ACTEC ESTATE AND GIFT TAX COMMITTEE
ANNUAL MEETING 2025 – La Quinta, CA
MEETING MARCH 20, 2025
1:00 pm – 3:30 pm (150 minutes)
AGENDA

Secretary: Robin Miskell

TOPIC	DISCUSSION LEADER	TIME
Chair Remarks: Approval of Minutes, Welcome	Beth Shapiro Kaufman	1:00 (5 min)
2801 Regulations	Michelle Graham	1:05 (15 minutes)
Evolving Law Concerning IRC Section 2036	Jennifer Jordan McCall, Scott Fillmore, and Stephanie Loomis-Price	1:20 (50 minutes)
TAP: What is it and what does it do?	Gideon Rothschild	2:10 (15 minutes)
What if you never fund the bypass trust?	Mickey Davis	2:25 pm (10 minutes)
“Too Hot” Topics	Cara Koss and Beth Kaufman	2:35 pm (45 minutes)
Suggestions for the PGP	Kevin Matz	3:20 pm (10 minutes)
Chair’s Farewell and Symbolic Passing of the Gavel	Beth Kaufman, Kim Cohen	3:28 pm (2 minutes)

Executive Committee Liaison: Melissa J. Willms

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Foundation Liaison: Charles Ian Nash

Please sign in online

ACTEC Executive Committee Liaison Report
2025 Annual Meeting

1. Thanks to the Program Committee chaired by Stephanie Loomis-Price (WA), all the Committee members, show-runners and speakers for an impactful line-up of Professional Programs (CLE) for this Annual Meeting.

2. The *L. Henry Gissel, Jr. Spirit of ACTEC Lecture* is Friday, March 21, 10:15 a.m. to 11:15 a.m., presented by Past President, Ann B. Burns, examining the importance of collaborative relationships in our profession. Saturday's schedule features *The Annual Joseph Trachtman Memorial Lecture*, 9:45 a.m. to 10:45 a.m., Counting Down, Counting Up: Flourishing, presented by Past President Stephen (Steve) R. Akers, exploring well-being and how estate planners can help clients and families thrive.

3. As ACTEC Fellows are aware, there is a current shortage of law school graduates pursuing careers in trust and estate law. On behalf of the College, President Susan D. Snyder has reached out to the directors of law school career centers in the U.S., with an invitation to arrange an ACTEC presentation for students about the exceptional career prospects in the trust and estate practice. This initiative is coordinated by the Long Range Planning Committee.

4. Please take a moment to reach out and thank the sponsors supporting this Annual Meeting. The sponsor display area is in the Flores Ballroom Foyer.

5. Following the conclusion of the Annual Meeting, a survey seeking feedback on your meeting experience including the program schedule, opportunities to network, tours, special events and the meeting venue will be sent to all attendees.

6. The 2025 Summer Meeting is scheduled **June 18-22, Montreal, Quebec, Canada at the Le Centre Sheraton.** The Summer Meeting Schedule of Events will be available after the conclusion of the Annual Meeting.

7. The 2025 Fall Meeting dates in Austin, TX have changed. New dates were announced in January and are **October 20-23, 2025.**

8. To be considered at the 2025 Fall Meeting at the Fairmont Austin in Austin, TX, nominations must be received by the national office, ready to poll by these deadlines: Nominations for **International Fellows Monday, June 23, at 4:30 p.m. Eastern Time** and Nominations for **Fellows and Academic Fellows Monday, July 28, 4:30 p.m. Eastern Time**. Nominations received after these deadlines will be held over for the 2026 Annual Meeting at the JW Marriott Water Street & Tampa Marriott Water Street in Tampa, FL.

9. See the *Meetings Announcements* sent each Monday for the list of upcoming National, State, Regional, and ACTEC Fellows Institute Meetings.

10. Keep up with the news, educational opportunities, webinars plus resources of the College and read the *Weekly Update* issued each Friday.

THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL
ACTEC
FOUNDATION

ACTEC Foundation Liaison Report
2025 Annual Meeting

1. The ACTEC Foundation welcomed the 10th Class of Dennis I. Belcher Young Leaders in September 2024. To date, fifteen former Young Leaders have been elected to the College through this Foundation grant-funded program of ACTEC's Diversity, Equity and Inclusivity Committee.

2. Stop by the Foundation's booth for a copy of The ACTEC Foundation's 2025 Annual Meeting Newsletter.

3. The Foundation-funded ACTEC Trust and Estate Talk Podcast has had over 633,000 total podcast downloads from 2018 to 2024.

4. The ACTEC Foundation website has a brand new look! Check it out, and get updates on the programs the Foundation supports and the stories of the people the Foundation has impacted: www.actecfoundation.org

5. The 2025 Mary Moers Wenig Student Writing Competition is now open. 2L and 3L students in ABA-accredited law schools should submit papers by June 30, 2025, and winners will be announced by July 15, 2025.

6. The Foundation is reviewing a new Mission Statement. Come to the Board of Directors meeting on Saturday, March 22 at 1:15 pm Pacific to hear the discussion. The Foundation will also be considering several interesting grant proposals.

Please support your ACTEC Foundation with a donation at actecfoundation.org/DonateNow.

ACTEC Estate and Gift Committee
Fall 2024 Meeting Minutes
Marriott Marquis, Chicago, Illinois
Sunday, September 22, 2024

1. **Chair Remarks: Approval of Minutes, Welcome**
    a. Chair Beth Kaufman welcomed Red Dot, Blue Dot, and Green Dot attendees.
    b. Minutes for summer meeting were approved.
2. **Washington Update – Cathy Hughes**
    a. Basis Consistency Regulations. IRS worked with ACTEC and others to make the regulations workable.
    b. Published proposed regulations under 2056A - Update addresses and titles on where to file and if making QDOT election
    c. FinCen - August 29 - Obligations re non-financed residential real estate. Attorneys may be a reporting person required to file reports. FinCen excepted certain transfers to trust where there is no consideration for transfer.
        i. Transferor must be individual or individual or their spouse AND
        ii. Transferor has to be the settlor of the trust.
            I. If that is the case, no-consideration transfer of real estate not subject to regs.
        iii. Effective date 12/1/2025
    d. Secure Act 2.0 Final Regulations and new Proposed Regulations
        i. Definition of "child" expanded to include stepchildren, adopted children, and eligible foster children
        ii. Trust provision - may simplify beneficiary designation information for funds to trust, as long as the trust is a see-through trust that provides trust will be divided immediately upon the employee's death. You can get separate trust treatment, but each share does not have to be held in a continued trust.
        iii. RMD is calculated based on age of youngest EDB, instead of the oldest EDB
    e. Basis Consistency Regulations
        i. Deleted the zero basis rule that would have denied basis for assets not reported
        ii. Deleted reporting requirement for transfers by recipients other than the trustee. If distributed in kind by trustee, trustee must still report basis.
        iii. Any reporting will be due February 1st of year following the year of the distribution by the distributing trustee.
        iv. Revised due date of reporting for inherited but undistributed property. For property acquired after initial due date, the reporting date is February 1 of the year following the year of acquisition.
        v. Supplemental reporting of changes are due 30 days after receipt of information that would change the basis.

vi. Existence of excepted property to be reported, but not value (like cash, life insurance proceeds).
vii. Form 6035. The cash exception includes coins, dollars, etc., but non-US. Life insurance paid in lump sum is an exception. Cash collateral denominated un USD. Crypto-currency, Bonds, Promissory Notes are NOT excepted assets.
viii. IRD exception - if it's 100% IRD, it's an exception. If not, it does not qualify for the exception to the reporting requirement.
ix. 1014(f) Basis Consistency and 6035(f) Reporting.

f. Working on forms to be OK for e-filing. The instructions will have to be changed to reflect regs.
g. Subsequent vs. supplemental recording requirements. Two different reports with two different due dates.
h. Hoping to get 2801 final regs and one more out this year. 2032 is possible, but not sure they'll get them in the next couple of months.

3. Estate of Anenberg – Keri Brown

a. Anenberg - Came out in May
b. Estate of McDougall - Transferred from Judge Halpern to Judge Toro, who wrote Anenberg.
c. Both cases are Tax Court opinions, not memoranda; they're binding statements of the law.
d. Anenberg - Termination of trust that held QTIP property. Spouse gifted assets to kids/sold some for notes. IRS averred:
    i. Termination of marital trust resulted in a gift of the trust property.
    ii. Alternatively, when sold, that was a gift.
e. Tax court agreed that the termination of the QTIP trust was not a taxable gift. Because marrying the tax fiction of a QTIP with reality
f. What happened afterward, was treated the same as it would be as though she just owned them.
g. McDougall - When QTIP trust terminated, should be a tax (transfer from Bruce to kids); when kids gave up interest to Bruce (transfer from kids to Bruce); eventually there would be a 3rd tax on Bruce's death.
h. The termination of the QTIP was <u>not</u> a gift. The kids giving up a right in the QTIP was a gift from the children.
    i. The big question here is how to value this gift from the children.
i. In QTIP - Bruce had testamentary LPOA over the property. On death, remainder to children, Linda and Peter.
j. Afterward, Bruce and children agree to terminate trust with balance distributed to Bruce. Commutation of trust. Deemed gift from Bruce to kids of qualifying income interest. Deemed gift of remainder interest from Linda and Peter to Bruce. Commutation was a disposition under 2519, with no gift tax results.

k. Court referred to Anenberg. Said there was no gift from Bruce to kids. But kids could make a gift to Bruce of their interest.
  i. When they relinquished remainder rights, that was a transfer.
  ii. Linda and Peter transferred valuable rights gratuitously.
    I. Example: if L&P transferred remainder to third party, that would definitely be a gift.

l. So what is the value of the gifted remainder interest?
  i. It was subject to a power of appointment
  ii. If he was going to give it to them anyway, have they lost anything?
  iii. What about Bruce's principal invasion power?
  iv. What is the economic benefit actually given up?
  v. Marital trust assets also burdened by estate tax obligation. Should value be reduced by 40% tax obligation?
  vi. What they gave away was of little value, but what Bruce received had a lot of value.
  vii. Example, even an underwater option has a value because it could come up.
  viii. Who is bound by the Nonjudicial Settlement Agreement? Do those beneficiaries have rights as against the kids, and do those rights affect valuation?
  ix. Who has burden of proof on valuation question? Taxpayer.

4. Loper Bright, Corner Post, and the Future of Estate and Gift Tax Regulations – Mark Parthemer and Jenny Johnson

a. Chevron deference. Arose out of wanting to allow New Deal to go forward without thousands of injunctions. Two Prong Test to uphold the regulation
  i. Is the regulation on point with the statute?
  ii. If yes, is it a reasonable interpretation?

b. Loper: Administrative Procedures Act requires courts to say what the law means, not administrative agencies. Focus on meaning when statute is enacted. Courts are the experts at statutory interpretation. If it's not the "best" interpretation, it's not permissible.
  i. "Best" is the only thing that is permissible.
  ii. Reasonable is not the standard.

c. Courts can still give weight to agencies, but don't have to defer. UNLESS there has been an express delegation to the agency. No more implied delegation.
  i. What is a good enough delegation to an agency?
  ii. How explicit does it have to be? What if it's general?
  iii. (This will likely be the focus of litigation.) Is delegation to an agency constitutional?

d. Where are we now?
  i. Re: Regs related to a statute
  ii. Re: Regs involving interpretation of a regulation
    1. Has there been a specific delegation of authority in the statute?

            a. Ex., "Treasury shall issue a regulation…"
            b. These regs will be given greater deference, as long as comment/notice period/APA rules are followed.
            c. Will be upheld unless arbitrary and capricious.
        2. What if there hasn't been?

e. <u>Skidmore</u>: Agency rulings, while not binding on a court, reflect a body of experience and judgment that can be looked to by litigants and courts for guidance. Requires the agency to show the court that its interpretation is reasonable and valuable.
f. An agency's power to interpret its own regulations is an element of delegated authority.
g. <u>Corner Post</u> case. Court interpreted the statute of limitations for bringing an action against the USA. Applies to APA challenges. Six years.
    i. Govt argued that SOL started when the regulation was published.
    ii. Supreme Court said the right of action didn't accrue until there was an injury, determined on a plaintiff-by-plaintiff basis. So a newly formed entity could "discover" that it has been injured.
    iii. Anti-injunction act prevents pre-enforcement actions, so does this matter?
        1. Still have to go to tax court within 90 days of receipt of 90-day letter.
        2. Six year SOL starts when 6-month claim for refund time has passed…
        3. Affirmative suit to have a reg declared to be unlawful - where taxpayer suffers an injury and action would not negatively impact government's ability to impose tax - 6 year SOL starts at time when person first suffers and injury. Injury - occurs when taxpayer starts paying money to prepare to deal with regulate.
    iv. What is the scope of the remedy available?
        1. Hold unlawful and set aside a regulation, What does it mean?
        2. Is it set aside as to everyone, or just a specific plaintiff? Courts are hesitant to rule on the regulation as a whole ("nationwide injunctions").
        3. Creates a problem on uniformity of application.
        4. Gov't does not want universal vacatur. Concurrence says that it must be that way.
h. Procedural options for challenging regulations
    i. Not in audit. You can bring it, but it won't go anywhere.
    ii. IRS appeals will not take into account litigation risk of challenging the regulation.
    iii. Have to go to court and challenge
        1. In tax court (may be a more favorable forum)
        2. District Court or Court of Claims (if you've paid the tax first)
    iv. Refund litigation based on a challenge to the refund.

    v. Direct suit under the APA.
        1. Need argument about injury (not just that there is tax due and owing)
        2. File a complaint in district court.
        3. An injury - maybe informational reporting? (Like the requirement for reports about captive insurance or conservation easements)

i. Venue is important in these cases. Different circuits will treat these matters differently.

j. Always submit comments, because these are a way to challenge regulations. Litigators make hay with these.

k. Regulations on 2801 to be issued soon. Proposed regs were published a long time ago. Statute enacted in 2008. Expatriation rules. People may have to report transactions that occurred as long ago as in 2008. What guidance does APA give about the lapse of time and retroactive imposition of reporting requirements?
    i. Could the time/delay be arbitrary and capricious?
    ii. Skidmore analysis mentions whether the regulation is contemporaneous with the statute as one factor.
    iii. Is it possible that retroactive application is subject to challenge? Yep, definitely.

l. Other regulations that would be subject to challenge, given the right parties?
    i. Foreign gift reporting regs.
        1. Especially vis a vis whether a transaction is a loan or a gift.
    ii. If plaintiff is not the taxpayer, but plaintiff has suffered an injury, that is more likely to be able to sidestep the anti-injunction act.

m. Business associations may bring this kind of litigation by finding a good case and funding it. (And not have a class action.)

n. This could cut both ways - Can the government challenge its own regulation? (To the detriment of the taxpayer?)
    i. This is not likely, in Jenny's opinion.
    ii. The government is probably going to follow its regulations!
    iii. Taxpayers have a right to rely on it.

o. Other regulations subject to attack.
    i. 661 regulations.
    ii. 2053 Regulations for Graegin Loans

5. Moore v. US: Impact on Wealth Tax Proposals – Elizabeth Pierson

a. Impact on wealth tax proposals. Was someone financing this litigation? Because it seems like the Moores didn't have a lot at stake in this case - $15,000.

b. Mandatory repatriation tax, enacted 2017 under the TCJA. A one-time, backward looking, passthrough tax on undistributed income of American owned foreign corporations.

c. Raised a constitutional issue about the scope of what taxation is permitted. Direct taxes must be apportioned among the states.

        i. The tax has to be spread among the states in relation to census population.
        ii. Indirect taxes can be applied uniformly, wherever taxpayer is situated.
    d. The Moores contended that the repatriation tax was a direct tax, and since not apportioned among the states, it was invalid.
    e. The analysis is relevant to wealth tax and mark to market tax concepts.
        i. The argument is that these would be direct taxes, and since they would not be apportioned among the states, they're not valid.
        ii. But Moore's holding that the repatriation tax is not a direct tax may help with concept that a wealth tax or mark to market tax may be constitutional.
        iii. But the opinion did state that there was a realization event within the corporation, and without that, in a true wealth tax or mark to market tax, the tax may be held to be unconstitutional (particularly with the current makeup of the court).

6. **Foreign Trust Reporting Rules – Ellen Harrison**
    a. Discussion of where regs exceed the authority of the statutes.
        i. Section 643(i) of Code. Treats loans and uses of property owned by a foreign trust as deemed distributions to US Grantors or US Beneficiaries.
            1. Also applies if loans/distributions are made to people related to them.
            2. Intent to avoid sham loans.
            3. But the regulations are very restrictive and go beyond the statute.
        ii. Regs apply to a loan to a foreign person who later becomes a US resident (no statutory basis)
    b. These rules are complicated. The Service interest in knowing about and following the reporting rules. Balanced with practicalities and some issues with how the regulations are actually written.
    c. Obligation to report when creating a foreign trust.
        i. What is a foreign trust?
    d. Throwback tax issues. For foreign trusts and US trusts that previously were foreign trusts.
        i. Default method
    e. Penalty relief: all of the penalties can be waived with a showing of reasonable cause.
    f. ACTEC provided comments on all of these regulations
    g. Bottom line: Ellen thinks these are very draconian rules that may have the effect of driving people underground, instead of providing help in compliance.

7. **Miscellaneous Items – Beth Kaufman**
    a. For annual meeting, planning for business entities for the E&G committee. What are E&G considerations for business interests?

ACTEC 2024 Fall Meeting

Chicago, Illinois

Estate and Gift Tax Committee

Sunday, September 22, 2024
8:00am - 10:30am

Chair	Beth Shapiro Kaufman
Vice Chair	Kimberly E. Cohen
Member and EC Liaison	Melissa J. Willms
Member and Foundation Liaison	Charles Ian Nash
Member	Stephen R. Akers
Member	Ronald D. Aucutt
Member	Jeffrey A. Baskies
Member	Turney P. Berry
Member	Marc J. Bloostein
Member	Keri D. Brown
Member	Elaine M. Bucher
Member	Chang H. Chae
Member	M. Patricia Culler
Member	Mickey R. Davis
Member	Michael C. Gerson
Member	Michael M. Gordon
Member	Carol A. Harrington
Member	Ellen M. Harrington
Member	T. Randolph Harris
Member	Ellen K. Harrison
Member	Jerome M. Hesch
Member	Catherine V. Hughes
Member	John M. Jolley
Member	Robert J. Kolasa
Member	Jill Lebowitz
Member	Jerome L. Levine
Member	Philip M. Lindquist
Member	Kevin Matz
Member	Carlyn S. McCaffrey
Member	Robin L. Miskell
Member	Phoebe Moffatt
Member	Mark R. Parthemer
Member	Nicole M. Pearl
Member	Elizabeth T. Pierson
Member	Les Raatz
Member	Charles A. Redd
Member	Cheyenne J.H. Reese
Member	Mario Santilli Jr.
Member	Anita M. Sarafa
Member	Judith A. Saxe
Member	Todd J. Schneider

ACTEC 2024 Fall Meeting

Chicago, Illinois

Estate and Gift Tax Committee

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Member	Susan B. Shields
Member	Anita J. Siegel
Member	Barbara A. Sloan
Member	David E. Sloan
Member	Susan Kimsey Smith
Member	Rebecca L. Smitherman
Member	Susan D. Snyder
Member	David E. Stutzman
Member	Rees M. Sumerford
Member	Professor Phyllis Taite
Member	R. Eric Viehman
Member	Michael P. Vito
Member	Christine S. Wakeman
Member	Robert A. Wells
Member	Robert M. Weylandt
Member	Vickie R. Wilcox
Member	Jerome L. Wolf
Member	Diana S.C. Zeydel
Visitor	Sue Abbott
Visitor	Frank T Adams
Visitor	Leslie Kiefer Amann
Visitor	Beth Anderson
Visitor	Kenneth Barczak
Visitor	Leigh-Alexandra Basha
Visitor	Carole Bass
Visitor	David Berek
Visitor	Rachel Blumenfeld
Visitor	Steve Bonneau
Visitor	Lee Brown
Visitor	Reyolds Cafferata
Visitor	Gene Carlino
Visitor	Jerry Carp
Visitor	Sandra Chan
Visitor	Mark Christopher
Visitor	Tami Conetta
Visitor	Anne Coventry
Visitor	Adam Damerow
Visitor	Janice Davies
Visitor	Melissa Dougherty
Visitor	Mark Doyle
Visitor	Hugh Drake
Visitor	Marissa Dungey

ACTEC 2024 Fall Meeting

Chicago, Illinois

Estate and Gift Tax Committee

Visitor	Scott Filmore
Visitor	Theron (Terry) Fry
Visitor	John Furniss
Visitor	Greg Gadarian
Visitor	Karen Gerstner
Visitor	Jeffrey Glaser
Visitor	Steve Gorin
Visitor	Randall Grove
Visitor	Amanda Gyeszly
Visitor	Mark Harder
Visitor	Susan M. Holzman
Visitor	Kirk Hoopingarner
Visitor	Bryan Howard
Visitor	Shaheen Imami
Visitor	John Ivimey
Visitor	Linda Johnson
Visitor	Bryan Kirk
Visitor	Sharon Klein
Visitor	Tye Klooster
Visitor	James Lamm
Visitor	T. James Lee
Visitor	Shari Levitan
Visitor	Erica Lord
Visitor	Elizabeth Luk
Visitor	Raj Malviya
Visitor	Richard A. Marone
Visitor	Tim Maximoff
Visitor	Katarinna McBride
Visitor	Jonathan Michael
Visitor	Kevin Millard
Visitor	Janet Montgomery
Visitor	Anna Katherine Moody
Visitor	Lee Moore
Visitor	Walter Morris
Visitor	Suma Nair
Visitor	Jennifer Olk
Visitor	Kelly Perez
Visitor	Sandra Perkins
Visitor	Karin Prangley
Visitor	Arielle Prangner
Visitor	Carolyn Reers
Visitor	Eric Reis
Visitor	Anne-Marie Rhodes

ACTEC 2024 Fall Meeting

Chicago, Illinois

Estate and Gift Tax Committee

Visitor	Lawrence Richman
Visitor	Lisa Rico
Visitor	Joshua Rogers
Visitor	Wendy Rusch
Visitor	Doyle Sanders
Visitor	Jill Scherff
Visitor	Jennifer Schooley
Visitor	Chris Siegle
Visitor	Douglas Siegler
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Visitor	Doug Stanley
Visitor	Todd Steinberg
Visitor	Dale Stone
Visitor	Akane Suzuki
Visitor	Jeff Thede
Visitor	E Diane Thompson
Visitor	Patrick Timmer
Visitor	Angela Titus McEwan
Visitor	Jim Walker
Visitor	Ryan Walsh
Visitor	Richard Wehrle
Visitor	Lee Wendel
Visitor	Jim Williams
Visitor	Gene Wolf
Visitor	Lauren J. Wolven
Visitor	Thomas Worth
Visitor	Gordon Wright

[4830-01-p]

This document is scheduled to be published in the
Federal Register on 01/14/2025 and available online at
https://federalregister.gov/d/2025-00284, and on **https://govinfo.gov**

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 28

[TD 10027]

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: Final regulations.

