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THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL

Please Address Reply to:

Executive Director
DEBORAH O. MCKINNON

July 9, 2014

Lara A. Banjanin
Attorney-Advisor
IRS Office of Associate Chief Counsel (International)
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Washington, DC 20224

Via Email: lara.a.banjanin@irscounsel.treas.gov

Dear Ms. Banjanin,

The American College of Trust and Estate Counsel (the "College") is pleased to submit this letter to address issues presented by the current version of Form 8854 (Initial and Annual Expatriation Statement) and its Instructions, and make recommendations for resolving these issues.[1]

The College is a professional organization of approximately 2,600 lawyers from throughout the United States. Fellows of the College are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of the College have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift, and GST tax planning, fiduciary income tax planning, and compliance. The College offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

The issues we are concerned with include (1) the appropriate treatment of certain grantor trusts and nongrantor trusts in the determination of an expatriate's net worth for purposes of section 877(a)(2)(B),[2] (2) whether the assets of all grantor trusts of a covered expatriate should be subject to the mark-to-market tax under section 877A, (3) whether a naturalized U.S. citizen is entitled to use as his or her basis in assets the value of those assets on the first date he or she became a resident, (4) the consequences of a late filing of Form 8854, (5) the effect of the tax compliance requirement for purposes of section 877's exception to covered expatriate treatment, (6) the scope of the required financial

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[1] References in this letter are to the 2013 version of Form 8854 and its Instructions.

[2] All references to "section" are to the Internal Revenue Code of 1986, as amended.

disclosure by an individual who qualifies for the exception to covered expatriate treatment under section 877A(g)(1)(B), (7) the application of the section 877A(g)((1)(B)(i) exception to covered expatriate status to an individual who has not been a continuous tax resident of the other country of which he or she became a citizen at birth, (8) the determination of the date of expatriation of a permanent U.S. resident who elects to be treated as a resident of a treaty country, and (9) the practical availability of an IRS valuation letter for an expatriate who wishes to be treated as having received his or her interest in a nongrantor trust as of the day before his or her expatriation.

We recognize that these are difficult issues and would welcome the opportunity to discuss their resolution with you. Each issue is discussed in the enclosure in the order listed above.

If you or your staff would like to discuss the issues or recommendations, please contact Ellen Harrison, Chair of the ACTEC Washington Affairs Committee, at (202) 663-8316, or ellen.harrison@pillsburylaw.com; or Leah Weatherspoon, ACTEC Communications Director, at (202) 688-0271, or lweatherspoon@actec.org.
Respectfully submitted,

Kathleen R. Sherby

Kathleen R. Sherby
President

cc: M. Grace Fleeman, Senior Technical Reviewer, IRS Office of Associate Chief Counsel (International)

This letter addresses issues presented by the current version of Form 8854 (Initial and Annual Expatriation Statement) and its Instructions and makes recommendations for resolving these issues.[3]

The issues we are concerned with include (1) the appropriate treatment of certain grantor trusts and nongrantor trusts in the determination of an expatriate's net worth for purposes of section 877(a)(2)(B),[4] (2) whether the assets of all grantor trusts of a covered expatriate should be subject to the mark-to-market tax under section 877A, (3) whether a naturalized U.S. citizen is entitled to use as his or her basis in assets the value of those assets on the first date he or she became a resident, (4) the consequences of a late filing of Form 8854, (5) the effect of the tax compliance requirement for purposes of section 877's exception to covered expatriate treatment, (6) the scope of the required financial disclosure by an individual who qualifies for the exception to covered expatriate treatment under section 877A(g)(1)(B), (7) the application of the section 877A(g)((1)(B)(i) exception to covered expatriate status to an individual who has not been a continuous tax resident of the other country of which he or she became a citizen at birth, (8) the determination of the date of expatriation of a permanent U.S. resident who elects to be treated as a resident of a treaty country, and (9) the practical availability of an IRS valuation letter for an expatriate who wishes to be treated as having received his or her interest in a nongrantor trust as of the day before his or her expatriation.

