *Id.* § 2503 (allowing annual exclusion up to \$14,000 in 2013).

<sup>16</sup> *Id.* § 2502(c); Treas. Reg. § 25.2502-2 (2013).

<sup>17</sup> PAMELA GREENE, CONGRESSIONAL BUDGET OFFICE, FEDERAL ESTATE AND GIFT TAXES, A SERIES OF ISSUE SUMMARIES FROM THE CONGRESSIONAL BUDGET OFFICE, 12 (2009) (Certain tax planning strategies used to reduce estate and gift taxes may be eliminated by an inheritance tax.).

<sup>18</sup> Treas. Reg. § 25.2501-1(b) (A resident is an individual who has his domicile in the United States at the time of the gift.).

<sup>19</sup> *Id.* (providing that residence without the requisite intent to remain indefinitely will not constitute domicile, nor will intent to change domicile effect such a change unless accompanied by actual removal).

<sup>20</sup> Treas. Reg. § 25.2511-3(b)(1).

<sup>21</sup> I.R.C. § 2511; *But see* I.R.C. § 2522.

<sup>22</sup> Treas. Reg. § 25.2511-3.

### **A. Gift Tax on the Transfer of Property Situated Only Within the United States by a Nonresident**

If a nonresident parent wishes to transfer a U.S.-based property to her son who is a U.S. citizen, the parent, as a donor, is subject to a gift tax on that property.<sup>23</sup> However, under the current federal tax statutes, there are loopholes that could lead to tax leakage. For example, if a nonresident transfers property that is located outside of the U.S., such as wire-transferred cash or other property, to a U.S. resident, the gift is not subject to a gift tax and is simply excluded from gross income.<sup>24</sup> The recipient is only required to file Form 3520,<sup>25</sup> which concludes the entire filing process. More practically, if the nonresident parent, using the same example above, sells the U.S.-based property to a third party and wire-transfers the cash or the sale proceeds from her foreign bank account to her son's United States bank account, there is no gift tax imposed.<sup>26</sup> The parent simply has to file Form 3520.<sup>27</sup> To that end, with such a tactic, the current Internal Revenue Code opens the door to those who wish to avoid the gift tax.

### **B. No Gift Tax on the Transfer of Intangible Assets**

The Internal Revenue Code does not impose a gift tax on the transfer of intangible property<sup>28</sup> by a nonresident.<sup>29</sup> What are intangible assets? There is no definition of the term "intangible assets" except as provided in I.R.C. § 197(d).<sup>30</sup> Thus, court decisions and

---

<sup>23</sup> I.R.C. § 2511(a).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* § 679 (requiring annual return to report transactions with foreign trust and receipt of certain foreign gifts).

<sup>26</sup> I.R.S. Priv. Ltr. Rul. 8210055 (Dec. 10, 1981) (holding that a transfer of cash by a check drawn on a foreign bank, and payable by a U.S. bank, is not subject to gift tax).

<sup>27</sup> I.R.C. § 679.

<sup>28</sup> I.R.C. § 2511(b).

<sup>29</sup> *Id.* § 2501(a)(2); Treas. Reg. § 25.2501-1(b) (2013) (providing that a nonresident or nondomiciliary donor, for this analysis, means a nondomiciliary alien whose domicile at the date of the gift was outside the United States and not a United States citizen).

<sup>30</sup> I.R.C. § 197(d); Arturo J. Aballi, *Gifts by Foreign Persons to US Taxpayers-Pitfalls and Planning Opportunities* (May 12, 2011), [http://www.ttn-taxation.net/pdfs/Speeches\\_Miami\\_2011/04-ArturoAballi.pdf](http://www.ttn-taxation.net/pdfs/Speeches_Miami_2011/04-ArturoAballi.pdf).

Internal Revenue Service (IRS) interpretations provide guidance as to the meaning of “intangible assets.”

