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## DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 28

[REG-112997-10]

RIN 1545-BJ43

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to a tax on United States citizens and residents who receive gifts or bequests from certain individuals who relinquished United States citizenship or ceased to be lawful permanent residents of the United States on or after June 17, 2008. These proposed regulations affect taxpayers who receive covered gifts or covered bequests on or after the date these regulations are published as final regulations in the **Federal Register**. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for January 6, 2016, at 10 a.m., must be received by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-112997-10), Room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-112997-10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC; or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS-REG-112997-10). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Karlene Lesho or Leslie Finlow at (202) 317-6859; concerning the submission of comments, the public hearing, or to be placed on the building access list to attend the hearing, Oluwafunmilayo Taylor at (202) 317-6901 (not toll-free numbers) or email at [Oluwafunmilayo.P.Taylor@irscounsel.treas.gov](mailto:Oluwafunmilayo.P.Taylor@irscounsel.treas.gov).

SUPPLEMENTARY INFORMATION:

### **Paperwork Reduction Act**

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, and to Clearance Officer, SE:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of IRS functions, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs of operation, maintenance, and purchase of services to provide information.

The collections of information in these proposed regulations are in §§28.2801-4(e), 28.2801-5(d), 28.6001-1, and 28.6011-1. The collection of information requirement in proposed regulation §28.2801-4(e) is required in order for the IRS to verify that the U.S. person who received a covered gift or covered bequest is entitled to a reduction in the section 2801 tax for certain foreign taxes paid on the transfer and, if so, the amount of such reduction. The collection of information is mandatory to obtain a benefit. The likely respondents are individuals, domestic trusts, and foreign trusts electing to be treated as domestic trusts.

The collection of information in §28.2801-5(d) is required to notify the IRS and the U.S. persons who are beneficiaries of a foreign trust that the trust is electing to be

treated as a domestic trust for purposes of section 2801. It is also required for the IRS to verify the proper amount of section 2801 tax due and to notify the beneficiaries who are U.S. citizens or residents in the event the election terminates. This alerts the IRS and the U.S. citizens and residents who are beneficiaries that the trust will be liable for payment of the section 2801 tax while the election is in effect, but that the U.S. beneficiaries will be liable for the tax if and when the election terminates. This collection of information is necessary for the proper performance of IRS functions in the collection of the section 2801 tax. This collection of information is mandatory to obtain a benefit. The likely respondents are the trustees of foreign trusts.

The collection of information in §28.6001-1 is required for the IRS to verify the books and records pertaining to covered gifts and covered bequests and for the proper performance of IRS functions in the collection of the section 2801 tax. It is also required to verify the receipt of covered gifts and covered bequests by U.S. persons and the value of such gifts and bequests. This collection of information is mandatory. The likely respondents are individuals and trustees of trusts.

The collection of information in §28.6011-1 is required for the IRS to verify the receipt of a covered gift or covered bequest and other information relevant to the tax imposed under section 2801. This collection of information is necessary for the proper performance of IRS functions in the collection of the section 2801 tax. This collection of information is mandatory. The likely respondents are individuals and trustees of trusts.

Estimated total annual reporting burden: 7,000 hours.

Estimated average annual burden hours per respondent: 1 hour to prepare and attach documentation to Form 708, "U.S. Return of Gifts or Bequests from Covered

Expatriates,” for the reduction of tax for foreign taxes paid; 2 hours for a trustee of an electing foreign trust to make the election and notify the beneficiaries; 1 hour for the trustee of the foreign trust to prepare annual certifications; 1 hour to notify the U.S. persons who are beneficiaries of the trust that the election is terminated; and, 2 hours to prepare taxpayer records and the Form 708 to report the section 2801 tax.

Estimated number of respondents: 1,000.

Estimated annual frequency of responses: annually or less.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

## **Background**

Section 301 of the Heroes Earnings Assistance and Relief Tax Act of 2008, Public Law 110-245 (122 Stat. 1624) (the HEART Act), added new section 877A to subtitle A of the Internal Revenue Code (Code), and new chapter 15 and new section 2801 to subtitle B, effective June 17, 2008. Prior to the addition of chapter 15, subtitle B contained chapters 11 through 14 relating to the estate tax, the gift tax, the generation-skipping transfer tax, and special valuation rules for purposes of subtitle B. New chapter 15 consists solely of section 2801.

Prior to the enactment of the HEART Act, citizens and long-term residents of the United States who expatriated to avoid U.S. taxes were subject to an alternative regime of U.S. income, estate, and gift taxes under sections 877, 2107, and 2501, respectively, for a period of 10 years following expatriation. Recognizing that citizens and residents of the United States generally are subject to estate tax on their world-wide assets at the time of death, Congress determined that it was appropriate, in the interests of tax equity, to impose a tax on U.S. citizens or residents who receive, from an expatriate, a transfer that would otherwise have escaped U.S. estate and/or gift taxes as a consequence of expatriation.

In an explanation of an earlier bill also proposing enactment of new chapter 15 and section 2801, the Report of the House Ways and Means Committee states that citizens and long-term residents of the United States have a right to physically leave the United States and relinquish their citizenship or terminate their residency. See H.R. Rep. No. 110-431 (2007). The Report states that the Committee believed that the Code should not be used to discourage individuals from relinquishing citizenship or terminating residency. At the same time, however, the Report states that the Code should not reward individuals who leave the United States. The Report concludes that an individual's decision to relinquish citizenship or terminate long-term residency should not affect the total amount of taxes imposed (that is, it should be "tax neutral"). The Report further states that, where U.S. estate or gift taxes are avoided with respect to a transfer of property to a U.S. person by reason of the expatriation of the donor, it is appropriate for the recipient to be subject to a tax similar to the donor's avoided transfer taxes.

With the enactment of sections 877A and 2801, sections 877 and 2107 apply only to individuals who relinquished United States citizenship or ceased to be lawful permanent residents prior to June 17, 2008. Section 2501 generally continues to apply to any individual, resident or nonresident, including individuals who expatriate, whether or not on or after June 17, 2008. Section 2501(a)(3) and (a)(5), however, provides special rules for expatriates subject to section 877(b), which are not applicable to individuals who expatriate on or after June 17, 2008.

Section 2801 imposes a tax (section 2801 tax) on covered gifts and covered bequests received by a citizen or resident of the United States (U.S. citizen or resident) from a covered expatriate. The section 2801 tax applies with regard to any property transferred to a U.S. citizen or resident which qualifies as a covered gift or covered bequest under section 2801, regardless of whether the property transferred was acquired by the donor or decedent covered expatriate before or after expatriation.

The value of a covered gift or covered bequest is its fair market value at the time the gift or bequest is received by the U.S. citizen or resident. A U.S. citizen or resident receiving a covered gift or covered bequest (U.S. recipient) is liable for payment of the section 2801 tax imposed under this chapter. A domestic trust that receives a covered gift or covered bequest is treated as a U.S. citizen and therefore is liable for payment of the section 2801 tax. A foreign trust may elect to be treated as a domestic trust (an electing foreign trust) for this purpose; absent this election, the trust's U.S. citizen or resident beneficiaries will be taxed as distributions are made from the trust (a non-electing foreign trust).

On July 20, 2009, the Treasury Department and the IRS issued Announcement 2009-57, 2009-29 I.R.B. 158. Announcement 2009-57 put taxpayers on notice that any covered gift or covered bequest received on or after June 17, 2008, is subject to the imposition of the section 2801 tax. Announcement 2009-57 states that the IRS intends to issue guidance under section 2801 and that the due date for reporting, filing, and payment of the tax imposed under section 2801 will be included in the guidance. The announcement further provides that the guidance the IRS intends to issue will provide a reasonable period of time between the date of issuance of the guidance and the date prescribed for the filing of the return and the payment of the tax.

On October 15, 2009, the Treasury Department and the IRS released Notice 2009-85, 2009-45 I.R.B. 598. Notice 2009-85 generally provides guidance for individuals who are subject to section 877A (added to the Code together with section 2801). With respect to gifts and bequests, section 9 of Notice 2009-85 provides that gifts or bequests from a covered expatriate on or after June 17, 2008, are subject to a transfer tax under new section 2801. Section 9 of Notice 2009-85 further provides that satisfaction of the reporting and tax obligations under section 2801 for covered gifts or covered bequests received on or after June 17, 2008, is deferred pending the issuance of separate guidance by the IRS.

### **Explanation of Provisions**

The proposed regulations amend title 26 of the Code of Federal Regulations by adding part 28 (Imposition of Tax on Gifts and Bequests from Covered Expatriates) under new section 2801 of the Code. The proposed regulations are divided into seven sections.



Section 28.2801-1 of the proposed regulations sets forth the general rules of liability for the tax imposed by section 2801(a). Section 2801 imposes a tax on United States citizens or residents who receive, directly or indirectly, covered gifts or covered bequests (including distributions from foreign trusts attributable to covered gifts and covered bequests) from a covered expatriate. For purposes of section 2801, domestic trusts and foreign trusts electing to be treated as domestic trusts are treated in the same manner as U.S. citizens.

### Definitions

Section 28.2801-2 of the proposed regulations defines terms for purposes of new chapter 15. The proposed regulations define the term “citizen or resident of the United States” as an individual who is a citizen or resident of the United States under the estate and gift tax rules of chapter 11 and chapter 12, respectively, in subtitle B of the Code. Accordingly, whether an individual is a “resident” is based on domicile in the United States, notwithstanding that section 877A adopts the income tax definition of that term. The Treasury Department and the IRS believe that, because section 2801 imposes a tax subject to subtitle B, the tax definition of resident under subtitle B generally should apply for purposes of section 2801. See §§20.0-1(b)(1) and 25.2501-1(b).

The proposed regulations generally define the term “covered gift” by reference to the definition of gift for purposes of chapter 12 of subtitle B. The proposed regulations define the term “covered bequest” as any property acquired directly or indirectly because of the death of a covered expatriate. Such property generally is property that would have been includible in the gross estate of the covered expatriate under

chapter 11 of subtitle B, had the covered expatriate been a U.S. citizen or resident at the time of death.

Section 2801 defines “covered expatriate” by reference to the section 877A(g)(1) definition of that term. Section 877A(g)(1) generally provides that an individual who expatriates on or after June 17, 2008, is a covered expatriate if, on the expatriation date, (1) the individual’s average annual net income tax liability is greater than \$124,000 (indexed for inflation) for the previous five taxable years, (2) the individual’s net worth is at least \$2,000,000 (not indexed), or (3) the individual fails to certify under penalty of perjury that he or she has complied with all U.S. tax obligations for the five preceding taxable years. See section 877A(g)(1); Notice 2009-85, 2009-45 I.R.B. 598. The proposed regulations provide that, if an expatriate meets the definition of a covered expatriate, the expatriate is considered a covered expatriate for purposes of section 2801 at all times after the expatriation date, except during any period beginning after the expatriation date during which such individual is subject to United States estate or gift tax as a U.S. citizen or resident.

Additionally, the proposed regulations define for purposes of section 2801 the terms “domestic trust,” “foreign trust,” “electing foreign trust,” “U.S. recipient,” “power of appointment,” and “indirect acquisition of property.”

#### Rules and Exceptions Applicable to Covered Gifts and Covered Bequests

Section 28.2801-3 addresses the rules in section 2801(e) and includes rules and several exceptions applicable to the definitions of covered gift and covered bequest. Exceptions include taxable gifts reported on a covered expatriate’s timely filed gift tax return, and property included in the covered expatriate’s gross estate and reported on

such expatriate's timely filed estate tax return, provided that the gift or estate tax due is timely paid. Qualified disclaimers of property made by a covered expatriate are excepted from the definitions of a covered gift and covered bequest. In addition, charitable donations that would qualify for the estate or gift tax charitable deduction are excepted from the terms "covered gift" and "covered bequest."

Section 28.2801-3(c)(4) provides that a gift or bequest to a covered expatriate's U.S. citizen spouse is excepted from the terms "covered gift" and "covered bequest" if the gift or bequest, if given by a U.S. citizen or resident, would qualify for the gift or estate tax marital deduction. In the case of a gift or bequest in trust, this means that, to the extent the gift or bequest to the trust (or to a separate share of the trust) would qualify for the estate or gift tax marital deduction, the gift or bequest is not a covered gift or covered bequest. A gift or bequest of a partial or terminable interest in property that a covered expatriate makes to his or her spouse is excepted from the definitions of a covered gift and covered bequest only to the extent that such gift or bequest is qualified terminable interest property (QTIP), as defined in section 2523(f) or section 2056(b)(7), and a valid QTIP election is made. To the extent a covered gift or covered bequest is made to a non-electing foreign trust (or to a separate share of such a trust), a distribution from the trust (or from the separate share of the trust) to the U.S. citizen spouse of the covered expatriate who funded the trust (whether in whole or in part) will not qualify for the exception. Note that gifts and bequests made by a covered expatriate to his or her noncitizen spouse are subject to an annual limit under section 2523(i). Furthermore, a bequest from a covered expatriate to his or her noncitizen surviving spouse who is a U.S. resident is not a covered bequest to the extent the bequest is

made to a qualified domestic trust (QDOT) that satisfies the requirements of section 2056A and the corresponding regulations, and for which a valid QDOT election is made.

Section 28.2801-3(d) provides rules to implement section 2801(e)(4) regarding covered gifts and covered bequests made in trust, including transfers of property in trust that are subject to a general power of appointment granted by the covered expatriate. In identifying the recipient of such covered gifts and covered bequests made in trust, the proposed regulations do not adopt the gift tax rule of treating the trust beneficiary or holder of an immediate right to withdraw the property as the recipient of that property. Instead, for purposes of section 2801, the proposed regulations treat transfers in trust that constitute covered gifts and covered bequests as transfers to the trust, to be taxed under the rules in section 2801(e)(4). Specifically, the proposed regulations provide that, if a covered expatriate makes a transfer in trust and such transfer is a covered gift or covered bequest, the transfer is treated as a covered gift or covered bequest to the trust, without regard to the beneficial interests in the trust or whether any person has a general power of appointment or a power of withdrawal over trust property. Under section 2801(e)(4), the transfer to the trust will be taxed either to the trust receiving the covered gift or covered bequest, in the case of a domestic trust or electing foreign trust, or to the U.S. beneficiaries or distributees of a non-electing foreign trust as trust distributions are made.

Section 28.2801-3(e) provides two rules addressing covered gifts and covered bequests arising from powers of appointment. First, consistent with the rules in chapters 11 and 12, the proposed regulations confirm that the exercise, release, or

lapse of a covered expatriate's general power of appointment for the benefit of a U.S. citizen or resident is a covered gift or covered bequest. Second, the proposed regulations provide that a covered expatriate's grant of a general power of appointment over property not held in trust is a covered gift or covered bequest to the powerholder as soon as both the power is exercisable and the transfer of the property subject to the power is irrevocable. See also §28.2801-4(d)(5)(ii). The preceding sentence applies only for purposes of section 2801, and should not be interpreted as having any impact on the determination of whether the grant of a general power of appointment over property not in trust is a completed gift for Federal gift tax purposes, which is a question to be resolved under chapter 12 without regard to this provision.

