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WEALTH MANAGEMENT

The Gifting of Cash

How the U.S. gift tax applies to foreign nationals is anything but straightforward when it comes to the treatment of cash gifts withdrawn from U.S. bank accounts.

Foreign nationals with no U.S. domicile can trigger taxable gifts in the U.S. when transfers of cash are made from their U.S. bank accounts, even if the cash is gifted to a non-U.S. person. In general, the IRS looks to the gift-giver to pay any gift taxes. A non-U.S. domiciliary can incur U.S. gift tax[1] on gifts of U.S. situs assets. The only gift tax exclusions that can mitigate the gift tax for foreign nationals are a small annual gift exclusion,[2] annual exemption for transfers to non-citizen spouses,[3] and the exemption for direct payment of qualified medical and educational expenses.[4] This is in stark contrast to U.S. citizens and domiciliaries who have a $12.92 million unified gift and estate tax exemption.

For these foreign individuals, the U.S. gift tax applies to real and tangible assets physically located in the U.S.,[5] such as a home, cars and art. Gifts of intangible assets, like stock of U.S. companies, are exempt.

Cash located in a U.S. safe deposit box is a clear example of a U.S. situs tangible asset. But the tax treatment of cash sitting in a foreign national's U.S. bank account isn't as clear-cut.

Although there is a rule that specifically exempts bank deposits from the U.S. estate tax,[6] it doesn't necessarily apply to transfers of bank deposits during a foreign national's life, whether by wire or check.[7]

Non-U.S. parents can unwittingly incur U.S. gift tax when transfers are made from their U.S. bank account to children living in the U.S. to pay for tuition,[8] for living expenses, to buy a car or apartment, or as a graduation gift of cash. To the extent these cash transfers exceed the annual exclusion amount and don't fall under one of the gift tax exclusions, they will be subject to U.S. gift tax. Keep in mind that even where transfers are made to someone who doesn't live in the U.S., the gift tax can still be triggered if the cash comes out of a foreign individual's U.S. bank account.

Gifting Securities as a Workaround

Although the U.S. transfer tax can be quite tricky for those unfamiliar with it, there are some workarounds. Since intangible assets are not considered to be U.S. situs, one technique is to convert the tangible asset – cash in a U.S. bank account, for example – into an intangible asset, like securities. It is common for U.S. Treasury bills or other securities to be gifted instead of cash which avoids U.S. gift tax.

Yet be aware that donees receive a carry-over basis[9] in gifts received. That means any built-in capital gains in gifted equities will later be taxable to the donee when the stock is sold.[10] Also keep in mind that the "step transaction"[11] doctrine could apply if the cash is converted to a tax-exempt gift for purposes of avoiding the gift tax,[12] or gifted securities are immediately converted to purchase real estate or a car, for example. Using the "step transaction" principle, the IRS may recharacterize these gifts as direct gifts of cash, real estate or a car – all tangible assets subject to gift tax if physically located in the U.S. Ensuring Treasury bills are held for an appropriate length of time before gifting them, and leaving enough time between the gift and any subsequent sale and new purchase, should mitigate this issue.

Ultimately, the IRS should not be able to find that there was a pre-existing plan to achieve a tax-free gift by virtue of converting the cash.

Transferring Cash from a Non-U.S. Account

Another workaround is to only transfer cash from a non-U.S. bank account,[13] as this cash will likely not be treated as a U.S. situs asset. A fool-proof way to ensure non-taxable treatment is to keep the transaction completely offshore by transferring cash from a non-U.S. account to the donee's non-U.S. account. This isn't always a practical option, as the donor or donee might not have bank accounts outside of the U.S. and setting one up – in particular for U.S. donees – is not always an easy thing to do.[14]

Any gifts over $100,000 received by a U.S. person from a foreign individual donor will need to be reported on the IRS Form 3520. This applies regardless of whether the gifted assets are considered U.S. situs or not.

Footnotes

[1]The highest U.S. gift tax rate reaches 40% on the fair market value of gifts worth more than $1 million.

[2]$17,000 (2023) per person but can be up to $34,000 from both spouses; IRC Section 2503(b).

[3]$175,000 (2023); IRC Section 2523(i).

[4]IRC Section 2503(e).

[5]IRC Section 2501(a)(2).

[6]IRC Section 2105(b); Treas. Reg. Section 20.2105-1(k).

[7]GCM 369860 (September 24, 1976); PLR 7737063 (June 17, 1977).

[8]IRC Section 2503(e).

[9]IRC Section 1015(a) provides that property acquired by gift shall have the same basis as it would in the hands of the donor except that if such basis is greater than the fair market value of the property at the time of the gift, the basis shall be the fair market value for the purpose of determining loss.

[10]This assumes the donee is a U.S. person. Foreign nationals with no U.S. domicile are generally not subject to U.S. capital gains tax on the sale of securities.

[11]See Gregory v. Heverling, 293 U.S. 465 (1935) where the court recharacterized a tax-motivated transaction. The step transaction doctrine, similar to the substance over form doctrine, is applied to prevent tax abuses by combining a series of formally separate steps which produced a certain tax result into a single event.

[12]DeGoldschmidt-Rothchild vs. Comm'r; 168 F2d 975 (2d Cir. 1957).

[13]See PLR 200340015 (October 3, 2003); PLR 200748008 (Nov 30, 2007); and PLR 201311004 (March 15, 2013).

[14]Since the 2010 enactment of the Foreign Account Tax Compliant Act (FATCA), many foreign financial institutions have decided that servicing U.S. taxpayers is not worth the extra administrative work and potential risks, and have declined to open or even maintain accounts for U.S. citizens or residents.

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