First, “cash,” “money,” or “currency” has been largely defined as tangible property,<sup>31</sup> although the issue is not completely free from doubt since, in 2003, the Seventh Circuit Court of Appeals held that “cash” was intangible property for purposes of an Indiana statute granting an exemption for certain property in a bankruptcy proceeding.<sup>32</sup> In contrast, a bank deposit is intangible property; it is a contract in which a debtor-creditor relationship is established between the bank and the depositor.<sup>33</sup> The bank is only required to return an equivalent sum of the money deposited, rather than the actual money which was deposited.<sup>34</sup> This leads to the conclusion that a bank deposit is a debt obligation of the bank to the depositor.<sup>35</sup> Court decisions have confirmed the IRS’s treatment of bank deposits as debt obligations and thus intangible property.<sup>36</sup> However, a debt obligation by a U.S. person or by the United States to a nonresident is considered property situated within the United States.<sup>37</sup> Thus, if a debt obligation owned by a nonresident is transferred to a resident donee, there is a gift tax consequence.<sup>38</sup>

### C. Transferee Liability

As mentioned earlier, a donor is responsible for paying the gift tax.<sup>39</sup> If spouses consent to gift splitting,<sup>40</sup> the entire gift tax liability

---

<sup>31</sup> *Blodgett v. Silberman*, 277 U.S. 1, 18 (1928) (holding that for gift taxation, currency is tangible personal property); I.R.S. Priv. Ltr. Rul. 77-37-063 (June 17, 1977) (holding that currency is not a debt obligation).

<sup>32</sup> *In Re Oakley*, 344 F.3d 709 (7th Cir. 2003).

<sup>33</sup> Arturo J. Aballi, *Gifts by Foreign Persons to US Taxpayers-Pitfalls and Planning Opportunities* (May 12, 2011), [http://www.ttn-taxation.net/pdfs/Speeches\\_Miami\\_2011/04-ArturoAballi.pdf](http://www.ttn-taxation.net/pdfs/Speeches_Miami_2011/04-ArturoAballi.pdf).

<sup>34</sup> *Id.*

<sup>35</sup> *See* *Citizens Bank of Md. v. Strumpf*, 516 U.S. 16 (1995); *Estate of Gade v. Comm’r.*, 10T.C. 585 (1948); *Estate of Annina Fabbriotti Fara Forni v. Comm’r.*, 47 B.T.A. 76 (1942).

<sup>36</sup> Rev. Rul. 55-143, 1955-1 C.B. 465 (agreeing that there was difference between moneys deposited with a bank and undeposited cash in a safety deposit box).

<sup>37</sup> *Id.* § 2104(c).

<sup>38</sup> *Id.* § 2511(b).

<sup>39</sup> *Id.* § 2502(c); Treas. Reg. § 25.2502-2.



becomes a joint and several liability of the spouses.<sup>41</sup> Thus, if spouses do not pay the tax voluntarily, the IRS may attempt to collect whatever amount it deems appropriate from either spouse, irrespective of the size of the gift that spouse actually made.<sup>42</sup>

What if the donor does not pay the gift tax and there is no spouse consenting to gift splitting? The Internal Revenue Code authorizes the IRS to collect taxes from persons other than the taxpayer.<sup>43</sup> The IRS may collect taxes from two categories of persons, transferees and fiduciaries. Transferees include donees, heirs, legatees, devisees, shareholders of dissolved corporations, parties to a reorganization, and other distributees.<sup>44</sup> Fiduciaries include executors and administrators of estates.<sup>45</sup> In general, the IRS collection limitations period for transferees expires one year after the limitations period for transferors.<sup>46</sup> The transferors may be income earners in the case of income taxes, executors in the case of estate taxes, and donors in the case of gift taxes.<sup>47</sup> This rule plays a significant role in a situation where a father with an unbearable amount of debt gives his son all of his money and files bankruptcy. Obviously, the father has no money to pay his gift tax. According to the foregoing rule, the IRS can hold the son liable to pay the gift tax on behalf of his father.<sup>48</sup>

---

<sup>40</sup> See I.R.C. § 2513 (providing a gift made by a person to someone other than his or her spouse may be considered as having been made one-half by each spouse); JAMES H. BOYD ET AL., FEDERAL TAXATION COMPREHENSIVE Volume 27:14 (Eugene Willis et al., 2010).

