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May 26, 2016

The Honorable John A. Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Guidance under Section 2801

Dear Messrs. Koskinen and Wilkins:

Enclosed please find comments on section 2801 regarding the imposition of tax on certain gifts and bequests from covered expatriates (“Comments”). These Comments are submitted on behalf of the American Bar Association Sections of Real Property, Trust and Estate Law (“RPTE”) and Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Sections of RPTE and Taxation would be pleased to discuss the Comments with you or your staff if that would be helpful.

Sincerely,

Robert J. Krapf
Chair, Section of Real Property, Trust
and Estate Law

George C. Howell, III
Chair, Section of Taxation

Enclosure

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**AMERICAN BAR ASSOCIATION
SECTION OF REAL PROPERTY, TRUST AND ESTATE LAW
SECTION OF TAXATION**

**Comments on Guidance under Section 2801 Regarding the Imposition of Tax on
Certain Gifts and Bequests from Covered Expatriates**

These comments (“Comments”) are submitted on behalf of the American Bar Association Sections of Real Property, Trust and Estate Law (“RPTE Section”) and Taxation (“Tax Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Scott A. Bowman and Marianne Kayan, Co-Chairs of the RPTE Section’s International Tax Planning Committee of the Income and Transfer Tax Planning Group, supervised and participated in the preparation of these Comments. Principal responsibility for preparing these Comments was exercised by Scott A. Bowman, Marianne Kayan, and Michael Rosenblum. Substantive contributions were made by Caryn Friedman, John Fusco, Corey Glass, David Kirk, Stephen Liss, Raj A. Malviya, Carly McKeeman, Brent Nelson, Severiano Ortiz, Kevin Packman, Justin Ransome, John Strohmeier, and Ashley Weyenberg. The Comments were further reviewed by Ellen K. Harrison, on behalf of the RPTE Section’s Committee on Government Submissions; Laura Hundley, as Chair of the Tax Section’s Estate and Gift Taxes Committee; John Bergner, as Council Director of the Tax Section’s Estate and Gift Taxes Committee; David Pratt, on behalf of the Tax Section’s Committee on Government Submissions; and Peter Blessing, as the Tax Section’s Vice-Chair (Government Relations).

Although the members of the RPTE Section and Tax Section who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: May 26, 2016

A. Description of Section 2801

The following description is included for reference purposes only. Commentary begins on page 9.

1. History of Section 2801 and the Proposed Regulations

Section 301 of the Heroes Earnings Assistance and Relief Tax Act of 2008¹ (the “HEART Act”) enacted sections 877A² and 2801, effective as of June 17, 2008. The HEART Act was enacted, in part, to impose a tax on U.S. citizens and residents (“U.S. persons”) who receive from a covered expatriate (“CE”) a transfer that would otherwise escape U.S. estate and/or gift taxes as a consequence of the transferor’s expatriation. Prior to the addition of sections 877A and 2801, U.S. expatriates were subject to an alternate U.S. estate and gift tax regime under sections 877 and 2107 for 10 years following expatriation; this regime still applies to U.S. citizens and long term residents who expatriated before June 17, 2008, while the newer sections 877A and 2801 regime applies to U.S. citizens and long term residents expatriating after that date.

On July 20, 2009, the Treasury and the Internal Revenue Service (“the Service”) put taxpayers on notice via Announcement 2009-57 that section 2801 would apply to subject transfers (explained below) received on or after June 17, 2008; the announcement reflected the Service’ intent to issue guidance on reporting and tax obligations imposed under section 2801. On October 15, 2009, the Treasury and the Service released Notice 2009-85, which deferred taxpayer obligations under section 2801 until the issuance of separate guidance by the Service.

2. General Description of Section 2801

Section 2801 generally taxes U.S. persons who receive, directly or indirectly, an otherwise nontaxable gift or bequest in excess of the gift tax annual exclusion (currently \$14,000) from a CE as defined in section 877A(g)(1) (a “covered gift or bequest” or, collectively, a “covered transfer”), unless the assets transferred were reported as a taxable transfer on a timely filed estate or gift tax return, as the case may be, or the transfer would have been eligible for a gift or estate tax charitable or marital deduction had the CE been a U.S. person (the “section 2801 tax”). Whether the CE acquired the transferred property before or after expatriation is irrelevant to application of the section 2801 tax. The section 2801 tax is equal to the product of the highest estate or gift tax rate on the date of receipt (currently 40%) multiplied by the fair market value of the covered transfer on the date of receipt, less a credit for any estate or gift tax paid on such transfer to a foreign country.

¹ Pub. L. No. 110-245, 122 Stat. 1624 (2008).

² Unless noted otherwise, all citations are to the Internal Revenue Code of 1986, as amended (the “Code”), and the Treasury Regulations promulgated thereunder.

The section 2801 tax treats domestic trusts as U.S. persons; thus, domestic trusts that receive a covered transfer must pay the section 2801 tax. Further, a foreign trust that elects to be treated as a domestic trust (an “electing foreign trust”) will also pay the section 2801 tax on covered transfers. Foreign trusts that do not elect to be treated as domestic trusts for section 2801 tax purposes (“non-electing foreign trusts”), are treated as non-U.S. persons, but distributions to a U.S. person from a non-electing foreign trust of assets received from a CE are deemed covered transfers, triggering section 2801 tax liability to the U.S. recipient.

3. Description of Proposed Regulations Upon Which Commentary Relies

a. Defined Terms

Proposed regulation section (“regulation”) 28.2801-2(b)³ clarifies that the determination of whether a recipient of a covered transfer is a U.S. recipient is made at the time of receipt of the covered transfer. Regulation 28.2801-2(e) defines “U.S. recipient,” a term used solely in the Proposed Regulations, as (1) a citizen or resident of the U.S., a domestic trust, or an electing foreign trust that receives a direct or indirect covered transfer; (2) a U.S. person receiving a distribution from a non-electing foreign trust if the distributions are attributable to covered gifts or bequests received by the foreign trust; and (3) U.S. interest-holders of a domestic entity that receives a covered transfer.

Regulation 28.2801-2(c) cross-references section 7701(a)(30)(E) to test whether a trust that has specifically elected domestic trust treatment is otherwise domestic; under this test, a trust is domestic if (1) a U.S. court is able to exercise primary supervision over the trust’s administration and (2) one or more U.S. persons have the authority to control all substantial decisions of the trust. Similarly, regulation 28.2801-2(d)(1) refers to section 7701(a)(31) to define otherwise foreign trusts (i.e., any trust that does not qualify as a domestic trust).

Regulation 28.2801-2(f) and (g) define covered bequests and gifts. The definitions confirm that (1) the situs and acquisition date of the transferred property are irrelevant for section 2801 tax purposes and (2) a distribution from a non-electing foreign trust to a U.S. person will be a covered transfer if attributable to a covered transfer made to the foreign trust.

Regulation 28.2801-2(h) defines expatriates and CEs, stating that for section 2801 purposes that if an individual is a CE as of the expatriation date, that person remains a CE at all times thereafter. If there are multiple expatriations for the same individual, the most recent expatriation date controls.

