

Relevant International Updates

2026 Year-End Estate Planning Advisory

November 19, 2026

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Unlike 2025, which brought significant change through the One Big Beautiful Bill Act (OBBBA), 2026 was relatively quiet in terms of new legislation and final regulations. Most developments were administrative, along with several proposed regulations targeting controlled foreign corporations (CFCs). The usual inflation adjustments affecting international private clients also continued.

Proposed regulations on CFCs and potential impact on traditional inbound planning

In late August, the Internal Revenue Service (IRS) and the US Department of the Treasury published proposed regulations (REG-115646-25) under sections 951 and 951A intended to equitably allocate a US shareholder's subpart F income or net CFC tested income inclusion when CFC ownership changes mid-year. Under law in effect before OBBBA, the so-called “hot potato” rule generally caused a US shareholder who held CFC stock on the last day of the CFC's taxable year to bear the full inclusion, even if the shareholder acquired the interest mid-year. In effect, this gave US shareholders a planning mechanism to dispose of CFC stock mid-year and avoid the subpart F income or net CFC tested income inclusion, although section 1248 would still apply to the mid-year disposition.

To address this distortion, the proposed regulations set forth a default allocation method, a mandatory closing of the CFC's taxable year upon a change in CFC status and an elective closing of the CFC's taxable year:

- **Default allocation.** The default method uses a daily proration based on (i) the percentage of CFC stock owned by the US shareholder and (ii) the percentage of the CFC's taxable year during which the US shareholder owned that stock.

- **Mandatory closing.** A CFC must close its books at the end of the day on which it becomes or ceases to be a CFC (a “status change event”), and the closing applies to all shareholders and for all purposes of the Code.
- **Elective closing.** If a “significant ownership variance” occurs, a “controlling section 958(a) shareholder” may elect to close the CFC's taxable year. Like the mandatory closing, an elective closing applies to all shareholders and for all purposes of the Code as of the end of the day on which the variance occurs.

For inbound planning, the traditional “diamond structure” (in which a trust owns two holding companies that in turn own a single holding company) may see a resurgence. The structure was used more routinely when the former “30-day” rule was in effect, under which a subpart F income inclusion could arise only if a US shareholder owned CFC stock for an uninterrupted 30-day period. A check-the-box election could be made for the single subsidiary effective before the death of the trust's grantor, and check-the-box elections could then be made for the two companies directly owned by the trust effective after the grantor's death. So long as those later elections were effective before US beneficiaries could be treated as indirectly owning the underlying company shares for an uninterrupted 30-day period, the successive elections (i) preserved the US estate tax blockers and (ii) avoided any CFC issue for the US beneficiaries.

After the 30-day rule was eliminated, and before OBBBA changed the *pro rata* share rules (the changes the proposed regulations address), a US beneficiary of a foreign grantor trust whose non-US grantor died could face the hot potato rule. With the OBBBA change and the proposed regulations, the diamond structure may again become more appealing: although a subpart F income or net CFC tested income inclusion may still arise, the amount of the inclusion should generally be smaller than under the hot potato rule.

Administrative changes: new IRS Form 708 and penalty relief changes

New IRS Form 708

At the beginning of 2026, the IRS finally addressed a long-standing reporting gap for gifts and bequests from “covered expatriates.” Subject to various exceptions, a covered expatriate is a US citizen who renounces citizenship, or a long-term green card holder who relinquishes his or her green card and who fails one of three tests (the tax liability test, the net worth test or the tax compliance test). A long-term green card holder is one who has held a green card during any part of eight of the last 15 taxable years. Two consequences generally follow covered expatriate status. First, the covered expatriate is deemed to sell all of his or her assets at fair market value (with special rules for certain deferred arrangements and non-grantor trusts). Second, a US recipient of a “covered gift” or

“covered bequest” from the covered expatriate is subject to what is effectively an inheritance tax on the amount received (again, with limited exceptions).