<sup>41</sup> I.R.C. § 2513(d).

<sup>42</sup> PRENTICE HALL, *supra* note 8, at 12-31.

<sup>43</sup> I.R.C. § 6901.

<sup>44</sup> Treas. Reg. § 301.6901-1(b).

<sup>45</sup> I.R.C. § 4975(e)(3); PRENTICE HALL, *supra* note 8, at 15-29.

<sup>46</sup> I.R.C. § 6901(c); See generally I.R.C. § 6901(f) (2013).

<sup>47</sup> *Id.* § 6901(a).

<sup>48</sup> *Id.*

### III. REFORM PROPOSALS ON GIFT TAX RULES

#### **A. Gift Tax on the Transfer of Property Situated Only Within the United States by a Nonresident; Taxing on the Transfer of Property by a Nonresident Whether the Property Was Situated Within or Outside the United States.**

As mentioned, a nonresident can escape gift tax liability by transferring the property situated outside of the United States, such as a wire-transfer, to a resident donee.<sup>49</sup> This problem was not contemplated at the time the current law was enacted in 1966<sup>50</sup> because wire-transfers were not as common as they are today.<sup>51</sup> It was far more difficult to transfer funds from one country to another and tax treaties or commerce treaties between countries were less sophisticated than they are today. On most occasions, a nonresident parent who wished to financially support her American son had to either bring money with her to the United States, or transfer her real property in the United States to her son by handing him title to the property. Both of the foregoing cases subjected the parent to gift tax liability on the grounds that the money<sup>52</sup> and real property transferred to her son were situated in the United States at the time of the gift.<sup>53</sup> Advanced technology has changed lifestyle patterns in many different ways, creating opportunities to avoid gift tax.

Several current tactics operate to avoid the United States gift tax. Consider the following hypothetical: a parent sells U.S.-based property to a third party and wire-transfers the sale proceeds to her son from her foreign bank account. Then, the son will be able to buy the very same property with no tax consequence.<sup>54</sup> Even safer and more advanced techniques exist to avoid gift tax.<sup>55</sup> For example, a parent can wire-

---

<sup>49</sup> *Id.* § 2501(a)(2); see I.R.S. Priv. Ltr. Rul. 82-10-055 (Dec. 10, 1981).

<sup>50</sup> Act of Nov. 13, 1966, Pub. L. No. 89-809, 80 Stat. 1539.

<sup>51</sup> I.R.C. § 2511(a) (2013).

<sup>52</sup> *Blodgett v. Silberman*, 277 48 S. Ct. 410, 416 (1928); I.R.S. Priv. Ltr. Rul 77-37-063 (June 17, 1977) (holding for gift taxation, currency is tangible personal property).

<sup>53</sup> I.R.C. § 2511(a) (2013).

<sup>54</sup> *But see Davies v. Comm’r*, 40 T.C. 525, 531 (1963) (holding donee under obligation to purchase United States situs realty from donor – gift of realty treated as occurring in substance).

<sup>55</sup> *But see De Goldschmidt-Rodthschild v. Comm’r*, 168 F.2d 975, 979 (1948) (holding that gift tax was still due when domestic stocks and bonds were

transfer funds to her son's foreign bank account outside of the U.S. and have her son draw the fund upon the foreign bank account to his American bank account. By doing this, the parent can avoid the existence of the fund transfer in the United States and ultimately escape the U.S. gift tax.<sup>56</sup>

In order to prevent these kinds of evasive tax transactions, the United States should impose a gift tax on the transfer of property from a nonresident to a citizen of the United States, regardless of where the transferred property is situated. For example, suppose that there is a nonresident parent who wishes to transfer funds to her American son. When the parent transfers the funds to her son's foreign bank account, and then the son wire-transfers the funds to his American bank account, the funds are a gift by the parent to her son regardless of which venue has been used to transfer the gift. The gift economically benefitted the American son; therefore it should be taxable without reference to the jurisdiction of transfer occurrence.