#### Liability for Section 2801 Tax

Section 28.2801-4 provides specific rules regarding who is liable for the payment of the section 2801 tax. Generally, the U.S. citizen or resident who receives the covered gift or covered bequest is liable. Similarly, the proposed regulations provide rules explaining that a domestic trust that receives a covered gift or covered bequest is treated as a U.S. citizen and thus is liable for payment of the section 2801 tax imposed under this section. An electing foreign trust also is treated as a U.S. citizen. See §§28.2801-2(b) and 28.2801-5(d). However, a non-electing foreign trust is not liable for the section 2801 tax. Instead, a U.S. citizen or resident who receives a distribution from a non-electing foreign trust is liable for the section 2801 tax on the receipt of that distribution to the extent the distribution is attributable to covered gifts or covered bequests to that trust. Under section 2801(e)(4)(B)(ii), that U.S. citizen or resident may be entitled to a limited deduction under section 164 against income tax for the

section 2801 tax paid on the distribution. The deduction is limited to the extent that the section 2801 tax is imposed on that portion of the distribution that is reported in the gross income of the U.S. citizen or resident. Section 28.2801-4(a)(3)(ii) of the proposed regulations describes how to compute that deduction.

Section 28.2801-4(a)(2)(ii) of the proposed regulations provides that, in the case of a domestic trust or an electing foreign trust, the trust's payment of the section 2801 tax for which the trust is liable does not result in a taxable distribution under section 2621 of the Code to any beneficiary of the trust for generation-skipping transfer (GST) tax purposes. This provision is consistent with the GST tax consequences of a trust's payment of tax, which differ depending upon whether the trust or the trust beneficiary is liable for the tax being paid.

Section 28.2801-4(a)(2)(iv) provides a special rule for certain non-electing foreign trusts that become domestic trusts (migrated foreign trusts). A migrated foreign trust will be treated solely for purposes of section 2801 as a domestic trust for the entire year during which the change from foreign trust to domestic trust occurred. The trust must file a timely Form 708 for the year in which the trust becomes a domestic trust and must report and pay the section 2801 tax on all covered gifts and covered bequests received by the trust during the year it becomes a domestic trust as well as on the portion of the trust's value attributable to any covered gifts and covered bequests received by the trust prior to the year in which it becomes a domestic trust determined as of December 31 of the year prior to the year it becomes a domestic trust.

#### Charitable Remainder Trusts

Section 28.2801-4(a)(2)(iii) of the proposed regulations provides rules for charitable remainder trusts (CRTs), as defined in section 664, contributions to which are made by covered expatriates for the benefit of one or more charitable organizations described in section 170(c) and a U.S. citizen or resident other than such a charitable organization (non-charitable U.S. citizen or resident). Section 2801(e)(3) indicates that the value of the charitable organization's remainder interest in a CRT is excluded from the definition of a covered gift or covered bequest. The value of the interest of the non-charitable U.S. citizen or resident in such contributions to the CRT is a covered gift or covered bequest, unless otherwise excluded.

Under section 664, a CRT must be a domestic trust. Accordingly, when a covered expatriate contributes a covered gift or covered bequest to a CRT, the CRT is liable for the payment of the section 2801 tax attributable to the value of the non-charitable U.S. person's interest in the trust. Section 664(d)(1)(B) and (d)(2)(B) and §1.664-3(a)(4) of the Income Tax Regulations provide that no amount other than the annuity or unitrust amount may be paid "to or for the use of any person other than an organization described under section 170(c)." This rule has been applied in Revenue Ruling 82-128 (1982-2 CB 71) to disqualify a trust as a CRT if the trust could be required to pay estate taxes by reason of the applicable state apportionment statute. Thus, if the CRT's liability for payment of section 2801 tax attributable to the non-charitable recipient's interest in the CRT were to be deemed comparable to the CRT's liability for payment of estate tax, the CRT would not qualify as a CRT under section 664.

A CRT's liability for payment of the section 2801 tax is distinguishable from a CRT's liability for payment of estate tax because the section 2801 tax is imposed expressly on the CRT under a federal tax statute, section 2801(e)(4)(A). In addition, the section 2801 tax is imposed on the CRT as a primary obligation of the CRT, rather than an obligation imposed on the CRT for the payment of a liability belonging to or attributable to another taxpayer. Accordingly, a CRT's payment of the section 2801 tax on the portion of each transfer to the CRT that is a covered gift or covered bequest is not a distribution to or for the use of any person within the meaning of section 664(d)(1)(B) and (d)(2)(B), and the CRT's liability for such a payment will not cause the trust to be disqualified as a CRT defined in section 664. The proposed regulations confirm that the charitable remainder interest's share of each transfer to the CRT is not a covered gift or covered bequest and provide the method for computing the net covered gifts and covered bequests that are taxable to the CRT under section 2801.

#### Computation of Section 2801 Tax

Section 28.2801-4 of the proposed regulations also provides guidance on how to compute the section 2801 tax. Generally, 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 (\$14,000 in 2015), and then multiplying the net amount by the highest estate or gift tax rate in effect during that calendar year. 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; section 2801 does not incorporate the substantive rule of section 2503(b) that applies to donors of gifts under chapter 12. The resulting tax then is reduced by any estate or gift tax paid to a foreign country with regard to those transfers. See §28.2801-4(e).

#### Value of a Covered Gift or Covered Bequest

The value of a covered gift or covered bequest is the fair market value of the property on the date of its receipt by the U.S. citizen or resident. Section 28.2801-4(c) provides that the value of a covered gift is determined by applying the federal gift tax valuation principles under section 2512 and chapter 14 and the corresponding regulations. Similarly, the value of a covered bequest is determined by applying the federal estate tax valuation principles under section 2031 and chapter 14 and the corresponding regulations, but without regard to sections 2032 and 2032A.

#### Date of Receipt

The proposed regulations identify the date of the receipt of a covered gift or covered bequest by a U.S. citizen or resident. See §28.2801-4(d). In general, a covered gift is received on the same date it is given for purposes of chapter 12. In general, a covered bequest is received on the date the property is distributed from the estate or the covered expatriate's revocable trust. However, in the case of property that passes by operation of law or beneficiary designation upon the covered expatriate's death, the date of receipt is the date of death. The proposed regulations provide more detail with regard to the determination of the date of receipt of covered gifts and covered bequests received from a non-electing foreign trust, those received pursuant to powers of appointment, and those received indirectly.

## Foreign Trusts

Section 28.2801-5 of the proposed regulations provides guidance on the treatment of foreign trusts under section 2801. If a covered gift or covered bequest is made to a foreign trust, the section 2801 tax applies to any distribution from that trust, whether of income or corpus, to a recipient that is a U.S. citizen or resident, unless the foreign trust elects to be treated as a domestic trust for purposes of section 2801. The proposed regulations define the term “distribution” broadly to include any direct, indirect, or constructive transfer from a foreign trust, including each disbursement from such a trust pursuant to the exercise, release, or lapse of a power of appointment.

### Distributions from Foreign Trusts

The section 2801 tax applies only to the portion of a distribution from a non-electing foreign trust that is attributable to covered gifts and covered bequests contributed to the foreign trust. Section 28.2801-5(c) of the proposed regulations provides that the amount of the distribution attributable to covered gifts and covered bequests is determined by multiplying the total distribution by a ratio, as in effect at the time of the distribution, that is redetermined after each contribution to the trust. The proposed regulations explain how to compute that ratio and provide that each distribution from the foreign trust is considered to be made proportionally from the covered and non-covered portions of the trust, without any tracing with regard to particular assets. One effect of this rule is that the portion of a distribution from a foreign trust that is attributable to covered gifts and covered bequests contributed to the foreign trust includes the ratable portion of any appreciation and income that has

accrued on the foreign trust's assets since the contribution of the covered gifts and covered bequests to the foreign trust.

#### Election by Foreign Trust to Be Treated as Domestic Trust

Section 2801(e)(4)(B)(iii) provides that, solely for purposes of section 2801, a foreign trust may elect to be treated as a domestic trust. Consequently, the section 2801 tax is imposed on the electing foreign trust when it receives covered gifts and covered bequests, rather than on the U.S. trust beneficiaries when distributions are made from the trust. The election may be made for a calendar year whether or not the foreign trust received a covered gift or covered bequest during that calendar year.

Section 28.2801-5(d)(3) of the proposed regulations provides guidance on the time and manner of making the election. In order for an election to be valid, the trustee of the foreign trust must satisfy several requirements. The trustee must make the election on a timely filed Form 708 and, if tax is due, timely pay the section 2801 tax (as computed under §28.2801-5(d)(3)(iii)) by the due date of the Form 708 for that year and include a computation of how the applicable ratio and tax liability were calculated. Further, the trustee must designate and authorize a U.S. agent for purposes of section 2801, and must agree to file annually a Form 708 either to certify that no covered gifts or covered bequests were received by the foreign trust during the calendar year, or to report and, if tax is due, pay the section 2801 tax on covered gifts and covered bequests received by the foreign trust during the calendar year. The trustee also must report the portion of the trust attributable to covered gifts and covered bequests and all distributions attributable to covered gifts and covered bequests made to U.S. recipients in years prior to the year of the election. Finally, the trustee must notify the permissible U.S.

distributees of the trust that the trustee is making the election to be treated as a domestic trust for purposes of section 2801.

Under §28.2801-5(d)(3)(iii), an electing foreign trust that received covered gifts or covered bequests in prior calendar years when the election to be treated as a domestic trust was not in effect also must pay the section 2801 tax liability for all prior calendar years at the time the election is made on Form 708. Such liability is based on the fair market value of the trust attributable to covered gifts and covered bequests as of the last day of the calendar year immediately preceding the year for which the election is made, using the ratio calculated and then in effect under §28.2801-5(c). If the trustee is unable to determine the portion of the trust attributable to covered gifts and covered bequests, then the fair market value of the entire trust as of the last day of the calendar year immediately preceding the year for which the election is made is subject to the section 2801 tax.

A valid election to be treated as a domestic trust is effective as of the beginning of the calendar year for which the Form 708 is filed. The effect of a valid election is that, as of such effective date of the election and until the election is terminated, U.S. citizens and residents receiving a distribution from that foreign trust will not be subject to section 2801 tax on that distribution. Instead, the electing foreign trust, like a domestic trust, must report and pay the section 2801 tax on each covered gift and covered bequest as it is received. The election, however, will not change the section 2801 tax liability of the U.S. recipients with regard to distributions made from the trust prior to the effective date of the election. The election has no impact outside of section 2801 on the taxation or reporting of trust distributions to U.S. persons.

### Dispute as to Amount of Section 2801 Tax Owed by Electing Foreign Trust

If the IRS asserts that additional section 2801 tax is due from the electing foreign trust because, for example, the trust undervalued the covered gift or covered bequest or failed to report all covered gifts and covered bequests, then the IRS will notify the trustee of the foreign trust and the U.S. agent of the additional tax due on the asserted additional value or additional covered gifts or covered bequests, including any penalties and interest, and request payment by the due date identified in the IRS letter. If the trustee of the electing foreign trust and the IRS are unable to come to an agreement and the trustee fails to timely pay the additional tax and other asserted amounts, then the election is deemed to be an “imperfect election.” This means that the election terminates as of the first day of the calendar year for which the IRS asserts that the additional section 2801 tax is due. In this event, the covered gifts and covered bequests for which the return was timely filed, but only to the extent of the value on which the section 2801 tax was timely paid, are no longer considered to be covered gifts or covered bequests for purposes of determining the ratio under §28.2801-5(c)(1), and distributions relating to such amounts will not be taxable to a U.S. citizen or resident who receives a trust distribution. However, with regard to the asserted additional value or additional covered gifts or covered bequests on which the trust did not timely pay the section 2801 tax asserted by the IRS, the foreign trust is not an electing foreign trust and thus is not the taxpayer responsible for the payment of that additional section 2801 tax. Instead, as of the effective date of the termination of the trust’s election, the usual rule of section 2801(e)(4)(B) applies with regard to the taxation of distributions from foreign trusts. Specifically, the U.S. citizens or residents who receive any trust

distributions on or after the effective date of the terminated election should take into consideration the additional value or additional covered gifts or covered bequests asserted by the IRS in determining the ratio under §28.2801-5(c)(1) to be applied to such distributions. If the U.S. recipient does not take the additional value or additional covered gifts or covered bequests asserted by the IRS into consideration in computing that ratio, and the IRS challenges the computation of that ratio during its review of the U.S. recipient's Form 708 reporting the distribution, the IRS's assertion of the additional value or additional covered gifts or covered bequests then will become an issue to be resolved as part of the usual examination process for the U.S. recipient's Form 708. See §28.2801-5(e), Example 4.

#### Termination of Status as Electing Foreign Trust

An electing foreign trust's failure to file the Form 708 on an annual basis or to timely pay its section 2801 tax terminates that foreign trust's election to be treated as a domestic trust as of the first day of the calendar year for which the certification is not timely made or for which its section 2801 tax is not timely paid. But see §28.2801-5(d)(6) in the case of a dispute as to the amount of section 2801 tax owed by an electing foreign trust. In the event of the termination of the election, the trustee should notify the permissible U.S. distributees of the effective date of the termination and that each U.S. recipient of a distribution made from the foreign trust on or after that date is subject to the section 2801 tax to the extent the distribution is attributable to covered gifts or covered bequests. After an election is terminated, a foreign trust is not prohibited from making a new election to be treated as a domestic trust by complying with all applicable requirements.

## Other Provisions

Section 28.2801-6(a) addresses how the basis rules under sections 1014, 1015(a), and 1022 impact the determination of the U.S. recipient's basis in the covered gift or covered bequest. Unlike section 1015(d), which generally allows gift tax paid on the gift to be added to the donee's basis, section 2801 does not provide a similar basis adjustment for the payment of the section 2801 tax.

Section 28.2801-6(b) clarifies the applicability of the GST tax to certain section 2801 transfers and cross-references the GST rules.

Section 28.2801-6(c) discusses the interaction of section 2801 and the information reporting provisions of sections 6039F and 6048(c). Generally, pursuant to section 6039F and Notice 97-34, 1997-1 CB 422, a U.S. person (other than an organization described in section 501(c) and exempt from tax under section 501(a)) who receives a gift or bequest (including a covered gift or covered bequest) from a foreign person (other than through a foreign trust) must report such gift or bequest on Part IV of Form 3520, "Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts," if the total value of such gifts and bequests exceeds a certain threshold. A U.S. citizen or resident, as defined under §28.2801-2(b) and thus including a domestic trust as defined in §28.2801-2(c), but not including a foreign trust that elects to be treated as a domestic trust, is included within the definition of a U.S. person for purposes of section 6039F.

Under section 6039F(c)(1)(A), if a U.S. person fails to furnish all of the information regarding the gift or bequest in accordance with the requirements of Form 3520, and any related guidance, within the time prescribed (in the case of a U.S.

citizen or resident, the time for filing the Form 1040, including extensions), then, absent reasonable cause, a monthly penalty of 5 percent of the amount of the gift or bequest (not to exceed 25 percent) may be imposed until such information is furnished. In addition, the tax consequences of the receipt of such gift or bequest may be determined by the Secretary. Taxpayers should be aware that the information reported on Part IV of Form 3520, whether or not timely filed, may be considered in determining whether a U.S. citizen or resident received a covered gift or covered bequest.

Pursuant to section 6048(c) and Notice 97-34, a U.S. person must report any distributions received from a foreign trust on Part III of Form 3520. Under section 6677(a), a penalty of the greater of \$10,000 or 35 percent of the gross value of the distribution may be imposed on a U.S. person who fails to timely report the distribution. A U.S. citizen or resident, as defined in §28.2801-2(b), but not including a foreign trust that elects to be treated as a domestic trust, generally would be required to report such a distribution under section 6048(c).

Further, if adequate records are not provided to determine the treatment of such a distribution, to the extent provided in Notice 97-34, as modified by the instructions to Form 3520 and any subsequent guidance, such distribution may be treated as an accumulation distribution includible in the gross income of the distributee. Taxpayers similarly should be aware that information reported on Part III of Form 3520 may be used to determine if a U.S. citizen or resident received a trust distribution attributable to a covered gift or covered bequest.