Each issue is discussed below in the order listed above.

1. <u>The Inclusion of Certain Trust Interests in an Expatriate's Net Worth</u> - <u>Form 8854, Part V (Balance Sheet and Income Statement), Schedule A (Balance Sheet), Lines 9 & 10; Instructions to Part IV, Section A, Line 2 (page 5).</u>

   The Instructions provide that an individual who expatriated under the tax regime instituted under section 877A must determine his or her net worth by using Schedule A in Part V of Form 8854. The net worth analysis is one of the three tests for determining whether the taxpayer is a "covered expatriate" under section 877A(g) (1). This net worth test is the same as the one under the former alternative tax regime, as set forth in section 877(a)(2). The Code does not define "net worth."

   Lines 9 and 10 of Schedule A include in net worth:

   "9 Assets held by trusts you own under sections 671 through 679

   10 Beneficial interests in nongrantor trusts"

[3] References in this letter are to the 2013 version of Form 8854 and its Instructions.

[4] All references to "section" are to the Internal Revenue Code of 1986, as amended.

Line 9 Analysis: Line 9 requires the expatriate to include as part of his or her net worth all assets held in trusts that he or she is treated as owning under sections 671 through 679 (a "grantor trust"). This requirement is inconsistent with guidance contained in Notice 97-19 (the "97 Notice").[5] The 97 Notice contains the most recent guidance issued by the Service on the subject of the determination of an expatriate's net worth. The Notice does not require inclusion in an expatriate's net worth of assets held in his or her grantor trusts. Under the 97 Notice, trust assets are includable in net worth only if they would have been subject to gift tax if the expatriate had transferred his or her interest by gift immediately before expatriation.

The 97 Notice states that Treasury and the Service expect to issue regulations under section 877 and to incorporate the notice's guidance in those regulations. It also states that taxpayers are required to comply with the Notice until regulations are issued.

In order to comply with the 97 Notice, we suggest that Line 9 of Schedule A to Form 8854 be revised to read as follows: "Assets held in trusts that would be subject to U.S. gift tax if you had transferred your interest by gift immediately before your expatriation (see instructions)." Corresponding changes to the instructions should be made.

Line 10 Analysis: Schedule A's Line 10 includes in the taxpayer's net worth "beneficial interests in nongrantor trusts." We suggest that the reference in this line to "nongrantor" trusts should be eliminated because, for purposes of the net worth test, there should not be a distinction between grantor and nongrantor trusts. The 97 Notice provides: "An individual's beneficial interest in a trust must be included in the calculation of that individual's net worth." [Emphasis added.] The Notice makes no distinction between grantor and nongrantor trusts as regards the net worth test.

As a result, Line 10 should read: "Beneficial interests in trusts not included in line 9."

However, the question of how to value beneficial interests is a troubling one. The 97 Notice adopts some principles that are problematic. Section III of this Notice includes the following statement:

> SPECIAL RULES FOR DETERMINING BENEFICIAL INTERESTS IN TRUSTS. An individual's beneficial interest in a trust must be included in the calculation of that individual's net worth. For this purpose, the value of an individual's beneficial interest in a trust will be determined using a two-step process. First, all interests in property held by the trust must be allocated to beneficiaries (or potential beneficiaries) of the trust based on all relevant facts and circumstances, including the terms of the trust instrument, letter of wishes

[5] 1997-1C.B. 394. Although the notice was issued under §877, it applies to §877A as well. See Notice 2009-85, 2009-45 I.R.B. 598, Section 2B.