### 1. Double Taxation

First, one may argue that this reform would result in double taxation on the grounds that the transfer made outside the United States would be taxed by the other country. This issue is no different than any other international transaction subject to double taxation when funds flow through an economic transaction. Further, many domestic transactions have double taxation consequences.<sup>57</sup> State taxation, in addition to federal income tax, is a good example of existing, and relatively uniformly accepted, domestic double taxation.<sup>58</sup> Nevertheless, this concern can be mitigated by tax treaties or a foreign tax credit<sup>59</sup> which provides a gift tax credit for gift tax paid to another country.<sup>60</sup>

---

converted into Treasury notes and make into gifts in trust solely to avoid taxation).

<sup>56</sup> I.R.C. § 2501(a)(2) ; *see also* I.R.S. Priv. Ltr. Rul. 82-10-055 (Dec. 10, 1981).

<sup>57</sup> Treas. Reg. § 521.117 (2013) (providing claims in cases of double taxation).

<sup>58</sup> *See generally* 12 U.S.C. § 548 (2013).

<sup>59</sup> I.R.C. § 642(a) (2013).

<sup>60</sup> *Id.* § 901.

## 2. Constitutional Considerations

Second, one may also contend that it is unconstitutional to exercise the taxing power over a transaction that occurs outside the United States. Under the Sixteenth Amendment, “Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.”<sup>61</sup> Nothing in the United States Constitution limits federal taxing power to transactions which only occur inside the United States. In fact, all global income must be reported as part of gross income regardless of where the income is derived.<sup>62</sup> Therefore, we should not exclude foreign gifts from a taxable base solely on the grounds of the gift’s location.

The Supreme Court of the United States upheld the constitutionality of the gift tax on the grounds that “a tax imposed upon a particular use of property or the exercise of a single power over property incident to ownership is an excise. . . .”<sup>63</sup> for which the United States government has constitutional taxing powers. In other words, the Supreme Court acknowledged that the federal government has the authority to exercise its taxation power on the use of property.<sup>64</sup> Thus, the federal government is allowed to impose a gift tax on the transfer of property by a nonresident to a United States resident solely on the basis that the United States resident has the use of the gift. In such cases, where the United States exercises its taxing power on the taxpayer’s power of use rather than the power of gift,<sup>65</sup> the United States Supreme Court has held:

[S]ince property is the sum of all the rights and powers incident to ownership, if an unapportioned tax on the exercise of any of them is upheld, the distinction between direct and other classes of taxes may be wiped out, since the property itself may likewise be taxed by resort to the expedient of levying numerous taxes upon its uses; that one of the uses of property is to keep it, and that a tax upon the possession or keeping of property is no different from a tax on the property itself.”<sup>66</sup>

---

<sup>61</sup> U.S. CONST. amend. XVI.

<sup>62</sup> I.R.C. § 61.

<sup>63</sup> *Bromly v. McCaughn*, 280 U.S. 124, 136 (1929) (providing for tax on gifts and applied to transfers of property by gift is not invalid).

<sup>64</sup> *See id.*

<sup>65</sup> *Nicol v. Ames* 173 U.S. 509, 519 (1899).

<sup>66</sup> *Bromley*, 280 U.S. 124, 137 (1929).

It can be analogized to a sale and use tax relationship. For example, if a Massachusetts resident, Manny, drives to New Hampshire and purchases tires for his car, he does not pay a sales tax<sup>67</sup> in New Hampshire simply because New Hampshire does not have a sales tax. Nonetheless, Manny is still required to pay a sales tax to Massachusetts based on the irrebuttable presumption that he will use those tires in Massachusetts - it is called a use tax.<sup>68</sup> In other words, while Manny is not taxed on the purchase of the property, he is still taxed on the use of the property.<sup>69</sup> The same idea can be applied to the gift tax reform proposal. When a U.S. person<sup>70</sup> receives a gift from a nonresident, whether the gift was situated within or outside the United States, the United States government should have its taxing power on the use of property by the U.S. donee.<sup>71</sup>