Until now, the IRS had no form to enforce disclosure of covered gifts and covered bequests under section 2801. Form 708 now fills that gap. Although issued in January 2026, Form 708 applies to covered gifts and covered bequests received in 2025. The general due date is the 15th day of the 18th month following the close of the taxable year in which the covered gift or covered bequest was received, so Form 708 for 2025 receipts is due June 15, 2027. Special due dates apply to certain covered bequests, to foreign trusts that migrate to domestic status and to foreign trusts that elect to be treated as domestic trusts.

IRS penalty relief changes and procedures

Amid the recent downsizing of the IRS, the agency has made several changes to its approach to penalties for international information returns, affecting penalties for late Reports of Foreign Bank and Financial Accounts (FBARs), first-time penalty abatement and penalties on Form 3520 reports of gifts received by US persons from nonresident aliens.

- **Delinquent FBARs.** The IRS website previously described a “Delinquent FBAR Submission Procedure,” under which a US person with reasonable cause for late filing who had timely filed federal income tax returns, properly reported all income and was not under civil or criminal investigation could file delinquent FBARs without penalty. In July 2026, the IRS quietly removed the procedure from its website, creating uncertainty about its posture on delinquent FBARs. Statutory relief remains available, however, if a US person can show that the failure to file was non-willful and due to reasonable cause. The removal may signal that the IRS wishes to retain more discretion over whether and when to grant penalty relief.
- **Late-filed Forms 3520.** In 2024, practitioners raised concerns that the IRS was automatically assessing penalties, of up to 25% of the gift or bequest, on late-filed Forms 3520 reporting gifts or bequests from nonresident aliens, without considering reasonable cause. The IRS announced at the end of 2024 that it would stop automatic assessments and updated the Internal Revenue Manual accordingly toward the end of 2025. As a result, the IRS should now consider the merits of a reasonable cause statement before assessing a penalty, rather than requiring the taxpayer to contest the assessment on appeal.
- **First-time abatement.** In 2026, the IRS replaced its First Time Abatement (FTA) administrative waiver for certain failure-to-file and other penalties with an Automatic Exemption from Penalty (AEP). Neither the FTA nor the AEP applies to delinquent international information returns (such as FBARs and Forms 8938 and 5471); the IRS expressly excludes information return penalties from the AEP program. Taxpayers with delinquent international information returns therefore

must continue to rely on traditional administrative programs, such as the Streamlined Filing Compliance Procedures, or on statutory relief (generally, a showing of reasonable cause).

Inflation adjustments

The usual inflation adjustments affecting international private clients continued:

- **Gifts to a non-citizen spouse.** Although the unlimited marital deduction is unavailable for gifts to a non-citizen spouse, an enhanced annual exclusion applies. The exclusion was $190,000 for 2025 and increased to $194,000 for 2026 and will be $201,000 for 2027.
- **Foreign earned income exclusion.** The exclusion for US persons earning certain income while living abroad increased from $130,000 for 2025 to $132,900 for 2026 and will be $137,300 for 2027.
- **Covered expatriate tax liability test.** The average annual net income tax liability threshold for the five years before expatriation was $206,000 for 2025, increased to $211,000 for 2026 and will be $218,000 for 2027.
- **Covered expatriate exclusion.** The exclusion from gross income available against a covered expatriate's deemed sale of assets was $890,000 for 2025, increased to $910,000 for 2026 and will be $940,000 for 2027.

Key things to know

- Federal tax, administrative and reporting changes affecting international private clients were far fewer in 2026 than in 2025.
- The proposed CFC regulations are a welcome change and reopen the door to the diamond structure in inbound planning.
- New Form 708 should be taken into account now for covered gifts and covered bequests received from covered expatriates.
- Recent changes appear to narrow certain administrative penalty abatement paths for delinquent international information returns, which may signal increased IRS scrutiny, although statutory avenues for penalty relief are unaffected.

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