Finally, §28.2801-6(d) addresses the section 6662 accuracy-related penalties on underpayments of tax, the section 6651 failure to file and pay penalties, and the



section 6695A penalty on substantial and gross valuation misstatements attributable to incorrect appraisals. The Treasury Department and the IRS recognize that taxpayers have had to defer their tax reporting and payment obligations with respect to covered gifts and covered bequests received after the effective date of section 2801 (as described in Notice 2009-85). Thus, there may be circumstances under which a taxpayer who received a covered gift or covered bequest in a year prior to the issuance of final regulations may have difficulty in complying with the deferred filing and payment requirements with respect to those receipts. A taxpayer who establishes that such failure in this regard is due to reasonable cause and not to willful neglect will not be subject to the section 6651 penalties for failure to file or pay. The determination of whether an exception to the other penalties applies will be made on a case-by-case basis.

Section 28.2801-7 provides guidance on the responsibility of a U.S. recipient, as defined in §28.2801-2(e), to determine if tax under section 2801 is due. The Treasury Department and the IRS realize that, because the tax imposed by this section is imposed on the U.S. citizen or resident receiving a covered gift or covered bequest, rather than on the donor or decedent covered expatriate making the gift or bequest, U.S. taxpayers may have difficulty determining whether they are liable for any tax under section 2801. Nevertheless, the same standard of due diligence that applies to any other taxpayer to determine whether the taxpayer has a tax liability or a filing requirement also applies to U.S. citizens and residents under this section. Accordingly, it is the responsibility of each U.S. citizen or resident receiving a gift or bequest, whether directly or indirectly, from an expatriate (as defined in section 877A(g)(2)) to determine

its tax obligations under section 2801. Thus, the burden is on that U.S. citizen or resident to determine whether the expatriate was a covered expatriate (as defined in section 877A(g)(1)) and, if so, whether the gift or bequest was a covered gift or covered bequest.

The Treasury Department and the IRS understand that a U.S. citizen or resident receiving a gift or bequest from an expatriate may be unable to obtain directly from the expatriate, the expatriate's attorney, the expatriate's executor, or other reliable sources the information necessary to make the above determinations. If the IRS receives a request from a U.S. citizen or resident who received a gift from an expatriate who has consented to the disclosure of certain return information to that donee, a gift from an expatriate who is deceased at the time of the request, or a bequest from an expatriate, the IRS may in certain circumstances disclose to such U.S. citizen or resident the return or return information of the donor or decedent expatriate that may assist the U.S. citizen or resident in determining whether the donor or decedent was a covered expatriate and whether the transfer was a covered gift or covered bequest. See section 6103. The types of information and requirements and procedures for requesting such information will be set forth in guidance published in the Internal Revenue Bulletin.

Although the IRS, if authorized, may disclose returns and return information upon request, the IRS will not make the determinations as to whether an expatriate from whom a gift or bequest was received was a covered expatriate or whether the gift or bequest was a covered gift or covered bequest. Furthermore, the U.S. citizen or resident receiving a gift or bequest from an expatriate may not rely on any information

provided by the IRS that the U.S. citizen or resident knows or has reason to know is incorrect. These determinations are the responsibility of the U.S. citizen or resident.

The proposed regulations provide that, if a living expatriate donor does not authorize the IRS to release to a U.S. citizen or resident the donor's relevant return or return information, there is a rebuttable presumption that the expatriate donor is a covered expatriate and that each gift from that expatriate to a U.S. citizen or resident is a covered gift. A taxpayer who reasonably concludes that a gift or bequest is not subject to section 2801 and intends to rebut the presumption may choose to file a protective return to start the period for assessment of any section 2801 tax. See §§28.2801-7(b)(2), 28.6011-1(b).

#### Administrative Regulations

The proposed regulations also include administrative regulations that address filing and payment due dates, returns, extension requests, and recordkeeping requirements with respect to the section 2801 tax. See §§28.6001-1, 28.6011-1, 28.6060-1, 28.6071-1, 28.6081-1, 28.6091-1, 28.6101-1, 28.6107-1, 28.6109-1, 28.6151-1, 28.6694-1, 28.6694-2, 28.6694-3, 28.6694-4, 28.6695-1, 28.6696-1, 28.7701-1. Section 28.6011-1(a) provides the return requirements to report the receipt of covered gifts and covered bequests from covered expatriates using Form 708.

The Treasury Department and IRS will permit the filing of a protective Form 708, unaccompanied by any payment of tax under section 2801, in limited circumstances when a U.S. citizen or resident receives a gift or bequest from an expatriate and reasonably concludes, after exercising due diligence, that the gift or bequest is not a covered gift or covered bequest from a covered expatriate. The mere absence of

information confirming that the expatriate is a covered expatriate or that the gift or bequest is a covered gift or covered bequest is not a sufficient basis for a protective return. Section 28.6011-1(b)(i) provides that filing a protective Form 708, together with the required attachments, will start the period for the assessment of any section 2801 tax.

The IRS intends to issue Form 708 once these regulations are published as final regulations in the **Federal Register**. The IRS will provide the due date for filing Form 708 and for payment of the section 2801 tax liability in the final regulations. Consistent with Announcement 2009-57, U.S. recipients will be given a reasonable period of time after the date the final regulations are published in the **Federal Register** to file the Form 708 and to pay the section 2801 tax on covered gifts and covered bequests received on or after June 17, 2008, and before the date of publication of the final regulations in the **Federal Register**. Interest will not accrue on the section 2801 tax liability for any taxable years until the due date for payment, as specified in the final regulations, has passed.

### **Effect on Other Documents**

The following publication will be obsolete when regulations finalizing these proposed regulations are published in the **Federal Register**:

Announcement 2009-57, 2009-29 I.R.B. 158.

### **Special Analyses**

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has been determined that

section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that this regulation does not affect small entities because it applies to individuals and certain trusts. Accordingly, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Code, these proposed regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

### **Statement of Availability for Documents Published in the Internal Revenue Bulletin**

For copies of recently issued revenue procedures, revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin or Cumulative Bulletin, please visit the IRS Web site at <http://www.irs.gov>.

### **Drafting Information**

The principal authors of these regulations are Karlene Lesho and Leslie Finlow, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. The Treasury Department

and the IRS request comments on all aspects of the proposed regulations. In particular, comments are requested with respect to the following issues:

1. How to calculate the amount of a distribution from a foreign trust that is attributable to a covered gift or covered bequest if the U.S. recipient does not have adequate books and records or information available to make such a determination.

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.

3. How contributions to or distributions from a non-electing foreign trust to a U.S. 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).

All comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request.

A public hearing has been scheduled for January 6, 2016, at 10 a.m. in the IRS Auditorium Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a

signed original and eight (8) copies) by **[INSERT DATE 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**. A period of 10 minutes will be allotted to each person for making comments. Copies of the agenda will be available free of charge at the meeting.

### **List of Subjects in 26 CFR Part 28**

Expatriation taxes, Reporting and recordkeeping requirements.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR chapter 1 is proposed to be amended by adding part 28 to subchapter B to read as follows:

#### **PART 28—IMPOSITION OF TAX ON GIFTS AND BEQUESTS FROM COVERED EXPATRIATES**

Sec.

28.2801-0 Table of contents.

28.2801-1 Tax on certain gifts and bequests from covered expatriates.

28.2801-2 Definitions.

28.2801-3 Rules and exceptions applicable to covered gifts and covered bequests.

28.2801-4 Liability for and payment of tax on covered gifts and covered bequests; computation of tax.

28.2801-5 Foreign trusts.

28.2801-6 Special rules and cross-references.

28.2801-7 Determining responsibility under section 2801.

28.6001-1 Records required to be kept.

28.6011-1 Returns.

28.6060-1 Reporting requirements for tax return preparers.

28.6071-1 Time for filing returns.

28.6081-1 Automatic extension of time for filing returns reporting gifts and bequests from covered expatriates.

28.6091-1 Place for filing returns.

28.6101-1 Period covered by returns.

28.6107-1 Tax return preparer must furnish copy of return or claim for refund to taxpayer and must retain a copy or record.

28.6109-1 Tax return preparers furnishing identifying numbers for returns or claims for refund.

28.6151-1 Time and place for paying tax shown on returns.

28.6694-1 Section 6694 penalties applicable to return preparer.

28.6694-2 Penalties for understatement due to an unreasonable position.

28.6694-3 Penalty for understatement due to willful, reckless, or intentional conduct.

28.6694-4 Extension of period of collection when tax return preparer pays 15 percent of a penalty for understatement of taxpayer's liability and certain other procedural matters.

28.6695-1 Other assessable penalties with respect to the preparation of tax returns for other persons.

28.6696-1 Claims for credit or refund by tax return preparers and appraisers.

28.7701-1 Tax return preparer.

Authority: 26 U.S.C. 7805

Section 28.6001-1 also issued under 26 U.S.C. 6001(a).

Section 28.6011(a)-1 also issued under 26 U.S.C. 6011(a).

Section 28.6060-1 also issued under 26 U.S.C. 6060(a).

Section 28.6071(a)-1 also issued under 26 U.S.C. 6071(a).

Section 28.6081-1 also issued under 26 U.S.C. 6081(a).

Section 28.6091-1 also issued under 26 U.S.C. 6091.

Section 28.6101-1 also issued under 26 U.S.C. 6101.

Section 28.6107-1 also issued under 26 U.S. C. 6107(c).

Section 28.6109-1 also issued under 26 U.S.C. 6109(a).

Section 28.6151-1 also issued under 26 U.S.C. 6151.

Section 28.6695-1 also issued under 26 U.S.C. 6695(b).



Section 28.6696-1 also issued under 26 U.S.C. 6696(c).

**§28.2801-0 Table of contents.**

This section lists the captions in §§28.2801-1 through 28.2801-7.

**§28.2801-1 Tax on certain gifts and bequests from covered expatriates.**

- (a) In general.
- (b) Effective/applicability date.

**§28.2801-2 Definitions.**

- (a) Overview.
- (b) Citizen or resident of the United States.
- (c) Domestic trust.
- (d) Foreign trust.
  - (1) In general.
  - (2) Electing foreign trust
- (e) U.S. recipient.
- (f) Covered bequest.
- (g) Covered gift.
- (h) Expatriate and covered expatriate.
- (i) Indirect acquisition of property.
- (j) Power of appointment.
- (k) Effective/applicability date.

**§28.2801-3 Rules and exceptions applicable to covered gifts and covered bequests.**

- (a) Covered gift.
- (b) Covered bequest.
- (c) Exceptions to covered gift and covered bequest.
  - (1) Reported taxable gifts.
  - (2) Property reported as subject to estate tax.
  - (3) Transfers to charity.
  - (4) Transfers to spouse.
  - (5) Qualified disclaimers.
- (d) Covered gifts and covered bequests made in trust.
- (e) Powers of appointment.
  - (1) Covered expatriate as holder of power.
  - (2) Covered expatriate as grantor of power.
- (f) Examples.
- (g) Effective/applicability date.

**§28.2801-4 Liability for and payment of tax on covered gifts and covered bequests; computation of tax.**

- (a) Liability for tax.
  - (1) U.S. citizen or resident.
  - (2) Domestic trust.

- (i) In general.
- (ii) Generation-skipping transfer tax.
- (iii) Charitable remainder trust.
- (iv) Migrated foreign trust.
- (3) Foreign trust.
  - (i) In general.
  - (ii) Income tax deduction.
- (b) Computation of tax.
  - (1) In general.
  - (2) Net covered gifts and covered bequests.
- (c) Value of covered gift or covered bequest.
  - (d) Date of receipt.
    - (1) In general.
    - (2) Covered gift.
    - (3) Covered bequest.
  - (4) Foreign trusts.
  - (5) Powers of appointment.
    - (i) Covered expatriate as holder of power.
    - (ii) Covered expatriate as grantor of power.
- (6) Indirect receipts.
  - (e) Reduction of tax for foreign estate or gift tax paid.
  - (f) Examples.
  - (g) Effective/applicability date.

§28.2801-5 Foreign trusts.

- (a) In general.
- (b) Distribution defined.
- (c) Amount of distribution attributable to covered gift or covered bequest.
  - (1) Section 2801 ratio.
    - (i) In general.
    - (ii) Computation.
      - (2) Effect of reported transfer and tax payment.
      - (3) Inadequate information to calculate section 2801 ratio.
  - (d) Foreign trust treated as domestic trust.
    - (1) Election required.
      - (2) Effect of election.
        - (3) Time and manner of making the election.
          - (i) When to make the election.
          - (ii) Requirements for a valid election.
        - (iii) Section 2801 tax payable with the election.
        - (iv) Designation of U.S. agent.
          - (A) In general.
          - (B) Role of designated agent.
          - (C) Effect of appointment of agent.
        - (4) Annual certification or filing requirement.
        - (5) Duration of status as electing foreign trust.

- (i) In general.
- (ii) Termination.
- (iii) Subsequent elections.
- (6) Dispute as to amount of section 2801 tax owed by electing foreign trust.
  - (i) Procedure.
  - (ii) Effect of timely paying the additional section 2801 tax amount.
  - (iii) Effect of failing to timely pay the additional section 2801 tax amount (imperfect election).
- (A) In general.
- (B) Notice to permissible beneficiaries.
- (C) Reasonable cause.
- (D) Interim period.
- (7) No overpayment caused solely by virtue of defect in election.
- (e) Examples.
- (f) Effective/applicability date.

**§28.2801-6 Special rules and cross-references.**

- (a) Determination of basis.
- (b) Generation-skipping transfer tax.
- (c) Information returns.
  - (1) Gifts and bequests.
  - (2) Foreign trust distributions.
  - (3) Penalties and use of information.
- (d) Application of penalties.
  - (1) Accuracy-related penalties on underpayments.
  - (2) Penalty for substantial and gross valuation misstatements attributable to incorrect appraisals.
  - (3) Penalty for failure to file a return and to pay tax.
- (e) Effective/applicability date.

**§28.2801-7 Determining responsibility under section 2801.**

- (a) Responsibility of recipients of gifts and bequests from expatriates.
- (b) Disclosure of return and return information.
  - (1) In general.
  - (2) Rebuttable presumption.
- (c) Effective/applicability date.

**§28.2801-1 Tax on certain gifts and bequests from covered expatriates.**

(a) In general. Section 2801 of the Internal Revenue Code (Code) imposes a tax (section 2801 tax) on covered gifts and covered bequests, including distributions from foreign trusts attributable to covered gifts or covered bequests, received by a United States citizen or resident (U.S. citizen or resident) from a covered expatriate during a

calendar year. Domestic trusts, as well as foreign trusts electing to be treated as domestic trusts for purposes of section 2801, are subject to tax under section 2801 in the same manner as if the trusts were U.S. citizens. See section 2801(e)(4)(A)(i) and (e)(4)(B)(iii). Accordingly, the section 2801 tax is paid by the U.S. citizen or resident, domestic trust, or foreign trust electing to be treated as a domestic trust for purposes of section 2801 that receives the covered gift or covered bequest. For purposes of this part 28, references to a U.S. citizen or U.S. citizens are considered to include a domestic trust and a foreign trust electing to be treated as a domestic trust for purposes of section 2801.

(b) Effective/applicability date. This section applies on and after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Once these regulations have been published as final regulations in the **Federal Register**, taxpayers may rely upon the final rules of this part for the period beginning June 17, 2008, and ending on the date preceding the date these regulations are published as final regulations in the **Federal Register**.

#### **§28.2801-2 Definitions.**

(a) Overview. This section provides definitions of terms applicable solely for purposes of section 2801 and the corresponding regulations.