> (and any similar document), historical patterns of trust distributions, and any functions performed by a trust protector or similar advisor. Interests in property held by the trust that cannot be allocated based on the factors described in the previous sentence shall be allocated to the beneficiaries of the trust under the principles of intestate succession (determined by reference to the settlor's intestacy) as contained in the Uniform Probate Code, as amended. Second, interests in property held by a trust that are allocated to the expatriate must be valued under the principles of section 2512 and the regulations thereunder without regard to any prohibitions or restrictions on such interest. The following example illustrates this special rule.
>
> EXAMPLE 2. B, a former long-term resident, expatriated on December 31, 1996. B is a potential beneficiary of two trusts during his lifetime. …
>
> Trust 2 was established by B's father for the benefit of B and C. Under the terms of Trust 2, the trust income and corpus may be distributed at the trustee's discretion to either B or C. For purposes of determining B's net worth, all of the interests in property owned by Trust 2 must first be allocated to either B or C based on all relevant facts and circumstances. If the facts and circumstances do not indicate how the interest in the trust's property should be allocated between B and C, the trust property will be allocated under the rules of intestate succession (determined by reference to B's father's intestacy) as contained in the Uniform Probate Code. If B's father had died intestate, the Uniform Probate Code would have allocated his property equally between B and C. Thus, for purposes of determining B's net worth, B will be treated as owning half of the interests in property owned by Trust 2. The value of these interests in property will be determined under the principles of section 2512.

Although we do not suggest that Form 8854 and its instructions should depart from the principles set forth in the 97 Notice, we do suggest that the IRS and the Treasury reconsider these principles, particularly that part of the Notice that allocates trust interests among beneficiaries based on their status as intestate successors of the trust's creator. As a matter of economic reality, beneficial interests in trusts are often not subject to valuation and may have very little value to any particular beneficiary. Indeed, with respect to discretionary trusts of the type described in Trust 2 of the Example, it is quite possible that neither B nor C will ever receive any distributions from the trust. In cases of this sort, a beneficiary's interest is little more than a mere expectancy. The application of the Uniform Probate Code's intestacy rules seems to create a property interest that does not in fact exist.

2. <u>Identification of Trust Interests That Are Subject to the Mark-to-Market Tax</u> - <u>Instructions to Form 8854: Part IV, Section B (Property Owned on Date of Expatriation), Line 8</u>.

   The instructions for Line 8 on property includible in the mark-to-market tax base provide as follows:

> An interest in property includes money or other property regardless of whether it produces any income or gain. . . . However, do not list the following. . . . 3. Interests in nongrantor trusts.
>
> You are considered to own any interest in property that would be included in your gross estate for federal estate tax purposes under Chapter 11 of Subtitle B of the Code if you died on the day before the expatriation date as a citizen or resident of the United States… [Y]ou are [also] considered to own your beneficial interest(s) in each trust (or part of a trust), other than a nongrantor trust subject to section 877A(f), that would not be included in your gross estate as described in the preceding sentences.[6]

The first portion of the text seems to tell the covered expatriate to exclude his or her interests in nongrantor trusts. The second portion seems to require their inclusion if the trust property would be includible in his or her gross estate.

These Instructions are similar to Section 3.A. (Identification of a covered expatriate's property and determination of fair market value) of the 09 Notice. But the 09 Notice language seems more clearly to take the position that the section 877A(c) exclusion for nongrantor trusts supersedes the general rule that all interests includable in the covered expatriate's gross estate are subject to the mark-to-market regime. The corresponding portion of the 09 Notice provides:

> For purposes of the mark-to-market regime, the covered expatriate is deemed to have sold any interest in property that he or she is considered to own under the rules of this paragraph **other than property described in section 877A(c)** [emphasis added]. For purposes of computing the tax liability under the mark-to-market regime, a covered expatriate is considered to own any interest in property that would be taxable as part of his or her gross estate for Federal estate tax purposes under Chapter 11 of Subtitle B of the Code as if he or she had died on the day before the expatriation as a citizen or resident of the United States. . . .[A] covered expatriate is also deemed to own his or her beneficial interests) in each trust (or portion of a trust), that would not constitute part of his or her gross estate . . . .