### 3. Administrative Technicalities

Third, one may question administrative technicality. It appears extremely difficult to keep track of each U.S. persons' foreign bank accounts to see whether a gift was received. However, our tax system was built on the idea of self-assessment.<sup>72</sup> Each individual reports his or her own taxes and makes payments if there is a balance due.<sup>73</sup> Federal tax authority usually does not step in to assess taxpayers' tax liability unless the taxpayer fails to report his income in a timely manner or fails to report correct income.<sup>74</sup> The same notion should apply to enforcement of the gift tax. Federal investigation is only

---

<sup>67</sup> Treas. Reg. § 1.164-3(e) (2013).

<sup>68</sup> *Id.* § 1.164-3(h) (meaning a tax which is imposed on the use, storage, or consumption of items and which is complementary to a general sales tax).

<sup>69</sup> *Id.*

<sup>70</sup> 31 C.F.R. § 1010.350(b) (defining U.S. person as a citizen of the United States, a resident of the United States who is a resident alien under 26 U.S.C. 7701(b), and an entity, including but not limited to, a corporation, partnership, trust, or limited liability company created, organized, or formed under the laws of the United States, any State, the District of Columbia, the Territories and insular Possessions of the United States, or the Indian Tribes).

<sup>71</sup> *Id.* § 1.164-3(b).

<sup>72</sup> JAMES J. FREELAND ET AL., *FUNDAMENTALS OF FEDERAL INCOME TAX*'N 894 (Robert C. Clark et al. eds., 17<sup>th</sup> ed. 2013).

<sup>73</sup> *Id.*

<sup>74</sup> *See* I.R.C. § 6203 (2013); Treas. Reg. § 301.6203-1 (providing method of assessment).

required for a taxpayer's failure to correctly report a gift or file in a timely fashion.<sup>75</sup> To make matters easier, the current regulations require taxpayers to report certain foreign bank accounts. Under current IRS regulations, a U.S. person is required to file a Financial Bank Account Reporting ("FBAR") if he had a financial interest in a foreign financial account which exceeded \$10,000 at any time during the year,<sup>76</sup> or if he holds any interest in specified foreign financial assets under certain conditions.<sup>77</sup> Such reporting requirements would make it easier for the United States government to discover unreported gift transactions.<sup>78</sup> The benefit of this gift tax reform would be enormous.

#### 4. Benefits of Gift Tax Reform

First, federal tax revenues will drastically increase for obvious reasons. Gift transactions by nonresidents which otherwise would be tax-free under the current tax law<sup>79</sup> will generate gift tax revenues.

Second, gift tax reform will educate U.S. taxpayers and promote honest reporting. By the nature of gift tax, a responsible taxpayer is a donor and not a donee.<sup>80</sup> As such, the donor who is a nonresident in the context of our discussion should be informed of this proposed tax rule by the donee who is a citizen of the United States. This may be an opportunity for American citizens to educate themselves on how to comply with the gift tax rules by informing the nonresident donors of such rules.

Third, this tax reform proposal is consistent with the fundamental purpose of the gift tax on the transfer of property by a nonresident.<sup>81</sup> A close examination of such a tax tactic— a donor transferring funds to a donee's foreign bank account and the donee wire-transferring it back

---

<sup>75</sup> *Id.*

<sup>76</sup> Amendments to the Bank Secrecy Act Regulations-Reports of Foreign Financial Accounts, 76 FR 10234 (Feb. 24, 2011); *accord* 31 U.S.C. § 5314; *accord* 31 C.F.R. § 1010.350.

<sup>77</sup> I.R.C. § 6038D(a) (2014) (providing foreign financial assets are required to be reported if the aggregate value of all such assets exceeds \$50,000).

<sup>78</sup> *See* 31 U.S.C. § 5321 (2014) (providing the Secretary of the Treasury may impose an additional civil penalty on a person not filing a report, or filing a report containing a material omission or misstatement).