SUMMARY: This document contains final regulations that provide guidance on the application of a tax on United States citizens and residents, as well as certain trusts, that receive, directly or indirectly, gifts or bequests from certain individuals who relinquished United States citizenship or ceased to be lawful permanent residents of the United States. The final regulations also provide guidance on the method of reporting and paying this tax. The final regulations primarily affect United States citizens and residents, as well as certain trusts, that receive one or more such gifts or bequests.

DATES: *Effective Date*: These regulations are effective **[INSERT DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]**.

Applicability Dates: For dates of applicability, see §§28.2801-1(b), 28.2801-2(n), 28.2801-3(g), 28.2801-4(g), 28.2801-5(f), 28.2801-6(e), 28.2801-7(d), 28.6001-1(c), 28.6011-1(c), 28.6060-1(b), 28.6071-1(d), 28.6081-1(e), 28.6091-1(b), 28.6107-1(b), 28.6109-1(b), 28.6151-1(b), 28.6694-1(b), 28.6694-2(b), 28.6694-3(b), 28.6694-4(b), 28.6695-1(b), 28.6696-1(b), and 28.7701-1(b).

FOR FURTHER INFORMATION CONTACT: Mayer R. Samuels, Daniel J. Gespass, or Karlene M. Lesho at (202) 317-6859 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Authority

This document contains additions and amendments to 26 CFR part 28 (Imposition of Tax on Gifts and Bequests from Covered Expatriates) addressing the application of section 2801 of the Internal Revenue Code (Code) and related provisions (the "final regulations"). The additions and amendments are issued under sections 2801, 6001, 6011, 6060, 6071, 6081, 6091, 6101, 6107, and 6109 pursuant to the express delegations of authority provided under those sections. The express delegations relied upon are referenced in the Background section of this preamble and in the Summary of Comments and Explanation of Revisions describing the individual sections of the final regulations. The final regulations are also issued under the express delegation of authority under section 7805 of the Code.

Background

This document amends subchapter B of 26 CFR chapter 1 (Estate and Gift Taxes) by adding part 28 under section 2801 and by expanding several existing regulations to also apply to the filing and furnishing of returns and payment of the tax imposed by section 2801 (section 2801 tax). Section 301 of the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act), Public Law 110-245, 122 Stat. 1624 (2008), added chapter 15 (Gifts and Bequests from Expatriates) to subtitle B of the Code (subtitle B), effective June 17, 2008. Before the addition of chapter 15, subtitle B contained chapters 11 through 14 relating to the estate tax, the gift tax, and the generation-skipping transfer (GST) tax, as well as special valuation rules applicable for purposes of subtitle B. Chapter 15 consists solely of section 2801 and imposes the section 2801 tax on certain transfers of property by gift (covered gifts) and on certain transfers of property by bequest (covered bequests) from certain individuals who expatriate on or after June 17, 2008 (covered expatriates).

The section 2801 tax is imposed on each United States (U.S.) citizen or resident

receiving a covered gift or covered bequest (U.S. recipient). For this purpose, domestic trusts and foreign trusts that elect to be treated as domestic trusts solely for purposes of section 2801 (electing foreign trusts) are included in the definition of a U.S. citizen. Foreign trusts that do not elect to be treated as domestic trusts for purposes of section 2801 (non-electing foreign trusts) are not U.S. citizens or residents and, therefore, do not become subject to the section 2801 tax upon receipt of covered gifts and covered bequests. Instead, the beneficiaries of non-electing foreign trusts who are U.S. citizens or residents (U.S. citizen or resident beneficiaries) become subject to the section 2801 tax upon their receipt of a distribution from a non-electing foreign trust that is attributable to covered gifts and covered bequests made to that non-electing foreign trust.

The section 2801 tax will be computed on Form 708, *United States Return of Tax for Gifts and Bequests Received from Covered Expatriates*, on which a U.S. recipient will report covered gifts and covered bequests received during the calendar year. If the aggregate value of the covered gifts and covered bequests received by the U.S. recipient during the calendar year exceeds the amount of the inflation-adjusted annual exclusion under section 2503(b) of the Code ($18,000 for 2024), the section 2801 tax is computed by multiplying the excess by the highest estate tax rate specified in section 2001(c) of the Code in effect on the date of receipt, and then reducing the product by any gift or estate taxes paid to a foreign country with respect to the covered gifts and covered bequests. The value of each covered gift and covered bequest is its fair market value as of the date of its receipt.

On September 10, 2015, a notice of proposed rulemaking and a notice of public hearing (REG-112997-10) were published in the *Federal Register* (80 FR 54447) proposing rules related to the section 2801 tax (proposed regulations). A total of sixteen comments on the proposed regulations were received and are available at https://www.regulations.gov or upon request. A public hearing on the proposed

regulations was held on January 6, 2016. After consideration of all the comments, this Treasury decision adopts the proposed regulations, with revisions, as final regulations. The revisions are discussed in the following *Summary of Comments and Explanation of Revisions* section. Unless otherwise indicated in the *Summary of Comments and Explanation of Revisions*, provisions of the proposed regulations for which no comments were received are adopted without substantive change. The final regulations include non-substantive modifications, including modifications that promote consistency across definitions, rules, and examples and improve the overall clarity of the guidance. Such modifications are not addressed in the *Summary of Comments and Explanation of Revisions*.

Summary of Comments and Explanation of Revisions

1. General Comments on Section 2801 and the Tax-Neutral Objective

The Department of the Treasury (Treasury Department) and the IRS received several general comments on section 2801. One comment objects to the enactment of section 2801, opining that the section 2801 tax is unnecessary, infringes on privacy rights, and unfairly applies to former long-term permanent residents. Other comments object by pointing out several ways in which the statutory provisions of section 2801 are not tax neutral, treat expatriates more harshly than if they had remained subject to U.S. gift and estate taxes, and thus violate what the commenters described as the intent of Congress in enacting section 2801 to make expatriation a tax-neutral event with regard to U.S. transfer taxes. Some comments request changes and additions to the proposed regulations to create a more tax-neutral outcome than under the statute.

The Background section of the preamble of the proposed regulations describes the history of the addition of chapter 15 and section 2801 to the Code and references the idea, as explained in a report of the House Ways and Means Committee regarding an earlier, pre-HEART Act, bill to enact chapter 15 and section 2801, that the decision

to relinquish citizenship ought to be “tax neutral.” *See* H.R. Rep. No. 110-431, at 113 (2007). More specifically, the report states that an individual’s decision to relinquish citizenship or terminate long-term residency should not affect the total amount of taxes imposed; that is, the decision should be “tax neutral.” The report further states that, if 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 transfer tax that the donor or donor’s estate would have been subject to, had the donor not expatriated. *Id.* at 114.

Despite the language in the report, section 2801 imposes a tax on the receipt by a U.S. citizen or resident of certain gifts or bequests which does not equal, and in some cases is not similar to, the tax that would have been imposed on the transfer of such gifts or bequests by a U.S. transferor (that is, one who had not expatriated), as illustrated by a comparison of the relevant statutory provisions of chapter 11 (estate tax), chapter 12 (gift tax), and chapter 13 (GST tax), with chapter 15 (section 2801 tax). Obvious dissimilarities between section 2801 and the provisions of chapters 11 through 13 include the absence in chapter 15 of an applicable credit amount that can be applied to offset or reduce the estate or gift tax liability (see sections 2010 and 2505 of the Code, for which transfers of up to $13.99 million (the 2025 inflation-adjusted amount) over a lifetime may be offset for purposes of gift and estate taxes) and the absence of a GST tax for covered gifts and covered bequests to a U.S. recipient who is a skip person (see section 2601 of the Code, imposing an additional transfer tax on GSTs). There are many other dissimilarities between section 2801 and the other transfer tax provisions.

The role of the Treasury Department and the IRS is to implement section 2801, as enacted by the HEART Act. Thus, to the extent the comments suggest changes to the statutory text of chapter 15 and section 2801, the Treasury Department and the IRS do not further address those comments in this preamble. To the extent the comments

suggest changes or additions to the proposed regulations to create a more tax-neutral outcome, the Treasury Department and the IRS have responded to specific comments as the relevant issues are discussed in this preamble, and in doing so considered both the statutory language of section 2801 and the scope of regulatory authority granted by Congress.

2. Definitions

A. Expatriate and covered expatriate

Section 2801(f) and proposed §28.2801-2(h) define the term *covered expatriate* by reference to section 877A(g)(1) of the Code. Proposed §28.2801-2(h) defines the term *expatriate* by reference to section 877A(g)(2). Proposed §28.2801-2(h) further provides 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 (estate or gift tax) as a U.S. citizen or resident. For this exception, the proposed regulations cite to section 877A(g)(1)(C) of the Code, which indicates that an individual will not be treated as a covered expatriate for certain purposes during the time that they are subject to tax as a U.S. citizen or resident.

Section 877A relies on the income tax definition of the term *resident* as described in section 7701(b)(1)(A). Section 28.2801-2(b) of the proposed regulations, however, applies the estate and gift tax rules under chapters 11 and 12 of subtitle B to define U.S. resident for purposes of section 2801, which also is in subtitle B, thereby providing consistency across the provisions.

One comment suggests that the exception in proposed §28.2801-2(h), which excludes an expatriate from being treated as a covered expatriate during any period in which the expatriate is subject to estate or gift tax, creates a coherent structure for

purposes of section 2801, but leaves open the possibility that an individual could be a covered expatriate for purposes of section 877A but not for purposes of section 2801 and vice versa. The comment states that this result seems to conflict with sections 2801(f) and 877A(g)(1)(C) and suggests that the final regulations provide that an expatriate who is deemed to be an income tax resident of the U.S. will be deemed not to be a covered expatriate. Another comment expresses support for the rule in proposed §28.2801-2(h) as arguably necessary because applying sections 2801(f) and 877A(g)(1)(C) using the income tax definition of U.S. resident would create a convenient and simple way to avoid imposition of the section 2801 tax. For instance, a covered expatriate could become an income tax resident in one year during which such person does not also satisfy the transfer tax definition of *resident*. During that year, the covered expatriate could make gifts that would not be subject to gift tax. The following year, the covered expatriate could terminate the covered expatriate's income tax residency, thereby allowing the gifts to completely escape transfer taxation. The Treasury Department and the IRS agree with the latter comment that using the transfer tax definition of *resident* for the exception in proposed §28.2801-2(h) avoids creating an opportunity to circumvent the section 2801 tax. Further, section 2801 is a transfer tax and is part of subtitle B; section 7701(b) of the Code specifically provides that the definitions in section 7701(b)(1) do not apply for purposes of subtitle B. Accordingly, applying the definition of *resident* under subtitle B for purposes of this transfer tax under section 2801 and the corresponding regulations is consistent with the purpose of the statute. Moreover, as one comment acknowledges, the use of the transfer tax definition is consistent with the concept of neutrality because it eliminates the avoidance of estate and gift tax that otherwise would result from expatriation. For these reasons, the final regulations adopt the transfer tax definition of U.S. resident without change.

One comment points out that the date on which a person loses U.S. citizenship

was changed by the HEART Act. The comment explains that this change could create ambiguity as to the exact date of a taxpayer's expatriation under certain circumstances. The comment requests clarification of how that date is determined for persons who had determined that they had expatriated before the effective date of the HEART Act, and for those with dual citizenship under section 7701(a)(50)(B). The Treasury Department and the IRS agree that such clarification would be both appropriate and helpful. Such clarification, however, would impact significantly more issues than those related to the section 2801 tax, and would be better addressed in guidance under sections 877A and 7701, rather than in regulations under section 2801. This issue is, therefore, beyond the scope of these final regulations. Accordingly, the final regulations adopt the language in proposed §28.2801-2(h) without change.

B. Foreign trust and domestic trust

Section 2801(a) provides that the section 2801 tax is imposed on a covered gift or covered bequest received by a U.S. citizen or resident. Section 2801(e)(4)(A) and (B)(iii) explains that a domestic trust or an electing foreign trust that receives a covered gift or covered bequest is treated as a U.S. citizen for the purposes of section 2801. If a covered gift or covered bequest is received by a non-electing foreign trust, however, section 2801(e)(4)(B)(i) provides that the section 2801 tax is imposed on any distribution attributable to the covered gift or covered bequest from the trust to a U.S. citizen or resident. Therefore, it is important to properly classify a trust receiving a covered gift or covered bequest as either a domestic or foreign trust in order to determine the identity of the U.S. citizen or resident liable for, and the timing of, payment of the section 2801 tax. Section 28.2801-2(c) and (d)(1) of the proposed regulations defines the terms *domestic trust* and *foreign trust* by reference to section 7701(a)(30)(E) and (31)(B), respectively. No comments were received regarding the definitions of domestic trust or foreign trust. These final regulations

maintain the same definitions as in the proposed regulations.

C. Covered bequest

Section 2801(e)(1)(B) defines a covered bequest as any property acquired directly or indirectly by reason of the death of an individual who, immediately before such death, was a covered expatriate. The proposed regulations define covered bequest in section 28.2801-2(f) and confirm that this definition includes any property acquired directly or indirectly by reason of the death of a covered expatriate, regardless of the situs of such property and whether such property was acquired by the covered expatriate before or after the covered expatriate's expatriation from the United States. Proposed §28.2801-3(b), which contains additional rules and exceptions applicable to covered bequests, provides that property acquired by reason of the death of a covered expatriate for purposes of 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 had the covered expatriate been a U.S. citizen at the time of death.

One comment acknowledges that including property that would have been includible in the gross estate of the covered expatriate had the covered expatriate been a U.S. citizen at the time of death appears to be consistent with legislative intent. However, the comment expresses concern that the definition of covered bequest in §28.2801-2(f), which includes all property passing by reason of the decedent's death, was too broad. The comment points out that not all property passing by reason of a decedent's death would be includible in the decedent's gross estate. The comment provides, as an example, property passing to a child from a trust created by a grandparent after a term measured by a now deceased parent's life. The comment suggests revising the definition of covered bequest in §28.2801-2(f) to include property acquired by reason of the death of a covered expatriate, but only to the extent the

property would have been included in the gross estate of the covered expatriate had the covered expatriate been a United States citizen immediately before death.

The comment correctly observes that including any property acquired directly or indirectly by reason of the death of a covered expatriate may inappropriately subject property to section 2801 tax, such as in the example provided by the comment (assuming the facts do not support an indirect gift). However, the suggestion to limit the definition of covered bequest to property acquired by reason of the death of a covered expatriate that would have been included in the gross estate of the covered expatriate is too narrow. Such a definition, for example, would wrongly exclude property that would otherwise be included in the gross estate of a covered expatriate even though the property was not acquired on the death of the covered expatriate (for example, under section 2035, which increases the gross estate by the value of certain property transferred within the 3-year period ending on the date of the covered expatriate's death). The comment's suggested definition also would exclude all distributions made by reason of the death of a covered expatriate from non-electing foreign trusts to the extent the distributions are attributable to covered gifts and covered bequests made to the foreign trust on or after June 17, 2008. Under section 2801(e)(4)(B)(i), a distribution from a non-electing foreign trust that is attributable to a covered gift or covered bequest made to the trust is subject to section 2801 tax in the same manner as if the distribution were a covered gift or covered bequest. When such a distribution is made by reason of a death of a covered expatriate, the distribution is more similar to a covered bequest described in section 2801(e)(1)(B) than a covered gift described in section 2801(e)(1)(A) and, therefore, is appropriately classified as a covered bequest.

To address the concern expressed in the comment as to property that would not have been included in the gross estate of the decedent, the definition of covered bequest in the final regulations instead describes three categories of property that are

included in the definition of covered bequest. The first category includes in the definition of covered bequest property acquired by a recipient on or after June 17, 2008, directly or indirectly by reason of the death of a covered expatriate but only to the extent the property would have been included in the covered expatriate's gross estate if the covered expatriate had been a U.S. citizen immediately before death. The second category includes in the definition property received from a covered expatriate that would have been included in the covered expatriate's estate, even if not acquired directly or indirectly by reason of the death of a covered expatriate, for example property includible under section 2035. The third category includes in the definition distributions made by reason of the death of a covered expatriate from a non-electing foreign trust to the extent the distributions are attributable to covered gifts and covered bequests made to the foreign trust on or after June 17, 2008.

D. Indirect acquisition of property

A covered gift or covered bequest is defined in section 2801(e) as any property acquired directly or indirectly by gift from or by reason of the death of a covered expatriate. Using transfer tax principles, §28.2801-2(i) of the proposed regulations identifies the transfers that constitute indirect acquisitions of property, to include property (1) acquired through ownership of an interest in a corporation or other entity, (2) acquired through one or more foreign trusts, entities, or persons not subject to the section 2801 tax, (3) paid in satisfaction of a debt or liability, (4) acquired through a power of appointment over property not in trust granted by a covered expatriate to a non-covered expatriate, and (5) acquired as a result of any other indirect transfer by a covered expatriate. Comments were received with respect to each example.

One comment states that the examples of an indirect acquisition of property in §28.2801-2(i)(2) and (3) of the proposed regulations go too far in that they are not limited by the extent to which the interest indirectly received is attributable to a covered

gift or covered bequest. Although these examples illustrate the definition of "indirect acquisition of property" for purposes of the 2801 tax, this definition is relevant only to the extent that the indirect acquisition is of an interest in a covered gift or covered bequest. When the definition of indirect acquisition is applied in relation to a covered gift or covered bequest, the appropriate limitation is applied. As a result, no change is needed in the final regulations to achieve the limitation sought by the commenter.

Several comments observe that the rule in §28.2801-2(i)(1) of the proposed regulations is consistent with the rule in §25.2511-1(h)(1) of the Gift Tax Regulations, which describes the gift tax consequences of a transfer made to a corporation. One comment requests that proposed §28.2801-2(i)(1) be revised to clarify the metrics used for determining a U.S. citizen or resident owner's share of a covered gift or covered bequest made to the entity. For instance, the commenter noted that an owner of an interest in an entity could have a mix of interests and/or rights in capital, profits, voting, distribution, liquidation, etc., and suggested that the final regulations permit taxpayers to use any reasonable method to account for these interests and rights. The Treasury Department and the IRS note that this issue is not unique to section 2801; the same issue arises in the gift tax context under chapter 12. *See, e.g.*, §25.2511-1(h)(1) (extent of a shareholder's interest relevant to determine the gift tax consequences of a transfer made by a corporation to another shareholder). Given the broader, more factual nature of determining the extent of an owner's interest and rights in an entity, this issue is better addressed under the Gift Tax Regulations, and therefore is beyond the scope of these final regulations. As a result, this suggestion is not adopted.

Several comments state that the illustrations in proposed §28.2801-2(i)(2), (3), and (5) are overbroad. In particular, the comments state that the illustrations in §28.2801-2 (i)(2) (regarding property acquired through one or more persons not subject to the section 2801 tax) and (3) (regarding property paid in satisfaction of a debt or

liability) are not tethered to any consideration of timing or gratuitous intent. One comment observes that the proposed definition would require a recipient to trace a potentially long chain of title to determine whether the property received would be a covered gift or covered bequest to that recipient. Another comment states that a non-covered expatriate family member of the covered expatriate and the U.S. recipient should not be considered an intermediary of the covered expatriate if that family member had dominion and control over the property and acted independently of the covered expatriate. Two comments suggest replacing §28.2801-2(i)(2) and (5) of the proposed regulations with a rule that would include, as an indirect acquisition, only property acquired pursuant to a plan, one of the principal purposes of which is the avoidance of transfer tax, similar to the rules in §§1.643(h)-1 and 1.679-3(c) of the Income Tax Regulations. The rules in §§1.643(h)-1 and 1.679-3(c) employ a substance over form approach with respect to certain transfers made through an intermediary.

These final regulations modify, in part, the definition of indirect acquisition of property to address some of the concerns regarding proposed §28.2801-2(i)(2), (3), and (5) as expressed in the comments. The Treasury Department and the IRS agree that the illustrations in §28.2801-2(i)(2) and (5) of the proposed regulations may capture transfers that, in some cases, are not truly indirect transfers and should not be subject to tax under section 2801. Thus, the final regulations replace the rules in proposed §28.2801-2(i)(2) and (5) with a single illustration that refers to an acquisition that is, in substance, a covered gift or covered bequest from a covered expatriate. In addition, the final regulations add a more general description of property that is gratuitously passed from or conferred by the covered expatriate through another person or entity, and the rules in proposed §28.2801-2(i)(1) through (5) are converted in the final regulations to a nonexclusive list of illustrations describing the application of the definition for purposes of section 2801. The suggestion is not adopted to replace the rule in proposed

§28.2801-2(i)(2) and (5), applicable to acquisitions of property, with a rule that would add a principal purpose of tax avoidance test applicable to distributions from and to foreign trusts, similar to the rules in §§1.643(h)-1 and 1.679-3(c). As with other interpretations of terms in section 2801 (for example, U.S. resident), applying transfer tax principles to section 2801 is the better interpretation of the statute both because section 2801 is a transfer tax, and the intent of the transferor generally is irrelevant for transfer tax purposes.

Finally, comments recommend narrowing the scope of proposed §28.2801-2(i)(4) to include only property acquired pursuant to a non-covered expatriate's non-general power of appointment (as opposed to all types of powers of appointment) granted by a covered expatriate over property not in trust. Such a change would ensure that the exercise, release, or lapse of a non-covered expatriate's general power of appointment over property not in trust would not be a covered gift or covered bequest, which the commenters contend is consistent with the general gift tax treatment of the holder of a general power of appointment as the owner of the property subject to the power. If the commenters' recommendation were adopted, it would allow a covered expatriate to avoid the section 2801 tax by granting a general power of appointment over non-trust property to a person who is neither a covered expatriate nor a U.S. citizen or resident, but who will exercise or release the power or allow it to lapse in favor of a U.S. citizen or resident. Thus, the final regulations continue to describe the acquisition of property pursuant to a non-covered expatriate's power of appointment (whether general or non-general) granted by a covered expatriate over property not in trust as an example of an indirect acquisition of property for purposes of section 2801. The final regulations clarify, however, that acquiring property pursuant to a power of appointment means as the result of an exercise, release, or lapse of that power, without regard to the de minimis exceptions in section 2041(b)(2) or 2514(e). This latter clarification is

necessary because section 2801(c) provides the only *de minimis* exception to the imposition of section 2801 tax.