The first sentence of the text of Section 3A of the 09 Notice provides the general statement that the covered expatriate is deemed to have sold any interest in property that he or she is considered to own other than section

[6] This statement presumably subjects to the mark-to-market tax trust a taxpayer's interest in a grantor trust that would not be included in his or her gross estate. An example of such a trust is a trust that is treated as owned by a beneficiary under section 678 by reason of a lapsed power that did not result in he or she being treated as a transferor to the trust.

877A(c) property.[7] The second and third sentences quoted above tell us what kind of property interests the covered expatriate is deemed to own. There are only two such interests. First, the covered expatriate is considered to own assets includible in his or her gross estate. Second the covered expatriate is considered to own his or her beneficial interests in trusts that are not includible in his or her gross estates. From this text it seems reasonably clear that trust property includible in a covered expatriate's gross estate is an interest in property considered to be owned by him or her but that if that interest is an interest in a nongrantor trust, it is excluded from the mark-to-market regime by section 877A(c).[8]

This conclusion is consistent with the text of section 877A. A contrary conclusion would create a significant double tax exposure. There is nothing in section 877A that relieves the trustee of a nongrantor trust from the section 877A(f) withholding requirements simply because the beneficiary paid a mark-to market tax when he or she expatriated. Additionally, the fact that the beneficiary may have a basis step-up in his or her interest in the trust by reason of the deemed sale that took place on his or her expatriation will not give the trust a basis step-up in its assets. As a result, a post-expatriation sale by the trustees of a U.S. nongrantor trust of appreciated assets on which the covered expatriate paid tax will be taxed again to the trustee. If the trustee adds the gain to the trust's distributable net income and distributes it to the expatriated beneficiary, the trustee will pay no tax but will be required to withhold.

We believe that the conclusion reached in the 09 Notice is that assets in nongrantor trusts are not subject to the mark-to-market tax even if they are includable in the expatriate's gross estate. However, the Instructions could be read to require the inclusion of all trust property includable in the covered expatriate's gross estate whether the trust is a grantor trust or a nongrantor trust. We suggest that the Instructions be clarified to make it clear that property in a nongrantor trust is excluded from the mark-to-market regime.

Additional confusion has been caused by an inconsistency between Section 1 and Section 3.A. of the 09 Notice. Section 1 provides: "If the covered expatriate is

[7] The immediately following sentence of the 09 Notice, as well as the Instructions to Line 8 of Part IV, Section B, provide that whether property would be included in an expatriate's gross estate will be determined "without regard to sections 2010 through 2016." The references to sections 2010 through 2016 seem to be an error. Sections 2010 through 2016 deal with tax credits and are not relevant to whether assets are included in a person's gross estate.

[8] A nongrantor trust can be includable in the grantor's gross estate either because of a retained beneficial interest or because of a power exercisable by the grantor. Both are not necessary. For example, if a grantor retained a testamentary limited power of appointment exercisable with the consent of an adverse party, and a discretionary beneficial interest in a trust in an asset protection jurisdiction also exercisable only with the consent of an adverse party, the trust would be a nongrantor trust and would be includable in the grantor's estate under section 2036(a)(2).

treated as the owner of any portion of a trust under the grantor trust rules (sections 671 through 679) on the day before the expatriation date, the assets held by that portion of the trust are subject to the mark-to-market regime…."

The statement in Section 3.A. seems to reflect the correct view. Section 3.A. would be irrelevant to grantor trusts if the mark-to-market tax applied to all grantor trusts, and would be entirely irrelevant if nongrantor trusts are not subject to mark-to-market tax at all, as section 877A(c)(3) appears to provide.

Grantor trust assets that had been transferred by the taxpayer in a completed gift and would not be includable in the gross estate arguably should not be taxed under the expatriation regime because the expatriate would not have avoided gift or estate tax in connection with the trust as a result of his or her expatriation. Although income tax could be reduced if both the expatriate grantor and the trust cease to be taxed on all income accruing to the grantor trust, in most cases section 684 will impose a similar mark-to-market regime and tax unrealized appreciation on trust assets.