Regulation 28.2801-2(i) lists five types of indirect transfers that qualify as covered transfers: (1) acquisitions by a business association (i.e., a corporation or partnership)

³ Unless noted otherwise, all references herein to “regulation” or the “regulations” are to the proposed regulations issued 9/10/2015 in Fed. Reg. Vol. 80, No. 175, P 54447.

owned by the U.S. person (but only to the extent of the ownership interest), (2) acquisitions by an entity not subject to the section 2801 tax on behalf of a U.S. person, (3) transfers by a CE to satisfy the debts or liabilities of a U.S. person, regardless of the payee, (4) transfers resulting from a non-CE's power of appointment ("POA") granted by a CE over property not in trust (unless previously subjected to the section 2801 tax upon grant of the POA or the CE only had a limited POA), and (5) "other transfers" not made directly by the CE to a U.S. person.

b. Rules and Exceptions for Covered Gifts and Bequests

Regulation 28.2801-3(a) defines a covered gift by incorporating the standard definition of a gift under general gift tax principles without regard to the statutory exceptions for (1) transfers of intangible property by non-resident aliens ("NRAs"), (2) transfers to political organizations, (3) transfers of certain stock in a foreign corporation, (4) the gift tax annual exclusion, (5) educational and medical expenses, and (6) the waiver of certain pension rights.

Regulation 28.2801-3(b) indicates that, with respect to covered bequests, property acquired "by reason of the death of a CE" includes any property that would be includible in the CE's gross estate if the CE were a U.S. citizen at death. As such, covered bequests specifically include: (1) transfers by bequest, devise, trust provision, beneficiary designation, contract, or operation of law, (2) transfers that would be subject to sections 2036, 2037, or 2038 inclusion in the CE's gross estate had they been a U.S. citizen at death, (3) transfers from QTIP trusts established by the CE's spouse that would be subject to estate taxation under section 2044 if the CE was a U.S. citizen at death, and (4) other "would be taxable" property such as joint tenancy property under section 2040, annuities, general POAs, and life insurance proceeds under section 2042.

Regulation 28.2801-3(c) identifies five exceptions to covered transfers: (1) taxable gifts that are timely reported and paid on a gift tax return (Form 709), (2) gross estate property that is timely reported and paid (including QDOT distributions) on an estate tax return (Form 706), (3) normally deductible charitable transfers (for transfer tax purposes), (4) normally deductible marital transfers including QTIP and QDOT assets if valid elections are made, and (5) qualified disclaimers. Annual exclusion gifts cannot be excluded under the first category even if timely reported. Testamentary transfers from a CE cannot be excluded from the second category if the estate is not required to file a Form 706-NA and does not actually file timely; this exclusion also does not apply to non U.S.-situs property passing to U.S. persons.

Regulation 28.2801-3(d) regulates transfers by a CE to a trust, stating that a domestic trust or electing foreign trust is not "looked through" to assess the status of the beneficiaries, and it is the trust rather than the beneficiaries that is liable for the section 2801 tax.

Regulation 28.2801-3(e) addresses general POAs when the CE is the holder or the grantor. It imports the traditional estate tax treatment of general POAs for situations in

which the CE is the power holder (i.e., exercise or release in favor of a U.S. person is a covered transfer and a lapse is a release to the extent of the greater of \$5,000 or 5% of the value of the property subject to the general POA). The regulation also includes as a covered transfer the exercise of a POA that violates the rule against perpetuities pursuant to sections 2041(a)(3) and 2514(d). The grant by a CE to a U.S. person of a general POA over non-trust property is also a covered transfer.

c. Tax Liability and Payment Mechanics

Regulation 28.2801-4 elaborates on liability for, payment of, and computation of the section 2801 tax. The tax is determined by multiplying the highest estate or gift tax rate in effect during the year of the transfer by the net value of all covered gifts and bequests received that year (i.e., the total value less the per-donee annual exclusion). Under regulation 28.2801-4(c), values are based on general estate and gift tax valuation principles, without regard to alternate valuation or special use valuation for covered bequests.

Because values for covered gifts and bequests are determined as of the “date of receipt,” regulations 28.2801-4(d)(2) and (3) elaborate that the date of receipt of a covered gift is the same as the gift date would be for gift tax purposes had the transferor been a U.S. citizen, while the date of receipt for a covered bequest is the date of distribution unless the transfer is by operation of law, contract, or beneficiary designation. If a non-electing foreign trust is involved, regulation 28.2801-4(d)(4) states that the date of receipt is the date of distribution by the trust.

Pursuant to regulation 28.2801-4(d)(5), the date of receipt for covered transfers pursuant to a POA differs based on whether the CE is the power holder or the power grantor. The date of exercise, release, or lapse of a POA held by a CE is the date of receipt if the transfer is a covered gift. If the exercise, release, or lapse of a POA held by a CE is a covered bequest, the date of receipt is the date of distribution unless the POA property passes at death by operation of law, beneficiary designation, or contract (in which case, the date of receipt is the date of death). Where the CE is the power grantor of a general POA over non-trust property, the regulations state that the date of receipt is the earliest date that (1) the U.S. person can exercise the POA and (2) the general POA property has been irrevocably transferred by the CE.

Regulation 28.2801-4(d)(6) defines the date of receipt for indirect covered gifts or bequests as the date a U.S. person becomes the first recipient of the underlying property. Thus, if a CE grants a limited POA over non-trust property to a foreign person who later exercises the POA in favor of a U.S. person, the date of receipt is the date the U.S. person actually obtains the property. Relatedly, if a CE makes a transfer to conduit entities not subject to the section 2801 tax that later distribute the property to a U.S. person, the date of receipt is the date the U.S. person acquires the property from the intermediary entity.

Under regulation 28.2801-4(a)(2)(iii), a domestic charitable remainder trust (“CRT”) is liable for covered gifts and bequests, but the charitable remainder beneficiary’s share of

the transfer is not a covered transfer. The regulation provides that the section 2801 tax liability of a CRT is calculated by (1) determining (pursuant to the regulations under section 664) the value of the charitable remainder interest in the contribution on the date of transfer, (2) subtracting the charitable remainder interest value from the total value of the respective contribution, and (3) adding all of the remaining income in a given taxable year.

While U.S. recipients of distributions from non-electing foreign trusts are liable for section 2801 taxes attributable to covered gifts or bequests made to such trust, regulation 28.2801-4(a)(3)(ii) provides an income tax deduction (to the extent the distribution is included in the recipient's gross income) under section 164 equal to the portion of the section 2801 tax attributable to the distribution and calculated as follows:

$$\frac{\text{(Section 2801 tax liability)} \times \text{(foreign trust distributions attributable to covered transfers that are also included in gross income)}}{\text{total covered transfers received}}$$

Regulation 28.2801-4(e) requires that in order for a covered transfer recipient to claim a foreign estate or gift tax credit against the section 2801 tax, the U.S. recipient must attach to Form 708: (1) a copy of the foreign estate or gift tax return, (2) a copy of the receipt or cancelled payment check for such taxes, (3) a "break out" that attributes such taxes to each covered transfer, (4) a description and value of the property with respect to such taxes, (5) a statement describing any refunds allowed and, if claimed, the refund amounts, and (6) all other information necessary for verification and computation of the reduction. The foreign taxing entity may be a political subdivision of the foreign country. However, no reductions are allowed for interest and penalties on foreign taxes.