E. Other definitions

Several comments suggest other revisions to §28.2801-2 of the proposed regulations to make the regulations more user friendly, including using consistent terminology. Those suggestions include the replacement of *citizen or resident of the United States* with the term used in the statute, *U.S. citizen or resident*, the addition of a definition of the term *non-electing foreign trust*, and the correction of the reference in the definition of the term *general power of appointment* to section 2041(b)(1) (rather than section 2041(b)) to clarify that the exclusions for lapses and certain pre-1943 powers under section 2041(b)(2) and (3), respectively, do not apply for purposes of section 2801. These suggestions have been adopted and the appropriate changes are reflected in the final regulations. The suggestion that other terms (such as *gift* and *charitable remainder trust*) used throughout the proposed regulations, as well as other terms unique to section 2801 that are defined elsewhere in the proposed regulations (in the particular section where each is relevant), either be defined in §28.2801-2 or referred to by cross-references, has not been adopted. Several such terms are defined elsewhere in the Code or in the corresponding regulations, and those that are specific to a particular issue under section 2801 are defined and applied in the discussion of that particular issue in the relevant section of the regulations in an effort to make the regulations more readily understood.

3. Exceptions to Definitions of Covered Gift and Covered Bequest

A. Transfers otherwise subject to gift or estate tax

Section 2801(e)(2)(A) and (B) excepts from the definitions of covered gift and covered bequest, respectively, any taxable gift by a covered expatriate and any property included in the gross estate of a covered expatriate, if such property is reported on a

timely filed gift or estate tax return (timely filed requirement).

One comment suggests that a covered expatriate be allowed to treat transferred property as a transfer of a U.S. situs asset, report the transfer on a timely filed gift or estate tax return, and thereby avoid the transfer being a covered gift or covered bequest. By reducing the effective tax rate on the transfer, the comment states that this approach would be consistent with the tax neutrality intended at enactment of section 2801.[1] These final regulations do not adopt the commenter's suggestion, because it is inconsistent with section 2801. Additionally, if adopted, such a filing in effect would override the provisions of sections 2511(a) (applying the gift tax only to transfers by nonresident, noncitizens of property situated within the United States) and 2103 (including in the gross estate of nonresident, noncitizens only that part of property that is situated within the United States at the time of death) for certain transfers by covered expatriates, a result not contemplated by the statutory language of section 2801. While section 2801 allows a foreign trust to elect to be treated as a domestic trust, there is no indication that Congress intended to allow other elections that would operate in the way suggested by this commenter.

i. Timely Paid Requirement

For property reported on the covered expatriate's gift or estate tax return to be excluded from the definition of a covered gift or covered bequest, §28.2801-3(c)(1) and (2) of the proposed regulations requires not only the timely filing of that return, but also the timely payment of the tax shown on that return (timely paid requirement).

Comments state that the timely paid requirement should be eliminated because there is no statutory basis for imposing that requirement. Comments also note that the timely paid requirement would cause a double tax to be imposed on a single transfer if

[1] For a discussion of the "tax neutral" objective stated in H.R. Rep. No. 110-431 with regard to an earlier, pre-HEART Act, bill, see part 1 of the *Summary of Comments and Explanation of Revisions* section of this preamble.

the gift or estate tax is not timely paid: gift or estate tax due from the covered expatriate or covered expatriate's estate, as well as section 2801 tax due from the U.S. recipient of that property. As to the latter comment, the Treasury Department and the IRS note that the potential for imposing tax on both the covered expatriate or the covered expatriate's estate and the U.S. citizen or resident receiving the covered gift or covered bequest is already created by the timely filed requirement under section 2801(e)(2)(A) and (B), which would deny the exception if the gift or estate tax return is filed late. Like the timely filed requirement, the timely paid requirement limits the potential for tax avoidance by ensuring that an excepted transfer is timely reported and that the tax on such excepted transfer is timely paid by the covered expatriate, over whom it may be difficult for the IRS to assert jurisdiction to enforce that tax liability.

Providing a timely paid requirement is not beyond the Treasury Department and IRS's general regulatory authority to implement the Congressional mandate of section 2801, including addressing compliance concerns. However, the Treasury Department and the IRS have considered other existing gift and estate tax enforcement mechanisms which also could address compliance concerns, such as under subtitle F of the Code and the ability of the IRS to collect the tax liability of the covered expatriate or covered expatriate's estate from any transferee of the property. See section 6324 of the Code (establishing special estate and gift tax liens that are separate and distinct from the general tax lien) and section 6901 of the Code (providing transferee gift tax or estate tax liability is to be assessed, paid, and collected in the same manner and subject to the same provisions and limitations as the tax imposed on the decedent or donor). Further, a timely paid requirement could present administrability and finality challenges – for example, when the amount paid with the return differs from the amount that is ultimately owed due to a valuation change or other adjustment after examination. In view of the above, the final regulations adopt the commenters' suggestion to

eliminate the timely paid requirement as it relates to this exception from the definitions of covered gift and covered bequest.

ii. Both Section 2801 Tax and Gift or Estate Tax on Same Transfer.

As discussed in part 3.A.i. of the *Summary of Comments and Explanation of Revisions* section of this preamble, a late filing of a gift or estate tax return by a covered expatriate or covered expatriate's estate prevents the transferred property from being excluded from the definition of a covered gift or covered bequest and may lead to the imposition of gift or estate tax as well as the imposition of the section 2801 tax on the same transfer of that property. Further, both the gift or estate tax and the section 2801 tax ultimately may be payable by the U.S. citizen or resident if transferee liability is imposed if the covered expatriate or covered expatriate's estate fails to pay the gift or estate tax due. See sections 6324(a)(2) and (b) and 6901.

Comments suggest that the final regulations provide a remedy to avoid the payment, on the same transfer, of both gift or estate tax by the covered expatriate or covered expatriate's estate and the section 2801 tax by the U.S. citizen or resident receiving the covered gift or covered bequest. The comments suggest alternative proposals to be added to the final regulations, including (a) providing for a refund to a U.S. citizen or resident who paid the section 2801 tax when gift or estate tax has been paid by a covered expatriate or covered expatriate's estate; (b) providing a credit or refund to the U.S. citizen or resident, or the covered expatriate or covered expatriate's estate, of whichever of those taxes is paid last; and (c) eliminating the timely filed requirement if the gift or estate tax is paid by the covered expatriate or the covered expatriate's estate prior to the due date of Form 708.

Section 2801(e)(2)(A) and (B) excepts from the definitions of covered gift and covered bequest, and thus from liability for the section 2801 tax, property reported on a timely filed gift or estate tax return. These sections explicitly provide an exception only

for property shown on a timely filed return, and any exception from tax for covered gifts or covered bequests not reported on a timely return would ignore and give no meaning to the timely filed language in section 2801. Accordingly, eliminating liability for the section 2801 tax when the transfer of such property is not timely reported by a covered expatriate or covered expatriate's estate on a gift or estate tax return is contrary to the statute. Thus, despite the potential for the imposition of either estate or gift tax on the transfer of such property as well as the imposition of the section 2801 tax on the recipient's acquisition of such property, these final regulations do not adopt the suggestions of the comments.

Similarly, one comment suggests that a recipient who paid the U.S. gift or estate tax liability of the donor or decedent due to transferee liability should have a credit for those taxes against the recipient's section 2801 tax liability. These final regulations do not adopt this comment for the following reasons. First, a credit given to the recipient for gift or estate tax paid pursuant to transferee liability could incentivize the transferor subject to gift or estate tax to resist payment and force collection from the recipient. Second, section 2801 (unlike section 1446(d) of the Code,[2] for example) does not provide for such a credit.

Finally, in response to a comment, *Example 2* in proposed §28.2801-3(f) is updated in the final regulations to clarify that, under the facts of the example, the covered expatriate's estate must file an estate tax return (Form 706-NA, *United States Estate (and Generation-Skipping Transfer) Tax Return*, *Estate of nonresident not a citizen of the United States*), and pay the estate tax with respect to certain property, despite the requirement that the son of the covered expatriate in that example file Form 708 and pay the section 2801 tax with respect to the same property.

B. Property subject to section 2801 tax both as covered gift and as covered bequest

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[2] Section 1446(d) provides a credit under section 33 of the Code for a foreign partner's share of the withholding tax paid by the partnership under section 1446.

Noting that a U.S. citizen or resident may receive property that constitutes a covered gift and, subsequently, a covered bequest, a comment suggests that the definition of covered bequest should exclude any property treated as acquired by reason of the death of a covered expatriate if the property previously was subject to the section 2801 tax as a covered gift from the same covered expatriate. For instance, when a covered expatriate transfers a remainder interest in real property to a U.S. recipient and retains a life estate, the value of the remainder interest is a covered gift, and the value of the entire real property is a covered bequest at the covered expatriate's death. See section 2036(a)(1).

The Treasury Department and the IRS are sympathetic to the commenter's concern that the same property could be subject to section 2801 tax first as a covered gift and subsequently as a covered bequest acquired from the same covered expatriate, and agree there should be no such duplication of the liability under section 2801. However, rather than excluding from the definition of covered bequest any property previously subject to the section 2801 tax as a covered gift, it is appropriate and more in line with the structure of the transfer tax system to exclude instead the value of the covered gift that was previously subject to section 2801 tax from the value of the covered bequest of that same property. In this way, similar to the way that section 2001(b) does not subject to estate tax the value of a gift that was previously subject to gift tax, the value already subjected to section 2801 would not be retaxed and the computation of the section 2801 tax would be able to properly take into account the post-gift appreciation in the value of the transferred property through the U.S. persons' receipt of the covered bequest. Accordingly, §28.2801-3(c)(3) of the final regulations includes a rule that limits the value of a covered bequest to the amount that exceeds the value of the covered gift to which the section 2801 tax previously applied.

C. Transfers to spouse

Section 2801(e)(3) excepts from the definitions of covered gift and covered bequest a gift or bequest that would qualify for a marital deduction under section 2056 or 2523 if the donor or decedent were a U.S. person.

i. QDOT and QTIP Elections for Non-U.S. Situs Property

Under proposed §28.2801-3(c)(4), the exception to the definitions of covered gift and covered bequest for transfers to a spouse that are dependent upon the making of a qualified terminable interest (QTIP) or qualified domestic trust (QDOT) election only applies if a valid QTIP or QDOT election in fact is made. Because these are elective choices with different tax consequences, the desire to make the election cannot be presumed in all cases.

Many of the comments received on the proposed rule requiring the making of a valid QTIP or QDOT election concern non-U.S. situs property. The comments received generally fall into two categories: those comments that conclude that a covered expatriate or a covered expatriate's executor may make a valid QTIP or QDOT election with respect to only U.S. situs property; and those comments that conclude that a QTIP or QDOT election also may be made with respect to non-U.S. situs property and request guidance on how such an election might be made with respect to non-U.S. situs property. With respect to the former, the comments state that a covered expatriate or a covered expatriate's estate is limited to making a QTIP or QDOT election with respect to U.S. situs property because only the transfer of U.S. situs property by a covered expatriate is subject to U.S. gift and estate taxation under sections 2511(a) and 2103. With respect to the latter, different comments suggest various methods of allowing a QTIP or QDOT election to be made with respect to non-U.S. situs property, including on a Form 706-NA filed by a trust, on a Form 708 filed by a U.S. recipient, and by a trust that is a U.S. recipient of a foreign non-electing trust.

The Treasury Department and the IRS agree with the comments in the first

category that, for the exception to the definitions of covered gift and covered bequest to apply under section 2801(e)(3), a covered expatriate or a covered expatriate's estate is limited to making a QTIP or QDOT election with respect to only U.S. situs property. Section 2801(e)(3) provides no basis for allowing a QTIP or QDOT election to be made for property that is not subject to U.S. gift or estate tax, and, furthermore, it provides no mechanism for making the election and no indication that the IRS should create such a mechanism through regulations. In addition, adopting the position of the latter comments and providing a method to make a QTIP or QDOT election for non-U.S. situs property (in addition to U.S. situs property) would be inconsistent with the QTIP and QDOT statutory provisions that defer, but do not eliminate, transfer tax on property qualifying for the marital deduction. If such a rule were adopted so that such property would not be subject to section 2801 tax upon the initial gift or bequest by the covered expatriate, such property also would not be subject to gift or estate tax under section 2519, 2044, or 2056A(b) upon any disposition or distribution or on the death of the covered expatriate's spouse. Consequently, covered expatriates and the estates of covered expatriates would be afforded more favorable transfer tax treatment than that available to U.S. citizens. The Treasury Department and the IRS also note that a covered expatriate may obtain the benefits of the exception in section 2801(e)(3) with respect to non-U.S. situs property by making an outright gift or bequest of that property to a U.S. citizen spouse, or a bequest to a trust described in section 2056(b)(5) that provides the surviving spouse with both a life estate and a general power of appointment. For these reasons, the final regulations retain the proposed rule that requires a valid QTIP and/or QDOT election in order for property to qualify for this exception to the definitions of covered gift and covered bequest, and the regulations further clarify that such an election can be made only with respect to property subject to gift or estate tax, that is, only with respect to U.S. situs property.

ii. Distributions from Non-Electing Foreign Trusts

Transfers from a covered expatriate to a non-electing foreign trust are covered gifts or covered bequests, but are not subject to the tax under section 2801 until a distribution is made from that trust. Specifically, section 2801 imposes the tax on distributions from that trust to a U.S. recipient to the extent those distributions are attributable to the covered gifts or covered bequests contributed to the trust.

A few comments suggest that, for transfers to a non-electing foreign trust, section 2801(e)(4)(B)(i) supports applying the marital exception at the time of the distribution from the non-electing foreign trust to the U.S. spouse, because that is when tax under section 2801 tax is imposed. Recognizing that the marital deduction is applied at the time of the transfer giving rise to gift or estate tax, these comments contend that this approach would be consistent with transfer tax principles. These comments also state that this approach would be consistent with the goal of tax neutrality as applied to surviving spouses, in that the imposition of the section 2801 tax should not depend upon whether a non-electing foreign trust (that would qualify for the marital deduction) is interposed between the donor or decedent and the receipt by the surviving spouse. See part 1 of the *Summary of Comments and Explanation of Revisions* section of this preamble for a discussion of the “tax neutral” objective stated in H.R. Rep. No. 110-431 with regard to an earlier, pre-HEART Act, bill. The comments acknowledge that, under their interpretation, a transfer of property to a non-electing foreign trust would be treated differently than a transfer of property to a domestic trust or an electing foreign trust; however, they posited that the difference is justified by the timing of the transfer taxable under section 2801. Specifically, the comments point out that by its express terms, the statute treats a non-electing trust differently with regard to the timing of the imposition of the tax and the payee of that tax.

The Treasury Department and the IRS have carefully considered the merits and

implications of the suggestion to apply the marital exception at the time of the distribution from the non-electing foreign trust. The proper interpretation of section 2801(e)(3) and (4)(B)(i), however, does not permit the creation of a special rule for non-electing foreign trusts that would provide an opportunity for a marital exception at the time of a distribution from the trust. Unlike the marital deduction for estate and gift taxes, the exception for marital transfers under section 2801 is an exception to the definitions of covered gift and covered bequest. Those definitions apply to determine whether a contribution to a non-electing foreign trust is a covered gift or covered bequest, and thus the availability of that exception is determined as of the time of the covered expatriate's funding of the non-electing foreign trust. For this reason, even though the U.S. spouse's receipt of property attributable to the covered gift or covered bequest occurs and becomes taxable under section 2801 only upon its distribution out of the trust, the availability of the marital exception cannot be applied instead at the time of the distribution from that trust.

Two other comments suggest that a distribution from a non-electing foreign trust to a U.S. citizen or resident spouse should be treated as an indirect gift or bequest to which the exception could be applied. However, to do so would imply that all trust distributions are indirect transfers, which would go too far. In addition, if such an indirect transfer would have qualified for the transfer tax marital deduction at all, it effectively would override section 2801(e)(4), would confer a tax advantage on a covered expatriate that is unavailable to a U.S. person, and would be (as one comment concludes) overly generous. For example, a transfer of non-U.S. situs property by a covered expatriate at death outright to the covered expatriate's U.S. citizen spouse is not a covered bequest, because such transfer would have qualified for the estate tax marital deduction if the covered expatriate were a U.S. person. Similarly, a transfer of non-U.S. situs property by a covered expatriate at death to a non-electing foreign trust

that qualifies for the estate tax marital deduction under section 2056(b)(5) is not a covered bequest because such transfer would have qualified for the estate tax marital deduction if the covered expatriate were a U.S. person. In these situations, because the contributions to the trust are not covered bequests, not only are distributions from the non-electing foreign trust to the covered expatriate's U.S. citizen spouse not subject to the section 2801 tax pursuant to the exception in section 2801(e)(3), but distributions to the remainder beneficiary upon such spouse's death also are not subject to the section 2801 tax. By contrast, a transfer of non-U.S. situs property from a covered expatriate at death to a trust for the benefit of the covered expatriate's U.S. citizen spouse and U.S. citizen children is a covered bequest because such transfer would not have qualified for the estate tax marital deduction if the covered expatriate were a U.S. person. If such trust is a non-electing foreign trust, the section 2801 tax is not payable until there is a distribution to a U.S. citizen or resident. When the trust makes a distribution to the covered expatriate's U.S. citizen spouse, that spouse is liable for the section 2801 tax because the distribution is attributable to a covered bequest and is taxed "in the same manner as if such distribution were a covered gift or covered bequest." Section 2801(e)(4)(B)(i).

These final regulations explicitly address the application of the section 2801(e)(3) exception to the definition of covered gift or covered bequest in §28.2801-3(c)(5) and in *Example 2* to §28.2801-5(e).

D. Transfers to charity

To the extent a gift or bequest would qualify for a charitable deduction under section 2055 or 2522 if the donor or decedent were a U.S. citizen or resident, such gift or bequest is excepted under section 2801(e)(3) and §28.2801-3(c)(3) of the proposed regulations from the definitions of covered gift and covered bequest. Regarding distributions to qualifying charitable organizations from a non-electing foreign trust, a

few comments assert that section 2801(e)(4)(B)(i) supports applying the exception at the time of distribution and explain that this would avoid imposing the section 2801 tax on a U.S. charity. The comments explain that their analysis regarding the marital exception, which is set forth in part 3.C.ii. of the *Summary of Comments and Explanation of Revisions* section of this preamble, applies equally to the charitable exception. Because this exception depends upon the contribution to the trust being eligible for a transfer tax charitable deduction, and for the reasons described in part 3.C.ii. of the *Summary of Comments and Explanation of Revisions* section of this preamble, these final regulations have not adopted the interpretation advanced by the comments.

Section 28.2801-4(a)(2)(iii) of the proposed regulations provides that 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, and that the charitable remainderman's share of each transfer to the charitable remainder trust is not a covered gift or covered bequest. The proposed regulations further provide that, 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.

One comment notes that the proposed regulations do not indicate whether the

payment of section 2801 tax by a charitable remainder trust is disregarded in computing the amount of annuity or unitrust distributions and in determining whether the 10 percent minimum remainder requirement in section 664(d)(1)(D) and (2)(D) and the probability of exhaustion test described in Rev. Rul. 70-452, 1970-2 C.B. 199, are satisfied. The comment observes that, if the tax imposed by section 2801 were considered in determining whether the 10 percent minimum remainder requirement and probability of exhaustion tests are satisfied, then most trusts that owe tax under section 2801 are likely to be disqualified as a charitable remainder trust. The comment also observes, however, that, if the tax is not considered in determining the annuity amount, then the charitable remainder will be overvalued.

One comment points out that the proposed regulations do not provide guidance on whether a charitable remainder trust's payment of section 2801 tax should be allocated to income or principal for the purpose of determining the character of distributions under section 664(b) and §1.664-1(d)(2).

The proposed regulations also do not contain any guidance on how a domestic trust or electing foreign trust that qualifies as a charitable lead trust under section 2055(e)(2)(B) or 2522(c)(2)(B) is to compute the 2801 tax. Several comments suggest that the final regulations provide that a charitable lead trust should compute the section 2801 tax in a similar manner to a charitable remainder trust, such that the charitable lead interest could be subtracted from the total value of the covered gift or bequest to determine the amount that is subject to the section 2801 tax.

As the comments note, the proposed regulations do not provide any rules on the effect of a charitable remainder trust's tax payment on the trust's qualification under section 664. This is a complex and foundational issue, such that final rules regarding charitable remainder trusts should not be promulgated without further consideration and an opportunity for notice and comment. Additionally, as the comments point out, the

proposed regulations do not provide any rules on charitable lead trusts, and, therefore, final rules regarding charitable lead trusts should not be promulgated without further consideration and an opportunity for notice and comment. Accordingly, §28.2801-4(a)(2)(iii) of the final regulations is reserved for these purposes.

4. Computation of Section 2801 Tax

Under section 2801(a) and (c), the section 2801 tax is determined by reducing the total value of covered gifts and covered bequests received by a U.S. recipient during the calendar year by the dollar amount of the per-donee exclusion in effect under section 2503(b) for that calendar year ($18,000 in 2024) (section 2801(c) amount), and then multiplying the net amount by the highest estate or gift tax rate in effect during that calendar year (40 percent in 2024). The reference in section 2801(c) to section 2503(b) has the sole purpose of defining the amount by which to reduce the aggregate value of covered gifts and covered bequests received by a U.S. citizen or resident during the calendar year, as acknowledged in the comments. Under section 2801(d), the resulting tax then is reduced by any estate or gift tax paid to a foreign country with regard to such covered gifts and covered bequests. Section 28.2801-4(b) (on the computation of the section 2801 tax) and 28.2801-4(e) (on the reduction of the section 2801 tax for foreign gift or estate tax paid) of the proposed regulations are consistent with these statutory rules.

A. Effective tax rate

Several comments note that the effective tax rate of the section 2801 tax on a covered gift is much higher than the effective tax rate for a gift subject to gift tax because the base on which the section 2801 tax is imposed includes the amount of the section 2801 tax payable by the U.S. recipient (making it "tax inclusive") while the base on which the gift tax is imposed does not include the amount of the gift tax payable by the donor (making it "tax exclusive"). These comments contend that this result is a

deviation from Congress' stated goal of tax neutrality, and one comment suggests that the final regulations allow a covered expatriate instead to elect to treat a gift as a transfer of U.S. situs property, to reduce the effective section 2801 tax rate on the covered gift.