In order to alleviate the confusion, we suggest that the following be added to the above-quoted part of the Form 8854 Instructions: "Assets held in a trust which you are considered to own for income tax purposes under sections 671-679 are not includible in the mark-to-market tax base for that reason alone."

The requirement in the 09 Notice and in the Instructions that a covered expatriate's interest in a grantor trust the assets of which is subject to the mark-to-market regime causes the same difficult valuation issues that are discussed in section 1 of this letter. We recommend that, in order to relieve the expatriate of the burden of determining the value of a beneficial trust interest in a grantor trust and allocating and including unrealized gain in the immediate mark-to-market tax, an expatriate be permitted to elect into the taxation scheme for nongrantor trusts under section 877A(f). Under this scheme, the taxable portion of a distribution to the covered expatriate is subjected to a 30% withholding tax and, if property distributed in kind to the covered expatriate has unrealized gain, the gain is recognized. Accordingly, by making an election into taxation under the special rules for nongrantor trusts, the expatriate is not avoiding tax. Instead, tax is merely deferred. This election would be particularly appropriate if discretionary, rather than mandatory, beneficial interests are attributed to a grantor.

As discussed below, although there is no statutory foundation for such an election, the Instructions and the 09 Notice allow an election by nongrantor trusts to pay the expatriation tax up front and the 09 Notice provides that an electing expatriate will avoid withholding. This election also is not grounded in the statute but seems to make good sense from the standpoint of administrative efficiency.

3. <u>Basis in assets of Naturalized U.S. Citizens and Long-Term Residents</u> - <u>Form 8854, Part V, Schedule A, Column (d) [FMV on beginning date of U.S. residency (optional, for long-term residents only)]; Instructions to Column (d) (page 8).</u>

Form 8854 seems to suggest that the inbound basis step-up to fair market value as of the beginning date of U.S. residency [Part V, Schedule A, column (d)] is available only to long term resident aliens and not to naturalized U.S. citizens. The Instructions indicate that the inbound basis step-up is available only to long-term residents and refers to section 877(e)(3)(B) and section 877A(h)(2). Section 877(e) (3)(B) does limit the basis adjustment to long-term residents but this section does not apply to section 877A's mark-to-market tax. Section 877A(h) (2) clearly provides the basis step-up to any individual who becomes a U.S. resident. It contains no language that would deprive such an individual of the basis step-up because he or she became a U.S. citizen.

We suggest that the Instructions to Column (d) be changed to add the following underlined language:

> If you are a former U.S. LTR, <u>including an LTR who later became a naturalized U.S. citizen,</u> it may benefit you to complete column (d).

Conforming changes should be made to the caption on Part V of Schedule A, Column (d) of Form 8854 by adding after "long-term residents" the words "and naturalized U.S. citizens."

Some confusion arises because Part V deals with the net worth calculation and not the mark-to-market calculation and basis is irrelevant to the net worth calculation. Therefore, we suggest that this information be included instead on column C on Line 8 of Section B of Part IV.

4. <u>Late Filings of Form 8854</u> - <u>Instructions to Form 8854: Expatriation After June 16, 2008 (page 2)</u>.

Section 877A does not fix a time for making a certification of an expatriate's tax compliance. Certification of tax compliance for the five tax years preceding expatriation is not necessary to make an effective expatriation, but such certification is necessary to avoid classification as a covered expatriate. For example an individual who does not meet the net worth or income tax test (or who is a dual citizen or a minor who is excepted from these tests) is a covered expatriate unless the certification of tax compliance is made. Form 8854 is used to make this certification. Form 8854 is due at the time the individual's income tax return is due for the year in which he or she expatriates (or would have been due had a return been required). This leaves unresolved the question of whether a late filed Form 8854 may be filed to certify tax compliance assuming that failure to timely file Form 8854 solely for this purpose is not itself the sort of failure to comply with tax obligations that prevents making such certification.