Unlike section 1015(d), which generally allows gift tax paid on a gift to be added to the donee's basis, section 2801 does not provide a basis adjustment for payment of the section 2801 tax.

d. Special Rules for Foreign Trusts

Regulation 28.2801-5 governs the application of the section 2801 tax regime to non-electing foreign trusts. Generally, the section 2801 tax is imposed on a U.S. recipient who receives distributions of income or principal from a non-electing foreign trust to the extent such distributions are attributable to covered transfers to such trust. Regulation 28.2801-5(b) defines a "distribution" as any direct, indirect, or constructive transfer from a foreign trust and includes disbursements pursuant to the exercise, release, or lapse of all POAs.

Recognizing that a foreign trust can be funded by covered and non-covered contributions, regulation 28.2801-5(c)(1) creates a “section 2801 ratio” to determine the respective covered and non-covered portions of such trust. The covered portion includes the covered transfer and any appreciation and income accrued as a result of these transfers. The section 2801 ratio is determined as follows:

$$\frac{[(\text{Pre} - \text{Contribution FMV of Trust}) \times (\text{Pre} - \text{Contribution Section 2801 Ratio})] + [\text{Current Contribution FMV Attributable to Covered Transfer}]}{\text{Post} - \text{Contribution FMV of Trust}}$$

Important to the above calculation is the regulation 28.2801-5(c)(1)(ii) directive that once a section 2801 tax is timely paid on undistributed foreign trust property, that property is no longer considered a covered transfer. If the foreign trustee or U.S. recipient is missing information necessary to perform the above calculation, the entire distribution is deemed attributable to a covered transfer (i.e., the section 2801 ratio is one and the entire distribution is subject to the section 2801 tax).

Regulation 28.2801-5(d) describes the effect of the election by which a foreign trust is treated as a domestic trust. The election subjects the electing foreign trust to the section 2801 tax on (1) all covered transfers received by the trust that year and for future years in which the election remains effective and (2) the portion of the trust attributable to covered gifts and bequests in prior years. Because previously taxed covered transfers are removed from the determination of the covered portion of the trust under regulation 28.2801-5(d)(2), upon election, the section 2801 ratio of the electing foreign trust becomes zero until the election is terminated and a subsequent covered transfer is made. However, distributions in prior calendar years by the now elected foreign trust remain subject to the previous section 2801 ratio and taxable to the U.S. beneficiary.

Regulation 28.2801-5(d)(3) governs the time and manner of making the election. A valid election is made on a timely filed Form 708 for the calendar year in which the foreign trust seeks to subject itself to section 2801 tax and must: (1) include timely payment of any section 2801 tax resulting from the election, (2) include the computations relative to the contemporaneous payment, (3) designate and authorize a “U.S. agent” (discussed further below), and agreement to file Form 708 annually thereafter, (4) provide a history of all prior distributions to U.S. recipients attributable to covered gifts and bequests (including U.S. taxpayer names, addresses, and taxpayer identification numbers (“TINs”)), and (5) notify each “permissible distributee” that the election is being made and provide the Service with the names, addresses, and TINs of each permissible distributee. Permissible distributees are defined as U.S. persons who: (1) may receive current distributions of trust income or principal (“current beneficiaries”), (2) have a withdrawal right over income or principal (regardless of any contingencies) (“withdrawal beneficiaries”), or (3) would be able to receive current distributions of trust income or principal if either all current beneficiaries’ interests or all withdrawal beneficiaries’ interests terminated. If no covered transfers are received by the electing foreign trust in a given year, the trustee must still file a Form 708 certifying as such.

Regulation 28.2801-5(d)(3)(iv) requires the foreign trustee to provide the aforementioned U.S. agent with all information necessary to comply with any information request or summons by the Treasury Secretary, including requests and summons to examine or produce records and testimony related to covered transfers. Appointment of a U.S. agent does not in and of itself cause an electing foreign trust to have an office or permanent establishment in the U.S. or be considered engaged in a trade or business in the U.S.

Under regulation 28.2801-5(d)(5)(ii), a valid foreign trust election is effective as of January 1 of the calendar year for which the Form 708 on which the election is made is filed and remains effective until terminated. The election is automatically terminated if: (1) the foreign trust fails to timely file the Form 708 and pay any section 2801 tax then due or (2) fails to pay additional section 2801 taxes resulting from an “imperfect election” (described further below). Like the election itself, the termination is effective for the entire year at issue. However, subsequent elections for a year in which a termination occurs are expressly allowed under regulation 28.2801-5(d)(5)(iii).

Regulation 28.2801-5(d)(6) outlines the procedure for disputes between the Service and an electing foreign trust over the section 2801 tax. The Service must send a letter (but not a notice of deficiency) to the electing foreign trustee and the U.S. agent detailing the disputed information and recalculated tax and the payment due date for maintenance of the election. If the trustee timely pays and enters into a closing agreement with the Service, the election is not terminated. In the absence of fraud, malfeasance, or material factual misrepresentations, any recalculated values are deemed finally determined and binding on the Service and the foreign trust, preventing future challenges to all disclosed covered gifts and bequests on the Form 708 at issue.

Under regulation 28.2801-5(d)(6)(iii), if the additional tax is not timely paid, the election is terminated and retroactively becomes an “imperfect election.” An imperfect election requires that the U.S. recipients of distributions from such trust “take into consideration” the additional value determined by the Service when calculating section 2801 ratios. Disagreements regarding the additional value are to be resolved during review of the U.S. recipient’s (rather than the electing foreign trust’s) Form 708.

Under regulation 28.2801-5(d)(6)(iii)(B), the trustee “should” promptly notify each permissible distributee (defined above) of: (1) the additional value assessed by the Service and not timely paid, (2) that the foreign trust’s election was terminated as of January 1 of the actual year of the termination, and (3) the U.S. recipient’s section 2801 tax liability with respect to the portion of distributions attributable to covered gifts and bequests. Under regulation 28.2801-5(d)(6)(iii)(C), if an imperfect election occurs and the U.S. recipient files a Form 708 and pays his or her share of additional section 2801 tax within six months of becoming aware (by notification or otherwise) that a valid election was not in effect, the U.S. recipient is excused from willful neglect penalties under section 6651.

Under regulation 28.2801-5(d)(6)(iii)(D), if a non-electing foreign trust migrates and becomes a domestic trust (a “migrated foreign trust”), the trust must timely file a Form

708 for the year of migration and pay any section 2801 taxes due based on the same calculation as an electing foreign trust (i.e., on all covered gifts and bequests received by the trust during the year in which domestication occurs, as well as on the portion of the trust's value at the end of the year preceding the year of domestication that is attributable to all prior covered gifts and bequests).

e. Responsibility for Section 2801 Tax

Regulation 28.2801-7(a) places the burden of ascertaining a taxpayer's obligations under the section 2801 tax regime on the taxpayer, including the determination of whether (1) the transferor is a CE and (2) a transfer is a covered transfer. The Service has reserved the right to provide the taxpayer with information about the transferor to assist the taxpayer, but the taxpayer can only rely on the Service's information if the taxpayer has no knowledge or reason to know that the Service's information is incorrect.