As discussed in part 1 of the *Summary of Comments and Explanation of Revisions* section of this preamble, section 2801 imposes a tax that does not equal, and in some cases is not similar to, the tax that would have been imposed on the same transfer by a U.S. transferor. The effective tax rate on covered gifts under section 2801 as compared to the effective tax rate on taxable gifts under chapter 12 is another example of this. While Congress could have allowed a covered expatriate to elect to treat a covered gift of non-U.S. situs property as a transfer of U.S. situs property, it did not do so. (But see section 2801(e)(4)(B)(iii) allowing foreign trusts to elect to be treated as a domestic trust for purposes of section 2801). The statute does not provide any reasonable regulatory interpretation that the section 2801 tax on covered gifts should be levied on less than the entire amount of the covered gift, and the statute does not contemplate a regulatory rule allowing for a deduction or exclusion to estimate a tax exclusive section 2801 tax rate. Accordingly, these final regulations do not adopt the commenters' suggestion as it would be contrary to the statute.

B. Section 2801(c) amount

Section 28.2801-3(d) of the proposed regulations provides that the recipient of a covered gift or covered bequest made to a trust is the trust and not any individual who holds a general power of appointment or power of withdrawal over trust property. Several comments recommend that the final regulations treat a transfer to a trust as a transfer to an individual to the extent of the individual's general power or withdrawal right. The comments acknowledge that this would increase the section 2801(c) amount available to shield a covered gift or covered bequest from the section 2801 tax when

multiple individuals have withdrawal rights, but state this treatment is consistent with the treatment of withdrawal rights under gift tax principles and thus furthers the statutory goal of tax neutrality. See part 1 of the *Summary of Comments and Explanation of Revisions* section of this preamble for a discussion of the "tax neutral" objective stated in H.R. Rep. No. 110-431 with regard to an earlier, pre-HEART Act, bill. One comment suggests that there is no authority to deny the status of recipient to the holder of a withdrawal right. For the reasons stated below, these final regulations do not adopt the commenters' recommendation.

The holder of a withdrawal right over trust property is the holder of a general power of appointment. For gift tax purposes, neither the grant nor the receipt of a general power of appointment is treated as a taxable gift; rather, it is the possession of such a power at death, or the exercise or release of such a power that is a taxable event for gift and estate tax purposes. Thus, the proposed treatment of a general power of appointment – that is, not as the receipt of a covered gift or bequest – is consistent with transfer tax principles. In addition, while section 2801 is silent on the treatment of general powers of appointment, section 2801(e)(4) provides specific rules applicable to a covered gift or covered bequest made to a domestic or electing foreign trust: specifically, the section 2801 tax is imposed on the recipient trust. Implementing the recommendation proposed by the commenters would violate the provisions of section 2801(e)(4)(A)(ii) requiring that the tax imposed on a covered gift or covered bequest made to a domestic trust be paid by that trust. By, in effect, defining the donee domestic trust as the recipient of the covered gift or covered bequest, the statute imposes the filing and tax payment obligations on the domestic trust, regardless of the identity and rights of the trust beneficiaries. As a result, the receipt of property by the domestic trust does not have to be reported by and taxed to both the trust and each holder of a general power of appointment or withdrawal right over trust property.

Treating each such power holder as an additional recipient at the time of the trust contribution would add administrative complexity and burden both to taxpayers and the IRS.

Similarly, under section 2801(e)(4)(B), it is the recipient of a distribution from a non-electing foreign trust who is treated as the recipient of the covered gift or covered bequest to the trust. No section 2801 tax is imposed on covered gifts or covered bequests to a non-electing foreign trust until a trust distribution is made to a U.S. recipient. It is the property distribution pursuant to the exercise, release, or lapse of a general power of appointment over such a trust, rather than the grant of such a power, that is a distribution triggering the imposition of the section 2801 tax.

As a result, in the case of a transfer to a trust, a domestic trust is the recipient who is entitled to reduce the value of a covered gift or covered bequest received during the calendar year by the section 2801(c) amount. These rules also apply to an electing foreign trust.

Finally, comments request guidance for trusts in the potential situation where a domestic trust or an electing foreign trust may be unable to pay the section 2801 tax upon the exercise of an individual withdrawal right. Such a situation, where the trustee is faced with balancing the obligation to satisfy tax obligations with the duty to make distributions as directed by the trust instrument, is not unique to the section 2801 tax (for example, an obligation to satisfy an estate tax obligation may conflict with a specific bequest, or an obligation to satisfy a GST tax obligation may conflict with a distribution provision to a trust beneficiary). Given the broader issues concerning a trustee's duty to administer a trust, such issues are better addressed in more comprehensive regulations and are therefore beyond the scope of these final regulations.

C. Foreign gift or estate tax

Consistent with section 2801(d), §28.2801-4(e) of the proposed regulations

provides that the section 2801 tax is reduced by the amount of any gift or estate tax paid to a foreign country with respect to a covered gift or covered bequest. Pointing to section 2014(a), which allows a credit against estate tax for any estate, inheritance, legacy, or succession taxes paid to any foreign country, two comments suggest that, in the interest of tax neutrality, these final regulations also allow a reduction for any foreign tax imposed on a covered gift or covered bequest that is similar to, but imposed in lieu of, a gift or estate tax, such as an inheritance tax or a deemed capital gains tax. See part 1 of the *Summary of Comments and Explanation of Revisions* section of this preamble for a discussion of the "tax neutral" objective stated in H.R. Rep. No. 110-431 with regard to an earlier, pre-HEART Act, bill. These final regulations do not adopt the commenters' suggestion, because the plain language of section 2801(d) unambiguously limits the reduction to the amount of gift or estate tax paid to a foreign country with respect to a covered gift or covered bequest and does not contain the kind of statutory language that appears in section 2014.

A comment also suggests that these final regulations allow a refund of the section 2801 tax if foreign gift or estate tax is paid after payment of the section 2801 tax. In such a scenario, a refund is available under section 6511 if the U.S. recipient files a claim for refund or a protective claim for refund on or before the expiration of the applicable period of limitations. To confirm the U.S. recipient's ability to file a protective claim for refund, paragraph (e)(2) is added to §28.2801-4 of the final regulations.

5. Value of a Covered Gift or Covered Bequest

Section 28.2801-4(c) of the proposed regulations defines value using transfer tax principles, including the special valuation rules of chapter 14 (sections 2701 through 2704). Several comments recommend that the final regulations be amended to disregard chapter 14. Alternatively, the comments suggest that the value of a covered gift should be determined by subtracting from the value of the covered gift the total

value of any interest retained by a covered expatriate donor, without regard to section 2701 or 2702. The comments posit that, because the section 2801 tax is payable by the recipient, unlike the gift and estate taxes that are payable by the donor or decedent's estate, the requested deviation from the usual gift tax valuation rules is necessary. However, like the gift and estate taxes, the section 2801 tax is a transfer tax. The transfer tax valuation rules, therefore, including the special valuation rules of chapter 14, apply to value the property subject to section 2801. The section 2801 tax is imposed on transfers that otherwise would have escaped gift or estate taxation as a consequence of the donor's or decedent's expatriation. Revising the section 2801 regulations in the suggested manner would decrease the value of a covered gift to which sections 2701 and 2702 apply below what otherwise would have been its gift tax value had the covered expatriate been a U.S. citizen. This result is inconsistent with the intended purpose of section 2801, and Congress did not provide an exception for the special valuation rules. Thus, the requested revisions are not adopted.

One comment suggests that sections 2701 and 2702 should not apply in determining the tax liability of a covered bequest, because those sections have no applicability to the estate tax. While the Treasury Department and the IRS acknowledge that sections 2701 and 2702 generally apply only to inter vivos transfers, section 2701(d) provides in certain circumstances for a potential increase in the taxable estate of a transferor. Accordingly, the final regulations provide that the special valuation rules under chapter 14 apply only to the extent those rules are applicable to the specific transfer.

6. Date of Receipt of a Covered Gift or a Covered Bequest

Under §28.2801-4(d)(2) of the proposed regulations, the date of receipt of a covered gift, which is the date the section 2801 tax is imposed, generally is determined by reference to the date of the gift under chapter 12 principles, as if the covered

expatriate had been a U.S. citizen at the time of the transfer. In the event of a transfer of assets by a covered expatriate to a domestic revocable trust, proposed §28.2801-4(d)(2) provides that the date of receipt of the transfer is the date the covered expatriate relinquishes the right to revoke the trust. Proposed §28.2801-4(d)(3) provides that the date of receipt of a covered bequest generally is the date the property is distributed from the covered expatriate's estate or revocable trust, unless the interest passes by operation of law or beneficiary designation, in which case the date of receipt is the date of the decedent's death. Comments recommend changing the rules regarding the date of receipt for both covered gifts and covered bequests.

With respect to the date of receipt of a covered gift, comments point out that the date on which a covered expatriate makes a gift often is not the same date on which the property is received by the U.S. citizen or resident donee. A discrepancy between those dates can impact a recipient's ability to pay the section 2801 tax liability because the recipient may not yet have received the economic benefit of the gifted property. Comments suggest different methods of determining the date of receipt: (1) the date of "actual" receipt; (2) the date an interest in property becomes possessory; or (3) the date of distribution to the U.S. citizen or resident. The third method is intended to be comparable to the proposed rule for the date of receipt of a covered bequest. A few comments also suggest that the rule determining the date of receipt for purposes of the section 2801 tax should distinguish between receipt of a present interest in property and receipt of a future interest in property. Finally, a comment requests that the final regulations further elaborate on the date of receipt when a transfer of assets to a domestic revocable trust is an incomplete gift, pointing out that relinquishment of the right to revoke the trust may not be the trigger that completes the gift.

With respect to the date of receipt of a covered bequest, some comments object to treating interests passing by operation of law or beneficiary designation as received

on the date of death, rather than on the date property is distributed to the recipient. Comments note that a decedent's property devolves to heirs at death by operation of law in civil law jurisdictions, even though significant time may elapse before the heirs' interests become possessory. Again, this delay could impact a recipient's ability to pay the section 2801 tax. To address these concerns, a few comments suggest defining the date of receipt of a covered bequest as the date of actual receipt by the recipient, whether a distribution from a decedent's estate or revocable trust or the transfer of property by operation of law, beneficiary designation, or other contractual arrangement. Another comment suggests that, if the date of receipt of a covered bequest is not changed from that identified in the proposed regulations, the final regulations should include an election to defer payment of the section 2801 tax and interest until the recipient's interest becomes possessory. Still another comment suggests that, because a date of death valuation is likely to be performed on inherited assets for non-section 2801 purposes, recipients should be able to elect to treat a covered bequest as received as of the date of death rather than the date of actual distribution to avoid the need for additional appraisals.

Defining the date of receipt of both a covered gift and a covered bequest as the date on which the recipient obtains actual receipt or a possessory interest in the transferred property would eliminate the concern regarding the recipient's ability to pay the section 2801 tax, particularly in civil law jurisdictions where property passes by operation of law to heirs at death but distribution is delayed for a period during administration of the decedent's estate. However, such a definition outside of the context of a distribution from a decedent's estate or revocable trust would raise other issues and administrability concerns. For instance, in some cases it may be difficult to determine the date of actual receipt of a covered gift or covered bequest, such as the receipt of a remainder interest in property or, in the case of a delay in distribution of

property after title has vested in a civil law jurisdiction during the period of administration. In cases where property is distributed or an interest becomes possessory long after the transfer by the covered expatriate, it may be difficult for the recipient to obtain the information needed to determine whether the transfer is subject to the section 2801 tax and otherwise comply with reporting and paying the section 2801 tax. Further, such a definition could open the door to possible manipulation of the date of receipt and potential abuse, such as planning designed to ensure a covered gift or covered bequest is considered non-possessory for an extended period to delay and possibly defeat any section 2801 tax liability.

In most instances, the lengthy amount of time between the date of receipt and the due date of the return and payment of the section 2801 tax, which generally is 17.5 months after the close of the year in which the covered gift or covered bequest is received, should be sufficient to allow a U.S. recipient to make necessary arrangements to timely report and pay any section 2801 tax liability. See §28.6071-1(a). Moreover, the rules for transfers in trust satisfactorily resolve the potential problems for many situations of deferred possession.

However, for future interests in property that are not held in a trust (for example, a remainder interest in real property), the Treasury Department and the IRS appreciate the administrative and valuation concerns with the proposed definitions of the date of receipt. In view of these concerns, §28.2801-4(d)(8)(i) of the final regulations includes a special rule providing that the date of receipt of a covered gift or covered bequest of a future interest in property that is not held in trust is the earlier of (1) the date the future interest is disposed of by the U.S. recipient or (2) the date that is the later of the date that the interest vests in the U.S. recipient or the date that the last term interest in the property held by an intervening recipient terminates. Further, to assist recipients both in achieving finality regarding the section 2801 tax liability and in avoiding the potential for

administrative hurdles caused by a long delay in receipt, §28.2801-4(d)(8)(ii) of the final regulations provides that the U.S. recipient of a covered gift or covered bequest of a future interest in property not held in trust may elect to treat the covered gift or covered bequest as having been received on the date of receipt of the gift or on the covered expatriate's date of death, respectively. To the extent a domestic or electing foreign trust receives or may eventually receive a covered gift or covered bequest that is a future interest in property that is not in trust, such domestic or electing foreign trust may take advantage of this election.

Finally, to provide further clarification on the date of receipt of a transfer to a domestic trust or an electing foreign trust that is an incomplete gift, a new paragraph is added in §28.2801-4(d)(4) of the final regulations. In the event of a transfer by a covered expatriate to a revocable domestic trust or electing foreign trust, the date of receipt by the trust is the later of (1) the date the right to revoke the trust is relinquished or extinguished and (2) the date of extinguishment of all powers over or interests in the trust that would prevent the transfer from being a competed transfer for gift tax purposes. In the event of a transfer by a covered expatriate to an irrevocable domestic trust or electing foreign trust over or in which the covered expatriate retains powers or interests that prevents the transfer from being complete, the trust receives the transfer on the date all of such powers or interests are extinguished.

7. Non-Electing Foreign Trusts

The section 2801 tax applies to a distribution attributable to a covered gift or covered bequest to a U.S. citizen or resident from a non-electing foreign trust. See section 2801(e)(4)(B)(i).

A. Distributions

Section 28.2801-5(b) of the proposed regulations defines the term *distribution* broadly to include any direct, indirect, or constructive transfer from a non-electing

foreign trust, including each disbursement from such non-electing foreign trust pursuant to the exercise, release, or lapse of a power of appointment. In response to some comments, the final regulations clarify that a distribution includes a transfer to the extent made for less than full and adequate consideration in money or money's worth.

Several comments request clarification as to whether the uncompensated use of trust property by, or a loan from a non-electing foreign trust to, a U.S. citizen or resident would constitute a distribution for section 2801 tax purposes and point out that these are treated as distributions for income tax purposes under section 643(i). The comments recommend that neither one be treated as a distribution for purposes of section 2801 and request that the final regulations explicitly state that the deemed distribution rules of section 643(i) do not apply for purposes of section 2801. The comments suggest that, because there is no specific statutory direction to vary from the ordinary definition of distribution, the deemed distribution rules of section 643(i) should not be used to interpret the term as used in section 2801. The Treasury Department and the IRS agree with the latter recommendation to clarify that the deemed distribution rules of section 643(i) are not adopted as part of the definition of a distribution for purposes of section 2801(e)(4)(B)(i). However, that does not mean that a loan or use of property cannot be a distribution and thus a covered gift. To the extent that a loan from, or the use of property of, a non-electing foreign trust constitutes a gift under chapter 12 of the Code, then the portion of that loan or use received by a U.S. recipient constitutes a distribution and thus a covered gift to the extent of the trust's section 2801 ratio. The final regulations include this clarification.

One comment recommends that the final regulations provide that a loan from a foreign trust which is a qualified obligation under section 643(i) and Notice 97-34, 1997-1 C.B. 422, should not be treated as a distribution for section 2801 tax purposes (even if it otherwise would be treated as a distribution using gift tax principles). The final

regulations provide, as other comments suggest, that distribution should not be interpreted using principles from section 643(i), because Congress did not indicate that such standards should be used. Consistent with this approach of not using section 643(i) principles, the suggestion to exclude from the definition of a covered gift or bequest this particular category of loans described in section 643(i) is not adopted. Comments also recommend that the final regulations clarify that the uncompensated use of trust property that is de minimis, whether determined by duration or value, does not constitute a distribution, noting that it is costly, impractical, and time-consuming to value the use of property. Because foreign trusts with U.S. beneficiaries already must determine these values for income tax purposes (given that there is no de minimis exception under section 643(i)), taxpayers are not subject to any additional administrative burden. Accordingly, this recommendation has not been adopted.

B. Section 2801 ratio

Section 28.2801-5(c) of the proposed regulations provides that the amount of the distribution attributable to a covered gift or covered bequest is determined by multiplying the distribution by a ratio (section 2801 ratio) that is redetermined after each contribution to the non-electing foreign trust. The proposed regulations explain how to compute the section 2801 ratio and provide that each distribution from the non-electing foreign trust is considered to be made proportionally, without any tracing to particular property.

i. Calculating the Section 2801 Ratio

While acknowledging that the proposed method for determining the section 2801 ratio is based on the existing method for determining the inclusion ratio of a trust for GST tax purposes, several comments nonetheless object to this methodology, saying that its complexity, particularly the requirement to revalue trust property at each contribution, would discourage compliance. Comments offer multiple suggestions to

avoid the complications of a section 2801 ratio of more than zero but less than one. Some suggestions involve recognizing separate accounting or separate shares within, or the severance of, a single trust so that separate section 2801 ratios could apply to the separate shares. For instance, such an approach could allow a non-electing foreign trust to utilize separate accounting for the portion of the trust that consists of only covered gifts and covered bequests (similar to separate accounting in the GST context under section 2654(b) and §26.2654-1(a)(2) of the Generation-Skipping Transfer Tax Regulations for portions of a trust attributable to transfers from different transferors). Another approach could allow a non-electing foreign trust to treat a covered gift or covered bequest earmarked for a particular beneficiary as a separate share with a distinct section 2801 ratio (similar to separate share rules utilized for other tax purposes such as §26.2654-1(a)(1) and §§1.672(f)-3(b)(3) and (d) and 1.663(c)-3 of the Income Tax Regulations). Another approach could allow the trustee to sever a trust with a mixed section 2801 ratio into two separate trusts, each with a section 2801 ratio of either zero or one, using the same method provided for qualified severances in section 2642(a)(3) and §26.2642-6.

The Treasury Department and the IRS recognize that, in the absence of an election by the foreign trust to be treated as an electing foreign trust, computing and re-computing the section 2801 ratio in the event of additional contributions may pose challenges to U.S. distributees unless the non-electing foreign trust has a section 2801 ratio of either one or zero. Nevertheless, a rule recognizing separate section 2801 ratios in the event of separate accounting, separate shares, or a severance of a single non-electing foreign trust presents administrability and enforcement concerns. For instance, because of the lack of jurisdiction over a foreign trust, it will be difficult to verify whether a single trust consists of substantially separate and independent shares with no commingling of trust assets and whether a qualified severance was done in a manner

that complies with rules similar to §26.2642-6. Although certain reporting and other administrative requirements are imposed in order for separate accounting, separate shares, and qualified severances to be recognized, no similar reporting or other administrative requirements could be enforced against the trustee of a non-electing foreign trust. Furthermore, the proposal to allow for separate accounts that are not actually separated into different shares or trusts similar to section 2654(b) would not eliminate the need for revaluation at each contribution, because revaluation would be necessary after each contribution in order to determine the portion of the trust allocable to each account. See §26.2654-1(a)(2)(ii) (requiring the computation of a fraction that utilizes fair market valuations of the trust as well as of the portions treated as separate trusts). Accordingly, the final regulations do not adopt the commenters' suggestions related to separate accountings similar to that provided in section 2654(b) and §26.2654-1(a)(2), separate shares similar in concept to those recognized in §26.2654-1(a)(1) and §§1.672(f)-3(b)(3) and (d) and 1.663(c)-3, or severance of a single trust similar to qualified severances described in section 2642(a)(3) and §26.2642-6.

Another comment suggests allowing a non-electing foreign trust to treat as a separate share gifts and bequests received prior to the effective date of section 2801. As is explained in part 7.B.ii. of the *Summary of Comments and Explanation of Revisions* section of the preamble, such receipts are not included in the definition of a covered gift or covered bequest. Because the final regulations provide that such receipts are merely another example of noncovered receipts, this suggestion is not adopted for the same administrability concerns identified in the prior paragraph. See §28.2801-2(f) and -2(g) and *Example 3* of §28.2801-5(e) of these final regulations.

One comment suggests that separate accounting for the purpose of recognizing separate section 2801 ratios be permitted in the event a covered expatriate's contributions to a non-electing foreign trust can be traced to specific assets. Another

comment recommends that the final regulations adopt a rule that would treat a distribution from a non-electing foreign trust as made either first or last from a covered gift or covered bequest, similar to the income tax treatment of certain inventory under sections 471 and 472, or in a manner analogous to the tiers applicable to distributions from a charitable remainder trust. Requiring the tracing or tracking of specific trust assets has the potential to be more onerous to administer than the section 2801 ratio, especially as trust property produces income, is reinvested, or otherwise changes form over time, and to the extent it is commingled or reinvested with other assets. Additionally, because the IRS has no jurisdiction over the foreign trustee, it would be difficult to verify that the assets were being traced or tracked properly. Given these administrability concerns, these suggestions are not adopted.

One comment suggests that the final regulations permit a non-electing foreign trust to use the value of each contribution to the trust as of the date of its contribution to compute the section 2801 ratio, thus eliminating the need for revaluations at the time of each subsequent contribution. However, as the comment acknowledges, computing the section 2801 ratio using contributed values is a less desirable alternative because, although simpler to administer, it would be far from accurate, so this suggestion has not been adopted.

The Treasury Department and the IRS recognize that calculation of a foreign trust's section 2801 ratio may be complicated when a single trust receives contributions attributable to both covered gifts or covered bequests and non-covered gifts or non-covered bequests at different points in time. In some circumstances, the complexity can be eliminated by establishing separate trusts and making covered gifts or covered bequests to one trust and non-covered gifts and non-covered bequests to the other trust. The Treasury Department and the IRS recognize that this might not always be possible or practical, particularly in the event of one or more transfers to a non-electing

foreign trust as a result of the death of a covered expatriate. However, for the reasons previously stated, the final regulations retain the section 2801 ratio concepts enumerated in the proposed regulations.

ii. Inadequate Information to Calculate Section 2801 Ratio

Section 28.2801-5(c)(3) of the proposed regulations provides that, 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. Some comments object to this assumption, contending that it is unduly harsh in that U.S. recipients of foreign trust distributions may be unable to determine the section 2801 ratio despite their best efforts. Comments also suggest applying a presumption under which property acquired by a non-electing foreign trust prior to June 17, 2008, would be presumed not to be a covered gift or covered bequest, and property acquired on or after that date would be presumed to be a covered gift or covered bequest.