We recommend that the Service clarify in the Instructions that certification of tax compliance may be made on a late-filed Form 8854, and that such certification be given effect retroactively.

5. <u>The Effect of the Tax Compliance Requirement</u> - <u>Instructions to Form 8854: Part IV, Section A [Expatriation Information], Line 6 (page 5).</u>

These instructions provide in part as follows:

> Check the "Yes" box if you have complied with your tax obligations for the 5 tax years ending before the date on which you expatriated, including but not limited to, your obligations to file income tax, employment tax, gift tax, and information returns, if applicable, and your obligation to pay all relevant tax liabilities, interest, and penalties. *You will be subject to tax under section 877A if you have not complied with these obligations. [Emphasis added]*

In our opinion, the sentence in italics does not accurately state the law. Section 877(a)(2)(C) provides that, to avoid being subject to tax as a covered expatriate under Section 877A, the expatriate must "certify under penalty of perjury that he has met the requirements of this title [Title 26] for the 5 preceding taxable years…" Nowhere is it provided that if the certification turns out to be inaccurate because the expatriate has not met all such requirements, the taxes of section 877A will apply. Instead, the penalty for failure to make an accurate certification is a possible prosecution for perjury, not taxation under section 877A.

We suggest that the sentence in italics be changed to: *You will be subject to tax under section 877A if you fail to certify under penalty of perjury that you have complied with these obligations.*

6. <u>Required Financial Disclosure</u> - <u>Form 8854, Part IV, Section A [Expatriation Information], Lines 1 & 2</u>.

Section 877A(g)(1)(B)(i) provides that certain dual-citizens will not be treated as meeting the requirements of subparagraph (A) or (B) of section 877(a)(2) if the individual:

> (1) became at birth a citizen of the United States and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and
>
> (2) has been a resident of the United States for not more than 10 taxable years during the 15-taxable year period ending with the taxable year during which the expatriation date occurs.

Similarly, section 877A(g)(1)(B) provides that an individual who relinquishes his or her U.S. citizenship before attaining age 18½ if he or she has been a U.S. resident will not be treated as meeting the requirements of subparagraph (A) or (B) of section 877(a)(2) for less than 10 taxable years. Such an individual will not be subject to the expatriation tax even if his or her (i) average five-year net income tax liability exceeds the threshold amount or (ii) net worth was $2,000,000 or more on the date of expatriation. The individual, however, is still treated as a covered expatriate unless he or she certifies that he or she has complied with all federal tax obligations for the five tax years preceding the date of expatriation as required pursuant to subparagraph (C) of section 877(a)(2). Form 8854, which is used to make this certification, should not require disclosure of net worth or five-year average income tax liability because neither is relevant to his or her eligibility for the exception.

The requirement in several places of the Instructions that directs an expatriate who expatriated in the prior year to address these parts of the Form should be changed to clarify that the expatriate is not required to respond to Lines 1 and 2 of Section A of Part IV or to complete Schedule A if he or she satisfies the requirements of section 877A(g)(1)(B).

7. Scope of Dual Citizen Exception - Form 8854, Part IV, Section A [Expatriation Information], Line 3.

This line of the Form 8854 provides as follows:

> Did you become at birth a U.S. citizen and a citizen of another country, and do you continue to be a citizen of, and taxed as a resident of, that other country?

Although it is clear from Form 8854 that the expatriate must have remained at all times a citizen of the other country, it is not clear whether the person must have been at all times, from birth to the expatriation date, been taxed as a resident of that country in order to take advantage of the dual-citizen exception to the section 877A taxes.