Under regulation 28.2801-7(b), living expatriate donors who do not authorize disclosures to their U.S. recipients are deemed via rebuttable presumption to be CEs that have made a covered gift. A taxpayer may, in limited circumstances, file a protective Form 708 without payment to begin the assessment period of any section 2801 tax. To do so, the taxpayer must reasonably conclude after exercising due diligence that the transfer is not subject to the section 2801 tax. The Proposed Regulations specifically advise that the mere absence of information is not a sufficient basis for a protective Form 708.

Comments

Our comments follow the order set forth in the Proposed Regulations; we specifically note where we address the specific requests for comments.

B. Tax on Certain Gifts and Bequests from Covered Expatriates – Regulation 28.2801-1

1. The Resident Exception To Covered Expatriate

Section 2801(f) and regulation 28.2801-2(h) provide that the term covered expatriate is to have the same meaning for purposes of both sections 877A and 2801. An individual is excepted from the definition of a covered expatriate while he or she is a "resident" in the U.S. pursuant to section 877A(g)(1)(C). Whether an individual is a resident for income tax purposes is based on the mechanical tests of section 7701(b), while being a resident for estate tax, gift tax, and section 2801 tax purposes is based on domicile.

Regulation 28.2801-2(h) excludes an expatriate from the definition of a covered expatriate only while the expatriate is domiciled in the U.S. and, therefore, subject to U.S. estate or gift tax. While this creates a coherent structure for purposes of section 2801, it creates the possibility that a taxpayer could be a covered expatriate for section 877A purposes or section 2801 purposes, but not both. This divergence seems to be in conflict with the language of section 2801(f), as well as section 877A(g)(1)(C). We suggest that

the final regulations provide that an expatriate who is U.S. income tax resident will not be treated as a covered expatriate for purposes of section 2801.

C. Definitions – Regulation 28.2801-2

1. Consistently Utilize and Expand Upon Certain Definitional Rules

a. “Electing Foreign Trust”

The term “electing foreign trust” is defined, but is not consistently used, throughout the regulations. For example, the regulations refer to “foreign trusts electing to be treated as a domestic trust for purposes of section 2801” (see, e.g., regulation 28.2801-1(a)). Other instances where electing foreign trust should be utilized for consistency purposes include regulations 28.2801-2(b), -2(c), -6(c)(1), and -6(c)(2).

b. “General Power of Appointment”

Regulation 28.2801-2(j) defines “general power of appointment” by reference to sections 2041(b) and 2514(c). Section 2514(c) contains only a definition of general power of appointment. On the other hand, section 2041(b) includes more than just the definition of general power of appointment, which appears in section 2041(b)(1); it also includes rules related to the lapse of a power of appointment (section 2041(b)(2)) and powers of appointment created in a will executed on or before October 21, 1942 (section 2041(b)(3)). The gift tax provisions parallel to section 2041(b)(2) and (3) appear in section 2514(e) and (f), neither of which are referenced in regulation 28.2801-2(j). The final regulations should change the current reference to section 2041(b) in section 28.2801-2(j) to section 2041(b)(1), in order to avoid any confusion that the definition of general power of appointment includes the unrelated provisions of section 2041(b)(2) and (3).

c. Provide a Definition For “Non-Electing Foreign Trust”

The regulations distinguish electing foreign trusts from trusts that have not elected to be treated as domestic trusts for section 2801 purposes (see, regulations 28.2801-2(e), -2(f), -2(g), -4(d)(4)). Thus, a new defined term, “non-electing foreign trust” would help to clarify that distinction.

d. “Citizen or Resident of the United States”

Although section 28.2801-2(b) defines “citizen or resident of the United States,” that term is not used consistently throughout the regulations. Instead, the regulations refer to “United States citizen or resident” or “US citizen or resident” (see, e.g., regulations 28.2801-1(a), -2(e), -2(g), -3(e)(1), -4(a)(1), -5(c)(1)(i), -6(c)(1), -7(b)(1)). We believe that the final regulations should define “United States citizen or resident,” as opposed to “citizen or resident of the United States” for consistency purposes. The term “US person” may also be appropriate.

e. Provide Cross References For Terms That Are Defined Elsewhere in the Regulations

Some terms are defined throughout the regulations, but are not included in the listing of defined terms in regulation 28.2801-2. For example, the following terms defined in the regulations do not appear in regulation 28.2801-2: “gift” (regulation 28.2801-3(a)), “by reason of the death of a CE” (regulation 28.2801-3(b)), “charitable remainder trust” (regulation 28.2801-4(a)(2)(iii)), “foreign country” (section 28.2801-4(e)), “distribution” (regulation 28.2801-5(b)), and “imperfect election” (regulation 28.2801-5(d)(6)(iii)(A)). We believe regulation 28.2801-2 would be more “user friendly” if it either defined or referenced all defined terms.

2. Indirect Transfer Rules

a. Provide a Metric to Determine a US Citizen’s or Resident’s Ownership Interest In a Corporation or Other Entity

The reference in regulation 28.2801-2(i)(1) to “the extent of the [US citizen’s or resident’s] respective ownership interest” does not clarify what metric should be used to determine that ownership interest. An owner of an interest in an entity could conceivably have a mix of interests therein, including interests in capital, profits, voting, management, liquidation rights, distribution rights, and/or conversion rights. These various interests may not all be equivalent to one another.

We recommend that the final regulations clarify which interests in entities are to be used to determine the US recipient’s share of a covered gift or bequest. To that end, a possible approach would be to allow US recipients to use any reasonable method that takes into account the relative values of the recipient’s interests, provided that each US recipient must be consistent in the methodology used across all relevant entities.

b. Reduce Broad Scope of Section 28.2801-2(i)(2) and (5) By Implementing a Safe Harbor For Certain Bona Fide Transfers From Non-CEs

Under section 28.2801-2(i)(2), an indirect acquisition of property includes property acquired by or on behalf of a US citizen or resident, either from a CE or from a foreign trust that received a covered gift or bequest, through one or more other foreign trusts, other entities, or a person not subject to the section 2801 tax. Furthermore, regulation 28.2801-2(i)(5) includes in the definition of an indirect acquisition of property, any property acquired by or on behalf of a US citizen or resident in other transfers not made directly by the CE to the US citizen or resident.

As an example, if a CE bequeathed property to an unrelated non-US person who survived the CE by many years and then bequeathed the property to a US citizen or resident, the US citizen or resident could be considered in receipt of a covered bequest under the broad language of regulation 28.2801-2(i)(5). Consequently, an undue burden results to US

citizen or resident recipients who would have to know the chain of title of any acquired property, determine whether any of the past transferors of the title was a CE, and then pay the section 2801 tax if he/she determines that the gift or bequest was a covered gift or bequest.

The final regulations should be simplified by adding a safe harbor provision that mitigates the broad reach of regulation 28.2801-2(i)(2) and (5). This safe harbor could be modeled on section 1.643(h)-1, which generally provides that any property transferred to a U.S. income tax resident by another person (an intermediary) who received property from a foreign trust will be treated as property transferred directly from the foreign trust to the U.S. income tax resident if the intermediary received the property from the foreign trust pursuant to a plan one of the principal purposes of which was the avoidance of U.S. tax. The regulation also creates a presumption that transfers made by a related intermediary within 24 months of receipt have a principal purpose of avoiding US tax. This regulation could be modified to address indirect section 2801 transfers as well. This would have the advantage of extending an existing rule that many advisors are comfortable with rather than creating a new rule with associated uncertainty.