<sup>79</sup> I.R.C. § 2511.

<sup>80</sup> I.R.C. § 2502(c); Treas. Reg. § 25.2502-2 (2013).

<sup>81</sup> I.R.C. § 2501(a)(1) .

to his domestic bank account—reveals that it is a fund transfer from the donor to the donee, and the American donee benefits from the transferred fund. Taxing the wire-transfer of funds is consistent with the purpose of the current tax law<sup>82</sup> which provides that a gift tax shall apply, whether a gift is made directly or indirectly.<sup>83</sup>

Fourth, this proposed tax reform is consistent with the general purpose of tax imposition.<sup>84</sup> When a U.S. person accumulates income outside the United States, such income is subject to United States tax<sup>85</sup> under the irrebuttable presumption that the U.S. person benefitted from the income and thus is required to contribute to the United States by paying taxes. Therefore, it would be consistent to impose a gift tax on the transfer of any property that benefits a U.S. person regardless of the location of the gift transfer occurrence.

**B. No Gift Tax on the Transfer of Intangible Assets; Taxing on the Transfer of Property by a Nonresident Regardless of Its Form Whether It Is Tangible or Intangible.**

Pursuant to the Internal Revenue Code regarding intangible property that is gifted by a nonresident, the nonresident is not subject to the gift tax.<sup>86</sup> As addressed earlier, intangible assets are defined as assets that are not physical in nature such as goodwill, patent, trademarks, and copyrights.<sup>87</sup> Therefore, when a nonresident transfers goodwill<sup>88</sup> to her son who is a U.S. person, there is no gift tax consequence simply because goodwill is an intangible asset.<sup>89</sup> It is critical to understand that under the current tax rules, different tax consequences are expected depending upon the form of property transferred.<sup>90</sup> In order to eliminate this inconsistency, a gift tax should

---

<sup>82</sup> *Id.* § 2511.

<sup>83</sup> *Id.* § 2501.

<sup>84</sup> *See* U.S. CONST. amend. XVI.

<sup>85</sup> I.R.C. § 61 (providing a list of sources that constitute “income”).

<sup>86</sup> I.R.C. § 197.

<sup>87</sup> I.R.C. § 2501(a)(2).

<sup>88</sup> BRIAN C. SPILKER ET AL., *TAXATION OF INDIVIDUALS AND BUSINESS ENTITIES* 16-8 (Benjamin C. Ayers et al eds., 2015 ed. 2014) (defining goodwill as excess purchase price over the fair market value of identifiable assets acquired). *Compare with* the SMITH definition of “goodwill” *infra* note 92.

<sup>89</sup> I.R.C. § 197 (2013).

<sup>90</sup> I.R.C. § 2501 (2013).

be imposed on the transfer of property by a nonresident regardless of its form - whether it is a tangible or intangible asset. The following sections outline the serious issues that this reform would remedy.

### 1. Inconsistency

First, the current Internal Revenue Code creates inconsistency in the application of gift tax rules. For example, a nonresident, Melissa, has been running a business in the United States and now wishes to give it to her son, Steven, who is a citizen of the United States. After many successful years of operation, the business has retained a good reputation and thus is valued at \$10,000,000. On the other hand, the fair market value of her business equipment and other personal property has depreciated to \$2,000,000 due to the length of time that the business has been in operation. As such, when Steven receives this business as a gift, under the current tax rules, Melissa will be taxed only on the lower fair market value of property or \$2,000,000, leaving the remaining \$8,000,000 untaxed<sup>91</sup> because it represents goodwill<sup>92</sup>. If the donor is a U.S. person instead, the same fact pattern produces a very different result. When Steven receives the business, the U.S. person, as donor, is taxed on the fair market value of the entire business, \$10,000,000 which is composed of the fair market value of property and goodwill. In other words, a nonresident donor simply escapes a gift tax on the goodwill portion or \$8,000,000 of the business, while a resident donor does not.<sup>93</sup>

### 2. Inequity

Second, a close examination of the two preceding hypotheticals sheds light on inequity from a different angle. As in the above example, the nonresident donor can simply escape a gift tax on the goodwill portion, which is \$8,000,000 of the business.<sup>94</sup> But if the nonresident donor sells the business and hands over the proceeds from the sale to the donee, totaling \$10,000,000, then the donor is subject to gift tax on the entire sale proceeds, including the goodwill portion of

---

<sup>91</sup> I.R.C. § 2511(a) (2013).