The Treasury Department and the IRS are persuaded that the entire trust should not be assumed to have a section 2801 ratio of one merely because the U.S. recipient cannot determine whether certain transfers are attributable to covered gifts and covered bequests. Accordingly, the final regulations retain the rule in the proposed regulations, but clarify that the assumption applies only to the extent the section 2801 ratio cannot be substantiated. See §28.2801-5(c)(3) of these final regulations. For instance, even if the U.S. recipient lacks adequate information to determine whether certain transfers to a non-electing foreign trust are covered gifts or covered bequests, the U.S. recipient can still treat other transfers to the non-electing foreign trust as not being covered gifts or covered bequests if the U.S. recipient has adequate information to show that those

transfers are not covered gifts or covered bequests. Additionally, the final regulations clarify that the assumption that a distribution is attributable to a covered gift or covered bequest can be rebutted to the extent the taxpayer can supply information sufficient to persuade the Commissioner that the assumption is not correct.

As to the suggestion to apply a presumption about property acquired by a non-electing foreign trust prior to the effective date of section 2801, the Treasury Department and the IRS agree that the final regulations should clarify the status of pre-enactment contributions to non-electing foreign trusts. However, rather than a presumption, the final regulations update the definitions of covered gift and covered bequest to clarify that such terms include only gifts and bequests made to the non-electing foreign trust after the effective date of section 2801. Thus, property attributable to a covered gift or covered bequest does not include pre-section 2801 contributions to the non-electing foreign trust. See §28.2801-2(f) and -2(g) and *Example 3* of §28.2801-5(e) of these final regulations.

Other comments propose that a U.S. recipient of a distribution from a non-electing foreign trust may use any reasonable method to estimate the section 2801 ratio based on the information available, such as affidavits from persons with relevant knowledge and reasonable assumptions regarding growth rates, contributions, and other pertinent information. The adequacy of the method and information used to compute the section 2801 ratio to avoid application of the assumption is most appropriately determined on a case-by-case basis. Accordingly, these final regulations do not contain a detailed list of the types of information, and the combinations thereof, that may be used to calculate the section 2801 ratio and rebut the presumption in §28.2801-5(c)(3) of the final regulations.

One comment suggests that the burden to establish the section 2801 ratio should shift to the IRS if the U.S. recipient (i) affirms under penalties of perjury that best

attempts were made to obtain necessary information, (ii) discloses all relevant information that the U.S. recipient has to the IRS, and (iii) identifies parties believed to have the necessary information. The Treasury Department and the IRS acknowledge that U.S. recipients of distributions from non-electing foreign trusts whose trustees do not keep proper records, or who do not cooperate with the U.S. recipients, may end up computing their section 2801 tax using an overstated section 2801 ratio. However, because all the information is in the hands of the trustees of the foreign trust (over which the IRS is unlikely to have any jurisdiction) and the IRS has limited ability to independently determine the section 2801 ratio of a non-electing foreign trust, leaving the burden of proof with the U.S. recipient more likely ensures that section 2801 tax is levied on all covered gifts and covered bequests. Accordingly, the final regulations do not adopt the suggestion to shift the burden in establishing the section 2801 ratio to the IRS.

iii. Impact of Section 2801(c) Amount on Section 2801 Ratio

One comment requests clarification on when a section 2801 tax is deemed to have been paid and suggests that an example be added to the final regulations. Section 28.2801-5(c)(2) of the proposed regulations provides that, 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 determining the trust's section 2801 ratio. Section 28.2801-5(c)(2) of the proposed regulations further provides that 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. The final regulations clarify in §28.2801-5(c)(1) that, because a non-electing foreign trust itself is not taxed on its receipt of covered gifts and covered bequests, the trust is not entitled to the exclusion under section 2801(c); instead, the

section 2801(c) exclusion is allowed to the U.S. recipient with regard to distributions from the non-electing foreign trust. In addition, the final regulations expand an example to illustrate this situation. See *Example 4* of §28.2801-5(e) of the final regulations. In addition, section 28.2801-5(c)(2) of the final regulations also is modified to provide that section 2801 tax is deemed to have been timely paid on amounts for which no section 2801 tax was due as a result of the section 2801(c) amount, whether or not those amounts were reported as a covered gift or covered bequest on a timely filed Form 708.

C. Income tax deduction for section 2801 tax on certain distributions

Section 2801(e)(4)(B)(ii) allows a U.S. recipient of a distribution from a non-electing foreign trust to deduct under section 164 the section 2801 tax imposed on the portion of the distribution included in the U.S. recipient's gross income for the year. Section 28.2801-4(a)(3)(ii) of the proposed regulations provides instructions for calculating the amount of this deduction. That income tax deduction is available for the year in which the section 2801 tax is paid. Commenters questioned whether an accumulation distribution, taxable to a U.S. person in a given year, is to be included in this reference to "gross income" when computing this deduction.

Section 662(a), in effect, determines how to determine the portion of a trust's distributable net income (DNI) that is taxable to each beneficiary of the trust in a given year. That section provides that the gross income of a beneficiary of a complex trust includes both amounts required to be distributed to the beneficiary and amounts properly distributed to the beneficiary. That section and §1.662(a)-3(c) provide that a beneficiary receiving such a distribution in a given year will recognize the distribution as gross income only to the extent the distribution is made out of the trust's DNI for the year.

Under section 665, a foreign trust's distribution to a beneficiary of income that exceeds that trust's DNI for the year is a distribution of income earned by the trust in a

prior year, which is an accumulation distribution that is comprised of undistributed net income (UNI). That amount, therefore, would not be included in the reference to gross income as used in section 662(a).

Section 667(a) provides that a beneficiary receiving such an accumulation distribution must include that distribution as income in the year the distribution is received but must compute the tax on that distribution (to the extent it would have been included in the beneficiary's income under section 662) as though it had been received in a preceding taxable year. Section 667 provides the mechanism to compute the applicable income tax and interest charge on the distribution (throwback tax).

One comment suggests that the final regulations permit a deduction under section 164 of the full amount of the section 2801 tax paid on an accumulation distribution. The comments observe that, if any portion of a distribution from a non-electing foreign trust is attributable to a covered gift or covered bequest and is an accumulation distribution, the aggregate amount of the section 2801 tax and the throwback tax might exceed the amount of the distribution.

Other comments suggest limiting the total tax liability under section 2801 and the throwback tax on a specific distribution to the amount of the distribution. One comment suggests this might be achieved by reducing the amount of the distribution that is treated as an accumulation distribution. The final regulations do not adopt the commenters' suggestions that involve limiting the total tax liability, other than through a deduction under section 164 as provided in section 2801(e)(4)(B)(ii) and described above. There is no mechanism under the income tax rules to re-classify an accumulation distribution as DNI because an accumulation distribution is, by definition, income in excess of DNI. Section 2801 does not limit the total tax liability under that section or the throwback tax.

Although section 2801(e)(4)(B)(ii) uses the term *gross income*, that section merely limits the available tax deduction to tax paid on income that was subjected to income tax. The reference to gross income does not reference any particular definition of that term and thus does not appear to create a distinction between different types of taxable income. For that reason, the final regulations provide that the reference to gross income in this section includes all forms of income subject to income tax in that year, including an accumulation distribution.

Section 28.2801-4(a)(3)(ii) of the proposed regulations provides that the deduction under section 164 provided in section 2801(e)(4)(B)(ii) is available in the year in which the tax is paid or accrued. As a result, a cash method taxpayer will be entitled to the deduction only in the tax year in which the section 2801 tax is paid. Several comments suggest that the deduction instead should be available to a cash method taxpayer in the year the distribution is received and subject to income tax. The final regulations do not adopt this suggestion for the following reasons. Both section 2801(e)(4)(B)(ii) and section 164(a) allow the deduction only in the year in which the tax is paid or accrued, and references in the Code to items accrued generally do not apply to cash basis taxpayers. Congress has not provided a special rule (such as section 164(b)(4)(B) or 691(c), for example) allowing the deduction in the year of the distribution. Additionally, allowing the deduction in the year of the distribution for cash method taxpayers would be administratively difficult because the section 2801 tax for a distribution from a non-electing foreign trust attributable to a covered gift or covered bequest generally is due in the calendar year after the income tax attributable to that distribution is due (17.5 months after the close of the calendar year of receipt versus 3.5 months after the close of the calendar year). Although the deduction for section 2801 tax paid cannot be taken against the income carried out from the distribution attributable to the covered gift or bequest, the deduction can be taken against income in the year

the section 2801 tax is paid (including against distributions of accumulated income). Accordingly, the final regulations retain the rule in the proposed regulations that the deduction under section 164 is available only in the year the section 2801 tax is paid or accrued.

8. Election by Foreign Trust to be Treated as Domestic Trust

Section 2801(e)(4)(B)(iii) allows a foreign trust to elect to be treated as a domestic trust solely for purposes of section 2801. That election may be revoked with the consent of the Secretary of the Treasury or her delegate, but also may be terminated by the trust's failure to comply with the requirements for maintaining a valid election. An election to be treated as a domestic trust causes the electing foreign trust to become liable for the section 2801 tax liability on covered gifts and covered bequests received by the trust, thus relieving each U.S. citizen or resident receiving a trust distribution attributable to such covered gifts or bequests from that tax liability.

A. Reporting requirements

Section 28.2801-5(d)(4) of the proposed regulations provides that 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. One comment requests that the final regulations eliminate the requirement to file a Form 708 for years in which no covered gift or covered bequest was received. The Treasury Department and the IRS agree that the trustee's requirement to certify annually that the electing foreign trust did not receive any covered gifts or bequests creates a burden that outweighs the benefit to the enforcement and administration of the section 2801 tax. Accordingly, the final regulations do not require annual reporting for electing foreign trusts. Instead, reporting will be required only by an electing foreign trust for years in which the total value of the

covered gifts and covered bequests received by the electing foreign trust in that year exceeds the section 2801(c) amount for that year.

Section 28.2801-5(d)(3)(ii) of the proposed regulations details the requirements for a valid election. Among these is the requirement to notify and provide to the IRS information on each U.S. citizen or resident who is a permissible distributee of the trust. For this purpose, a permissible distributee is a U.S. citizen or resident who either may or must receive trust distributions, has a right (whether current or future) to withdraw income or principal from the trust, or would have been so described if either the trust or the interest of all persons so described had just terminated. Comments observe that this requirement is burdensome, infringes upon disclosure and privacy standards, and requests information that is not required to ensure that the tax is adequately administered. One comment suggests revising the requirements for making the election to be treated as a domestic trust so that only beneficiaries that have received distributions during the relevant period must be identified on Form 708. Another comment suggests adopting the standards devised for the Foreign Account Tax Compliance Act (FATCA) information reporting under sections 1471 and 1472, so that only beneficiaries who actually receive a distribution or who have a mandatory payment right during the relevant period must be identified on Form 708.

It is necessary for the trustee to provide information to the IRS on all U.S. citizens or residents who may receive distributions from the trust, because those persons may have to pay tax under section 2801 if the election terminates. Although the Treasury Department and the IRS are sensitive to the policy concerns of the commenters, this concern is outweighed by the IRS's need to obtain information from the trustee that would be necessary to assure the collection of tax should the election terminate. Additionally, because the final regulations do not require annual filings in the absence of the receipt of a covered gift or covered bequest by the electing foreign trust, as the

proposed regulations did, an electing foreign trust's most recent return may be filed many years before the termination of the election (for example, if the election terminates for failure to pay 2801 tax or to file a return in a year that a contribution is made to the trust). In that event, the commenter's request would deprive the IRS of needed information about the actual distributees in the year of the termination of the election. Accordingly, the final regulations retain the definition of permissible distributee under the proposed regulations.

Section 28.2801-5(d)(3)(iv) of the final regulations confirms that the appointment of the required U.S. agent is made by filing Form 2848, *Power of Attorney and Declaration of Representative*, or as may be directed otherwise in IRS forms or publications. Merely confirming the name and identifying information of that agent on the electing trust's Form 708 is not sufficient for this purpose.

B. Termination of electing foreign trust status

Under §28.2801-5(d)(5)(ii) of the proposed regulations, an election to be treated as a domestic trust is terminated by the failure of the foreign trust to timely file Form 708 or timely pay any required section 2801 tax. The termination is effective as of the first day of the calendar year for which the failure occurs.

A comment suggests that the trustee of an electing foreign trust should be permitted to cure the late filing of Form 708 and/or late payment of the section 2801 tax to avoid the retroactive termination of the foreign trust's election to be treated as a domestic trust for purposes of the section 2801 tax. The comment contends that an opportunity to cure is needed to avoid placing a reporting burden on a U.S. citizen or resident who received a distribution during the year for which the election is being terminated.

As provided in paragraph 8.A. of the *Summary of Comments and Explanation of Revisions* section of this preamble, the final regulations do not require annual filings for

electing foreign trusts for years in which the electing foreign trust receives no covered gifts or covered bequests. Accordingly, under the final regulations, an electing foreign trust's election will not terminate for the failure to file a Form 708 for such a year. The final regulations, however, require that, unless the total value of the covered gifts and covered bequests received by the electing foreign trust in a calendar year does not exceed the section 2801(c) amount, the trustee of an electing foreign trust must report all covered gifts and covered bequests received during that calendar year on a timely filed Form 708 and timely pay the section 2801 tax in full. Because the IRS may lack jurisdiction to assess tax on a foreign trustee, voluntary payment by the foreign trustee is the only way to ensure collection of section 2801 tax on an electing foreign trust. If the foreign trustee fails to pay the section 2801 tax, then the section 2801 tax must be collected from the U.S. recipient to ensure collection. Providing a grace period to file a return and make a payment of tax beyond the original due date of the required return to provide the suggested opportunity to cure is not tenable because the identity of the taxpayer during this period would be uncertain, creating confusion and delaying finality as to whether the U.S. beneficiaries of the trust or the trustee of the trust is responsible for the payment of the section 2801 tax. In addition, providing such a grace period could encourage trustees to delay payment to the end of the grace period, notwithstanding that the original due date for such payment already is more than 17.5 months after the close of the year in which the covered gift or covered bequest was received. For these reasons, the regulations provide that, unless the total value of the covered gifts and covered bequests received by the electing foreign trust in a calendar year does not exceed the section 2801(c) amount, the failure to report all covered gifts and covered bequests received on a timely filed Form 708 or to timely pay the section 2801 tax in full will result in the termination of the foreign trust's election. The final regulations in §28.2801-5(d)(5)(ii)(A)(*3*) further provide a method for the trust to

affirmatively terminate its election to be treated as a domestic trust for purposes of section 2801.

C. Dispute as to amount of section 2801 tax owed

Section 28.2801-5(d)(6)(i) of the proposed regulations describes the process for resolving or otherwise accounting for proposed adjustments to the amount of the section 2801 tax owed by an electing foreign trust. The proposed procedure entails the IRS notifying the trustee of the foreign trust of the additional tax due, including any penalties and interest, and the due date of payment. 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 by the stated due date, then the election is terminated retroactively, effective as of January 1 of the year for which the Form 708 was filed and is converted as of that same date to an imperfect election. Any additional value determined by the IRS on which the foreign trust did not timely pay the section 2801 tax then is treated as a covered gift or covered bequest to the trust and should be taken into account as a covered gift or covered bequest by a U.S. recipient in computing the section 2801 ratio applicable to any distribution from the trust, although that valuation adjustment is an issue that may be challenged or otherwise resolved on examination of that U.S. recipient's Form 708 reporting a distribution.

Comments suggest that the final regulations provide the same opportunity, procedures, and rights to the electing foreign trust as are applicable to any other U.S. taxpayer, with regard to any challenge to the IRS's determination of value. One comment recommends that the IRS issue a statutory notice of deficiency to make possible these administrative and judicial review processes. Another comment suggests that allowing the electing foreign trust to resolve these valuation issues with the IRS would avoid the possibility that different trust beneficiaries might reach different resolutions of the same issue as their individual Forms 708 are separately examined by

the IRS.

Establishing a statutory notice of deficiency process for resolving or otherwise addressing proposed adjustments to the amount of the section 2801 tax owed by an electing foreign trust would have a harmful effect on the IRS's ability to collect any unpaid deficiency, even a deficiency that has been reduced to judgment, given the IRS's lack of jurisdiction over the trustees and assets of a foreign trust. Additionally, if the foreign trust in such a situation refuses to pay the deficiency, it is not clear that the IRS would have the ability to assert transferee liability against a U.S. citizen or resident receiving distributions from the trust under section 6901 or 31 U.S.C. 3713. Therefore, allowing the continued validity of the election despite an unresolved dispute or unpaid tax and issuing a statutory notice of deficiency would jeopardize the IRS's ability to collect the unpaid deficiency from either the foreign trust or the U.S. recipient of a trust distribution.

Given the jurisdictional limitations and because the statute contemplates that the section 2801 tax will be paid by the electing foreign trust, the proposed procedures for handling disputes involving electing foreign trusts are the practical approach and strike the appropriate balance of fairness, administrability, and enforcement of the section 2801 tax. However, the final regulations improve administrability by clarifying in §28.2801-5(d)(6)(i) that the payment of any additional amount of section 2801 tax must be made either by the due date specified in the letter or the due date otherwise agreed to by the Commissioner. Note that the procedures as finalized also include the availability of a reasonable cause defense to the imposition of failure to file and failure to pay penalties under section 6651 on the U.S. recipient's obligations with regard to distributions made from the trust. See, for example, §28.2801-5(d)(6)(iii)(C) of the final regulations. Thus, the request of the commenters is not adopted.

9. Income Tax Effects of Section 2801 Tax

A. Income tax basis

Section 28.2801-6(a) of the proposed regulations provides that the recipient's basis in property received as a covered gift is determined under section 1015. The proposed regulations further provide that section 1015(d) does not apply to increase the basis in a covered gift by the amount of the section 2801 tax paid with respect to that covered gift. Several comments state that a basis increase should be allowed for the section 2801 tax paid with respect to a covered gift based on simple fairness and to serve the statutory goal of tax neutrality. One comment acknowledges that section 1015(d) is inapplicable to section 2801 because section 1015(d) applies only to gift taxes paid under chapter 12 of the Code, not to the taxes on covered gifts defined in chapter 15. However, this comment states that section 164 does apply to increase basis in property received as a covered gift by the amount of the section 2801 tax paid because section 164(a) treats taxes that have been paid but are not deductible under section 164 as part of the acquisition cost of the property. As such, the comment concludes that payment of the section 2801 tax does increase the recipient's basis in the property.

The comment is correct that the basis adjustment available under section 1015(d) is applicable only to gift tax paid under chapter 12. Section 2801 does not apply the rule of section 1015(d) to the section 2801 tax, which is in chapter 15 of subtitle B of the Code. However, neither does section 164 provide for an increase in the basis of property received as a covered gift by the amount of the section 2801 tax paid. The flush language in section 164(a) clarifies the treatment of certain taxes (other than those enumerated in section 164(a)) that are incurred in a trade or business or in an income-producing activity and are connected with the acquisition or disposition of property. Specifically, such taxes are treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the

disposition. *See* H. Conf. Rept. 99-841 (Vol. 2), at II-20 (1986), 1986-3 C.B. 20 (Vol. 4); *Sleiman v. Commissioner*, T.C. Memo. 1997-530 at 10. The section 2801 tax paid on the receipt of a covered gift or covered bequest does not come within this description because, by its nature, it is not a tax that is incurred in a trade or business or an income-producing activity.

The Treasury Department and the IRS understand the general proposition of the commenters that allowing a basis increase for the section 2801 tax paid with respect to a covered gift would be consistent with the rule in section 1015(d) that takes gift tax paid into account and thus would further serve the goal of tax neutrality and that such a rule might more fairly represent the acquisition cost of property received in a covered bequest. However, in order to create a special rule for an adjustment to the basis in property subject to the section 2801 tax, a statutory amendment to section 1015, 2801, or other statutory authority would be needed.

B. Deduction for portion of section 2801 tax paid attributable to income in respect of a decedent

Section 691(c)(1) provides that a person who includes an amount of income in respect of a decedent (IRD) in gross income under section 691(a) is allowed as an income tax deduction, for the same taxable year, a portion of the estate tax paid by reason of the inclusion of that IRD in the decedent's gross estate. A comment likens the estate tax paid to the section 2801 tax paid and suggests that, in the interest of tax neutrality, the final regulations should allow a U.S. recipient to deduct from gross income the portion of the section 2801 tax paid with respect to an item of IRD, when the amount of IRD is included in the U.S. recipient's gross income for the same taxable year.

Although estate tax may be similar to section 2801 tax on the receipt of a covered bequest, in section 691(c)(2)(A), Congress explicitly defined the term *estate tax* for purposes of that section as the tax imposed on the estate of a decedent under

section 2001 or 2101, and did not include analogous taxes imposed under other sections of the Code such as section 2801. Furthermore, where Congress believed that a deduction for section 2801 taxes paid is appropriate, it provided for that deduction explicitly. While section 2801(e)(4)(B)(ii) provides for an income tax deduction under section 164 for a certain amount of section 2801 tax imposed on a distribution from a non-electing foreign trust included in gross income that is attributable to a covered gift or covered bequest, Congress did not provide an income tax deduction under section 691(c) for section 2801 tax that is attributable to IRD.

Additionally, the method for computing the deduction under section 691(c)(2) for estate taxes paid uses variables that are not applicable to the tax under section 2801. For instance, section 691(c)(1)(A) provides a deduction based on the "net value" for estate tax purposes of all items of IRD described in section 691(a). Section 691(c)(2)(C) provides that the net value shall be an amount equal to the excess of the estate tax over the estate tax computed without including in the gross estate such net value. Therefore, there would be no way to calculate the amount of an IRD deduction for section 2801 tax paid using the rules provided under section 691. Accordingly, in order to establish a similar regime for section 2801, the final regulations would need to contain a new set of comprehensive rules for determining the amount of a deduction against items of IRD for section 2801 tax paid.

For these reasons, adopting the commenter's suggestion would be both impractical and beyond what is provided by statute.

10. Information Reporting Under Sections 6039F and 6048(c)

Generally, sections 6039F and 6048(c), respectively, require each U.S. person (as defined for income tax purposes) who receives a gift or bequest from a foreign person or a distribution from a foreign trust to report such receipt or transaction by filing Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of*

Certain Foreign Gifts. However, §28.2801-6(c)(1) and (2) of the proposed regulations provides that, for purposes of the information reporting provisions of sections 6039F and 6048(c), *U.S. person* is defined to include a U.S. citizen or resident, as that term is defined in proposed §28.2801-2(b), which adopts the gift and estate tax meaning of the term resident under subtitle B, based on domicile.