D. Rules and Exceptions Applicable to Covered Gifts and Bequests – Regulation 28.2801-3

1. How Contributions to or Distributions From a Non-Electing Foreign Trust to a US Citizen Spouse Could Qualify For the Marital Exception in Section 2801(e)(3), Taking Into Account the Rules Applicable to Domestic Trusts and Foreign Trusts in Section 2801(e)(4)

Treasury and the Service specifically requested comments on this topic.

Although the request for comments is limited to US citizen spouses, our answer will address both US citizen and non-citizen surviving spouses because a non-US citizen can be a US resident for section 2801 purposes. Further, the requirements for the marital deduction are different for citizen and non-citizen surviving spouses.

Section 2801(e)(3) provides, in relevant part, that covered gifts and bequests do not include any property with respect to which a marital deduction would be allowed under sections 2056 or 2523 if the decedent/donor were a US person. The regulations confirm this exception, specify that it extends to transfers made in trust, and clarify that a Qualified Terminable Interest Property (“QTIP”) Trust or Qualified Domestic Trust (“QDOT”) marital deduction will not be allowed unless a valid QTIP/QDOT election is made.

If a CE does not have any US situs property and, therefore, does not have a gross estate within the meaning of section 2103, it may not be possible for a valid QTIP or QDOT election to be made on Form 706NA. In such a situation, we recommend that the regulations be modified to (1) permit either the non-electing foreign trust or the US resident spouse to make the relevant election on Form 708 or (2) to explicitly permit the

executor of the CE's estate to file Form 706NA and to make the relevant election for section 2801 purposes.

A bequest by a CE to a non-electing foreign trust will not result in section 2801 tax because the trust is not a US recipient. As a result, the section 2801(e)(3) marital deduction is not necessary. The trust will have a 2801 ratio greater than zero. We believe it is appropriate for the final regulations to treat distributions from a non-electing foreign trust to a US citizen spouse as an indirect covered gift from the CE. Thus, these transfers would qualify for the section 2523 marital deduction and section 2801 tax would not be due. A distribution from such a trust to a resident non-citizen spouse should also be treated as an indirect covered gift from the CE. While it would not qualify for an unlimited marital deduction under section 2523, section 2801 tax would not be due, provided that the distribution remained below the section 2523(i)(2) \$100,000 inflation adjusted threshold.

2. The Requirement to Timely Report and Pay Estate or Gift Tax Should Be Eliminated from the Regulations, or a Mechanism Should Be Created to Mitigate Potential Double Taxation

Under section 2801(e)(2), if a transfer is subject to US estate or gift tax and timely reported, it is not a covered gift or bequest. The regulations (regulation 28.2801-3(c)(1), (2)) provide an additional requirement that any gift or estate tax must also be timely paid (the "timely paid requirement"). The timely paid requirement creates an additional scenario in which taxpayers may need to pay both gift or estate tax and the section 2801 tax, creating an unintended windfall for Treasury due to the lack of an available mechanism to offset this double taxation. We recommend that Treasury and the Service minimize such situations to the extent possible by eliminating the timely paid requirement.

In the context of foreign clients, US estate and gift reporting is regularly delayed because of difficulties in identifying assets and determining US tax filing obligations. For example, an executor may realize that a decedent owned stock in US corporations more than nine months after the decedent's death. This would cause filing of the US estate tax return and payment of any estate tax liability to be untimely. Therefore, we believe that Treasury and the Service should address this issue, and provide relief for individuals who find themselves caught in these common situations.

The regulations contain an example (regulation 28-2801-3(f), Ex. 2) that gives some guidance on this issue. However, the example could be clarified. While the example makes clear that "S" will owe tax under section 2801, the example is not explicit on the US estate tax liability of "CE's" estate. It would be helpful if this example could be expanded to state whether US estate tax will continue to be due on CE's interest in the condominium.

As a solution for resolving the double tax issue, Treasury could create a mechanism that allows a refund claim for US recipients who paid the section 2801 tax on a covered gift

or bequest where the estate or gift tax thereon is subsequently reported and paid. The refund claim could be made by filing an amended Form 708 and attaching a statement that the estate and gift tax had been paid. Further, in all cases where late gift or estate filing and payment occurs, prior to the due date of the Form 708, the estate or gift tax payment should eliminate the requirement to file Form 708 filing and pay 2801 tax.

3. Powers of Appointment Over Property Not Transferred in Trust

There are several instances where the regulations refer to a power of appointment "over property not transferred in trust" or "property not in trust" included regulations 28.2801-2(i)(4) and 28.2801-3(e)(2). It would helpful to provide examples of a power of appointment over property that is not in trust and to explain how that differs from fee simple ownership.

E. Liability For and Payment of Tax on Covered Gifts and Covered Bequests; Computation of Tax –Regulation 28.2801-4

1. Define Date of Receipt Using Language From Section 170(a)(3) to Prevent Current Section 2801 tax Liability on Property that a Beneficiary Has Not Fully “Received”

Pursuant to regulation 28.2801-4(d)(2), the date of receipt of a covered gift is the same date of the gift for gift tax purposes. For covered bequests, regulation 28.2801-4(d)(3) defines date of receipt as either (1) the date of distribution from the estate or decedent’s revocable trust, or (2) the decedent’s date of death for property passing upon the decedent’s death by operation of law, beneficiary designation, or other contractual agreement.

The definition of “date of receipt” contained in the regulations may prove to be problematic, especially for gifts and bequests of property passing in civil law jurisdictions. For property passing in certain civil law jurisdictions, title transfers upon the decedent’s date of death, but actual distributions do not occur until after a period of administration (often referred to as a meeting of the “community of heirs”). During the community of the heirs period, the beneficiary is only partially in receipt of the property. Date of receipt can also prove to be problematic for gifts and bequests of future interests. For example, a beneficiary of a remainder interest in a life estate does not have full, current economic or legal enjoyment of that interest. Thus, the definition of date of receipt in the regulations might operate to cause current taxation under section 2801 on property that a beneficiary has not fully “received.”

In order to avoid the aforementioned potential problems, we suggest that the definition of date of receipt be changed by using the language from section 170(a)(3). Thus, date of receipt could be defined as the date of transfer, except where there are intervening interests which prevent the beneficiary from deriving current economic benefit from the

property. A definition similar to 170(a)(3) would delay the imposition of the section 2801 tax on an individual until the time all legal and economic interests in the property vest.

2. Provide a Method For Charitable Lead Trusts to Determine the Amount of a Covered Gift or Bequest That is Subject to Section 2801 Tax

The regulations provide guidance on how charitable remainder trusts (“CRTs”) compute the section 2801 tax. However, the regulations do not discuss how the section 2801 tax would be computed for charitable lead trusts (“CLTs”).

Pursuant to section 2801(e)(3) and regulation 28.2801-4(a)(2)(iii), the charitable remainder interest’s share of each transfer to the CRT is not a covered gift or bequest. The formula utilized by the Proposed Regulations computes the amount of a transfer to a CRT that is subject to the section 2801 tax by subtracting the value of the transfer allocable to the charitable remainder interest from the total value of the covered gift or bequest.