<sup>92</sup> EDWARD J. SMITH, 15 MERTENS LAW OF FEDERAL INCOME TAX'N §59:64 (West, 2014) (stating for purposes of tax law, goodwill is the expectation of earnings in excess of a fair return on the capital invested in tangibles or other means of production); Rev. Rul. 59-60, 1959-1 C.B. 237.

<sup>93</sup> I.R.C. § 2511(a).

<sup>94</sup> *Id.*



the business.<sup>95</sup> The transfer of the \$10,000,000 cash versus the transfer of a business of the same value produces very different results for the donor, although the substance of the transaction remains the same.

By amending current tax statutes to implement a gift tax on the transfer of property by a nonresident, regardless of whether it is tangible or intangible, we can stop nonresident individuals and business owners from escaping gift taxes on off-balance sheet assets.

Goodwill is a value attributable to the expectation of continued customer patronage<sup>96</sup> and is calculated as a value in excess of fair market value of tangible assets of a business, and is only recognized when a business is acquired.<sup>97</sup> The appreciation of a business value due to goodwill does not show up on the balance sheet. If the business is simply transferred by gift to a donee, then the goodwill remains undetected on the grounds that it is only recognized when the business is acquired by a buyer in the amount of purchase price in excess of fair market value of its tangible assets.<sup>98</sup>

Like the previously suggested tax reforms, this proposed reform would also increase federal tax revenue.

### **C. Improving Effectiveness in Requiring Nonresidents to Comply with a Gift Tax Return Proposal; Withholding From Nonresident Donors**

When a nonresident is required to file and pay a gift tax, it is very difficult to compel the nonresident to do so.<sup>99</sup> Not only may he be unfamiliar with the United States tax system, the United States does not have jurisdiction over foreign countries. If a nonresident simply leaves the United States, it is a complex process for the United States to collect tax obligations in a foreign country. Although the IRS is

---

<sup>95</sup> *Id.* § 2501; *Blodgett v. Silberman*, 277 U.S. 410 (1928); I.R.S. Priv. Ltr. Rul. 77-37-063 (June 17, 1977) (holding that currency is tangible personal property for gift taxation).

<sup>96</sup> JAMES J. FREELAND ET AL., *FUNDAMENTALS OF FEDERAL INCOME TAX* 398 (Robert C. Clark et al. eds., 17<sup>th</sup> ed. 2013).

<sup>97</sup> SMITH, *supra* note 92, at §59:64 (stating where there is a sale of an active trade or a business, both the seller and purchaser must allocate the consideration to transferred assets, including goodwill, under the residual method); *accord* I.R.C. § 1060(a).

<sup>98</sup> I.R.C. § 197.

<sup>99</sup> Richard Neal, *IRS To Improve Nonresident Alien Tax Compliance*, ACCOUNTING TODAY FOR WEB CPA (May 14, 2010), <http://www.accountingtoday.com/news/IRS-Improve-Nonresident-Alien-Tax-Compliance-54241-1.html>.

allowed to collect from a donee in situations where the donor is unavailable, this is only permitted after exhausting efforts to collect from the donor.<sup>100</sup>

In order to close this tax loophole, this Note proposes amending the Internal Revenue Code to require a donee to withhold a tentative percentage of the value of property over annual exclusion from a nonresident donor. When the withheld tax is remitted to the IRS, and a donor later wishes to apply for a refund on the grounds that there should have been no gift tax due or less due than the amount of the tax withheld, the donor is required to file a gift tax return.<sup>101</sup> There are many anticipated benefits from this policy.