(b) Citizen or resident of the United States. A citizen or resident of the United States (U.S. citizen or resident) is an individual who is a citizen or resident of the United States under the rules applicable for purposes of chapter 11 or 12 of the Code, as the case may be, at the time of receipt of the covered gift or covered bequest. Furthermore, for purposes of this part 28, references to U.S. citizens also include domestic trusts, as

well as foreign trusts electing to be treated as a domestic trust under §28.2801-5(d). See §28.2801-1(a)(1).

(c) Domestic trust. The term domestic trust means a trust defined in section 7701(a)(30)(E). For purposes of this part 28, references to a domestic trust include a foreign trust that elects under §28.2801-5(d) to be treated as a domestic trust solely for purposes of section 2801.

(d) Foreign trust—(1) In general. The term foreign trust means a trust defined in section 7701(a)(31).

(2) Electing foreign trust. The term electing foreign trust is a foreign trust that has in effect a valid election to be treated as a domestic trust solely for purposes of section 2801. See §28.2801-5(d).

(e) U.S. recipient. The term U.S. recipient means a citizen or resident of the United States, a domestic trust, and an electing foreign trust that receives a covered gift or covered bequest, whether directly or indirectly, during the calendar year. The term U.S. recipient includes U.S. citizens or residents receiving a distribution from a foreign trust not electing to be treated as a domestic trust for purposes of section 2801 if the distributions are attributable (in whole or in part) to one or more covered gifts or covered bequests received by the foreign trust. This term also includes the U.S. citizen or resident shareholders, partners, members, or other interest-holders, as the case may be (if any), of a domestic entity that receives a covered gift or covered bequest.

(f) Covered bequest. The term covered bequest means any property acquired directly or indirectly by reason of the death of a covered expatriate, regardless of its situs and of whether such property was acquired by the covered expatriate before or

after expatriation from the United States. The term also includes distributions made by reason of the death of a covered expatriate from a foreign trust that has not elected under §28.2801-5(d) to be treated as a domestic trust for purposes of section 2801 to the extent the distributions are attributable to covered gifts or covered bequests made to the foreign trust. See §28.2801-3 for additional rules and exceptions applicable to the term covered bequest.

(g) Covered gift. The term covered gift means any property acquired by gift directly or indirectly from an individual who is a covered expatriate at the time the property is received by a U.S. citizen or resident, regardless of its situs and of whether such property was acquired by the covered expatriate before or after expatriation from the United States. The term also includes distributions made, other than by reason of the death of a covered expatriate, from a foreign trust that has not elected under §28.2801-5(d) to be treated as a domestic trust for purposes of section 2801 to the extent the distributions are attributable to covered gifts or covered bequests made to the foreign trust. See §28.2801-3 for additional rules and exceptions applicable to the term covered gift.

(h) Expatriate and covered expatriate. The term expatriate has the same meaning for purposes of section 2801 as that term has in section 877A(g)(2). The term covered expatriate has the same meaning for purposes of section 2801 as that term has in section 877A(g)(1). The determination of whether an individual is a covered expatriate is made as of the expatriation date as defined in section 877A(g)(3), and if an expatriate meets the definition of a covered expatriate, the expatriate is considered a covered expatriate for purposes of section 2801 at all times after the expatriation date.

However, an expatriate (as defined in section 877A(g)(2)) is not treated as a covered expatriate for purposes of section 2801 during any period beginning after the expatriation date during which such individual is subject to United States estate or gift tax (chapter 11 or chapter 12 of subtitle B) as a U.S. citizen or resident. See section 877A(g)(1)(C). An individual's status as a covered expatriate will be determined as of the date of the most recent expatriation, if there has been more than one.

(i) Indirect acquisition of property. An indirect acquisition of property, as referred to in the definitions of a covered gift and covered bequest, includes--

(1) Property acquired as a result of a transfer that is a covered gift or covered bequest to a corporation or other entity other than a trust or estate, to the extent of the respective ownership interest of the recipient U.S. citizen or resident in the corporation or other entity;

(2) Property acquired by or on behalf of a U.S. citizen or resident, either from a covered expatriate or from a foreign trust that received a covered gift or covered bequest, through one or more other foreign trusts, other entities, or a person not subject to the section 2801 tax;

(3) Property paid by a covered expatriate, or distributed from a foreign trust that received a covered gift or covered bequest, in satisfaction of a debt or liability of a U.S. citizen or resident, regardless of the payee of that payment or distribution;

(4) Property acquired by or on behalf of a U.S. citizen or resident pursuant to a non-covered expatriate's power of appointment granted by a covered expatriate over property not in trust, unless the property previously was subjected to section 2801 tax upon the grant of the power or the covered expatriate had no more than a non-general

power of appointment over that property; and

(5) Property acquired by or on behalf of a U.S. citizen or resident in other transfers not made directly by the covered expatriate to the U.S. citizen or resident.

(j) Power of appointment. The term power of appointment refers to both a general and non-general power of appointment. A general power of appointment is as defined in sections 2041(b) and 2514(c) of the Code and a non-general power of appointment is any power of appointment that is not a general power of appointment.

(k) Effective/applicability date. This section applies on and after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Once these regulations have been published as final regulations in the **Federal Register**, taxpayers may rely upon the final rules of this part for the period beginning June 17, 2008, and ending on the date preceding the date these regulations are published as final regulations in the **Federal Register**.

**§28.2801-3 Rules and exceptions applicable to covered gifts and covered bequests.**

(a) Covered gift. Subject to the provisions of paragraphs (c), (d), and (e) of this section, the term gift as used in the definition of covered gift in §28.2801-2(g) has the same meaning as in chapter 12 of subtitle B, but without regard to the exceptions in section 2501(a)(2), (a)(4), and (a)(5), the per-donee exclusion under section 2503(b) for certain transfers of a present interest, the exclusion under section 2503(e) for certain educational or medical expenses, and the waiver of certain pension rights under section 2503(f).



(b) Covered bequest. Subject to the provisions of paragraphs (c), (d), and (e) of this section, property acquired “by reason of the death of a covered expatriate” as described in the definition of covered bequest in §28.2801-2(f) includes any property that would have been includible in the gross estate of the covered expatriate under chapter 11 of subtitle B if the covered expatriate had been a U.S. citizen at the time of death. Therefore, in addition to the items described in §28.2801-2(f), the term covered bequest includes, without limitation, property or an interest in property acquired by reason of a covered expatriate’s death--

(1) By bequest, devise, trust provision, beneficiary designation or other contractual arrangement, or by operation of law;

(2) That was transferred by the covered expatriate during life, either before or after expatriation, and which would have been includible in the covered expatriate’s gross estate under section 2036, section 2037, or section 2038 had the covered expatriate been a U.S. citizen at the time of death;

(3) That was received for the benefit of a covered expatriate from such covered expatriate’s spouse, or predeceased spouse, for which a valid qualified terminable interest property (QTIP) election was made on such spouse’s, or predeceased spouse’s, Form 709, “U.S. Gift (and Generation-Skipping Transfer) Tax Return,” Form 706, “United States Estate (and Generation-Skipping Transfer) Tax Return,” or Form 706-NA, “United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States,” which would have been included in the covered expatriate’s gross estate under section 2044 if the covered expatriate was a U.S. citizen at the time of death; or

(4) That otherwise passed from the covered expatriate by reason of death, such as--

(i) Property held by the covered expatriate and another person as joint tenants with right of survivorship or as tenants by the entirety, but only to the extent such property would have been included in the covered expatriate's gross estate under section 2040 if the covered expatriate had been a U.S. citizen at the time of death;

(ii) Any annuity or other payment that would have been includible in the covered expatriate's gross estate if the covered expatriate had been a U.S. citizen at the time of death;

(iii) Property subject to a general power of appointment held by the covered expatriate at death; or

(iv) Life insurance proceeds payable upon the covered expatriate's death that would have been includible in the covered expatriate's gross estate under section 2042 if the covered expatriate had been a U.S. citizen at the time of death.

(c) Exceptions to covered gift and covered bequest. The following transfers from a covered expatriate are exceptions to the definition of covered gift and covered bequest.

(1) Reported taxable gifts. A transfer of property that is a taxable gift under section 2503(a) and is reported on the donor's timely filed Form 709 is not a covered gift, provided that the donor also timely pays the gift tax, if any, shown as due on that return. A transfer excluded from the definition of a taxable gift, such as a transfer of a present interest not in excess of the annual exclusion amount under section 2503(b), is

not excluded from the definition of a covered gift under this paragraph (c)(1) even if reported on the donor's Form 709.

(2) Property reported as subject to estate tax. Property that is included in the gross estate of the covered expatriate and is reported on a timely filed Form 706 or Form 706-NA is not a covered bequest, provided that the estate also timely pays the estate tax, if any, shown as due on that return. For this purpose, estate tax imposed on distributions from or on the remainder of a qualified domestic trust (QDOT) are deemed to be reported on a timely filed Form 706, if the tax due thereon was timely paid. Thus, if the covered expatriate's gross estate is not of sufficient value to require the filing of a Form 706-NA, for example, and no Form 706-NA is timely filed, the property passing from that covered expatriate is not excluded from the definition of a covered bequest under the rule of this paragraph (c)(2). Further, this exclusion does not apply to the property not on such a form, whether or not subject to United States estate tax (that is, non U.S.-situs property that passes to U.S. citizens or residents).

(3) Transfers to charity. A gift to a donee described in section 2522(b) or a bequest to a beneficiary described in section 2055(a) is not a covered gift or covered bequest to the extent a charitable deduction under section 2522 or section 2055 would have been allowed if the covered expatriate had been a U.S. citizen or resident at the time of the transfer.

(4) Transfers to spouse. A transfer from a covered expatriate to the covered expatriate's spouse is not a covered gift or covered bequest to the extent a marital deduction under section 2523 or section 2056 would have been allowed if the covered expatriate had been a U.S. citizen or resident at the time of the transfer. To the extent

that a gift or bequest to a trust (or to a separate share of the trust) would qualify for the marital deduction, the gift or bequest is not a covered gift or covered bequest. For purposes of this paragraph (c)(4), a marital deduction is deemed not to be allowed for qualified terminable interest property (QTIP) or for property in a qualified domestic trust (QDOT) unless a valid QTIP and/or QDOT election is made. The term covered bequest also does not include assets in a QDOT funded for the benefit of a covered expatriate by the covered expatriate's predeceased spouse, but only if a valid election was made on the predeceased spouse's Form 706 or Form 706-NA to treat the trust as a QDOT.

(5) Qualified disclaimers. A transfer pursuant to a covered expatriate's qualified disclaimer, as defined in section 2518(b), is not a covered gift or covered bequest from that covered expatriate.

(d) Covered gifts and covered bequests made in trust. For purposes of section 2801, when a covered expatriate transfers property to a trust in a transfer that is a covered gift or covered bequest as determined under this section, the transfer of property is treated as a covered gift or covered bequest to the trust, without regard to the beneficial interests in the trust or whether any person has a general power of appointment or a power of withdrawal over trust property. Accordingly, the rules in section 2801(e)(4) and §28.2801-4(a) apply to determine liability for payment of the section 2801 tax. The U.S. recipient of a covered gift or a covered bequest to a domestic trust or an electing foreign trust is the domestic or electing foreign trust, and the U.S. recipient of a covered gift or a covered bequest to a non-electing foreign trust is any U.S. citizen or resident receiving a distribution from the non-electing foreign trust. See §28.2801-2(e) for the definition of a U.S. recipient.

(e) Powers of appointment--(1) Covered expatriate as holder of power. The exercise or release of a general power of appointment held by a covered expatriate over property, whether or not in trust (even if that covered expatriate was a U.S. citizen or resident when the general power of appointment was granted), for the benefit of a U.S. citizen or resident is a covered gift or covered bequest. The lapse of a general power of appointment is treated as a release to the extent provided in sections 2041(b)(2) and 2514(e). Furthermore, the exercise of a power of appointment by a covered expatriate that creates another power of appointment as described in section 2041(a)(3) or section 2514(d) for the benefit of a U.S. citizen or resident is a covered gift or a covered bequest.

(2) Covered expatriate as grantor of power. The grant by a covered expatriate to an individual who is a U.S. citizen or resident of a general power of appointment over property not transferred in trust by the covered expatriate is a covered gift or covered bequest to the powerholder. For the rule applying to the grant by a covered expatriate of a general power of appointment over property in trust, see paragraph (d) of this section.

(f) Examples. The provisions of this section are illustrated by the following examples:

Example 1. Transfer to spouse. In Year 1, CE, a covered expatriate domiciled in Country F, a foreign country with which the United States does not have a gift tax treaty, gives \$300,000 cash to his wife, W, a U.S. resident and citizen of Country F. Under paragraph (c)(4) of this section, the \$100,000 exemption for a noncitizen spouse, as indexed for inflation in Year 1, is excluded from the definition of a covered gift under section 2801 because only that amount of the transfer would have qualified for the gift tax marital deduction if CE had been a U.S. citizen at the time of the gift. See sections 2801(e)(3) and 2523(i). The remaining amount (\$300,000 less the \$100,000 exemption for a noncitizen spouse as indexed for inflation), however, is a covered gift from CE to W. W must timely file Form 708, "U.S. Return of Gifts or Bequests from

Covered Expatriates,” and timely pay the tax. See §§28.6011-1(a), 28.6071-1(a), and 28.6151-1(a). W also must report the transfer on Form 3520, “Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts,” and any other required form. See §28.2801-6(c)(1).

Example 2. Reporting property as subject to estate tax. (i) CE, a covered expatriate domiciled in Country F, a foreign country with which the United States does not have an estate tax treaty, owns a condominium in the United States with son, S, a U.S. citizen. CE and S each contributed their actuarial share of the purchase price when purchasing the condominium and own it as joint tenants with rights of survivorship. On December 14, Year 1, CE dies. At the time of CE’s death, the fair market value of CE’s share of the condominium, \$250,000, is included in CE’s gross estate under sections 2040 and 2103.

(ii) On September 14 of the following calendar year, Year 2, the executor of CE’s estate timely files a Form 4768, “Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes,” requesting a 6-month extension of time to file Form 706-NA, and a 1-year extension of time to pay the estate tax. The IRS grants both extensions but CE’s executor fails to file the Form 706-NA until after March 14 of the calendar year immediately following Year 2.

(iii) S learns that the executor of CE’s estate did not timely file Form 706-NA. Because CE is a covered expatriate, S received a covered bequest as defined under §28.2801-2(f) and paragraph (b) of this section. S must timely file Form 708 and pay the section 2801 tax. See §§28.6011-1(a), 28.6071-1(a), and 28.6151-1(a). S also must file Form 3520 to report a large gift or bequest from a foreign person, and any other required form. See §28.2801-6(c)(1).

Example 3. Covered gift in trust with grant of general power of appointment over trust property. (i) On October 20, Year 1, CE, a covered expatriate domiciled in Country F, a foreign country with which the United States does not have a gift tax treaty, transfers \$500,000 in cash from an account in Country F to an irrevocable foreign trust created on that same date. Under section 2511(a), no gift tax is imposed on the transfer and thus, CE is not required to file a U.S. gift tax return. Under the terms of the foreign trust, A, CE’s child and a U.S. resident, and Q, A’s child and a U.S. citizen, may receive discretionary distributions of income and principal during life. At A’s death, the assets remaining in the foreign trust will be distributed to B, CE’s other U.S. resident child, or if B is not living at the time of A’s death, then to CE’s then-living issue, per stirpes. The terms of the foreign trust also allow A to appoint trust principal and/or income to A, A’s estate, A’s creditors, the creditors of A’s estate, or A’s issue at any time. On March 5, Year 2, A exercises this power to appoint and causes the trustee to distribute \$100,000 to Q.