It seems reasonable to assume that a calculation similar to that for CRTs could be used to determine the section 2801 tax for CLTs. The charitable lead interest’s share of each transfer to the CLT would not be a covered gift or bequest under section 2801(e)(3). Therefore, the value of the transfer allocable to the charitable lead interest could be subtracted from the total value of the covered gift or bequest to determine the amount that is subject to the section 2801 tax. We request that the final regulations specifically address CLTs and include this calculation.

3. Clarify Procedure for Cash Method Taxpayers to Deduct Section 2801 Tax Paid in a Tax Year Later Than the Year that a Portion of a Covered Gift or Bequest is Included in Gross Income

A US recipient of a distribution from a foreign trust can receive an income tax deduction under section 164 in the year the section 2801 tax is paid or accrued, to the extent a covered gift or bequest is included in his/her US gross income. However, this can be problematic for cash method taxpayers because the section 2801 tax might not technically be due in the year the US recipient receives a covered gift or bequest. Thus, a cash method US recipient will not be able to take the deduction in the year he/she pays the income tax on the covered gift or bequest. We suggest that the final regulations modify regulation 28.2801-4(a)(3)(ii) to allow cash method taxpayers to deduct the section 2801 tax in the tax year the covered gift or bequest was received.

4. Value Received Property Without Reference to Chapter 14

The regulations define value of property with reference to the estate and gift tax valuation principles, including Chapter 14. In this situation, the additional gift amount calculated under Chapter 14 is a phantom gift that is not in fact received by a US recipient. We believe the value of received property should be determined based on the value of the interest actually received by the US recipient, and not the value of the interest in the

hands of the donor on the date of receipt by the US recipient. Thus, we recommend that the final regulations value received property (at the very least, non-US-situs property) without reference to Chapter 14.

5. Address Creditability of Foreign Taxes That are Imposed In Lieu Of Estate or Gift Taxes

Foreign estate and gift tax paid to a foreign country on a covered gift or bequest reduces the amount of the section 2801 tax. Regulation 28.2801-4(e) extends the credit to gift and estate taxes imposed by possessions and subdivisions of foreign states. However, the regulations do not address the creditability of other types of foreign taxes on covered gifts and bequests that are similar to, but imposed in lieu of, gift or estate taxes, such as inheritance taxes or deemed dispositions. For example, Canada has a deemed capital gains tax instead of an estate tax. The US-Canada Estate Tax Treaty treats that tax as equivalent to the US estate tax. Thus, it would seem that the Canadian deemed capital gains tax could be credited against the section 2801 tax. We request that the final regulations specifically include as taxes creditable against the section 2801 tax foreign taxes that are imposed in lieu of estate or gift taxes.

6. Create a Mechanism That Allows Deferral of the Section 2801 Tax

There are several Code provisions that allow deferral of tax in certain situations. For example, CEs can defer the exit tax under section 877A(b), with deferral potentially extending to the due date of the CE's income tax return for his/her year of death.

We request that the final regulations include a mechanism, mirroring section 877A(b), that allows for deferral of payment of the section 2801 tax. This could be helpful to many US recipients. For example, US recipients in receipt of covered gifts or bequests comprised of non-liquid assets would be afforded additional time to generate liquidity in order to pay the section 2801 tax.

7. Treatment of Gifts in Trust That Exceed the Section 2503(b) Amount

The section 2801 tax is determined by reducing the total amount of covered gifts and covered bequests received during the calendar year by the section 2801(c) amount, which is the dollar amount of the per-donee exclusion in effect under section 2503(b) for that calendar year and then multiplying the net amount by the highest estate or gift tax rate in effect during that calendar year. As stated in the preamble, the reference to section 2503(b) in section 2801 is included solely to provide a dollar amount by which to decrease the U.S. recipient's aggregate covered gifts and covered bequests received during that calendar year to determine the amount subject to the section 2801 tax.

In the case of a gift to a trust in which one or more beneficiaries have a right of withdrawal, commonly known as Crummey powers, the amount of exclusion available to the donor is dependent on the number of beneficiaries who have the right to withdraw a portion of the property gifted to that trust (i.e., a Crummey withdrawal right). However,

the proposed regulations make clear that this logic does not extend to the section 2801 tax; as such, the section 2801 tax payable by a domestic trust or electing foreign trust will only be reduced by 1 per-donee exclusion amount even if the trust instrument provides that multiple beneficiaries may exercise Crummey withdrawal rights upon contribution to such trust.

We respectfully request reconsideration of this approach, which substantially deviates from the definition of a gift under established gift tax law and jurisprudence. If this approach is adopted, we request clarification on how to properly resolve a situation where a CE makes transfers to a domestic trust in which the beneficiaries have Crummey rights and the beneficiaries exercise their withdrawal powers such that no liquidity remains in the trust, causing the trustee to have no liquidity with which to pay the section 2801 tax.

F. Foreign Trusts – Regulation 28.2801-5

1. How to Calculate the Amount of a Distribution From a Foreign Trust That is Attributable to a Covered Gift or Bequest if the US Recipient Does Not Have Adequate Books and Records or Information Available to Make Such a Determination

Treasury and the Service specifically requested comments on this topic.

Under regulation 28.2801-5(c)(3), if the trustee of a foreign trust does not have sufficient books and records to calculate the section 2801 tax, or if the US recipient is unable to obtain the necessary information with regard to the foreign trust, the US recipient must proceed upon the assumption that the entire distribution for purposes of section 2801 is a covered gift or bequest. As the Service cannot penalize a foreign trust due to jurisdictional issues, the US beneficiary bears an undue burden in instances where the trustee has inadequate records or is otherwise uncooperative. The assumption that the entire distribution is a covered gift or bequest is unduly harsh, especially in instances where the US beneficiary has no control over the trustee's actions. While we understand the need to impose taxes on undocumented or poorly substantiated transfers that could be covered gifts or bequests, we recommend that the Service carve out a safe harbor or provide an alternate way to address the issue.

Other pragmatic factors implicating a safe harbor generally revolve around the current commercially reasonable practices of foreign fiduciary administrators. Inquiry into the past citizenship of a trust settlor is not standard in accepted "know your customer"/anti-money laundering due diligence procedures. As such, foreign trustees are not now, have not been, and are unlikely to become sensitive to whether persons making transfers to their trusts are CEs. It is unlikely that most trust companies will amend their protocols as a result of the issuance of final regulations, thereby creating a real possibility that US recipients of foreign trust distributions will, despite their best efforts, be unable to effectively determine (1) whether the distribution is attributable to a covered gift or bequest and, if so, (2) the proper section 2801 ratio necessary for calculating the correct section 2801 tax.

In this situation, we recommend that the regulations allow an assumption to be made that pre-June 17, 2008 contributions were not covered gifts and all contributions after that date were covered gifts, and either treat such pre- June 17, 2008 amounts as first out, or last out.

Another calculation option is to assume that all assets contributed to the trust prior to the end of the trust accounting year that included June 17, 2008 were not covered gifts or bequests. Many trusts will have a record of the end of year asset value. Then, assume that any assets in a trust above that amount are covered gifts or bequests unless the trustee can certify that no additional gifts or bequests were received after that date. For such a trust, instead of the 2801 ratio system, assume distributions are made first from covered gifts or bequests. So, if a trust had \$10 million on 12/31/08 and now has \$15 million, it could be assumed that \$5 million came from covered gifts or bequests.