### 1. Defending the U.S. Tax Base

First, the withholding tax requirement<sup>102</sup> serves to better defend the U.S. tax base by ensuring that an appropriate level of tax is withheld and paid, minimizing the risk of interested parties failing to file appropriate returns and remitting the amount of tax that is due.<sup>103</sup> As a result, there will be a significant reduction in the tax administration costs to oversee and monitor compliance with respect to foreign gifts because a donor is required to file a gift tax return in order to get a refund if an overpayment was made.

### 2. Burden-Shifting

Second, it is more consistent with our social norms to shift the burden to withhold to the U.S. person, as the donee, rather than expecting a nonresident to comply with the United States tax system. This policy is illustrated in the Foreign Investment in Real Property Tax Act<sup>104</sup> (hereinafter “FIRPTA”) which came into effect on June 18,

---

<sup>100</sup> I.R.C. § 6901.

<sup>101</sup> *Id.* § 6511(a) (“Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the payer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed for 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid.”).

<sup>102</sup> I.R.C. § 6901; Treas. Reg. § 301.6901-1; 31 U.S.C. § 3713(b) (2013).

<sup>103</sup> CYM H. LOWELL, U.S. INT’L TAX’N: AGREEMENTS, CHECKLISTS & COMMENTARY 18.04 (West. 2014).

<sup>104</sup> I.R.C. § 1445; I.R.C. § 897.

1980, as part of the Omnibus Reconciliation Act of 1980.<sup>105</sup> Under FIRPTA, when a nonresident seller transfers real property to a buyer, the buyer is required to withhold ten percent of the gross sale price<sup>106</sup>. Afterward, the seller, who believes that either her tax on the capital gain<sup>107</sup> should be less than the amount withheld or there should be no tax on capital gain at all, must apply for a withholding certificate to get a refund.<sup>108</sup> This Act was legislated for the purposes of preventing prevalent tax evasion and reducing tax administration cost while avoiding the discouragement of foreign investors from investing in the United States.<sup>109</sup>

### 3. Withholding the Burden on a U.S. Donee

Third, it will be more effective to enforce compliance because of the withholding burden on a U.S. donee. When there is a gift tax requirement on a foreign donor, it may not be effective to force her to comply with the gift tax filing or payment requirement. But if there are requirements on both sides of the gift transaction, it is obvious that the likelihood of compliance will increase.

## IV. CONCLUSION

Our current tax rules allow nonresidents to make a tax-free gift by simply converting personal or real property situated in the United States to cash and then wire-transferring it to a U.S. resident. This trend has even become more prevalent as the worldwide banking system has rapidly advanced day by day.<sup>110</sup> In order for the United States to secure proper tax revenue and efficiently exercise its taxing authority, it should eliminate the limitations on gift-taxing on transfer of property by a nonresident.

An intangible asset exception to a gift tax<sup>111</sup> should be reconsidered. While the conversion from a tangible asset to an

---

<sup>105</sup> Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, §§ 1121-1125, 94 Stat. 2599 (1980) (codified at I.R.C. §§ 861 (a)(5), 897 6039C, 6652(g) (2014)).

<sup>106</sup> I.R.C. § 1445(a).

<sup>107</sup> *Id.* § 1001(a) (a capital gain is defined as the excess of the amount realized from disposition of property over the adjusted basis).

<sup>108</sup> *Id.* § 1445(b)(4).

<sup>109</sup> I.R.S. P.C.L. WL 454028 (2009).

<sup>110</sup> *See generally* GREENE, *supra* note 17, at 4.

<sup>111</sup> I.R.C. § 2501(a)(2).

intangible asset can be easily executed, the current gift tax rules applicable to nonresidents are mere letters with no power unless intangible assets are also included in taxable gifts.

Lastly, a new system should be implemented to effectively collect gift taxes imposed on nonresidents. The new system should require U.S. donees to withhold a tentative amount as a gift tax on the property transferred by a nonresident. Requiring such collection liability on the donee can effectively encourage taxpayers to comply with our tax system and can increase the efficiency of U.S. tax law administration.