(ii) On October 20, Year 1, the irrevocable foreign trust receives a covered gift for purposes of section 2801, but no section 2801 tax is imposed at that time. On March 5, Year 2, when Q receives \$100,000 from the irrevocable foreign trust pursuant to the

exercise of A's power of appointment, Q has received a distribution attributable to a covered gift and section 2801 tax is imposed on Q as of the date of the distribution. See §28.2801-4(d). Q must timely file Form 708 to report the covered gift from a foreign person (specifically, from CE). See section 6039F(a) and §§28.6011-1(a), 28.6071-1(a), and 28.6151-1(a). Under section 2501, A makes a taxable gift to Q of \$100,000 when A exercises the general power of appointment for Q's benefit. See section 2514(b). Accordingly, A must report A's \$100,000 gift to Q on a timely filed Form 709. See section 6019. Because A is considered the transferor of the \$100,000 for gift and GST tax purposes, the distribution to Q is not a generation-skipping transfer under chapter 13. See §26.2652-1(a)(1). Furthermore, because the \$100,000 is being distributed from a foreign trust, Q must report the gift on a Form 3520 as a distribution from a foreign trust. See §28.2801-6(c)(2).

**Example 4. Lapse of power of appointment held by covered expatriate.** (i) A, a U.S. citizen, creates an irrevocable domestic trust for the benefit of A's issue, CE, and CE's children. CE is a covered expatriate, but CE's children are U.S. citizens. CE has the right to withdraw \$5,000 in each year in which A makes a contribution to the trust, but the withdrawal right lapses 30 days after the date of the contribution. In Year 1, A funds the trust, but CE fails to exercise CE's right to withdraw \$5,000 within 30 days of the contribution. The \$5,000 lapse is not considered to be a release of the power, so it is neither a gift for U.S. gift tax purposes, nor a covered gift for purposes of section 2801 under paragraph (e)(1) of this section.

(g) **Effective/applicability date.** This section applies on and after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Once these regulations have been published as final regulations in the **Federal Register**, taxpayers may rely upon the final rules of this part for the period beginning June 17, 2008, and ending on the date preceding the date these regulations are published as final regulations in the **Federal Register**.

**§28.2801-4 Liability for and payment of tax on covered gifts and covered bequests; computation of tax.**

(a) **Liability for tax--(1) U.S. citizen or resident.** A U.S. citizen or resident who receives a covered gift or covered bequest is liable for payment of the section 2801 tax.

(2) Domestic trust--(i) In general. A domestic trust that receives a covered gift or covered bequest is treated as a U.S. citizen and is liable for payment of the section 2801 tax. See section 2801(e)(4)(A)(i) and §28.2801-2(b).

(ii) Generation-skipping transfer tax. A trust's payment of the section 2801 tax does not result in a taxable distribution under section 2621 to any trust beneficiary for purposes of the generation-skipping transfer tax to the extent that the trust, rather than the beneficiary, is liable for the section 2801 tax.

(iii) Charitable remainder trust. A domestic trust qualifying as a charitable remainder trust (as that term is defined in §1.664-1(a)(1)(iii)(a)) is subject to section 2801 when it receives a covered gift or covered bequest. Section 2801(e)(3) excepts from the definition of covered gift and covered bequest property with respect to which a deduction under section 2522 or section 2055, respectively, would have been allowed if the covered expatriate had been a U.S. citizen or resident at the time of the transfer. See §28.2801-3(c)(3). As a result, the charitable remainder interest's share of each transfer to the charitable remainder trust is not a covered gift or covered bequest. To compute the amount of covered gifts and covered bequests taxable to the charitable remainder trust for a calendar year, the charitable remainder trust will (A) calculate, in accordance with the regulations under section 664 and as of the date of the trust's receipt of the contribution, the value of the remainder interest in each contribution received in such calendar year that would have been a covered gift or covered bequest without regard to section 2801(e)(3), (B) subtract the remainder interest in each such contribution from the amount of that contribution to compute the annuity or unitrust (income) interest in that contribution, and (C) add the total of such



income interests, each of which is the portion of the contribution that constitutes a covered gift or covered bequest to the trust. The charitable remainder trust then computes its section 2801 tax in accordance with paragraph (b) of this section.

(iv) Migrated foreign trust. A foreign trust (other than one electing to be treated as a domestic trust under §28.2801-5(d)) that has previously received a covered gift or covered bequest and that subsequently becomes a domestic trust as defined under section 7701(a)(30)(E) (migrated foreign trust), must file a timely Form 708, "U.S. Return of Gifts or Bequests from Covered Expatriates," for the taxable year in which the trust becomes a domestic trust. The section 2801 tax, if any, must be paid by the due date of that Form 708. On that Form 708, the section 2801 tax is calculated in the same manner as if such trust was making an election under §28.2801-5(d) to be treated as a domestic trust solely for purposes of the section 2801 tax. Accordingly, the trustee must report and pay the section 2801 tax on all covered gifts and covered bequests received by the trust during the year in which the trust becomes a domestic trust, as well as on the portion of the trust's value at the end of the year preceding the year in which the trust becomes a domestic trust that is attributable to all prior covered gifts and covered bequests. Because the migrated foreign trust will be treated solely for purposes of section 2801 as a domestic trust for the entire year during which it became a domestic trust, distributions made to U.S. citizens or residents during that year but before the date on which the trust became a domestic trust will not be subject to section 2801.

(3) Foreign trust--(i) In general. A foreign trust that receives a covered gift or covered bequest is not liable for payment of the section 2801 tax unless the trust makes an election to be treated as a domestic trust solely for purposes of section 2801 as

provided in §28.2801-5(d). Absent such an election, each U.S. recipient is liable for payment of the section 2801 tax on that person's receipt, either directly or indirectly, of a distribution from the foreign trust to the extent that the distribution is attributable to a covered gift or covered bequest made to the foreign trust. See §28.2801-5(b) and (c) regarding distributions from foreign trusts.

(ii) Income tax deduction. The U.S. recipient of a distribution from a foreign trust is allowed a deduction against income tax under section 164 in the calendar year in which the section 2801 tax is paid or accrued. The amount of the deduction is equal to the portion of the section 2801 tax attributable to such distribution, but only to the extent that portion of the distribution is included in the U.S. recipient's gross income. The amount of the deduction allowed under section 164 is calculated as follows:

(A) First, the U.S. recipient must determine the total amount of distribution(s) from the foreign trust treated as covered gifts and covered bequests received by that U.S. recipient during the calendar year to which the section 2801 tax payment relates.

(B) Second, of the amount determined in paragraph (a)(3)(ii)(A) of this section, the U.S. recipient must determine the amount that also is includable in the U.S. recipient's gross income for that calendar year. For purposes of this paragraph (a)(3)(ii)(B), distributions from foreign trusts includable in the U.S. recipient's gross income are deemed first to consist of the portion of those distributions, if any, that are attributable to covered gifts and covered bequests.

(C) Finally, the U.S. recipient must determine the portion of the section 2801 tax paid for that calendar year that is attributable to the amount determined in paragraph (a)(3)(ii)(B) of this section, the covered gifts and covered bequests received from the

foreign trust that are also included in the U.S. recipient's gross income. This amount is the allowable deduction. Thus, for a calendar year taxpayer, the deduction is determined by multiplying the section 2801 tax paid during the calendar year by the ratio of the amount determined in paragraph (a)(3)(ii)(B) of this section to the total covered gifts and covered bequests received by the U.S. recipient during the calendar year to which that tax payment relates (that is, 2801 tax liability x [foreign trust distributions attributable to covered gifts and covered bequests that are also included in gross income / total covered gifts or covered bequests received]).

(b) Computation of tax--(1) In general. The section 2801 tax is computed by multiplying the net covered gifts and covered bequests (as defined in paragraph (b)(2) of this section) received by a U.S. recipient during the calendar year by the greater of--

(i) The highest rate of estate tax under section 2001(c) in effect for that calendar year; or

(ii) The highest rate of gift tax under section 2502(a) in effect for that calendar year. See paragraph (f) of this section, Example 1.

(2) Net covered gifts and covered bequests. The net covered gifts and covered bequests received by a U.S. recipient during the calendar year is the total value of all covered gifts and covered bequests received by that U.S. recipient during the calendar year, less 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.

(c) Value of covered gift or covered bequest. The value of a covered gift or covered bequest is the fair market value of the property as of the date of its receipt by the U.S. recipient. See paragraph (d) of this section regarding the determination of the

date of receipt. As in the case of chapters 11 and 12, the fair market value of a covered gift or covered bequest is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a covered gift is determined in accordance with the federal gift tax valuation principles of section 2512 and chapter 14 and the corresponding regulations. The fair market value of a covered bequest is determined by applying the federal estate tax valuation principles of section 2031 and chapter 14 and the corresponding regulations, but without regard to sections 2032 and 2032A.

(d) Date of receipt--(1) In general. The section 2801 tax is imposed upon the receipt of a covered gift or covered bequest by a U.S. recipient.

(2) Covered gift. The date of receipt of a covered gift is the same as the date of the gift for purposes of chapter 12 as if the covered expatriate had been a U.S. citizen at the time of the transfer. Thus, for a gift of stock, if the covered expatriate delivers a properly endorsed stock certificate to the U.S. recipient, the date of delivery is the date of receipt for purposes of this section. Alternatively, if the covered expatriate delivers the stock certificate to the issuing corporation or its transfer agent in order to transfer title to the U.S. recipient, the date of receipt is the date the stock is transferred on the books of the corporation. For a transfer of assets by a covered expatriate to a domestic revocable trust, the trust receives the transfer on the date the covered expatriate relinquishes the right to revoke the trust. If, before the donor's relinquishment of the right to revoke the trust, the revocable trust distributes property to a U.S. citizen or resident not in discharge of a support or other obligation of the donor, then the U.S.

recipient receives a covered gift on the date of that distribution. For an asset subject to a claim of right of another involving a bona fide dispute, the date of receipt is the date on which such claim is extinguished.

(3) Covered bequest. The date of receipt of a covered bequest is the date of distribution from the estate or the decedent's revocable trust rather than the date of death of the covered expatriate. However, the date of receipt is the date of death for property passing on the death of the covered expatriate by operation of law, or by beneficiary designation or other contractual agreement. Notwithstanding the previous sentences, for an asset subject to a claim of right of another involving a bona fide dispute, the date of receipt is the date on which such claim is extinguished.

(4) Foreign trusts. The date of receipt by a U.S. citizen or resident of property from a foreign trust that has not elected to be treated as a domestic trust under §28.2801-5(d) is the date of its distribution from the foreign trust.

(5) Powers of appointment--(i) Covered expatriate as holder of power. In the case of the exercise, release, or lapse of a power of appointment held by a covered expatriate that is a covered gift pursuant to §28.2801-3(e)(1), the date of receipt is the date of the exercise, release, or lapse of the power. In the case of the exercise, release, or lapse of a power of appointment held by a covered expatriate that is a covered bequest pursuant to §28.2801-3(e)(1), the date of receipt is (A) the date the property subject to the power is distributed from the decedent's estate or revocable trust when the power of appointment is over property in such estate or trust, or (B) the date of the covered expatriate's death when the power of appointment is over property

passing on the covered expatriate's death by operation of law, by beneficiary designation, or by other contractual agreement.

(ii) Covered expatriate as grantor of power. The date of receipt of property subject to a general power of appointment granted by a covered expatriate to a U.S. citizen or resident over property not transferred in trust that constitutes a covered gift or covered bequest pursuant to §28.2801-3(e)(2) is the first date on which both the power is exercisable by the U.S. citizen or resident and the property subject to the general power has been irrevocably transferred by the covered expatriate. The date of receipt of property subject to a general power of appointment over property in a domestic trust or an electing foreign trust is determined in accordance with paragraphs (d)(2) and (d)(3) of this section, and over property in a non-electing foreign trust is determined in accordance with paragraph (d)(4) of this section. See §28.2801-3(d) for the rule applying to covered gifts and covered bequests made in trust.

(6) Indirect receipts. The date of receipt by a U.S. citizen or resident of a covered gift or covered bequest received indirectly from a covered expatriate is the date of its receipt, as determined under paragraph (d)(2) or (d)(3) of this section, by the U.S. citizen or resident who is the first recipient of that property from the covered expatriate to be subject to section 2801 with regard to that property. For example, the date of receipt of property (i) subject to a non-general power of appointment over property not held in trust given by a covered expatriate to a foreign person (other than another covered expatriate) is the date that property is received by the U.S. citizen or resident in whose favor the power was exercised, and (ii) received through one or more entities not

subject to section 2801 is the date of its receipt by the U.S. citizen or resident from a conduit entity.

(e) Reduction of tax for foreign estate or gift tax paid. The section 2801 tax is reduced by the amount of any gift or estate tax paid to a foreign country with respect to the covered gift or covered bequest. For this purpose, the term foreign country includes possessions and political subdivisions of foreign states. However, no reduction is allowable for interest and penalties paid in connection with those foreign taxes. To claim the reduction of section 2801 tax, the U.S. recipient must attach to the Form 708 a copy of the foreign estate or gift tax return and a copy of the receipt or cancelled check for payment of the foreign estate or gift tax. The U.S. recipient also must report, on an attachment to the Form 708:

(1) The amount of foreign estate or gift tax paid with respect to each covered gift or covered bequest and the amount and date of each payment thereof;

(2) A description and the value of the property with respect to which such taxes were imposed;

(3) Whether any refund of part or all of the foreign estate or gift tax has been or will be claimed or allowed, and the amount; and

(4) All other information necessary for the verification and computation of the amount of the reduction of section 2801 tax.

(f) Examples. The provisions of this section are illustrated by the following examples.

Example 1. Computation of tax. In Year 1, A, a U.S. citizen, receives a \$50,000 covered gift from B and an \$80,000 covered bequest from C. Both B and C are covered expatriates. In Year 1, the highest estate and gift tax rate is 40 percent and the section 2801(c) amount is \$14,000. A's section 2801 tax for Year 1 is computed by

multiplying A's net covered gifts and covered bequests by 40 percent. A's net covered gifts and covered bequests for Year 1 are \$116,000, which is determined by reducing A's total covered gifts and covered bequests received during Year 1, \$130,000 (\$50,000 + \$80,000), by the section 2801(c) amount of \$14,000. A's section 2801 tax liability is then reduced by any foreign estate or gift tax paid under paragraph (e) of this section. Assuming A, B, and C paid no foreign estate or gift tax on the transfers, A's section 2801 tax liability for Year 1 is \$46,400 ( $\$116,000 \times 0.4$ ).

Example 2. Deduction of section 2801 tax for income tax purposes. In Year 1, B receives a covered bequest of \$25,000. Also in Year 1, B receives an aggregate \$500,000 of distributions from a non-electing foreign trust of which \$100,000 was attributable to a covered gift. In Year 1, the highest estate and gift tax rate is 40 percent and the section 2801(c) amount is \$14,000. Based on information provided by the trustee of the foreign trust, B includes \$50,000 of the aggregate distributions from the foreign trust in B's gross income for Year 1. Under paragraph (a)(3)(ii) of this section, B (a cash basis taxpayer) is entitled to an income tax deduction under section 164 for the calendar year in which the section 2801 tax is paid. In Year 2, B timely reports the distributions from the foreign trust and pays \$44,400 in section 2801 tax ( $(\$125,000 - \$14,000) \times 0.4$ ). In Year 2, B is entitled to an income tax deduction because B paid the section 2801 tax in Year 2 on the Year 1 covered gift and covered bequest. B's Year 2 income tax deduction is computed as follows:

(i) \$100,000 of B's total covered gifts and covered bequests of \$125,000 received in Year 1 consisted of the portion of the distributions from the foreign trust attributable to covered gifts and covered bequests received by the trust. See paragraph (a)(3)(ii)(A) of this section.