Finally, we suggest that the regulations provide a safe harbor for US recipients where the US recipient, the foreign trustee, and all other available persons with institutional knowledge of the transfers of the foreign trust provide special affidavits. In this situation, the affiants would (1) confirm (under the penalty of perjury for US persons – we recognize the Service may have limited enforcement authority over non-US persons) that best attempts were made to obtain the information necessary to determine whether a foreign trust distribution is attributable to a covered gift or bequest, (2) disclose all relevant information to the Service, and (3) identify all parties believed to have knowledge relevant to the determination. Upon meeting this safe harbor threshold, the burden to prove that the section 2801 tax would be due on the distribution should shift to the Service.

2. How to Minimize the Burden Associated With a Foreign Trust Making an Election to be Treated as a Domestic Trust While Adequately Securing the Government's Interest in Collecting the Tax From the Foreign Trust

Treasury and the Service specifically requested comments on this topic.

A foreign trustee of a foreign trust must properly make the election for the trust to be treated as a domestic trust for purposes of section 2801 by filing Form 708. Under regulation 28.2801-5(d)(2) and (3), the electing foreign trust must still file Form 708 in subsequent years, even in cases where no additional covered gifts or bequests are received. This would seem like an unnecessary filing. We recommend that Treasury and the Service consider modifying the annual filing requirement for electing foreign trusts. An alternative rule might require the trustee of an electing foreign trust to file Form 708 only in years where the foreign trust received a covered gift or bequest.

3. Imperfect Election

A foreign trustee of an electing foreign trust must properly calculate the section 2801 tax amount. This includes calculation of the appropriate ratio of covered and non-covered gifts and bequests.

The Proposed Regulations provide for an “imperfect election,” in which a foreign trust elects domestic treatment, but the valuation of the trust assets are disputed by the Service. The electing foreign trust has no right to appeal a disputed valuation, and instead distributions will be partly taxable under section 2801.

a. Establish a Procedure That Reduces Potential Valuation Inconsistencies Across Assets Subject to the Section 2801 Tax

When there is an imperfect election, each beneficiary will need to agree upon the value of property contributed to the foreign trust and the resulting 2801 ratio. Different trust beneficiaries could have different 2801 ratios with respect to the same trust based on their particular negotiation or judicial determination. There should be a method to resolve valuation disputes that mitigates potential inconsistent results. To that end, we suggest the regulations authorize the Service to establish a procedure where these disputes are negotiated directly by the foreign trust; this procedure would require the trust to appoint a US agent for the sole purpose of settling the valuation issue.

b. Allow Qualified Severance For Electing Foreign Trusts

Although it is advisable for taxpayers to create trusts that are either fully subject to section 2801 or that are fully exempt, it is inevitable that some trusts will have a section 2801 ratio between zero and one. Thus, it would be helpful for the regulations to authorize a qualified severance for purposes of section 2801 modeled on regulation 26.2642-6. This would allow a trust to be split into separate portions, one part funded exclusively by covered gifts and bequests, and another part funded by non-covered gifts and bequests.

We recognize that providing for a qualified severance may seem an undue complication at this time and Treasury and the Service may be reluctant to delay issuing final regulations with respect to section 2801. If that is the case, we request that a space be reserved in the regulations for future guidance on the qualified severance of a trust with a section 2801 ratio between zero and one, and that the regulations permit taxpayers to obtain a private letter ruling approving a section 2801 qualified severance based on the principles contained in regulation 26.2642-6. Such a procedure would allow Treasury and the Service to obtain information over the next several years about the situations that lead to a section 2801 ratio between zero and one so that regulations can ultimately be crafted. In the interim, taxpayers will have a clear, though costly, way to address this situation.

c. Provide An Example Showing the Impact of Section 2801(c) on a Trust's Section 2801 Ratio

Once the section 2801 tax has been paid on property that subsequently remains in a foreign trust, that property is no longer considered to be attributable to a covered gift or bequest for purposes of computing the section 2801 ratio. For this purpose, regulation 28.2801-5(c)(2) states that a section 2801 tax is deemed to have been timely paid on an amount for which no section 2801 tax was due as long as those amounts were reported as a covered gift or bequest on a timely filed Form 708. We found this language confusing, but after discussing it with a Treasury official, our understanding is that this language is meant to address the effect of the section 2801(c) exclusion on a trust's section 2801 ratio. That is, because section 2801(c) excludes the gift tax annual exclusion amount from the definition of a covered gift or bequest, that amount is not taken into account in determining a trust's section 2801 ratio if it was properly reported as a covered gift or bequest on Form 708. If that is correct, an example demonstrating the impact of section 2801(c) on the section 2801 ratio would be helpful.

4. Loans and Uncompensated Use of Foreign Trust Property

Under regulation 28.2801-5(a), the section 2801 tax is imposed on a US recipient who receives distributions, whether of income or principal, from a foreign trust to the extent the distributions are attributable to one or more covered gifts or bequests made to that foreign trust. Distributions include direct, indirect, or constructive transfers, pursuant to regulation 28.2801-5(a). This leaves us to question whether loans from and uncompensated use of foreign trust property by a US beneficiary, where the foreign trust was funded (at least partially) by covered gifts and/or bequests, should be treated as distributions for purposes of section 2801.

We note that prior to the introduction of section 643(i), loans from foreign trusts were not treated as distributions. There is no equivalent to section 643(i) in section 2801. We recommend that a loan should not be treated as a distribution subject to the section 2801 tax. Alternatively, we request that the final regulations adopt the qualified obligation rules of section 643(i) to keep bona fide loans outside the scope of section 2801.

Further, we request clarification as to whether uncompensated use of property held by a foreign trust that is funded (at least partially) by covered gifts and/or bequests should be treated as a distribution from that trust subject to the section 2801 tax. Once again, prior to the recent modification of section 643(i), use of trust property was not treated as a distribution from a trust. In the absence of statutory authority, we do not believe the use of trust property should be treated as a distribution for section 2801 purposes. For example, we anticipate situations where a US person stays rent-free in a CE's vacation home for a short period. Calculation of the value of uncompensated use is quite technical, and can be costly, impractical and time-consuming to determine.

If section 643(i) applies, we recommend creating a safe harbor that would allow de minimus uncompensated use of certain property transferred or owned by a CE to be

exempt from the section 2801 tax. To that end, we suggest exempting from the section 2801 tax uncompensated use of property where (1) total use of such property is less than 30 days per tax year, or (2) total value of such use during the tax year is below \$30,000, indexed for inflation.

G. Special Rules and Cross-References – Regulation 28.2801-6

1. Allow Step Up in Basis For Section 2801 Tax Paid on Covered Gifts

Under regulation 28.2801-6(a), sections 1015 and 1014 are used to determine a US recipient's basis in property received as a covered gift or bequest, respectively. However, section 1015(d) does not apply to increase the basis in a covered gift to reflect the section 2801 tax paid thereon. The Preamble to the regulations does not mention why section 1015(d) is specifically excluded from the basis determination rules.

We recommend that the final regulations allow for the basis in a covered gift to be increased by the amount of section 2801 tax paid thereon. To that end, we propose that a US recipient's basis in a covered gift be the lesser of: (1) fair market value of the gift at the time of receipt, or (2) the property's adjusted basis in the hands of the donor (i.e., carry-over basis) plus any section 2801 tax paid on the transfer.