Several comments request that the final regulations revise the rule in §28.2801-6(c) of the proposed regulations to reflect that the reporting requirements under sections 6039F and 6048(c) apply to U.S. residents as the term *U.S. person* is defined for income tax purposes. See section 7701(a)(30) and (b)(1)(A). Under this suggestion, the scope of the reporting requirements on Form 3520 would not be expanded to individuals who are U.S. residents for transfer tax purposes but not for income tax purposes. The comments point out that these taxpayers who are U.S. residents only for transfer tax purposes are the same persons (other than an electing foreign trust) who will be required to file a Form 708 to report the receipt of a covered gift or covered bequest and thus that the proposed expanded scope of the reporting requirements would be duplicative and would serve no tax enforcement purpose. Consequently, the comments contend that the expanded scope of the reporting requirements would serve only to add complexity and burden to information reporting and to increase the risk of the imposition of penalties.

The Treasury Department and the IRS agree that the definition of U.S. person under section 7701(b)(1)(A) is the appropriate definition for purposes of the information reporting requirements under sections 6039F and 6048. Accordingly, the final regulations provide that the information reporting requirements in sections 6039F and 6048(c) apply only to U.S. persons within the meaning of section 7701(a)(30), and thus only apply to recipients of a covered gift or covered bequest who are U.S. persons for income tax purposes. See §28.2801-6(c)(1) and (2) of the final regulations. This will

include all U.S. citizens and domestic trusts receiving covered gifts and covered bequests, as well as U.S. residents as defined for income tax purposes.

11. Determining Responsibility under Section 2801

The proposed regulations confirm, in §28.2801-7(a), that it is the responsibility of the U.S. recipient of a gift or bequest from an expatriate, or a distribution from a trust funded at least in part by an expatriate, to determine whether the expatriate is a covered expatriate and whether the gift or bequest is a covered gift or covered bequest. Proposed §28.2801-7(b)(1) further provides that, in some circumstances to be described in IRB guidance, the IRS may be permitted to disclose return or return information of the donor or decedent expatriate upon the request of a U.S. citizen or resident in receipt of a gift or bequest from such expatriate. In the event of a living donor expatriate, §28.2801-7(b)(2) of the proposed regulations creates a rebuttable presumption that the donor is a covered expatriate and that the gift is a covered gift if donor does not authorize the disclosure of the donor's relevant return information.

The proposed rule further provides that a recipient may file a protective Form 708 in accordance with procedures set forth in proposed §28.6011-1(b), to start the running of the period of limitations for the assessment of any section 2801 tax in the event the recipient reasonably concludes that a gift or bequest is not subject to section 2801.

Several comments request guidance and suggest additional rules as to how a U.S. citizen or resident receiving a gift or bequest may avoid penalties and interest for nonpayment or underpayment of the section 2801 tax if the U.S. recipient incorrectly concludes that section 2801 does not apply. The comments ask how a recipient can satisfy its responsibility to ascertain whether the donor or decedent is a covered expatriate, and how to determine whether the gift or bequest is a covered gift or covered bequest. These comments note that the ability to comply is based on access to a donor's private information that the IRS may not be able to provide. These comments

predict that the U.S. recipient of a gift or bequest may encounter significant impediments to gathering the necessary information about the donor or decedent. Thus, the comments request that the rebuttable presumption be eliminated, and that the final regulations provide a safe harbor for making covered expatriate determinations based on facts reasonably available to the recipient.

Comments also request that the final regulations elaborate on the acceptable criteria necessary to satisfy the due diligence requirement for filing a protective Form 708 as set forth in §28.6011-1(b) of the proposed regulations, to start the running of the period of limitations for the assessment of any section 2801 tax, and to avoid penalties. For instance, some comments suggest that reliance on a certification as to covered expatriate status provided by the living donor or the decedent's estate should be sufficient, unless the U.S. recipient has reason to believe the certification is false. Alternatively, the comment suggests that the expatriate be required, on the Form 8854, *Initial and Annual Expatriation Statement,* filed at the time of expatriating, to authorize the IRS to disclose the relevant return information to each U.S. recipient of a gift from that expatriate. Another comment suggests that requesting certain information from the IRS and carrying out a background check on the donor or decedent should be sufficient for these purposes. Comments also suggest the creation of a searchable database of Forms 8854 that would allow the identification of covered expatriates. One comment suggests requiring the IRS to have a good faith basis for alleging that a donor or decedent is a covered expatriate before assessing a section 2801 tax because, otherwise, the IRS would be forcing recipients to prove a negative even where the IRS may have actual evidence to the contrary. Finally, another comment suggests creating a presumption in the final regulations that a donor is not a covered expatriate if the donor files a Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return* and provides a copy to the U.S. recipient.

The Treasury Department and the IRS carefully considered during the development and drafting of the proposed regulations the potential difficulty a U.S. recipient may face in obtaining the information necessary to determine whether it has a tax obligation under section 2801. For the reasons stated below, the final regulations do not adopt the commenters' suggestions.

Regarding a certification as to covered expatriate status or a background check to establish that a gift or bequest is not a covered gift or covered bequest from a covered expatriate, requesting information from the donor or decedent's estate and the IRS is the most tenable option because of the factual nature of the determination and jurisdictional limitations with respect to the expatriate. For instance, although a certification from the donor or the decedent's estate provides some evidence of covered expatriate status, the particular facts in a given situation may cause the IRS to require corroborating information (for example, in the event of conflicting information discovered during examination or otherwise). As to the relevance of the filing of a Form 709 by an expatriate, the filing of a Form 709 does not suggest a determination as to covered expatriate status, although a timely filing supports a determination that a gift or bequest is excepted from the definition of a covered gift or covered bequest.

A comment suggests eliminating the rebuttable presumption in proposed §28.2801-7(b)(2) based on the contention that neither section 2801 nor the general rule-making authority provided in section 7805(a) authorize creating a rule that requires U.S. recipients of gifts and bequests to demand proof of a living donor's status. The Treasury Department and the IRS do not agree that providing a rebuttable presumption that, in certain circumstances, a living donor is a covered expatriate is beyond its regulatory authority for implementing the Congressional mandate of section 2801. A rebuttable presumption is not a mandate or final determination. Rather, a rebuttable presumption provides an opportunity and an incentive for the recipient to overcome the

presumption through the exercise of due diligence. It is the recipient's responsibility to determine whether section 2801 tax liability applies to a transfer received from a donor or decedent's estate. In the absence of evidence sufficient to allow the recipient to determine whether the donor is a covered expatriate, if the living donor refuses to cooperate or otherwise fails to authorize the disclosure of relevant return information, the presumption is reasonable.

Finally, additional comments suggest that the IRS take action beyond issuing final regulations to make the information about the covered expatriate status of the donor or decedent more readily accessible. Specifically, comments suggest creating and administering a searchable and secure registry or database of expatriates and covered expatriates; modifying certain IRS forms (for example, Forms 8821, *Tax Information Authorization*, or Form W-8 BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)*), or creating new ones, to ensure only limited information relevant to the covered expatriate status of the donor or decedent is provided to the recipient. This would require the reconsideration of the retention policies and procedures of certain tax forms because section 2801 could require access to decades-old tax information.

The Treasury Department and the IRS understand the potential difficulties underlying the commenters' concerns. However, the resolution of these concerns also must take into account both the IRS's resource constraints and disclosure and privacy concerns. Additional procedures, as requested by the commenters, may be forthcoming in guidance published in the Internal Revenue Bulletin.

12. Recordkeeping Requirements

Section 28.6001-1 of the proposed regulations provides that 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. A comment suggests

that this retention standard be clarified, because it is open-ended and appears not to bear any relation to the three-to-six-year period of limitations for assessment for such return prescribed in section 6501.

The retention standard in §28.6001-1(a) of the proposed regulations is the same as the retention standard for both the estate and gift taxes under §§20.6001-1(a) and 25.6001-1(a), respectively. This expansive standard is appropriate for estate and gift tax, because the records associated with estate and gift tax returns can be relevant many years later in the context of a GST tax return, a surviving spouse's gift and/or estate tax return, and income tax basis, well after the period of limitations for assessment under section 6501 has expired for such returns. Additionally, because the gift tax and estate tax computations are cumulative in nature, the records associated with gift tax returns filed during life may be relevant many years later in the preparation and filing of the estate tax return.

The section 2801 tax is less likely than the estate and gift taxes to have application for as long a period of time after the period of limitations for assessment has expired. Therefore, upon consideration of the comments, the Treasury Department and the IRS agree that a less expansive retention standard is appropriate for the section 2801 tax. Accordingly, the final regulations adopt the more limited income tax retention standard under §1.6001-1(e), which requires documentation be retained so long as the contents thereof may become material in the administration of any internal revenue law.

13. Miscellaneous

A. Power of appointment over property not in trust

Various sections of the proposed regulations refer to a power of appointment over property that is not in trust. Multiple comments request an example, explaining that a power of appointment typically is over trust property. For purposes of the Code, the classification of an arrangement as a trust is determined under §301.7701-4 rather

than under local law. Consequently, an arrangement that is classified as a trust under local law may not be a trust under the Code. Such an arrangement may include a grant of a power to an individual that is in substance a power of appointment but, because the arrangement does not constitute a trust under the Code, the power of appointment is over property that is not in trust. This is merely one example but, given the variety of arrangements worldwide that are available to a covered expatriate seeking to transfer property by gift or by reason of death, there may be several others. Because the determination of whether a certain arrangement is a power of appointment not in trust is fact specific, the final regulations do not include specific examples of a power of appointment over property that is not in trust.

B. Estate and gift tax treaties

The proposed regulations do not address the effect of estate and gift tax treaties on the section 2801 tax, except to explicitly state in several examples that the covered expatriate in the example resides in a non-treaty country. Several comments request guidance on the application of estate and gift tax treaties to section 2801 when a gift or bequest is made by a covered expatriate domiciled in a treaty country. One comment requests that the final regulations provide that section 2801 does not apply to property transfers by covered expatriates domiciled in a treaty country.

Neither the statutory language nor the legislative history of section 2801 provides any indication of Congressional intent concerning the effect of existing estate and gift treaties on the application of section 2801. In the absence of specific language overriding treaties, statutes generally are to work in harmony with existing treaties but, with the exception of certain treaty obligations in effect on August 16, 1954, neither the treaty nor the statute has preferential status. See section 7852(d). The U.S. currently has estate and gift tax treaties with Australia, Austria, Denmark, France, Germany, Japan, and the United Kingdom and estate tax-only treaties with Finland, Greece,

Ireland, Italy, the Netherlands, South Africa, and Switzerland. There are also estate tax provisions in the U.S.-Canada income tax treaty. The effect of a particular treaty on the application of section 2801 to a gift or bequest by a covered expatriate in a treaty country must be evaluated on a case-by-case basis when a particular transfer falls within the reach of both section 2801 and an estate or gift tax treaty. Any unresolved issue at that time as to the effect of a particular treaty may be elevated under the competent authority procedures. In view of the above, the final regulations do not include guidance on the effect of existing gift and estate tax treaties on the application of section 2801.

C. Correction in §28.2801-6(b)

Section 28.2801-6(b) of the proposed regulations clarifies the applicability of the GST tax to certain section 2801 transfers. A comment points out that the last sentence of §28.2801-6(b) of the proposed regulations mistakenly refers to the failure to timely file and pay the section 2801 tax and suggests this language be replaced with a reference to the failure to timely file and pay the estate or gift tax under chapters 11 and 12, respectively. In the final regulations, the last sentence of §28.2801-6(b) is revised to refer to the failure to timely file an estate or gift tax return. See §28.2801-3(c)(1) and (2) of the final regulations and part 3.A.i. of the *Summary of Comments and Explanation of Revisions* section of this preamble (discussing the accepted recommendation of commenters to remove the timely paid requirement from these final regulations).

Effect on Other Documents

Announcement 2009-57, 2009-29 I.R.B. 158, is obsolete as of **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Special Analyses

1. Regulatory Planning and Review

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations

under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

2. Paperwork Reduction Act

The collection of information contained in these final regulations under section 2801 is reported on Form 708, *United States Return of Tax for Gifts and Bequests Received from Covered Expatriates*, and has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2309. The collection of information in these final regulations is in §§28.2801-4(e), 28.2801-5(d), 28.6001-1, and 28.6011-1.

The collection of information in §28.2801-4(e) is required to enable the IRS to verify that the U.S. citizens or residents who receive covered gifts and covered bequests are entitled to reduce the section 2801 tax by certain foreign taxes paid with respect to such gifts and bequests and, if so, the amount of the reduction. The collection of information is required to obtain a benefit. The likely respondents are individuals, domestic trusts, and electing foreign trusts.

The collection of information in §28.2801-5(d) is required to notify the IRS and certain U.S. citizen or resident beneficiaries of a foreign trust that the foreign trust is electing to be treated as a domestic trust for purposes of section 2801. It also is required for the IRS to verify the proper amount of the section 2801 tax due. This alerts the IRS and the U.S. citizen or resident beneficiaries that the foreign trust will be liable for payment of the section 2801 tax while the election is in effect. 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 required to obtain a benefit. The likely respondents are 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 also is required to verify the receipt of covered gifts and covered bequests by U.S. citizens or residents and the value of such gifts and bequests. This collection of information is mandatory. The likely respondents are individuals and trusts.

The collection of information in §28.6011-1 is required for the IRS to verify the receipt of covered gifts and covered bequests 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 trusts.

Estimated total annual reporting burden: 6,000 hours.

Estimated average annual burden hours per respondent: 1 hour to prepare and attach documentation to Form 708 for the reduction of the section 2801 tax for foreign taxes paid; 2 hours to elect to treat a foreign trust as a domestic trust and notify the U.S. citizen or resident beneficiaries; 1 hour to notify the U.S. citizen or resident beneficiaries 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.

Books and records relating to a collection of information must be retained as long as their contents might 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.

3. Regulatory Flexibility Act

It is hereby certified that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. These regulations do not affect small entities because they apply to individuals and certain trusts. Thus, the number of affected small entities is not substantial.

4. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. The final regulations do not include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

5. Executive Order 13132: Federalism

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. These proposed regulations do not have federalism implications and do not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive Order.

6. Congressional Review Act

Pursuant to the Congressional Review Act (5 U.S.C. 801 et seq.), the Office of Information and Regulatory Affairs designated this rule as not a major rule, as defined by 5 U.S.C. 804(2).

Availability of Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at https://www.irs.gov.

Drafting Information

The principal authors of these regulations are Mayer R. Samuels, Daniel J. Gespass, and S. Eva Wolf of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 28

Taxes, Expatriate gifts and bequests, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, the Treasury Department and the IRS amend 26 CFR subchapter B as follows:

Paragraph 1. Part 28 is added to read as follows:

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

Authority: 26 U.S.C. 7805.
Section 28.2801-0 through 28.2801-7 also issued under 26 U.S.C. 2801.
Section 28.6001-1 also issued under 26 U.S.C. 6001.
Section 28.6011(a)-1 also issued under 26 U.S.C. 6011 and 6011(a).
Section 28.6060-1 also issued under 26 U.S.C. 6060 and 6060(a).
Section 28.6071(a)-1 also issued under 26 U.S.C. 6071 and 6071(a).
Section 28.6081-1 also issued under 26 U.S.C. 6081 and 6081(a).
Section 28.6091-1 also issued under 26 U.S.C. 6091 and 6091(a).
Section 28.6101-1 also issued under 26 U.S.C. 6101.
Section 28.6107-1 also issued under 26 U.S. C. 6107 and 6107(c).
Section 28.6109-1 also issued under 26 U.S.C. 6109 and 6109(a).
Section 28.6151-1 also issued under 26 U.S.C. 6151.
Section 28.6694-1 through 28.6694-4 also issued under 26 U.S.C. 6694.
Section 28.6695-1 also issued under 26 U.S.C. 6695.
Section 28.6696-1 also issued under 26 U.S.C. 6696 and 6696(c).
Section 28.7701-1 also issued under 26 U.S.C. 7701.

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 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.

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

§28.2801-0 Table of contents.

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

§28.2801-1 Tax on certain gifts and bequests from covered expatriates.
(a) In general.
(b) Applicability date.

§28.2801-2 Definitions.
(a) Overview.
(b) U.S. citizen or resident.
(c) Domestic trust.
(d) Foreign trust.
(1) In general.
(2) Electing foreign trust.

(3) Non-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) Section 2801 tax.
(l) Section 2801(c) amount.
(m) Statutory references.
(1) Code.
(2) Subtitle B.
(n) 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) Covered bequest previously subject to section 2801 tax as a covered gift.
(4) Transfers to charity.
(5) Transfers to spouse.
(6) 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) 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) [Reserved].
(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) Domestic trusts and electing foreign trusts.
(5) Non-electing foreign trusts.
(6) Powers of appointment.
(i) Covered expatriate as holder of power.
(ii) Covered expatriate as grantor of power.
(7) Indirect receipts.
(8) Future interest in property not in trust.
(i) Date of receipt.
(ii) Date-of-receipt election for future interest in property not in trust.
(e) Reduction of tax for foreign gift or estate tax paid.
(1) In general.
(2) Protective claim for refund.
(f) Examples.
(g) 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) Filing requirement.
(5) Duration of status as electing foreign trust.
(i) In general.
(ii) Termination.
(A) Manner of termination.
(B) Effective date of termination.
(C) Notice requirements upon termination.
(iii) Subsequent elections.
(6) Dispute as to amount of section 2801 tax owed by electing foreign trust.
(i) Procedure.
(ii) Effect of compliance.
(iii) Effect of failing to comply (imperfect election).
(A) In general.
(B) Notice to permissible distributees.
(C) Reasonable cause.
(D) Interim period.
(7) No overpayment caused solely by virtue of defect in election.

(e) Examples.
(f) 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) Applicability date.

§28.2801-7 Determining responsibility under section 2801.
(a) Responsibility of U.S. citizens or residents receiving gifts or bequests from expatriates.
(b) Disclosure of return and return information.
(1) In general.
(2) Rebuttable presumption.
(c) Protective return.
(d) 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 attributable to covered gifts and covered bequests from non-electing foreign trusts, received by a U.S. citizen or resident from a covered expatriate during a calendar year. Domestic trusts, as well as electing foreign trusts, 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 (B)(iii). Accordingly, the section 2801 tax is paid by the U.S. citizen or resident, domestic trust, or electing foreign trust that receives the covered gift or covered bequest, including distributions attributable to covered gifts and covered bequests from non-electing foreign trusts. For purposes of the regulations in this part 28 (26 CFR part 28), references to U.S. citizens are considered to include domestic trusts and electing foreign trusts.

(b) *Applicability date*. This section applies to covered gifts or covered bequests received on or after January 1, 2025.

§28.2801-2 Definitions.

(a) *Overview*. This section provides definitions of terms applicable solely for purposes of section 2801 of the Code and the regulations in this part 28.

(b) *U.S. citizen or resident*. A *U.S. citizen or resident* is an individual who is a citizen or resident of the United States for purposes of chapter 11 or 12 of subtitle B, as the case may be, at the time of receipt of the covered gift or covered bequest. Furthermore, references to a U.S. citizen also include a domestic trust, as well as an electing foreign trust. See §28.2801-1(a).

(c) *Domestic trust*. The term *domestic trust* means a trust defined in section 7701(a)(30)(E) of the Code. References to a domestic trust include an electing foreign trust.

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

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

(3) *Non-electing foreign trust*. The term *non-electing foreign trust* means any foreign trust other than an electing foreign trust described in paragraph (d)(2) of this section.

(e) *U.S. recipient*. The term *U.S. recipient* means a U.S. citizen or resident, a domestic trust, or 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 a U.S. citizen or resident receiving a distribution from a non-electing foreign trust if the distribution is attributable (in whole or in part) to one or more covered gifts or

covered bequests received by the non-electing foreign trust. *See* §28.2801-5(c) to determine the amount of a distribution attributable to covered gifts and covered bequests. This term also includes the U.S. citizen or resident shareholders, partners, or other interest-holders, as the case may be (if any), of a business entity that receives a covered gift or covered bequest.

(f) *Covered bequest*. The term *covered bequest* means any property acquired by a recipient on or after June 17, 2008, directly or indirectly by reason of the death of a covered expatriate, regardless of the situs of the property and of whether such property was acquired by the covered expatriate before or after expatriation from the United States, but only to the extent the property would have been included in the covered expatriate's gross estate for Federal estate tax purposes if the covered expatriate had been a U.S. citizen immediately before death. See paragraph (i) of this section for guidance in determining when property is acquired indirectly for purposes of this paragraph (f). The term *covered bequest* also includes any other property that would have been included in the covered expatriate's gross estate for Federal estate tax purposes (for example, under section 2035 of the Code) if the covered expatriate had been a U.S. citizen immediately before death, as well as distributions made by reason of the death of a covered expatriate from a non-electing foreign trust to the extent the distributions are attributable to covered gifts and covered bequests made to the non-electing foreign trust on or after June 17, 2008. *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 a recipient on or after June 17, 2008, by gift directly or indirectly from an individual who is a covered expatriate at the time the property is received by the recipient, regardless of the situs of such property and of whether such property was acquired by the covered expatriate before or after expatriation from the United States. See paragraph (i) of this

section for guidance in determining when property is acquired indirectly for purposes of this paragraph (g). The term *covered gift* also includes distributions made, other than by reason of the death of a covered expatriate, from a non-electing foreign trust to the extent the distributions are attributable to covered gifts and covered bequests made to the non-electing foreign trust on or after June 17, 2008. *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) of the Code. 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 a covered expatriate for purposes of section 2801 at all times after the expatriation date. However, an expatriate 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*. For purposes of paragraphs (f) and (g) of this section, an indirect acquisition of property means the receipt of an interest in property, gratuitously passed from or conferred by the covered expatriate, by or on behalf of the recipient through another person, or by a trust or entity in which the recipient has an interest, regardless of the means or device employed. Such an indirect acquisition includes but is not limited to—

(1) Property acquired by a recipient through a transfer to a corporation or other

entity other than a trust or estate, to the extent of the ownership interest of the recipient in that corporation or other entity;

(2) Money paid or property distributed by a covered expatriate, or distributed from a non-electing foreign trust that received a covered gift or covered bequest, in satisfaction of a debt or liability of the recipient, regardless of the payee of that payment or distribution;

(3) Property acquired by or on behalf of a recipient pursuant to the exercise, release, or lapse (without regard to the exception in section 2041(b)(2) or 2514(e) of the Code) of 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

(4) Property acquired through or from any person not subject to the section 2801 tax that is, in substance, a covered gift or covered bequest from a covered expatriate.