(ii) \$50,000 of the \$500,000 of trust distributions were includable in B's gross income for Year 1. This amount is deemed to consist first of distributions subject to the section 2801 tax (\$100,000). Thus, the entire amount included in B's gross income (\$50,000) also is subject to the section 2801 tax, and is used in the numerator to determine the income tax deduction available to B. See paragraph (a)(3)(ii)(B) of this section.

(iii) The portion of B's section 2801 tax liability attributable to distributions from a foreign trust is \$17,760 ( $\$44,400 \times (\$50,000/\$125,000)$ ). Therefore, B's deduction under section 164 is \$17,760. See paragraph (a)(3)(ii)(C) of this section.

Example 3. Date of receipt; bona fide claim. On October 10, Year 1, CE, a covered expatriate, died testate as a resident of Country F, a foreign country with which the United States does not have an estate tax treaty. CE designated his son, S, as the beneficiary of CE's retirement account. S is a U.S. citizen. CE's wife, W, who is a citizen and resident of Country F, elects to take her elective share of CE's estate under local law. S contests whether the retirement account is property subject to the elective share. S and W agree to settle their respective claims by dividing CE's assets equally between them. On December 15 of Year 2, Country F's court enters an order accepting



the terms of the settlement agreement and dismissing the case. Under paragraph (d)(3) of this section, S received a covered bequest of one-half of CE's retirement account on December 15, Year 2, when W's claim of right was extinguished.

(g) Effective/applicability date. This section applies on and after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Once these regulations have been published as final regulations in the **Federal Register**, taxpayers may rely upon the final rules of this part for the period beginning June 17, 2008, and ending on the date preceding the date these regulations are published as final regulations in the **Federal Register**.

#### **§28.2801-5 Foreign trusts.**

(a) In general. The section 2801 tax is imposed on a U.S. 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 covered bequests made to that foreign trust. See paragraph (d) of this section regarding a foreign trust's election to be treated as a domestic trust for purposes of section 2801.

(b) Distribution defined. For purposes of determining whether a U.S. recipient has received a distribution from a foreign trust, the term distribution means any direct, indirect, or constructive transfer from a foreign trust. This determination is made without regard to whether any portion of the trust is treated as owned by the U.S. recipient or any other person under subpart E of part I, subchapter J, chapter 1 of the Code (pertaining to grantors and others treated as substantial owners) and without regard to whether the U.S. recipient of the transfer is designated as a beneficiary by the terms of the trust. For purposes of section 2801, the term distribution also includes each disbursement from a foreign trust pursuant to the exercise, release, or lapse of a power

of appointment, whether or not a general power. In addition to the reporting requirements under this section, see section 6048(c) regarding the information reporting requirement for U.S. persons receiving a distribution or deemed distribution from a foreign trust during the year.

(c) Amount of distribution attributable to covered gift or covered bequest--

(1) Section 2801 ratio--(i) In general. A foreign trust may have received covered gifts and covered bequests as well as contributions that were not covered gifts or covered bequests. Under such circumstances, the fair market value of the foreign trust at any time consists in part of a portion of the trust attributable to the covered gifts and covered bequests it has received (covered portion) and in part of a portion of the trust attributable to other contributions (non-covered portion). The covered portion of the trust includes the ratable portion of appreciation and income that has accrued on the foreign trust's assets from the date of the contribution of the covered gifts and covered bequests to the foreign trust. For purposes of section 2801, the amount of each distribution from the foreign trust, whether made from the income or principal of the trust, that is considered attributable to the foreign trust's covered gifts and covered bequests is determined on a proportional basis, by reference to the section 2801 ratio (as described in paragraph (c)(1)(ii) of this section), and not by the identification or tracing of particular trust assets. Specifically, this portion of each distribution is determined by multiplying the distributed amount by the percentage of the trust that consists of its covered portion immediately prior to that distribution (section 2801 ratio). Thus, for example, the section 2801 ratio of a foreign trust whose assets are comprised exclusively of covered gifts or covered bequests and the income and appreciation

thereon, would be 1 and the full amount of each distribution from that foreign trust to a U.S. citizen or resident would be subject to section 2801.

(ii) Computation. The section 2801 ratio, which must be redetermined after each contribution to the foreign trust, is computed by using the following fraction:

$$\text{Section 2801 ratio} = \frac{(X + Y)}{Z}$$

where,

X = The value of the trust attributable to covered gifts and covered bequests, if any, immediately before the contribution (pre-contribution value); this value is determined by multiplying the fair market value of the trust assets immediately prior to the contribution by the section 2801 ratio in effect immediately prior to the current contribution. This amount will be zero for all years prior to the year in which the foreign trust receives its first covered gift or covered bequest;

Y = The portion, if any, of the fair market value of the current contribution that constitutes a covered gift or covered bequest; and

Z = The fair market value of the trust immediately after the current contribution.

See paragraph (e) of this section, Example 1, for an illustration of this computation.

(2) Effect of reported transfer and tax payment. Once a section 2801 tax has been timely paid on property that thereafter remains in a foreign trust, that property is no longer considered to be, or to be attributable to, a covered gift or covered bequest to the foreign trust for purposes of the computation described in paragraph (c)(1)(ii) of this section. For purposes of the prior sentence, a section 2801 tax is deemed to have been timely paid on amounts for which no section 2801 tax was due as long as those

amounts were reported as a covered gift or covered bequest on a timely filed Form 708, “U.S. Return of Gifts or Bequests from Covered Expatriates.”

(3) Inadequate information to calculate section 2801 ratio. If the trustee of the foreign trust does not have sufficient books and records to calculate the section 2801 ratio, or if the U.S. recipient is unable to obtain the necessary information with regard to the foreign trust, the U.S. recipient must proceed upon the assumption that the entire distribution for purposes of section 2801 is attributable to a covered gift or covered bequest.

(d) Foreign trust treated as domestic trust--(1) Election required. To be considered an electing foreign trust, so that the foreign trust is treated as a domestic trust solely for purposes of the section 2801 tax, a valid election is required.

(2) Effect of election. (i) A valid election subjects the electing foreign trust to the section 2801 tax on (A) all covered gifts and covered bequests received by the foreign trust during that calendar year, (B) the portion of the trust attributable to covered gifts and covered bequests received by the trust in prior years, as determined in paragraph (d)(3)(iii) of this section, and (C) all covered gifts and covered bequests received by the foreign trust during calendar years subsequent to the first year in which the election is effective, unless and until the election is terminated. To the extent that covered gifts and covered bequests are subject to the section 2801 tax under the prior sentence, those trust receipts are no longer treated as a covered gift or covered bequest for purposes of determining the portion of the trust attributable to covered gifts and covered bequests. Therefore, upon making a valid election, the foreign trust’s section 2801 ratio described in paragraph (c)(1)(ii) of this section will be zero until the

effective date of any termination of the election and the subsequent receipt of any covered gift or covered bequest, and a distribution made from the foreign trust while this election is in effect is not taxable under section 2801 to the recipient trust beneficiary.

(ii) This election has no effect on any distribution from the foreign trust that was made to a U.S. recipient in a calendar year prior to the calendar year for which the election is made. Thus, even after a valid election is made, a distribution to a U.S. recipient in a calendar year prior to the calendar year for which the election is made that was attributable to one or more covered gifts or covered bequests continues to be a distribution attributable to one or more covered gifts or covered bequests and the section 2801 ratio in place at the time of the distribution continues to apply to that distribution. Furthermore, an election under this section does not relieve the U.S. recipient from the information reporting requirements of section 6048(c).

(3) Time and manner of making the election--(i) When to make the election. The election is made on a timely filed Form 708 for the calendar year for which the foreign trust seeks to subject itself to the section 2801 tax as described in paragraph (d)(2)(i) of this section. The election may be made for a calendar year whether or not the foreign trust received a covered gift or covered bequest during that calendar year. See §28.6071-1.

(ii) Requirements for a valid election. To make a valid election to be treated as a domestic trust for purposes of section 2801, the electing foreign trust must timely file a Form 708 and must, on such form--

(A) Make the election, timely pay the section 2801 tax, if any, as determined under paragraph (d)(3)(iii) of this section, and include a computation illustrating how the

trustee of the electing foreign trust calculated both the section 2801 ratio described in paragraph (c)(1)(ii) of this section and the section 2801 tax;

(B) Designate and authorize a U.S. agent as provided in paragraph (d)(3)(iv) of this section;

(C) Agree to file Form 708 annually;

(D) List the amount and year of all prior distributions attributable to covered gifts and covered bequests made to a U.S. recipient and provide the name, address, and taxpayer identification number of each U.S. recipient; and

(E) Notify each permissible distributee that the trustee is making the election under this paragraph (d) and provide to the IRS a list of the name, address, and taxpayer identification number of each permissible distributee. For this purpose, a permissible distributee is any U.S. citizen or resident who:

(1) Currently may or must receive distributions from the trust, whether of income or principal;

(2) May withdraw income or principal from the trust, regardless of whether the right arises or lapses upon the occurrence of a future event; or

(3) Would have been described in paragraph (d)(3)(ii)(E)(1) of this section if either the interests of all persons described in (d)(3)(ii)(E)(1) or (E)(2) had just terminated or the trust had just terminated.

(iii) Section 2801 tax payable with the election. To make a valid election to be treated as a domestic trust for purposes of section 2801, the electing foreign trust must timely pay the section 2801 tax on all covered gifts and covered bequests received by the electing foreign trust in the calendar year for which the Form 708 is being filed. In

some cases, an electing foreign trust may have received covered gifts or covered bequests in prior calendar years during which no such election was in effect. In those cases, the trustee must also, at the same time, report and pay the tax on the fair market value, determined as of the last day of the calendar year immediately preceding the year for which the Form 708 is being filed, of the portion of the trust attributable to covered gifts and covered bequests received by such trust in prior calendar years (except as provided in paragraph (d)(6)(iii) of this section with regard to an imperfect election). That portion is determined by multiplying the fair market value of the trust, as of the December 31 immediately preceding the year for which the election is made, by the section 2801 ratio in effect on that date, as calculated under paragraph (c)(1)(ii) of this section. If the trustee does not have sufficient books and records to determine what amount of the corpus and undistributed income is attributable to undistributed prior covered gifts and covered bequests, then that amount is deemed to be the entire fair market value of the trust as of that December 31. See paragraph (c)(3) of this section.

(iv) Designation of U.S. agent--(A) In general. The trustee of an electing foreign trust must designate and authorize a U.S. person, as defined in section 7701(a)(30), to act as an agent for the trust solely for purposes of section 2801. By designating a U.S. agent, the trustee of the foreign trust agrees to provide the agent with all information necessary to comply with any information request or summons issued by the Secretary. Such information may include, without limitation, copies of the books and records of the trust, financial statements, and appraisals of trust property.

(B) Role of designated agent. Acting as an agent for the trust for purposes of section 2801 includes serving as the electing foreign trust's agent for purposes of

section 7602 (“Examination of books and witnesses”), section 7603 (“Service of summons”), and section 7604 (“Enforcement of summons”) with respect to--

(1) Any request by the Secretary to examine records or produce testimony related to the proper identification or treatment of covered gifts or covered bequests contributed to the electing foreign trust and distributions attributable to such contributions; and

(2) Any summons by the Secretary for records or testimony related to the proper identification or treatment of covered gifts or covered bequests contributed to the electing foreign trust and distributions attributable to such contributions.

(C) Effect of appointment of U.S. agent. An electing foreign trust that appoints such an agent is not considered to have an office or a permanent establishment in the United States, or to be engaged in a trade or business in the United States, solely because of the agent’s activities as an agent pursuant to this section.

(4) Annual certification or filing requirement. The trustee of an electing foreign trust must file a timely Form 708 annually either to report and pay the section 2801 tax on all covered gifts and covered bequests received by the trust during the calendar year, or to certify that the electing foreign trust did not receive any covered gifts or covered bequests during the calendar year.

(5) Duration of status as electing foreign trust--(i) In general. A valid election (one that meets all of the requirements of paragraph (d)(3) of this section) is effective as of January 1 of the calendar year for which the Form 708 on which the election is made is filed. The election, once made, applies for all calendar years until the election is terminated as described in paragraph (d)(5)(ii) of this section.



(ii) Termination. An election to be treated as a domestic trust for purposes of section 2801 is terminated either by the failure of the foreign trust to make the annual filing, together with any payment of the section 2801 tax, as required by paragraph (d)(4) of this section, or by the failure of the foreign trust to timely pay any additional amount of section 2801 tax (in accordance with the requirements of paragraph (d)(6)(ii) of this section) with respect to recalculations described in paragraph (d)(6) of this section (a failure that results in an imperfect election). A termination, if any, is effective as of the beginning of the calendar year for which the trustee fails to make the annual filing required by paragraph (d)(4) of this section or for which the trustee fails to pay any of the amounts described in this paragraph (d)(5)(ii). In the case of a terminated election, the trustee should notify promptly each permissible distributee, as defined in paragraph (d)(3)(ii)(E) of this section, that the foreign trust's election was terminated as of January 1 of the applicable year (with the actual year of the termination being set forth in the notice), and that each U.S. recipient of a distribution made from the foreign trust on and after that date is subject to the section 2801 tax on the portion of each such distribution that is attributable to covered gifts and covered bequests. See paragraph (d)(6)(iii)(B) of this section for an additional notification requirement in the case of an imperfect election.

(iii) Subsequent elections. If a foreign trust's election is terminated under paragraph (d)(5)(ii) of this section, the foreign trust is not prohibited from making another election in a future year, subject to the requirements of paragraph (d)(3) of this section.

(6) Dispute as to amount of section 2801 tax owed by electing foreign trust--

(i) Procedure. If the Commissioner disputes the value of a covered gift or covered bequest, or otherwise challenges the computation of the section 2801 tax, that is reported on the electing foreign trust's timely filed Form 708 for any calendar year, the Commissioner will issue a letter (but not a notice of deficiency as defined in section 6212) to the trustee of the electing foreign trust and the appointed U.S. agent that details the disputed information and the proper amount of section 2801 tax as recalculated. The foreign trust must pay the additional amount of section 2801 tax including interest and penalties, if any, in accordance with the requirements of paragraph (d)(6)(ii) of this section, on or before the due date specified in the letter to maintain its election.

(ii) Effect of timely paying the additional section 2801 tax amount. If the trustee of the foreign trust timely pays the additional amount(s) specified in the Commissioner's letter, or such other amount as agreed to by the Commissioner, and enters into a closing agreement with the IRS as described in section 7121, then the foreign trust's election to be treated as a domestic trust under paragraph (d) of this section remains in effect. In addition, in the absence of fraud, malfeasance, or misrepresentation of a material fact, that payment, in conjunction with the closing agreement, will be deemed to render any determination of value to which the closing agreement applies as final and binding on both the IRS and the foreign trust. Thus, subsequently, the IRS will not be able to challenge the section 2801 tax due from either the foreign trust or any of its beneficiaries who are U.S. citizens or residents for the year for which that Form 708 was filed by the foreign trust, except with respect to any covered gifts or covered bequests

not reported on that return, and neither the foreign trust nor any of its beneficiaries will be able to file a claim for refund with respect to section 2801 tax paid by the foreign trust on the covered gifts and covered bequests reported on that Form 708.