Section 877A(g)(1) is clear that the requirement to be taxed as a resident applies only as of the expatriation date:

> (B) Exceptions. An individual shall not be treated as meeting the requirements of subparagraph (A) or (B) of section 877(a)(2) if –
>
> > (i) the individual
> >
> > > (I) became at birth a citizen of the United States and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and taxed as a resident of, such other country, and …

The section adds the clarifying qualifier "as of the expatriation date". We suggest that the Form 8854 be changed to follow the statute, as follows:

> Did you become at birth a U.S. citizen and a citizen of another country and, as of the expatriation date, continue to be a citizen of, and taxed as a resident of, that other country?

There are no instructions for the question on this line 3. We suggest that the Instructions address this line and eliminate any ambiguity by stating that, as of the expatriation date, the expatriate must have been a resident of that same country of which he or she had been a citizen since birth, but that the individual need not have been a continuous resident of that country from birth through the expatriation date.

8. Expatriates With Treaty Protection - Instructions to Form 8854, Part I, Line 5 – Long-Term Resident with Dual Residency (page 4).

A dual-resident Green Card holder can terminate long-term U.S. residency by electing to be taxed as a resident of a treaty country on his or her U.S. income tax return. The Instructions provide as follows:

> If you are a person who expatriated after June 16, 2008, you expatriated as of the date that you commenced to be treated for tax purposes as a resident of the treaty country. But you must notify the IRS by filing a Form 8833 and a Form 8854 to avoid penalties.

The exact date of expatriation is important for several purposes under section 877A, For example, the day before the expatriation date is the date as of which assets are valued for purposes of the mark-to-market tax. The quoted Instructions do not provide the necessary clarity as to the date.

We suggest that the Instructions provide clarity as to the effective date of the election to be taxed as a treaty-country resident. Our recommended methodology would be to mark the effective date of expatriation as the first day of the tax year for which the election was made but we recommend that the time for filing forms related to the expatriation be measured from the date the election under the treaty is actually made. For example, in the case of payments subject to withholding under section 877A(d) and (f), Sections 5 F and 7 C of the 09 Notice require an expatriate to submit Form W-8CE to the trustee on the earlier of (1) the day prior to the first distribution from the trust on or after the expatriation date or (2) 30 days after the expatriation date. This is impossible to do where the expatriation date is retroactive. A person who fails to withhold prior to receipt of Form W-8CE should not be liable for the tax.

9. Mark to Market - Form 8854, Part IV, Section B [Property Owned on Date of Expatriation], Line 7d.

If a covered expatriate is the beneficiary of a non-grantor trust, defined as a trust for which the expatriate is not considered the owner on the day before the expatriation date, then taxable distributions to the expatriate generally will be subject to 30% withholding despite the availability of withholding protection under a treaty.[9] Paragraph 7. D of the 09 Notice, however, provides that the expatriate may elect to be treated as having received the value of his or her interest in the trust on the day before

[9] Notice 2009-45, Section 7D.

his or her expatriation date, in which case no subsequent distribution from the trust will be subject to withholding under section 877A(f)(1)(A) and the expatriate will not be precluded by section 877A(f)(4)(B) from claiming treaty benefits with respect to any distribution from the trust. This election is available even if no treaty is applicable. However, in order to make this election, the expatriate must obtain a letter ruling from the IRS as to the value, if ascertainable, of his or her interest in the trust on the day before the expatriation date by following the procedures in Rev. Proc. 2009-4 (or any subsequent publication that replaces Rev. Proc. 2009-4) and provide a copy of such ruling to the trustee together with certification that the tax on the deemed distribution has been paid. The Instructions to Line 7d provide for this election and require that a copy of the letter ruling be attached to Form 8854. The difficulty is caused by the requirement that the taxpayer obtain a valuation letter from the IRS before making this election.

The problems with the requirement for a valuation ruling and suggested alternatives are discussed below.