2. Modify Certain Language in Regulation 28.2801-6(b)

The final sentence of regulation 28.2801-6(b) states that a "transfer is subject to federal estate or gift tax, regardless of whether a federal estate or gift tax return reporting the transfer is timely filed and regardless of whether chapter 15 applies because of a CE's failure to file and pay the *section 2801 tax, if applicable*" (emphasis added). However, the reference to the section 2801 tax here is inconsistent with the statutory language of regulation 2801(e)(2)(A) and (B), which provides for the donor's timely filing of a return of tax imposed by chapter 12 and chapter 11, respectively. Instead, we believe the italicized language should be replaced with "tax imposed by chapter 12 or chapter 11, as applicable."

3. Remove Information Reporting Requirement

For purposes of the section 2801 tax, an individual's status as a US resident is determined under the estate and gift tax rules. That is, residency status is based on the individual's domicile (the "domicile test"). The domicile test can produce different results when compared to the income tax residency test, and the two tests are separate from one another.

The regulations seek to extend information reporting requirements applicable to income tax residents to individuals who are residents under the domicile test. For example, although section 6039F requires reporting on Form 3520 of certain gifts or bequests from a foreign person, the reporting requirement only applies to US income tax residents. However, regulation 28.2801-6(c)(1) defines a US resident by reference to regulation

28.2801-2 (i.e., by the domicile test). Thus, we believe that it is inappropriate to extend section 6039F reporting in this manner because (1) an individual who is a resident under the domicile test might not be a resident under the income tax residency rules, and (2) individuals who are US residents based on the domicile test are not otherwise required to file Form 3520.

A similar analysis applies to regulation 28.2801-6(c)(2) and its extension of section 6048(c) reporting requirements to individuals who are residents pursuant to the domicile test.

H. Determining Responsibility Under Section 2801 –Regulation 28.2801-7

1. Address and Mitigate Burdens Placed on US Beneficiaries to Compute and Pay the Section 2801 tax, Such As the Burden to Collect Information to Determine Whether a Gift or Bequest was from a CE

Beneficiaries have the burden of determining whether a gift or bequest is a covered gift or bequest for purposes of the section 2801 tax. To this end, beneficiaries must determine if the individual transferring cash or property is a CE. It will likely prove difficult for a beneficiary to determine whether a particular donor is a CE, a task that requires obtaining information on the donor's previous net worth, US income tax liabilities, and US tax compliance history. Further, practically any time a gift or bequest is received, the potential application of the 2801 tax arises; almost all US taxpayers who receive gifts or bequests will be impacted by the scope of the 2801 tax. The 2801 tax technically applies to relatively few, but to rule out the 2801 tax is in many cases, a significant undertaking for taxpayers, and for the Service to field inquiries.

A US recipient's ability to comply with their section 2801 reporting requirements is based on access to the CE's private information (i.e., the CE's relevant tax returns). Although the Service has stated that it will provide a mechanism for beneficiaries to request tax return information, the Service is not required to provide that information. It seems likely that many US recipients will encounter serious issues when attempting to gather this information in a timely manner. An obvious example is that the CE could have expatriated many years ago, and the required information may no longer be available; undoubtedly, there are others. The Service may have to consider its record retention policies and procedures because, in the future, the section 2801 tax could require access to tax return information that is decades old.

Although the Service does maintain a "list of expatriates" in the Federal Register, the publication is not comprehensive. Taxpayers who expatriate by relinquishing green cards, or who take treaty-based positions on their US tax returns, are not consistently included in the list of expatriates. Moreover, any information necessary to establish a reduction to or exemption from the section 2801 tax, such as a CE's timely filing and payment of US estate or gift tax on a transfer that is considered a covered gift or bequest under section 2801, will not be included in the list of expatriates due to the rules under section 6103 that limit access to that information.

We recommend that the final regulations provide a safe harbor to the rebuttable presumption of CE status under regulation 28.2801-7(b)(2), allowing a US recipient to determine CE status based on the facts that are reasonably available to him/her. The safe harbor would permit a U.S. person or foreign trust to satisfy the requirement to determine the applicability of section 2801 by establishing a set of parameters that, if satisfied and documented, deem a taxpayer to have complied with the obligation to investigate whether a donor/decedent/settlor is a CE.

The safe harbor would allow a taxpayer to certify that a gift or bequest was not a covered gift or bequest after requesting information from the Service pursuant to regulation 28.2801-7(b)(1) and performing a background check on the donor. The Service might add a box on Form 708 for the taxpayer to check indicating that he/she complied with the safe harbor requirements and reasonably concluded that the donor was not a CE. Possibly, the background check requirement could further presume no CE status where the background check reflected no US birth record or former US addresses. Further, a presumption of US citizenship should be allowed where an individual was born in the US and maintains a history of US addresses at the time of the gift or bequest.

Eventually, only a technology-based solution can make the section 2801 tax regime operate efficiently and effectively. Therefore, we recommend that the Service create a registry to store the Form 8854 it receives and to document all former and current green card holders. The registry would need to include information from June 17, 2008 and thereafter. To ensure that the registry is accurate and up-to-date, we recommend that the Service coordinate with United States Citizenship and Immigration Services to obtain information on green card holders. Many foreign trust companies, as well as US beneficiaries, would benefit from access to the database. Thus, the registry needs to be both searchable and secure. In order to protect sensitive taxpayer information, the Service can designate approved search firms to access the database. These search firms can meet Service guidelines for information security.

A US recipient should be able to rely on the advice of a tax or legal professional, considering the highly technical nature of section 2801 and the regulations, for purposes of determining CE status, whether a transfer is a covered gift or bequest, and the correct amount of section 2801 tax, to avoid any potential penalties or interest charges that may accrue from the nonpayment or underpayment of the section 2801 tax.

The final regulations should also contain an explicit requirement that the Service have a good faith basis for alleging that a donor is a covered expatriate prior to assessing a 2801 tax on a U.S. recipient. As drafted, the presumption is that all donors are covered expatriates and the Service could assess a tax under section 2801 even if the Service has no reason to believe the donor is in fact a covered expatriate. In the absence of this requirement, the Service could force taxpayers to prove a negative (donor was not a covered expatriate) even where the Service is in possession of actual evidence to the contrary.

2. Clarify Rules Regarding Filing a Protective Form 708

A taxpayer who reasonably concludes that a gift or bequest is not subject to section 2801 may file a protective Form 708 under regulation 28.2801-7(b)(2). Based on our interpretation of the regulations, we believe that the regulations may act to prohibit many protective Form 708 filings. A US recipient can only make a protective filing upon reasonably concluding that a gift or bequest is not subject to section 2801. Further, the Service has consistently taken the position that the mere absence of information is not a sufficient basis for a protective filing. There is no guidance to determine how much information is enough to for a reasonable basis to file a protective Form 708. Thus, we are concerned about situations where a US recipient has diligently attempted to ascertain information related to the CE, but has been unable to.

We request that the regulations or a revenue procedure provide additional rules to flesh out the protective filing procedure. Allowing US recipients to use reasonable methods to determine whether a transfer is subject to the section 2801 tax would be helpful for this purpose, as such a recipient could make a protective filing based on that same standard.