(iii) Effect of failing to timely pay the additional section 2801 tax amount (imperfect election)--(A) In general. If the foreign trust fails to timely pay the additional amount of section 2801 tax with interest and penalties, if any, claimed to be due by the IRS in accordance with the requirements of paragraph (d)(6)(ii) of this section, then the foreign trust's valid election is terminated and becomes an imperfect election. The foreign trust's election is terminated, and is converted into an imperfect election, retroactively as of the first day of the calendar year for which was filed the Form 708 with respect to which the additional amount of section 2801 tax is claimed to be due by the IRS. Thus, the value the foreign trust has reported on the Form 708 and on which the trust has paid the section 2801 tax is no longer considered to be attributable to covered gifts or covered bequests when computing the section 2801 ratio described in paragraph (c)(1)(ii) of this section applicable to distributions made by the foreign trust to U.S. recipients during the calendar year for which the Form 708 was filed and thereafter. The U.S. recipients of distributions from the foreign trust, however, should take into consideration the additional value determined by the IRS, on which the foreign trust did not timely pay the section 2801 tax, when computing the section 2801 ratio to be applied to a distribution from the trust. See paragraph (c) of this section. Any disagreement with regard to that additional value will be an issue to be resolved as part of the review of that U.S. recipient's own Form 708 reporting a distribution.

(B) Notice to permissible beneficiaries. If the trustee of the foreign trust fails to remit the additional payment of the section 2801 tax including all interest and penalties, if any, in accordance with the requirements of paragraph (d)(6)(ii) of this section, by the due date stated in the IRS letter, the trustee should notify promptly each permissible distributee, as defined in paragraph (d)(3)(ii)(E) of this section, of the amount of additional value on which the foreign trust did not timely pay the section 2801 tax as determined by the IRS and that:

(1) The foreign trust's election was terminated as of January 1 of the applicable year (with the actual year of the termination being set forth in the notice); and

(2) Each U.S. recipient of a distribution made from the foreign trust on and after that termination date is subject to the section 2801 tax on the portion of each such distribution attributable to covered gifts and covered bequests.

(C) Reasonable cause. If a U.S. recipient received a distribution from such trust on or after January 1 of the year for which the election was terminated and the election became an imperfect election, provided the U.S. recipient files a Form 708 and pays the section 2801 tax within a reasonable period of time after being notified by the trustee of the foreign trust or otherwise becoming aware that a valid election was not in effect when the distribution was made, the U.S. recipient's failure to timely file and pay are due to reasonable cause and not willful neglect for purposes of section 6651. For this purpose, a reasonable period of time is not more than six months after the U.S. recipient is notified by the trustee or the U.S. recipient otherwise becomes aware that a valid election is not in effect.

(D) Interim period. If a foreign trust's valid election is terminated and becomes an imperfect election, there is a period of time (interim period) after the effective date of the termination of the election during which both the foreign trust and its U.S. beneficiaries are likely to continue to comply with section 2801 as it applies to an electing foreign trust with a valid election in place. The interim period begins on the effective date of the termination of the foreign trust's election that resulted in an imperfect election as described in paragraph (d)(6)(iii)(A) of this section, and ends on December 31 of the calendar year immediately preceding the calendar year in which the additional section 2801 tax claimed by the IRS is due. As under the rule in paragraph (d)(6)(iii)(A) of this section regarding imperfect elections, the covered gifts and covered bequests received by the foreign trust during this interim period, which the foreign trust has reported on its timely filed Form 708 and on which the foreign trust has timely paid the section 2801 tax, are no longer considered to be covered gifts and covered bequests for purposes of computing the section 2801 ratio described in paragraph (c)(1)(ii) of this section as it applies to distributions made by non-electing foreign trusts to their U.S. beneficiaries. In addition, each distribution made by the foreign trust to a U.S. citizen or resident during this interim period must be reported on that U.S. recipient's Form 708 by applying the section 2801 ratio to that distribution. Once the interim period has ended, the foreign trust has no election in place and the rules of section 2801(e)(4)(B)(i) will apply until the foreign trust subsequently (if ever) makes another valid election to be treated as a domestic trust for purposes of section 2801.

(7) No overpayment caused solely by virtue of defect in election. Any remittance of section 2801 tax made by a foreign trust electing to be treated as a domestic trust

does not become an overpayment solely by virtue of a defect in the election. Instead, if at some subsequent time the IRS determines that the election was not in fact a valid election, then the election shall be considered valid only with respect to the covered gifts or covered bequests on which the section 2801 tax was timely paid by the foreign trust and each covered gift and covered bequest on which the section 2801 tax has been timely paid is no longer treated as a covered gift or covered bequest for purposes of determining the portion of the foreign trust attributable to covered gifts and covered bequests. See paragraphs (d)(2)(i) and (d)(6)(iii) of this section.

(e) Examples. The provisions of this section are illustrated by the following examples.

Example 1. Computation of section 2801 ratio. A and B each contribute \$100,000 to a foreign trust. A (but not B) is a covered expatriate and A's contribution is a covered gift. The section 2801 ratio immediately after these two contributions is 0.50, computed as follows: the pre-contribution value of the trust (\$0) times the pre-contribution section 2801 ratio (-0-), plus the current covered gift (\$100,000), divided by the post-contribution fair market value of the trust (\$200,000). See §28.2801-5(c). Therefore, 50 percent of each distribution from the trust is subject to the section 2801 tax until the next contribution is made to the trust. If the trustee distributes \$40,000 to C, a U.S. citizen, before the trust receives any other contributions, then \$20,000 ( $\$40,000 \times 0.5$ ) is a covered gift to C.

Example 2. Computation of section 2801 ratio when multiple contributions are made to foreign trust. (i) In 2005, A, a U.S. citizen, established and funded an irrevocable foreign trust with \$200,000 and reported the transfer as a completed gift. On January 1 of each of the following three years (2006 through 2008), A contributed an additional \$100,000 to the foreign trust. A reported A's contributions to the foreign trust as completed gifts on timely filed Forms 709, for calendar years 2005 through 2008. On August 8, 2008, a date after the effective date of section 2801 (June 17, 2008), A expatriated and became a covered expatriate. On January 1 of a year after 2008 (Year X), A makes an additional \$100,000 contribution to the trust. The aggregate \$600,000 contributed to the trust by A, both before and after expatriation, are the only contributions to the trust. Each year, the trustee of the foreign trust provides beneficiary B, a U.S. citizen, with an accounting of the trust showing each receipt and disbursement of the trust during that year, including the date and amount of each contribution by A.

(ii) The fair market value of the trust was \$610,000 immediately prior to A's contribution to the trust on January 1, Year X. Therefore, upon the Year X contribution of A's first and only covered gift, the portion of the trust attributable to covered gifts and covered bequests (covered portion) changed from zero to 0.14 ( $[(\text{section 2801 ratio of } 0 \times \$610,000 \text{ fair market value pre-contribution}) + \text{the } \$100,000 \text{ covered gift}] / \$710,000 \text{ fair market value post-contribution}$ ). See paragraph (c) of this section.

(iii) In February of Year X, B received a distribution of \$225,000 from the foreign trust. Although A contributed a total of \$600,000 to the foreign trust, A contributed only \$100,000 while A was a covered expatriate. Under paragraph (c) of this section, the portion of the \$225,000 distribution from the foreign trust attributable to a covered gift is \$31,500 ( $\$225,000 \times 0.14$  (section 2801 ratio)) because the distribution is made proportionally from the covered and non-covered portions of the trust. See paragraph (c)(1) of this section. Accordingly, B received a covered gift of \$31,500.

(iv) Pursuant to the terms of the foreign trust, the trust made a terminating distribution on August 5, Year X, when B turned 35, and B received the balance of the appreciated trust, \$505,000. The portion of this distribution attributable to covered gifts and covered bequests is \$70,700 ( $\$505,000 \times 0.14$ ). Therefore, B has received covered gifts from the foreign trust during Year X in the total amount of \$102,200 ( $\$31,500 + \$70,700$ ).

Example 3. Termination of foreign trust election. The trustee of a foreign trust that received a covered gift makes a valid election to be treated as a domestic trust under §28.2801-5(d) for Year 1. However, the trustee fails to file timely the Form 708 for the next year, Year 2. The foreign trust election is terminated as of January 1, Year 2, under paragraph (d)(5)(ii) of this section. Thus, any distributions made to U.S. recipients during Year 1 have a section 2801 ratio of zero and are not subject to the section 2801 tax. However, any such distributions made during Year 2 are subject to the section 2801 tax to the extent the distributions are attributable to a covered gift or covered bequest received by the trust during Year 2. Unless the trustee makes a new election as described in paragraph (d)(5)(iii) of this section, beginning in Year 2, the foreign trust's section 2801 ratio must be recomputed each time the foreign trust receives a contribution.

Example 4. Imperfect election by foreign trust. (i) In Year 1, CE, a covered expatriate, gives a 20 percent limited partnership interest in a closely held business to a foreign trust created for the benefit of CE's child, A, who is a U.S. citizen. The limited partnership interest is a covered gift. The trustee of the foreign trust makes a valid election to have the trust treated as a domestic trust for purposes of section 2801, trustee timely files a Form 708, and timely pays the section 2801 tax on the reported fair market value of the covered gift (\$500,000). Later in Year 1, the trust makes a \$100,000 distribution to A.

(ii) In Year 2, CE contributes \$200,000 in cash to the foreign trust. The cash is a covered gift. The trustee of the foreign trust timely files a Form 708 reporting the

transfer and pays the section 2801 tax. The trust does not make a distribution to any beneficiary during Year 2. Late in Year 3, the IRS disputes the reported value of the partnership interest transferred in Year 1 and determines that the proper valuation on the date of the gift was \$800,000. In Year 3, the IRS issues a letter to the trustee of the foreign trust detailing its finding of the increased valuation and of the resulting additional section 2801 tax including accrued interest, if any, due on or before a later date in Year 3 specified in the letter. The foreign trust fails to pay the additional section 2801 tax liability on or before that due date.

(iii) Under paragraph (d)(6)(iii) of this section, the foreign trust's election for Year 1 is an imperfect election; although it timely filed its return reporting the transfer and paid the tax, it failed to timely pay the additional section 2801 tax when the IRS notified the trust of an additional amount of section 2801 tax claimed to be due. Accordingly, the foreign trust's election is deemed to have terminated as of January 1 of Year 1. In computing the foreign trust's section 2801 ratio upon the receipt of the covered gift in Year 1, the \$500,000 of value on which the section 2801 tax was timely paid is no longer deemed to be a covered gift. See paragraph (d)(6)(iii) of this section. When the trustee advises A of the letter from the IRS, A must file a late Form 708 reporting the portion of the Year 1 distribution attributable to covered gifts and covered bequests. Although A may owe section 2801 tax and interest, A will not owe any penalties under section 6651 as long as A files the Form 708 and pays the tax within a reasonable period of time after A receives notice of the termination of the election from the trustee of the foreign trust or otherwise becomes aware of the termination of the election. See paragraph (d)(6)(iii)(C) of this section.

(iv) When A files the Form 708, the IRS will verify whether A treated the \$300,000 undervaluation claimed by the IRS as a covered gift in computing the section 2801 ratio. As with any other item reported on that return, A has the burden to prove the value of the covered gift to the foreign trust, and the IRS may challenge that value. If A treats the \$300,000 as a covered gift to the trust, under paragraph (c)(1)(ii) of this section, the section 2801 ratio after the Year 1 contribution is  $0.375 (\$0 + (\$300,000)/\$800,000)$ . Thus, 37.5 percent of all distributions made to A from the foreign trust during Year 1 are subject to the section 2801 tax.

(v) The foreign trust's timely filing of the Form 708 for Year 2 and the timely payment of the section 2801 tax shown on that return is not a valid election under paragraph (d)(5)(iii) of this section because the trust did not timely pay the section 2801 tax on all covered gifts and covered bequests in prior years as required in paragraph (d)(3) of this section; that is, the tax on the additional \$300,000 of value of the Year 1 transfer. However, under paragraph (d)(6)(iii)(D) of this section, because the foreign trust timely filed and paid the section 2801 tax on the Year 2 covered gift of \$200,000, and the additional unpaid tax was not due until Year 3, the \$200,000 amount is no longer considered a covered gift for purposes of computing the section 2801 ratio.

Example 5. Subsequent election after termination of foreign trust election. The facts are the same as in Example 4. In Year 3, the foreign trust does not receive a



covered gift or covered bequest. However, the trustee decides that making another election to be treated as a domestic trust would be in the best interests of the trust's beneficiaries. Accordingly, by the due date for the Form 708 for Year 3, the trustee timely files the return and pays the section 2801 tax on the portion of the trust attributable to covered gifts and covered bequests. See paragraph (d)(5)(iii) of this section. The trustee calculates the portion of the trust attributable to covered gifts and covered bequests received by the trust in prior calendar years by multiplying the fair market value of the trust on December 31, Year 2, by the section 2801 ratio in effect on that date. See paragraph (d)(3)(iii) of this section. The foreign trust is an electing foreign trust in Year 3.

(f) Effective/applicability date. This section applies on and after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Once these regulations have been published as final regulations in the **Federal Register**, taxpayers may rely upon the final rules of this part for the period beginning June 17, 2008, and ending on the date preceding the date these regulations are published as final regulations in the **Federal Register**.

#### **§28.2801-6 Special rules and cross-references.**

(a) Determination of basis. For purposes of determining the U.S. recipient's basis in property received as a covered gift or covered bequest, see sections 1015 and 1014, respectively. However, section 1015(d) does not apply to increase the basis in a covered gift to reflect the tax paid under this section. For purposes of determining a U.S. recipient's basis in property received as a covered bequest from a decedent who died during 2010 and whose executor elected under section 301(c) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 not to have the estate tax provisions apply, see section 1022.

(b) Generation-skipping transfer tax. Transfers made by a nonresident not a citizen of the United States (NRA transferor) are subject to generation-skipping transfer (GST) tax only to the extent those transfers are subject to federal estate or gift tax as

defined in §26.2652-1(a)(2). In applying this rule, taxable distributions from a trust and taxable terminations are subject to the GST tax only to the extent the NRA transferor's contributions to the trust were subject to federal estate or gift tax as defined in §26.2652-1(a)(2). See §26.2663-2. 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 covered expatriate's failure to timely file and pay the section 2801 tax, if applicable.

(c) Information returns--(1) Gifts and bequests. Pursuant to section 6039F and the corresponding regulations, and to the extent provided in Notice 97-34, 1997-1 CB 422, and Form 3520, Part IV, each U.S. person (other than an organization described in section 501(c) and exempt from tax under section 501(a)) who treats an amount received from a foreign person (other than through a foreign trust) as a gift or bequest (including a covered gift or covered bequest) must report such gift or bequest on Part IV of Form 3520 if the value of the total of such gifts and bequests exceeds a certain threshold. A U.S. citizen or resident, as defined in §28.2801-2(b) but not including a foreign trust that elects to be treated as a domestic trust, is included within the definition of a U.S. person for purposes of section 6039F.

(2) Foreign trust distributions. Pursuant to section 6048(c) and the corresponding regulations, and to the extent provided in Notice 97-34 and Part III of Form 3520, U.S. persons must report each distribution received during the taxable year from a foreign trust on Part III of Form 3520. Under section 6677(a), a penalty of the greater of \$10,000 or 35 percent of the gross value of the distribution may be imposed on a U.S. person who fails to timely report the distribution. A U.S. citizen or resident as defined in

§28.2801-2(b), but not including a foreign trust that elects to be treated as a domestic trust, generally is required to report such a distribution under section 6048(c).

(3) Penalties and use of information. The filing of Form 706, Form 706-NA, Form 708, or Form 709 does not relieve a U.S. citizen or resident who is required to file Form 3520 from any penalties imposed under section 6677(a) for failure to comply with section 6048(c), or from any penalties imposed under section 6039F(c) for failure to comply with section 6039F(a). Pursuant to section 6039F(c)(1)(A), the Secretary may determine the tax consequences of the receipt of a purported foreign gift or bequest.