The Instructions to Form 8854 (page 6) tell taxpayers to obtain a valuation letter ruling by following the procedures set forth in Rev. Proc. 2013-1. Section 6.02 of Rev. Proc. 2013-1 provides that the IRS generally does not issue rulings on factual matters, and it refers to Rev. Proc. 2013-3 and -7, and 2013-1, which provide a non-inclusive list of what is considered a factual matter. Although none of those resources specify that valuation is a factual matter, it is our understanding that the determination of value is based on the facts and circumstances relating to an asset. As a result, the Service may decline to provide a valuation ruling. The only reference we are able to find to any kind of valuation ruling is in Rev. Proc. 96-15, which explains how to request an IRS Statement of Value for art. In any case, even if a ruling is available, the IRS has the discretion not to rule. Accordingly, there is uncertainty as to whether an IRS valuation ruling is obtainable, which may create a logistical obstacle to making the election.

Assuming that a valuation letter ruling is available, it may not be possible to obtain the ruling by the time Form 8854 is due to be filed. If the ruling is not issued promptly and before the deadline for the Form 8854, the expatriate is unable to make the Line 7d election. There are three potential resolutions to this particular problem. One, the availability of an automatic extension of time to file Form 8854 could be permitted where more time for obtaining a ruling is necessary. Two, the form could allow for a provisional election pending the ruling. The covered expatriate should have the ability to withdraw the election any time before getting the letter ruling or upon receiving it and 60 to 90 days thereafter. Thus, the taxpayer would file Form 8854 on a timely basis, but reserve the right to file an amended 8854 from 60 to 90 days after obtaining the ruling or anytime before the ruling is granted. The third potential resolution is not to require the valuation letter ruling and to rely on the audit process.

Even if a valuation letter ruling is available on a timely basis, not all trust interests can be valued. There are no guidelines of how to value purely discretionary trusts, in which the trustee has sole discretion to distribute income or principal to the expatriate-beneficiary. The valuation process becomes even murkier and inherently unreliable if the expatriate is not the only discretionary beneficiary.

Third-party revocable trusts that name the expatriate as a beneficiary should be ignored on Form 8854, yet they are non-grantor trusts as to the expatriate. For example, if the expatriate's parent creates a revocable trust, which is a non-grantor trust as to the child, it will become vested once the parent dies, but until then the parent can revoke it. This trust interest should be valued at zero or ignored on Form 8854. The expatriate should not be required to get a ruling for such a trust, and the Form 8854 should provide a bright line test for such a trust.

Taxpayers need guidance concerning how the tax is computed when an election is made to treat an expatriate as having received his or her interest in a nongrantor trust immediately prior to his or her expatriation, and how basis adjustments will be made to trust assets.

Lastly, there is an inconsistency between the treatment of a grantor trust and a non-grantor trust. There also is no election available for a grantor trust to be taxed under the withholding regime applicable to nongrantor trusts, nor is there a requirement for a valuation letter ruling of a grantor trust to determine the expatriate's beneficial interest. Grantor and nongrantor trusts should be treated similarly to the extent the statute permits. That is, we favor (i) allowing grantor trusts to elect into the 30% withholding regime for nongrantor trusts and (ii) allowing nongrantor trusts to elect into the immediate tax under the mark-to-market rules under the same terms available to grantor trusts. Although the statute does not provide for any such elections, the 09 Notice and the Instructions to Form 8854 allow an election under clause (ii) but not under clause (i). The argument in support of a clause (i) election is that it avoids difficult valuation issues and a liquidity problem for an expatriate. A tax applies under the withholding regime only if, as and when distributions are received. The 09 Notice and the Instructions to Form 8854 permit nongrantor trusts to elect into the mark-to-market rules only on satisfying a condition that is not applicable to grantor trusts, specifically, getting a valuation letter ruling. We see no reason why such a condition should be imposed.

We appreciate your attention to our concerns, and we remain available to assist you in revising the Form 8854 and its Instructions.

Sincerely yours,

Kathleen R. Sherby

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