(j) *Power of appointment*. The term *power of appointment* refers to both a general and non-general power of appointment, except as expressly limited to one or the other in a particular provision of the regulations in this part 28. The term *general power of appointment* has the same meaning as in sections 2041(b)(1) and 2514(c). The term *non-general power of appointment* means any power of appointment that is not a general power of appointment. For purposes of section 2801, the term *power of appointment* is defined without regard to the exception in section 2041(b)(2) or 2514(e).

(k) *Section 2801 tax*. The term *section 2801 tax* has the meaning provided in §28.2801-1(a).

(l) *Section 2801(c) amount*. The term *section 2801(c) amount* is the dollar amount of the per-donee gift tax exclusion in effect under section 2503(b) for that calendar year.

(m) *Statutory references*--(1) *Code*. The term *Code* means the Internal Revenue Code.

(2) *Subtitle B*. The term *subtitle B* means subtitle B of the Code.

(n) *Applicability date*. This section applies to covered gifts or covered bequests received on or after January 1, 2025.

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

(a) *Covered gift*. Subject to the provisions of paragraphs (c) through (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), (4), and (5) of the Code, the per-donee exclusion under section 2503(b) of the Code 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) through (e) of this section, property acquired *by reason of the death of a covered expatriate* (one of the types of transfers defined as a 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, property acquired by reason of a covered expatriate's death 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, to the extent the property would have been includible in the covered expatriate's gross estate if the covered expatriate had been a U.S. citizen at death;

(2) That was transferred by the covered expatriate during life, either before or

after expatriation, and that would have been includible in the covered expatriate's gross estate under section 2036, 2037, or 2038 of the Code had the covered expatriate been a U.S. citizen at 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, *United States Gift (and Generation-Skipping Transfer) Tax Return*, Form 709-NA, *United States Gift (and Generation-Skipping Transfer) Tax Return of Nonresident Not a Citizen of the United States,* 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 includible in the covered expatriate's gross estate under section 2044 of the Code if the covered expatriate had been a U.S. citizen at death; or

(4) That otherwise passed from the covered expatriate by reason of his or her 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 includible in the covered expatriate's gross estate under section 2040 of the Code if the covered expatriate had been a U.S. citizen at 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 death;

(iii) Property subject to a general power of appointment held by the covered expatriate at death that would have been includible in the covered expatriate's gross estate under section 2041 if the covered expatriate had been a U.S. citizen 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 of the Code if the covered expatriate had been a U.S. citizen at death.

(c) *Exceptions to covered gift and covered bequest*. Notwithstanding the definitions of *covered gift* and *covered bequest* in §28.2801-2(f) and (g), respectively, as further described in paragraphs (a) and (b) of this section, the terms *covered gift* and *covered bequest* do not include property described in paragraphs (c)(1) through (6) of this section.

(1) *Reported taxable gifts*. Property transferred as a taxable gift under section 2503(a) that is reported on the donor's timely filed Form 709 or Form 709-NA is not a covered gift. However, property excluded from the definition of a taxable gift, such as 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 or Form 709-NA.

(2) *Property reported as subject to estate tax*. Property that is includible in the gross estate of the covered expatriate and is reported on a timely filed Form 706, Form 706-NA, or Form 706-QDT, *U.S. Estate Tax Return for Qualified Domestic Trusts*, or any successor form, is not a covered bequest. 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 reported 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) *Covered bequest previously subject to section 2801 tax as a covered gift*. If a covered bequest from a covered expatriate previously constituted a covered gift from that covered expatriate (for example, because of a retained power or right described in

section 2036), the property is a covered bequest only to the extent that the value of the covered bequest exceeds the value of the covered gift that was subject to section 2801.

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

(5) *Transfers to spouse*. Property transferred from a covered expatriate to the covered expatriate's spouse generally is not a covered gift or covered bequest to the extent a marital deduction under section 2523 or 2056 of the Code would have been allowed if the covered expatriate had been a U.S. citizen at the time of the transfer. To the extent that a gift or bequest of property to a trust (or to a separate share of the trust) would qualify for the marital deduction, the property transferred in the gift or bequest is not a covered gift or covered bequest. To the extent the gift or bequest of property to the trust (or to a separate share of the trust) would not qualify for the marital deduction, the property transferred in the gift or bequest is a covered gift or covered bequest to the trust, and in the case of a non-electing foreign trust, distributions attributable to such gift or bequest will subject the U.S. citizen or resident spouse receiving such distributions to the section 2801 tax. *See* §§28.2801-4(a)(3) and 28.2801-5(a). For qualified terminable interest property (QTIP) described in section 2056(b)(7) and for property in a qualified domestic trust (QDOT) described in section 2056A of the Code, a valid QTIP and/or QDOT election must be made by the covered expatriate or covered expatriate's estate in order for the gift or bequest of such property to qualify for the marital exclusion under section 2801(e)(3), and, thus not be a covered gift or covered bequest under this paragraph (c)(5). Such an election can be made only with respect to the transfer of property subject to gift or estate tax under section 2511(a) or 2103 of the Code.

Furthermore, to exclude from covered bequests property in a QDOT for the benefit of a covered expatriate, funded pursuant to a bequest by the covered expatriate's predeceased spouse who also was a covered expatriate, a valid QDOT election must have been made in the predeceased covered expatriate's estate.

(6) *Qualified disclaimers*. Property transferred pursuant to a covered expatriate's qualified disclaimer, as defined in section 2518(b) of the Code, is not a covered gift or covered bequest from that covered expatriate.

(d) *Covered gifts and covered bequests made in trust*. For transfers of property to a trust that are covered gifts or covered bequests as described in §§ 28.2801-2 and 28.2801-3, the 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 made to a domestic trust or to an electing foreign trust is the domestic or electing foreign trust, and the U.S. recipient of a covered gift or a covered bequest made to a non-electing foreign trust is each U.S. citizen or resident receiving a distribution from the non-electing foreign trust (without regard to whether that distribution is or is not pursuant to the exercise or release of a general power of appointment). *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. For this purpose, the lapse of a general power of appointment held by a covered expatriate is treated as a release to the

extent provided in sections 2041(b)(2) and 2514(e) of the Code. 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 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 held in trust 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:

(1) *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)(5) of this section, the $100,000 exclusion 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), 2523(i), and 2503(b). The remaining amount ($300,000, less the $100,000 exclusion for a noncitizen spouse, as indexed for inflation) is a covered gift from CE to W. W must timely file Form 708, *United States Return of Tax for Gifts and Bequests Received 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).

(2) *Example 2*: *Reporting property as subject to estate tax*--(i) *Year 1.* 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) *Year 2.* 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 Internal Revenue Service grants both extensions, but CE's executor fails to file the Form 706-NA until after March 14 of Year 3.

(iii) *Analysis.* S learns that the executor of CE's estate did not timely file Form 706-NA. CE's estate remains liable for estate tax on CE's interest in the condominium. In addition, because CE is a covered expatriate and CE's estate failed to timely file the tax return reporting the transaction, S received a covered bequest as defined in §28.2801-2(f) and paragraph (b) of this section and 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).

(3) *Example 3*: *Covered gift in trust with grant of general power of appointment over trust property*--(i) *Facts*. 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. The foreign trust does not elect to be treated

as a domestic trust for purposes of section 2801. 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) *Effects on Q*. On October 20, Year 1, the irrevocable, non-electing 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 receives a distribution attributable to a covered gift and section 2801 tax is imposed on Q. *See* §28.2801-4(d)(5). 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). 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).

(iii) *Effects on A*. Although A has no section 2801 reporting requirement, 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) of

this chapter.

(4) *Example 4*: *Lapse of power of appointment held by covered expatriate*. 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 by CE, 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.

(5) *Example 5*: *Property subject to section 2801 tax as a covered gift and as a covered bequest*. F, a CE, transfers an income interest in property to A, a U.S. citizen, while retaining the remainder interest. F was not required to, and did not, file a gift tax return. Upon F's death, A receives full title to the property. The initial transfer of the income interest was a covered gift valued at $1,000,000, upon which A paid the section 2801 tax. The value of the property at F's death is $4,500,000. Because the full value of the property would have been included in F's gross estate if F had died as a U.S. citizen, there is a covered bequest at F's death. The covered bequest is subject to section 2801 tax on the excess of the value of the covered bequest over the value of the covered gift ($4,500,000 minus $1,000,000), or $3,500,000.

(g) *Applicability date.* This section applies to covered gifts or covered bequests received on or after January 1, 2025.

§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 of the Code 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) [Reserved].

(iv) *Migrated foreign trust*. A non-electing foreign trust 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) of the Code (migrated foreign trust), must file a timely Form 708, *United States Return of Tax for Gifts and Bequests Received 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 were 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 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 non-electing foreign trusts.

(ii) *Income tax deduction*. The U.S. recipient of a distribution from a non-electing foreign trust is allowed a deduction against income tax under section 164 in the calendar year in which the U.S. recipient paid or accrued the section 2801 tax. Thus, for cash method taxpayers, the calendar year in which the payment of the section 2801 tax occurs is later than the year in which the distribution is received and becomes subject to income tax. 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 (which, for this purpose, also includes accumulation distributions under section 665(b)). 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 all non-electing foreign trusts 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 included in the U.S. recipient's gross income for that calendar year. For purposes of this paragraph (a)(3)(ii)(B), distributions from non-electing foreign trusts included 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 non-electing foreign trusts that also are 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 [non-electing 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 highest rate of estate tax under section 2001(c) in effect for that calendar year. See paragraph (f)(1) 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. The total value of all covered gifts and covered bequests received by a U.S. recipient during the calendar year includes distributions made from a non-electing foreign trust to the extent the distributions are attributable to covered gifts or covered bequests made to the foreign trust on or after June 17, 2008.

(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, as of the date of receipt, 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, to the extent applicable, 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 of subtitle B as if the covered expatriate had been a U.S. citizen at the time of the transfer (subject to the other provisions of this paragraph (d)). For example, 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. However, for an asset or property interest 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 (subject to the other provisions of this subparagraph (d)). However, the date of receipt for property passing on the death of the covered expatriate by operation of law, or by beneficiary designation or other contractual agreement, is the date of death of the covered expatriate. 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) *Domestic trusts and electing foreign trusts*. The U.S. recipient of a covered gift or covered bequest made to a domestic trust or an electing foreign trust is the trust. For a lifetime transfer of assets by a covered expatriate to a domestic trust or an electing foreign trust, the date of receipt of the covered gift is the date of the gift for purposes of chapter 12 of subtitle B, determined as if the covered expatriate had been a U.S. citizen at the time of the transfer. For example, in the event of a transfer by a covered expatriate to a revocable trust, the date of receipt is the later of the date the right to revoke the trust is relinquished or extinguished and the date when all powers over or interests in the trust (if any) that would prevent the transfer from being a completed transfer for gift tax purposes (determined as if the covered expatriate had been a U.S. citizen) are extinguished. Similarly, in the event of a transfer by a covered expatriate to an irrevocable domestic trust or electing foreign trust over or in which the covered expatriate retains powers or interests that would prevent the transfer from being a completed gift for gift tax purposes (determined as if the covered expatriate had been a U.S. citizen), the date of receipt by the trust is the date all such powers or interests are extinguished. Additionally, if before the relinquishment of the right to revoke the trust or relinquishment of some other powers or interests that would render the gift incomplete (determined as if the covered expatriate had been a U.S. citizen), such trust distributes property to a U.S. recipient not in discharge of a support or other

obligation of the donor, then the U.S. recipient of that distribution receives a covered gift on the date of that distribution.

(5) *Non-electing foreign trusts*. A U.S. citizen or resident is treated as receiving a covered gift or covered bequest on the date that person receives a distribution from a non-electing foreign trust attributable to a covered gift or covered bequest that was received by the trust. The date of such a receipt by a U.S. citizen or resident is the date of each distribution from the non-electing foreign trust. In the event of a sale, encumbrance, monetization, or other disposition of a U.S. recipient's interest in a non-electing foreign trust, the date of receipt is the date of such sale, encumbrance, monetization, or other disposition of the interest.

(6) *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 the date the property subject to the power is distributed from the decedent's estate or any trust if the power of appointment is over property in such estate or trust, or the date of the covered expatriate's death if the power of appointment is over property passing on the covered expatriate's death by operation of law, or by beneficiary designation, or 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 general power of appointment is exercisable by the U.S. citizen or resident and the property

subject to the general power of appointment 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) through (4) of this section, and over property in a non-electing foreign trust is determined in accordance with paragraph (d)(5) of this section. See §28.2801-3(d) for the rule applying to covered gifts and covered bequests made in trust.

(7) *Indirect receipts*. The date of receipt by a U.S. recipient of a covered gift or covered bequest received indirectly from a covered expatriate is the date of its receipt, as determined under this paragraph (d), 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 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. recipient in whose favor the power was exercised. Further, the date of receipt of property received through one or more entities not subject to section 2801 is the date of its receipt by the U.S. recipient from a conduit entity.

(8) *Future interest in property not in trust*--(i) *Date of receipt*. The date of receipt by a U.S. recipient (including a domestic trust or an electing foreign trust) of a future interest in property not held in trust is the earlier of the date such interest may be transferred by the U.S. recipient and the date that is the later of the date that such interest vests in the U.S. recipient or the date that the last intervening interest in the property is extinguished. For this purpose, a transfer includes a sale, encumbering, monetization, or other disposition of the interest.

(ii) *Date-of-receipt election for future interest in property not in trust*. A U.S. recipient of a covered gift or covered bequest that is a future interest in property not

held in trust instead may elect to treat the date of receipt as the date of the donor's transfer of that future interest in the event of a covered gift, or as the date of death of the covered expatriate in the event of a covered bequest. Such an election will be made on Form 708 for the year in which this elective date of receipt occurs, in accordance with the instructions for such form.

(e) *Reduction of tax for foreign gift or estate tax paid*--(1) *In general*. 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 territories 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 gift or estate tax return and a copy of the receipt or cancelled check for payment of the foreign gift or estate tax. The U.S. recipient also must report on an attachment to the Form 708:

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

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

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

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

(2) *Protective claim for refund*. A protective claim for refund under this section may be filed to preserve the U.S. recipient's right to claim a refund in the event any gift or estate tax with respect to the covered gift or covered bequest is owed but not yet paid to a foreign country until after the expiration of the period of limitation for filing a claim

for refund. Such a protective claim may be filed at any time before the expiration of the period of limitation prescribed in section 6511(a) for the filing of a claim for refund and shall be made in accordance with the usual procedures for filing a claim for refund. *See* https://www.irs.gov and Form 843, *Claim for Refund and Request for Abatement*, and its instructions. Action on a protective claim will proceed after the U.S. recipient has notified the Internal Revenue Service within a reasonable period that the gift or estate tax with respect to the covered gift or covered bequest has been paid to a foreign country.

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

(1) *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 tax rate is 40 percent and the section 2801(c) amount is $16,000. 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 $114,000, 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 $16,000. A's section 2801 tax liability then is reduced by any foreign gift or estate tax paid under paragraph (e) of this section. Assuming A, B, and C paid no foreign gift or estate tax on the transfers, A's section 2801 tax liability for Year 1 is $45,600 ($114,000 x 0.4).

(2) *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 $16,000. Based on information provided by

the trustee of the non-electing foreign trust, B includes $50,000 of the aggregate distributions from the non-electing 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 non-electing foreign trust and pays $43,600 in section 2801 tax (($125,000 - $16,000) x 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 non-electing 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 includible 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 non-electing foreign trust that are both covered gifts or covered bequests and includible in B's taxable income is $17,440 ($43,600 x ($50,000/$125,000)). Therefore, B's deduction under section 164 is $17,440. See paragraph (a)(3)(ii)(C) of this section.

(3) *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) *Applicability date*. This section applies to covered gifts or covered bequests received on or after January 1, 2025.

§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 non-electing 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 non-electing foreign trust, the term *distribution* means any direct, indirect, or constructive transfer from a non-electing foreign trust, including a transfer to the extent made for less than full and adequate consideration in money or money's worth. Although section 643(i) of the Code does not apply for the purpose of defining a distribution under this section, certain loans from or uncompensated use of property held by a non-electing foreign trust nevertheless may satisfy the definition of a distribution under this paragraph if the loan or use of trust property would be a gift as defined for purposes of chapter 12 of subtitle B. For purposes of determining whether a U.S. recipient has received a distribution from a non-electing foreign trust, the term

distribution also includes each distribution from a non-electing foreign trust pursuant to the exercise, release, or lapse (without regard to the exception in section 2041(b)(2) or 2514(e) of the Code) of a power of appointment, whether or not such power is a general power of appointment. In addition, the term *distribution* also includes the domestication of a foreign trust, and any sale, encumbering, monetization, or other disposition by the U.S. recipient of the recipient's interest in the trust to the extent of that disposition. *See* §28.2801-4(a)(2)(iv). The determination of whether a U.S. recipient has received a distribution is made without regard to whether any portion of the non-electing foreign 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. A U.S. recipient receiving a distribution for purposes of this section must determine whether the information reporting requirements of section 6048(c) apply. *See* §28.2801-6(c)(2).

(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 one and the full amount of each distribution from that foreign trust to a U.S. citizen or resident would be attributable to the foreign trust's covered gifts and covered bequests and subject to the imposition of section 2801 tax. Because the non-electing foreign trust itself is not taxed on its receipt of covered gifts and covered bequests, the trust is not entitled to an annual exclusion pursuant to section 2801(c); that exclusion is available only in computing the section 2801 tax payable by the U.S. recipient filing a Form 708, *United States Return of Tax for Gifts and Bequests Received from Covered Expatriates*.

(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)(1) of this section (*Example 1*), for an illustration of this computation.

(2) *Effect of reported transfer and tax payment*. With regard to the value of property on which a section 2801 tax has been timely paid, even though that property thereafter remains in a non-electing foreign trust, that value no longer is considered to be, or to be attributable to, a covered gift or covered bequest to that 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, provided those amounts were reported as a covered gift or covered bequest on a timely filed Form 708 or the total covered gifts and covered bequests received in a calendar year do not exceed the section 2801(c) amount. An amount for which no section 2801 tax was due refers to the amount of a covered gift or covered bequest received by an electing foreign trust not in excess of the section 2801(c) amount. *See* §28.2801-5(e) (*Example 4*).

(3) *Inadequate information to calculate section 2801 ratio*. A U.S. citizen or resident receiving a distribution from a non-electing foreign trust must proceed upon the assumption that the distribution is attributable to a covered gift or covered bequest to the extent the trustee of the foreign trust does not have sufficient books and records to calculate the section 2801 ratio or the taxpayer is unable to obtain the necessary information regarding the foreign trust to calculate the section 2801 ratio. The assumption is rebuttable to the extent the taxpayer can supply information sufficient to persuade the Internal Revenue Service (IRS) that the distribution is not entirely attributable to covered gifts and covered bequests.

(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 all covered gifts and covered bequests received by the foreign trust during that calendar year, 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 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 U.S. recipient.

(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). *See* §28.2801-6(c)(2).

(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 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 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 timely file Form 708 to report each covered gift and bequest made to the trust in accordance with §28.2801-5(d)(4);

(D) Identify 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;

(E) Provide a copy of the governing instrument of the trust and provide the name, address, and taxpayer identification number of each permissible distributee described in paragraph (d)(3)(ii)(F) of this section; and

(F) Affirm under penalties of perjury that each permissible distributee was notified that the trustee is making (or has made) the election, effective as of January 1 of the calendar year for which the Form 708 on which the election is made is filed. 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 during that year or in a future year, regardless of whether the right arises or lapses upon the occurrence of a future event; and

(*3*) Would be described in either or both of paragraphs (d)(3)(ii)(F)(*1*) and (*2*) of this section upon an immediate termination of either the trust or the interest of any person described in either or both of paragraphs (d)(3)(ii)(F)(*1*) and (*2*) of this section.

(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. The trustee must proceed upon the assumption that the corpus and undistributed income are attributable to covered gifts and covered bequests to the extent the trustee does not have sufficient books and records to determine what amount

of the corpus and undistributed income is attributable to prior covered gifts and covered bequests. The assumption is rebuttable by the taxpayer's furnishing information sufficient to persuade the IRS that corpus and undistributed income is not attributable to prior covered gifts or covered bequests. 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) of the Code, to act as an agent for the trust for purposes of section 2801. The designation and authorization are made on a duly filed Form 2848, *Power of Attorney and Declaration of Representative*, or as may be directed otherwise in IRS forms or publications. By designating a U.S. agent, the trustee of the trust agrees to provide the agent with all information necessary to comply with any information request or summons issued by the Secretary of the Treasury or her delegate (Secretary) that is relevant to the collection or determination of tax under section 2801. 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 an electing foreign trust for purposes of section 2801 includes serving as the trust's agent for purposes of section 7602 of the Code (*Examination of books and witnesses*), section 7603 of the Code (*Service of summons*), and section 7604 of the Code (*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 foreign trust and distributions of such contributions and the income therefrom; 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 foreign

trust and distributions of such contributions and the income therefrom.

(C) *Effect of appointment of 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) *Filing requirement*. The trustee of an electing foreign trust must timely file a Form 708 to report and pay the section 2801 tax on all covered gifts and covered bequests received by the trust during the calendar year. *See* §28.6071-1. Nevertheless, the trustee of an electing foreign trust is not required to file Form 708 for a calendar year in which either the trust received no covered gifts or covered bequests, or the total fair market value of all covered gifts and covered bequests received by the electing foreign trust during that calendar year is less than or equal to the section 2801(c) amount.

(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*--(A) *Manner of termination*. An election to be treated as a domestic trust for purposes of section 2801 is terminated by—

(*1*) A failure of the foreign trust to timely file a required Form 708 and timely pay the section 2801 tax, as required by paragraph (d)(4) of this section;

(*2*) A failure of the foreign trust to enter into a closing agreement and to timely pay any additional amount of section 2801 tax (in accordance with the requirements of paragraph (d)(6)(i) of this section) with respect to recalculations described in paragraph (d)(6) of this section (a termination that also results in the conversion of the trust's

election to an imperfect election); or

(*3*) An affirmative revocation of the election made in accordance with the instructions for Form 708.

(B) *Effective date of termination*. The effective date of the termination of an election to be treated as a domestic trust for purposes of section 2801 is as follows:

(*1*) For a termination described in paragraph (d)(5)(ii)(A)(*1*) of this section, the termination is effective as of the first day of the calendar year for which the Form 708 was required under paragraph (d)(4) of this section.