(d) Application of penalties--(1) Accuracy-related penalties on underpayments. The section 6662 accuracy-related penalty may be imposed upon any underpayment of tax attributable to--

(i) A substantial valuation understatement under section 6662(g) of a covered gift or covered bequest; or

(ii) A gross valuation misstatement under section 6662(h) of a covered gift or covered bequest.

(2) Penalty for substantial and gross valuation misstatements attributable to incorrect appraisals. The section 6695A penalty for substantial and gross valuation misstatements attributable to incorrect appraisals may be imposed upon any person who prepares an appraisal of the value of a covered gift or covered bequest.

(3) Penalty for failure to file a return and to pay tax. See section 6651 for the application of a penalty for the failure to file Form 708, or the failure to pay the section 2801 tax.

(e) Effective/applicability date. This section applies on and after the date of

publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Once these regulations have been published as final regulations in the **Federal Register**, taxpayers may rely upon the final rules of this part for the period beginning June 17, 2008, and ending on the date preceding the date these regulations are published as final regulations in the **Federal Register**.

**§28.2801-7 Determining responsibility under section 2801.**

(a) Responsibility of recipients of gifts and bequests from expatriates. It is the responsibility of the taxpayer (in this case, the U.S. citizen or resident receiving a gift or bequest from an expatriate or a distribution from a foreign trust funded at least in part by an expatriate) to ascertain the taxpayer's obligations under section 2801, which includes making the determination of whether the transferor is a covered expatriate and whether the transfer is a covered gift or covered bequest.

(b) Disclosure of return and return information--(1) In general. In certain circumstances, the Internal Revenue Service (IRS) may be permitted, upon request of a U.S. citizen or resident in receipt of a gift or bequest from an expatriate, to disclose to the U.S. citizen or resident return or return information of the donor or decedent expatriate that may assist the U.S. citizen or resident in determining whether the donor or decedent was a covered expatriate and whether the transfer was a covered gift or covered bequest. The U.S. citizen or resident may not rely upon this information, however, if the U.S. citizen or resident knows, or has reason to know, that the information received from the IRS is incorrect. The circumstances under which such information may be disclosed to a U.S. citizen or resident, and the procedures for

requesting such information from the IRS, will be as provided by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b)).

(2) Rebuttable presumption. Unless a living donor expatriate authorizes the disclosure of his or her relevant return or return information to the U.S. citizen or resident receiving the gift, there is a rebuttable presumption that the donor is a covered expatriate and that the gift is a covered gift. A taxpayer who reasonably concludes that a gift or bequest is not subject to section 2801 may file a protective Form 708 in accordance with §28.6011-1(b) to start the period for the assessment of any section 2801 tax.

(c) Effective/applicability date. This section applies on and after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**. Once these regulations have been published as final regulations in the **Federal Register**, taxpayers may rely upon the final rules of this part for the period beginning June 17, 2008, and ending on the date preceding the date these regulations are published as final regulations in the **Federal Register**.

**§28.6001-1 Records required to be kept.**

(a) In general. Every U.S. recipient as defined in §28.2801-2(e) subject to taxation under chapter 15 of the Internal Revenue Code must keep, for the purpose of determining the total amount of covered gifts and covered bequests, such permanent books of account or records as are necessary to establish the amount of that person's aggregate covered gifts and covered bequests, and the other information required to be shown on Form 708, "United States Return of Tax for Gifts and Bequests from Covered Expatriates." All documents and vouchers used in preparing the Form 708 must be

retained by the person required to file the return so as to be available for inspection whenever required.

(b) Supplemental information. In order that the Internal Revenue Service (IRS) may determine the correct tax, the U.S. recipient as defined in §28.2801-2(e) must furnish such supplemental information as may be deemed necessary by the IRS. Therefore, the U.S. recipient must furnish, upon request, copies of all documents relating to the covered gift or covered bequest, appraisals of any items included in the aggregate amount of covered gifts and covered bequests, copies of balance sheets and other financial statements obtainable by that person relating to the value of stock or other property constituting the covered gift or covered bequest, and any other information obtainable by that person that may be necessary in the determination of the tax. See section 2801 and the corresponding regulations. For every policy of life insurance listed on the return, the U.S. recipient must procure a statement from the insurance company on Form 712 and file it with the IRS office where the return is filed. If specifically requested by the Commissioner, the insurance company must file this statement directly with the Commissioner.

**§28.6011-1 Returns.**

(a) Return required. The return of any tax to which this part 28 applies must be made on Form 708, “United States Return of Tax for Gifts and Bequests from Covered Expatriates,” according to the instructions applicable to the form. With respect to each covered gift and covered bequest received during the calendar year, the U.S. recipient as defined in §28.2801-2(e) must include on Form 708 the information set forth in §25.6019-4. The U.S. recipient must file Form 708 for each calendar year in which a

covered gift or covered bequest is received. The U.S. recipient who receives the covered gift or covered bequest during the calendar year is the person required to file the return. A U.S. recipient is not required to file such form, however, for a calendar year in which the total fair market value of all covered gifts and covered bequests received by that person during that calendar year is less than or equal to 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.

(b) Protective return. (i) A U.S. citizen or resident (as defined in §28.2801-2(b)) that receives a gift or bequest from an expatriate and reasonably concludes that the gift or bequest is not a covered gift or a covered bequest from a covered expatriate may file a protective Form 708 in order to start the period for assessment of tax. To be a protective Form 708, it must provide all of the information otherwise required on Form 708, along with an affidavit, signed under penalties of perjury, setting forth the information on which that U.S. citizen or resident has relied in concluding that the donor or decedent, as the case may be, was not a covered expatriate, or that the transfer was not a covered gift or a covered bequest, as well as that person's efforts to obtain other information that might be relevant to these determinations. If that U.S. citizen or resident has obtained information from the Internal Revenue Service (IRS) (as described in §28.2801-7(b)(1)), it must attach a copy of such information. The U.S. citizen or resident also must attach a copy of a completed Form 3520, Part III, for all trust distributions, or Part IV for all gifts and bequests, if applicable. If the return meets the requirements of this paragraph (b)(i), and if the IRS does not assess a section 2801 tax liability for that tax year within the limitations period for assessment stated in

section 6501, the IRS may not later assess a section 2801 tax with regard to any transfer reported on that Form 708.

(ii) A U.S. citizen or resident who receives a gift or bequest from an expatriate and who files a protective Form 708 meeting the requirements of paragraph (b)(i) of this section showing no tax due, absent fraud or other special factors, will not be subject to any additions to tax for late filing under section 6651(a)(1) or for late payment under section 6651(a)(2), even if the gift or bequest is determined to be a covered gift or covered bequest from a covered expatriate within the limitations period for assessment stated in section 6501. Notwithstanding the foregoing, however, if a U.S. citizen or resident knows, or has reason to know, that the information provided by the IRS or any other source is incorrect or incomplete, that U.S. citizen or resident may not rely on that information, and except as provided in the preceding paragraph (b)(i) of this section, may be subject to all of the generally applicable provisions governing assessment of tax, collection of tax, and penalties. See sections 6501, 6502, 6651 and 6662.

(c) Effective/applicability dates. This section applies on and after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.6060-1 Reporting requirements for tax return preparers.**

(a) In general. A person that employs one or more signing tax return preparers to prepare a return or claim for refund of any tax to which this part 28 applies, other than for the person, at any time during a return period, must satisfy the recordkeeping and inspection requirements in the manner stated in §1.6060-1 of this chapter.

(b) Effective/applicability date. This section applies to returns and claims for



refund filed on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.6071-1 Time for filing returns.**

(a) In general--(1) A U.S. recipient as defined in §28.2801-2(e) must file Form 708, "U.S. Return of Gifts or Bequests from Covered Expatriates," on or before the fifteenth day of the eighteenth calendar month following the close of the calendar year in which the covered gift or covered bequest was received. Notwithstanding the preceding sentence, the due date for a Form 708 reporting a covered bequest that is not received on the decedent's date of death under §28.2801-4(d)(3) is the later of--

(i) The fifteenth day of the eighteenth calendar month following the close of the calendar year in which the covered expatriate died; or

(ii) The fifteenth day of the sixth month of the calendar year following the close of the calendar year in which the covered bequest was received.

(2) If a U.S. recipient receives multiple covered gifts and covered bequests during the same calendar year, the rule in paragraph (a)(1) of this section may result in different due dates and the filing of multiple returns reporting the different transfers received during the same calendar year.

(b) Migrated foreign trust. The due date for a Form 708 for the year in which a foreign trust becomes a domestic trust is the fifteenth day of the sixth month of the calendar year following the close of the calendar year in which the foreign trust becomes a domestic trust.

(c) Certain returns by foreign trusts--(1) Election under §28.2801-5(d) for calendar year in which no covered gift or covered bequest received. A foreign trust

making an election to be treated as a domestic trust for purposes of section 2801 under §28.2801-5(d) for a calendar year in which the foreign trust received no covered gifts or covered bequests must file a Form 708 on or before the fifteenth day of the sixth month of the calendar year following the close of the calendar year for which the election is made.

(2) Certification to maintain election under §28.2801-5(d) for calendar year in which no covered gift or covered bequest received. An electing foreign trust filing a Form 708 to certify that the electing foreign trust did not receive any covered gifts or covered bequests during the calendar year must file the Form 708 on or before the fifteenth day of the sixth month of the calendar year following the close of that calendar year. See §28.2801-5(d)(4).

(d) Transition period. The Form 708 reporting covered gifts or covered bequests received on or after June 17, 2008, and before the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**, will be due within a reasonable period of time after the date of that publication as specified in the final regulations, but in no event before the due date of the first return required under the final regulations for covered gifts or covered bequests received after the final regulations are published.

(e) Effective/applicability dates. This section applies to each Form 708 filed on or after the date on which a Treasury decision is published adopting these rules as final regulations in the **Federal Register**.

**§28.6081-1 Automatic extension of time for filing returns reporting gifts and bequests from covered expatriates.**

(a) In general. A U.S. recipient as defined in §28.2801-2(e) may request an

extension of time to file a Form 708, “U.S. Return of Gifts or Bequests from Covered Expatriates,” by filing Form 7004, “Application for Automatic Extension of Time to file Certain Business Income Tax, Information, and Other Returns.” A U.S. recipient must include on Form 7004 an estimate of the amount of section 2801 tax liability and must file Form 7004 with the Internal Revenue Service office designated in the Form’s instructions (except as provided in §301.6091-1(b) of this chapter for hand-carried documents).

(b) Automatic extension. A U.S. recipient as defined in §28.2801-2(e) will be allowed an automatic six-month extension of time beyond the date prescribed in §28.6071-1 to file Form 708 if Form 7004 is filed on or before the due date for filing Form 708 in accordance with the procedures under paragraph (a) of this section.

(c) No extension of time for the payment of tax. An automatic extension of time for filing a return granted under paragraph (b) of this section will not extend the time for payment of any tax due with such return.

(d) Penalties. See section 6651 regarding penalties for failure to file the required tax return or failure to pay the amount shown as tax on the return.

(e) Effective/applicability dates. This section applies to applications for an extension of time to file Form 708 filed on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

#### **§28.6091-1 Place for filing returns.**

A U.S. recipient as defined in §28.2801-2(e) must file Form 708, “U.S. Return of Gifts and Bequests from Covered Expatriates,” with the Internal Revenue Service office designated in the instructions applicable to the Form.

**§28.6101-1 Period covered by returns.**

See §28.6011-1 for the rules relating to the period covered by the return.

**§28.6107-1 Tax return preparer must furnish copy of return or claim for refund to taxpayer and must retain a copy or record.**

(a) In general. A person who is a signing tax return preparer of any return or claim for refund of any tax to which this part 28 applies must furnish a completed copy of the return or claim for refund to the taxpayer and retain a completed copy or record in the manner stated in §1.6107-1 of this chapter.

(b) Effective/applicability dates. This section applies to returns and claims for refund filed on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.6109-1 Tax return preparers furnishing identifying numbers for returns or claims for refund.**

(a) In general. Each tax return or claim for refund of the tax under chapter 15 of subtitle B of the Internal Revenue Code prepared by one or more signing tax return preparers must include the identifying number of the preparer required by §1.6695-1(b) of this chapter to sign the return or claim for refund in the manner stated in §1.6109-2 of this chapter.

(b) Effective/applicability date. This section applies on and after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.6151-1 Time and place for paying tax shown on returns.**

The tax due under this part 28 must be paid at the time prescribed in §28.6071-1 for filing the return, and at the place prescribed in §28.6091-1 for filing the return.

**§28.6694-1 Section 6694 penalties applicable to return preparer.**

(a) In general. For general rules regarding section 6694 penalties applicable to preparers of returns or claims for refund of the tax under chapter 15 of subtitle B of the Internal Revenue Code (Code), see §1.6694-1 of this chapter.

(b) Effective/applicability date. This section applies to returns and claims for refund filed, and advice provided, on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.6694-2 Penalties for understatement due to an unreasonable position.**

(a) In general. A person who is a tax return preparer of any return or claim for refund of any tax under chapter 15 of subtitle B of the Code is subject to penalties under section 6694(a) in the manner stated in §1.6694-2 of this chapter.

(b) Effective/applicability date. This section applies to returns and claims for refund filed, and advice provided, on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.6694-3 Penalty for understatement due to willful, reckless, or intentional conduct.**

(a) In general. A person who is a tax return preparer of any return or claim for refund of any tax under chapter 15 of subtitle B of the Code is subject to penalties under section 6694(b) in the manner stated in §1.6694-3 of this chapter.

(b) Effective/applicability date. This section applies to returns and claims for refund filed, and advice provided, on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.6694-4 Extension of period of collection when tax return preparer pays 15 percent of a penalty for understatement of taxpayer's liability and certain other procedural matters.**

(a) In general. For rules relating to the extension of the period of collection when a tax return preparer who prepared a return or claim for refund of tax under chapter 15 of subtitle B of the Code pays 15 percent of a penalty for understatement of taxpayer's liability, and for procedural matters relating to the investigation, assessment, and collection of the penalties under section 6694(a) and (b), the rules under §1.6694-4 of this chapter apply.

(b) Effective/applicability date. This section applies to returns and claims for refund filed, and advice provided, on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.6695-1 Other assessable penalties with respect to the preparation of tax returns for other persons.**

(a) In general. A person who is a tax return preparer of any return or claim for refund of any tax under chapter 15 of subtitle B of the Internal Revenue Code (Code) is subject to penalties for failure to furnish a copy to the taxpayer under section 6695(a) of the Code, failure to sign the return under section 6695(b) of the Code, failure to furnish an identification number under section 6695(c) of the Code, failure to retain a copy or list under section 6695(d) of the Code, failure to file a correct information return under section 6695(e) of the Code, and negotiation of a check under section 6695(f) of the Code, in the manner stated in §1.6695-1 of this chapter.

(b) Effective/applicability date. This section applies to returns and claims for refund filed on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.6696-1 Claims for credit or refund by tax return preparers and appraisers.**

(a) In general. For rules regarding claims for credit or refund by a tax return

preparer who prepared a return or claim for refund for any tax under chapter 15 of subtitle B of the Internal Revenue Code (Code), or by an appraiser that prepared an appraisal in connection with such a return or claim for refund under section 6695A of the Code, the rules under §1.6696-1 of this chapter will apply.

(b) Effective/applicability date. This section applies to returns and claims for refund filed, appraisals, and advice provided, on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

**§28.7701-1 Tax return preparer.**

For the definition of the term tax return preparer, see §301.7701-15 of this chapter.

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

[4830-01-p]

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