(*2*) For a termination described in paragraph (d)(5)(ii)(A)(*2*) of this section, the termination is effective as of the first day of the calendar year for which the Form 708 was filed with respect to which the additional amount of section 2801 tax is claimed to be due by the IRS.

(*3*) For a termination described in paragraph (d)(5)(ii)(A)(*3*) of this section, the termination is effective as of the first day of the calendar year for which a Form 708 was filed to affirmatively revoke the election.

(C) *Notice requirements upon termination*. In the case of a termination of the election, the trustee should notify promptly each permissible distributee of the trust, as defined in paragraph (d)(3)(ii)(F) of this section and determined as of the effective date of the termination of the election, that the foreign trust's election was terminated (or terminated and converted to an imperfect election) and the effective date of the termination, and that each U.S. recipient of a distribution made from the foreign trust on or after the effective date of that termination 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 IRS 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 IRS will issue a letter (but not a notice of deficiency as defined in section 6212 of the Code) to the trustee of the trust and the appointed U.S. agent that details the disputed information and the proper amount of section 2801 tax as recalculated. The trustee of the foreign trust must pay the additional amount of section 2801 tax including interest and penalties, if any, on or before the due date specified in the letter (or other date agreed to by the IRS) and enter into a closing agreement with the IRS as described in section 7121 to maintain its election.

(ii) *Effect of compliance*. If the trustee of the foreign trust complies with the requirements of paragraph (d)(6)(i) of this section, then the foreign trust's election to be treated as a domestic trust under paragraph (d) of this section remains in effect. In the absence of fraud, malfeasance, or misrepresentation of a material fact, any value determined in the closing agreement will be deemed to be final and binding on both the IRS and the foreign trust. Subsequently, the IRS will not challenge the amount of section 2801 tax due from either the foreign trust or any of its distributees 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. In addition, neither the foreign trust nor any of its distributees 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 comply (imperfect election*)--(A) *In general*. If the foreign trust fails to enter into the closing agreement and to timely pay any of the additional amount of section 2801 tax (with interest and penalties, if any) determined to be due by the IRS in accordance with the procedure in paragraph (d)(6)(i) of this section, then the foreign trust's valid election is terminated and is converted to an imperfect election. The conversion to an imperfect election is retroactive to the first day of the calendar year (subject year) for which the Form 708 was filed with respect to which the additional amount of section 2801 tax is claimed to be due by the IRS. The trust will be a non-electing foreign trust for the subject year and for each subsequent year until another valid election (if any) is made by the trust. However, the value the foreign trust reported on the Form 708 for the subject year and each other year during the interim period described in paragraph (d)(6)(iii)(D) of this section, and on which the trust 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) that will be applicable to distributions made by the foreign trust to U.S. recipients during the subject year and thereafter until the effective date of any subsequent election meeting the requirements of paragraph (d)(3) of this section. 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 distributees*. If the trustee of the foreign trust fails to enter into the closing agreement and to remit, by the due date specified or otherwise agreed to by the IRS, the additional section 2801 tax, including all interest and

penalties, in accordance with the procedure in paragraph (d)(6)(i) of this section, the trustee should notify promptly each permissible distributee, as defined in paragraph (d)(3)(ii)(F) of this section:

(*1*) That the foreign trust's election was terminated and the effective date of the termination (see paragraph (d)(5)(ii)(B)(*2*) of this section);

(*2*) Of the amount of additional value on which the foreign trust did not timely pay the section 2801 tax as determined or otherwise agreed to by the IRS, which value the IRS thus deems to be attributable to covered gifts and covered bequests; and

(*3*) That each U.S. recipient of a distribution made from the foreign trust on or 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 the foreign 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 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) that begins on the effective date of the termination of the election (see paragraph (d)(5)(ii)(B) of this section) 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 ends on the earlier of December 31 of the calendar year during which the additional amount of section 2801 tax was due to be paid, as described in paragraph (d)(6)(i) of this section, or the effective date of a subsequent valid election to be treated as a domestic trust for purposes of section 2801. As described in paragraph (d)(6)(iii)(A) of this section regarding imperfect elections, the value of the covered gifts and covered bequests received by the foreign trust during this interim period, which the foreign trust has reported on one or more filed Forms 708 and on which the foreign trust has paid the section 2801 tax, is no longer considered to be attributable to 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. If, once the interim period has ended, the foreign trust has no election in place, 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 an electing foreign 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 value of the covered gifts or covered bequests on which the section 2801 tax was paid by the foreign trust and such value on which the section 2801 tax has been paid is no longer treated as attributable to 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 (6)(iii) of this

section.

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

(1) *Example 1: Computation of section 2801 ratio*. A and B each contribute $100,000 to a new foreign trust. A (but not B) is a covered expatriate and A's contribution is a covered gift. The trustee of the trust does not make a valid election to have the trust treated as a domestic trust for purposes of section 2801. The section 2801 ratio immediately after these two contributions is 0.50, computed as follows: the pre-contribution value of the trust ($0) multiplied by 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 to a U.S. recipient 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 x 0.5) is a covered gift to C.

(2) *Example 2: Distribution to spouse*. In Year 1, A contributes $300,000 to a foreign trust. A is a covered expatriate. B, A's U.S. citizen spouse, and A's issue may receive discretionary distributions of income and principal. The transfer would not have qualified for the gift tax marital deduction if A had been a U.S. citizen or resident at the time of the gift; therefore, A's contribution is a covered gift. *See* sections 2801(e)(3) and 2523. No one pays foreign gift taxes on A's contribution. The trustee of the trust does not make a valid election to have the trust treated as a domestic trust for purposes of section 2801. The section 2801 ratio immediately after A's contribution is one. The highest gift tax rate is 40 percent, and the section 2801(c) amount is $17,000. The trustee distributes $200,000 to B in Year 1. The entire amount is a covered gift to B. *See* section 28.2801-3(c)(5). This is the only covered gift B receives in Year 1. B

receives no covered bequests in Year 1. B's section 2801 tax for Year 1 is computed by multiplying B's net covered gift by 40 percent. B's net covered gift for Year 1 is $183,000, which is determined by reducing B's covered gift received during Year 1 by the section 2801(c) amount. B's section 2801 tax liability for Year 1 is $73,200 ($183,000 x 0.4).

(3) *Example 3*: *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. 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. None of these contributions is a covered gift because the gifts predated the effective date of section 2801. 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. The trustee of the foreign trust does not make a valid election to have the trust treated as a domestic trust for purposes of section 2801. 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 ([(section 2801 ratio of 0 x $610,000 fair market value pre-contribution) plus the $100,000 covered gift]/ $710,000

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, only $100,000 of that total was a covered gift, being the only contribution made by A both after the enactment of section 2801 and after A's expatriation. 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 x 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 x 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).

(4) *Example 4: Termination of election*. (i) In Year 1, A contributes $200,000 and B contributes $100,000 to Trust, a foreign trust. A and B are covered expatriates. A's and B's contributions are covered gifts. No one pays foreign gift taxes on A's and B's contributions. The trustee of Trust makes a valid election to have Trust treated as a domestic trust for purposes of section 2801. The highest gift tax rate is 40 percent, and the section 2801(c) amount is $17,000. The section 2801 tax for Year 1 is computed by multiplying the net covered gifts and covered bequests by 40 percent. The net covered gifts and covered bequests for Year 1 total $283,000, determined by reducing the covered gifts and covered bequests received by Trust during Year 1, $300,000, by the section 2801(c) amount, $17,000. Trust's 2801 tax liability for Year 1 is $113,200 ($283,000 x 0.4). Any distributions made to U.S. recipients before the trust receives

another contribution have a section 2801 ratio of zero and are not subject to the section 2801 tax. See paragraph (d)(2)(i) of this section.

(ii) In Year 2, A contributes $100,000 to Trust, all of which is a covered gift. The trustee of Trust fails to timely file a Form 708 for Year 2 and timely pay the section 2801 tax. The fair market value of Trust was $400,000 immediately prior to A's contribution. The section 2801 ratio immediately after A's contribution is 0.20, computed as follows: the pre-contribution value of Trust ($400,000) multiplied by the section 2801 ratio in effect immediately prior to the Year 2 contribution (0), plus the fair market value of the Year 2 contribution that constitutes a covered gift ($100,000), divided by the fair market value of Trust after the Year 2 contribution ($500,000). See paragraph (c)(1) and (2) of this section. If the trustee distributes $40,000 to C, a U.S. citizen, after the contribution in Year 2, then $8,000 ($40,000 x 0.20) is a covered gift to C. In Year 2, C also receives a covered gift of $50,000 directly from B. No one pays foreign gift taxes on B's covered gift. C receives no covered bequests in Year 2. C's section 2801 tax for Year 2 is computed by multiplying C's net covered gifts and covered bequests by 40 percent. C's net covered gifts and covered bequests for Year 2 total $41,000, determined by reducing the covered gifts and covered bequests received by C during Year 2, $58,000 ($8,000 + $50,000), by the section 2801(c) amount, $17,000. C's section 2801 tax liability for Year 2 is $16,400 ($41,000 x 0.4).

(5) *Example 5: Imperfect election of 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, reports the fair market value of the covered gift as $500,000, and timely pays the section 2801 tax on the reported fair market value of the

covered gift. 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. 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 terminated and converted into an imperfect election as of January 1 of Year 1. In computing the foreign trust's section 2801 ratio for Year 1, the $500,000 of value on which the section 2801 tax was timely paid is no longer considered to be attributable to 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 six months 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 a Form 708 to report the Year 1 distribution, 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 (plus interest from the due date of the tax as if reported on a Form 708 that was timely filed as to Year 1).

(v) Although the foreign trust timely filed the Form 708 for Year 2 and timely paid the section 2801 tax shown on that return, and although the foreign trust's election had not yet been terminated and converted into an imperfect election during Year 2, the foreign trust nevertheless did not have a valid election for Year 2 because the trust did not timely pay the section 2801 tax on all covered gifts and covered bequests received in prior years as required in paragraph (d)(3) of this section, specifically, 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 the Form 708 and paid the section 2801 tax on the Year 2 covered gift of $200,000, the $200,000 amount is no longer considered a covered gift for purposes of computing the section 2801 ratio after that contribution.

(6) *Example 6: Subsequent election after termination of election*. The facts are the same as in paragraph (e)(5) of this section (*Example 5*). 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) *Applicability date*. This section applies to covered gifts or covered bequests received on or after January 1, 2025.

§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 of the Code, respectively. However, the basis adjustment provided in section 1015(d) does not apply to increase the basis in a covered gift to reflect the tax paid under this section.

(b) *Generation-skipping transfer tax*. Transfers made by a nonresident not a citizen of the United States (NRNC transferor) are subject to generation-skipping transfer (GST) tax only to the extent those transfers are subject to Federal estate or gift tax as described in §26.2652-1(a)(2) of this chapter. In applying this rule, taxable distributions and taxable terminations are subject to the GST tax only to the extent the NRNC transferor's contributions to the trust, as defined in §26.2652-1(b)(1) of this chapter, were subject to Federal estate or gift tax as described in §26.2652-1(a)(2) of this chapter. *See* §26.2663-2 of this chapter. 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 of the Code applies because of a covered expatriate's failure to timely file an estate or gift tax return.

(c) *Information returns*--(1) *Gifts and bequests*. Pursuant to section 6039F of the Code and any corresponding regulations and Form 3520, Part IV, each U.S. person who treats an amount received from a foreign person (other than through a foreign trust) as a gift or bequest (whether or not 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. For purposes of this provision, a U.S. person is as defined in section 7701(a)(30) of the Code and includes a U.S. resident within the meaning of section 7701(b)(1)(A) of the Code.

(2) *Foreign trust distributions*. Pursuant to section 6048(c) of the Code and the corresponding regulations, and to the extent provided in Notice 97–34 and Part III of Form 3520 and its Instructions, a U.S. person must report each distribution received during the taxable year from a foreign trust on Part III of Form 3520. Under section 6677(a) of the Code, 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. For purposes of this provision, the term *U.S. person* is as defined in section 7701(a)(30) and includes both U.S. citizens and U.S. residents within the meaning of section 7701(b)(1)(A).

(3) *Penalties and use of information*. The filing of Form 706, Form 706-NA, Form 706-QDT, Form 708, Form 709, or Form 709-NA, or any successor form, 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) of the Code for failure to comply with section 6039F(a). Pursuant to section 6039F(c)(1)(A), the Secretary of the Treasury or her delegate 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) *Applicability date*. This section applies on and after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

§28.2801-7 Determining responsibility under section 2801.

(a) *Responsibility of U.S. citizens or residents receiving gifts or 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 of the Code, 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. *See* section 6103 of the Code. 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 or incomplete. The circumstances under which such information may be disclosed to a U.S. citizen or resident, the process for authorizing disclosures, 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*) of this chapter).

(2) *Rebuttable presumption*. Unless a living donor expatriate authorizes the disclosure of the donor expatriate's 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.

(c) *Protective return*. A taxpayer who reasonably concludes that a gift or bequest is not subject to section 2801 may file a protective Form 708 to start the period of limitations for the assessment of any section 2801 tax. See §28.6011-1(b) that provides safe harbor procedures for filing a protective Form 708.

(d) *Applicability date*. This section applies on and after **[INSERT DATE OF PUBLICATION 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 subtitle B 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 Received from Covered Expatriates*, or any successor form. All documents and vouchers used in preparing Form 708 must be retained by the person required to file the return so as to be available for inspection so long as the contents thereof may become material in the administration

of any internal revenue law.

(b) *Supplemental information*. The U.S. recipient, as defined in §28.2801-2(e), must furnish such supplemental information as may be deemed necessary by the Internal Revenue Service (IRS) to allow the IRS to determine the correct amount of tax. 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 of the Code 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, *Life Insurance Statement,* or any successor form, and file it with the IRS office where the return is filed. If specifically requested by the IRS, the insurance company must file this statement directly with the IRS.

(c) *Applicability date*. This section applies on and after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

§28.6011-1 Returns.

(a) *Return required*. The return of any section 2801 tax imposed by chapter 15 of subtitle B of the Internal Revenue Code (Code) must be made on Form 708, *United States Return of Tax for Gifts and Bequests Received from Covered Expatriates*, in accordance with the instructions applicable to the form (or on such other form as may be provided in future guidance or instructions). 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 of this chapter. The U.S. recipient must file Form 708 for each calendar year in which the U.S.

recipient receives a covered gift or covered bequest. 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 (as defined in §28.2801-2(l)).

(b) *Protective return safe harbor*. A U.S. citizen or resident (as defined in §28.2801-2(b)) who 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 to start the running of the period of limitations for assessment of tax. Under the safe harbor procedure of this paragraph (b), a Form 708 will start the running of the period of limitations for assessment of tax if the return includes all of the information otherwise required on Form 708, along with an affidavit, signed under penalties of perjury, setting forth the information on which the 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. For purposes of this safe harbor, if the U.S. citizen or resident has obtained, and is permitted to rely on, information from the Internal Revenue Service (IRS) (as described in §28.2801-7(b)(1)), the U.S. citizen or resident must attach a copy of such information to the protective return. For purposes of this safe harbor, the U.S. citizen or resident also must attach a copy of a completed Part III of Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts,* for all trust distributions, or Part IV of Form 3520 for all gifts and bequests, if applicable.

(c) *Applicability date*. This section applies on and after **[INSERT DATE OF**

PUBLICATION 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 section 2801 tax, other than for that 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) *Applicability date*. This section applies with regard to returns and claims for refund filed on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

§28.6071-1 Time for filing returns.

(a) *In general*--(1) *Due Date.* A U.S. recipient, as defined in §28.2801-2(e), must file Form 708, *United States Return of Tax for Gifts and Bequests Received from Covered Expatriates*, or any substitute or successor form specified in guidance or instructions, 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 with 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) (electing foreign trust) 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.

(d) *Applicability date*. This section applies to covered gifts or covered bequests received on or after January 1, 2025.

§28.6081-1 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, *United States Return of Tax for Gifts and Bequests Received from Covered Expatriates*, by filing an appropriate form for extension as specified by guidance or instructions. A U.S. recipient must include on the form for extension an estimate of the amount of section 2801 tax liability and must file the form for extension with the Internal Revenue Service in the manner designated in the instructions issued with respect to such form.

(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 the form for extension 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 of the Code regarding penalties for failure to file the required tax return or failure to pay the amount shown as tax on the return.

(e) *Applicability date*. This section applies on and after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

§28.6091-1 Place for filing returns.

(a) *In general*. A U.S. recipient, as defined in §28.2801-2(e), must file Form 708, *United States Return of Tax for Gifts and Bequests Received from Covered Expatriates*, with the Internal Revenue Service in the manner prescribed by the instructions issued with respect to that form.

(b) *Applicability date*. This section applies on and after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

§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 section 2801 tax 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) *Applicability date*. This section applies to returns and claims for refund filed on or after **[INSERT DATE OF PUBLICATION 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 section 2801 tax

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) *Applicability date*. This section applies to returns and claims for refund filed on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

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

(a) *In general*. The section 2801 tax shown on the return must be paid at the time prescribed in §28.6071-1 for filing the return, and in the manner prescribed in §28.6091-1 for filing the return.

(b) *Applicability date*. This section applies to covered gifts or covered bequests received on or after January 1, 2025.

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

(a) *In general*. For general rules regarding penalties under section 6694 of the Code applicable to preparers of returns or claims for refund of the section 2801 tax, see §1.6694-1 of this chapter.

(b) *Applicability date*. This section applies with regard to returns and claims for refund filed, and advice provided, on or after **[INSERT DATE OF PUBLICATION 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 section 2801 tax is subject to penalties under section 6694(a) of the Code in the manner stated in §1.6694-2 of this chapter.

(b) *Applicability date*. This section applies to returns and claims for refund filed, and advice provided, on or after **[INSERT DATE OF PUBLICATION 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 section 2801 tax is subject to penalties under section 6694(b) of the Code in the manner stated in §1.6694-3 of this chapter.

(b) *Applicability date*. This section applies to returns and claims for refund filed, and advice provided, on or after **[INSERT DATE OF PUBLICATION 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 the section 2801 tax 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) of the Code, the rules under §1.6694-4 of this chapter apply.

(b) *Applicability date*. This section applies to returns and claims for refund filed, and advice provided, on or after **[INSERT DATE OF PUBLICATION 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 section 2801 tax 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), failure to furnish an identification number under section 6695(c), failure to retain a copy or list under section 6695(d), failure to file a correct information return under section 6695(e), and negotiation of a check under section 6695(f), in the manner stated in §1.6695-1 of this chapter.

(b) *Applicability date*. This section applies to returns and claims for refund filed

on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

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

(a) *In general*. With respect to claims for credit or refund by a tax return preparer who prepared a return or claim for refund for any section 2801 tax, 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) *Applicability date*. This section applies to returns and claims for refund filed, appraisals, and advice provided, on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

§28.7701-1 Tax return preparer.

(a) *In general*. For the definition of the term *tax return preparer*, see §301.7701-15 of this chapter.

ACTEC Estate and Gift Tax

Evolving Law Concerning IRC Section 2036:
Expansion of Taxable Gifts and Inclusion in the Estate of Transfers
Impact of IRS Sections 2701 and 2704 and Related Litigation Observations

March 20, 2025

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The presenters wish to thank Carol Herrington and Marc Bloostein for their contributions to the materials.

Agenda

- Recent cases asserting taxable gifts
  - (a) *Anenberg*
  - (b) *McDougall*
  - (c) CCA 202352018
- Loper Bright Including Impact on § 2036 Analysis
- Evolution of Case Law in § 2036 cases
  - *(a) Byrum*
  - *(b) Strangi*
  - *(c) Powell*
  - (d) Doctrines of implied agreement and right to control entitlement to income or principal of transferred assets
- IRC § 2701 and 2704
- Litigation Related Observations

IRC § 2519

- Property which has been qualified for the marital deduction is taxed at the surviving spouse's death under § 2044.
- Similarly, if the surviving spouse disposes of his or her income interest during life, this results in a taxable gift of all the assets (other than the income interest):

  > "**[A]ny disposition of all or part of a qualifying income interest for life in any [QTIP] shall be treated as a transfer of all interests in such property other than the qualifying income interest**." IRC Section 2519

- Recent cases illustrate the application of that rule, however, no taxable gift may occur when the disposition of the income interest does not reduce the assets of the surviving spouse's estate.

Anenberg v. Comm'r, 162 T.C. No. 9

- In Anenberg, the surviving spouse (S) and two children, the remaindermen of the QTIP trust, petitioned the court and received permission to terminate the trust. The trust assets were distributed to S, who later sold these to other trusts for the children in exchange for a note.

Anenberg v. Comm'r, 162 T.C. No. 9

- IRS asserted that the termination of the trust and later sale of the assets to the trusts for the children constituted a taxable gift, as a disposition of S's entire interest under IRS Section 2519.
- The Tax Court noted that §§ 2044 and 2519 create a "legal fiction" that the S is treated as owning the entire trust:

> **"Operating together, [§§ 2044 and 2519] generally mean that a QTIP election produces the same tax outcome that the marital deduction would have if the surviving spouse in fact owned the QTIP—namely, deferral until the surviving spouse dies or conveys his or her interest in the QTIP by gift."**

Anenberg v. Comm'r, 162 T.C. No. 9

- However, the Tax Court went on to say, **"[a] transfer alone . . . is insufficient to create a gift tax liability,"** taking into account §§ 2501 and 2511. The Court stated that **there must be gratuitous transfer** to amount to a taxable gift.
- Accordingly, the Tax Court held that the termination of the trusts did not result in a taxable gift by S since her economic position remained unchanged:
  - **"At the end of the day, she gave away nothing of value as a result of the deemed transfer."** We conclude that the estate of S was not reduced by reason of the trust termination and hence no taxable gift was deemed to have occurred by S.

Anenberg v. Comm'r, 162 T.C. No. 9

- Compare the holding of *Anenberg* to *Estate of Kite*, T.C. Memo 2013-43, where a trust was terminated and the assets were distributed to the spouse who sold them to the remaindermen in exchange for a private annuity. There the Court held that the spouse had made a taxable gift, concluding that she had not received full consideration.
- The *Anenberg* court did not address whether the remainder beneficiaries had made a gift when they consented to the trust termination.

McDougall v. Comm'r, 163 T.C. No. 5

- In *McDougall* the beneficiaries agreed to terminate a marital trust and the assets were distributed to the surviving spouse (S) pursuant to a non-judicial agreement.
- S sold the assets received to the children, who were the remaindermen, for a note.
- The agreement noted the gift by S under § 2519 and asserted this was offset by the gift from the remaindermen to S.

McDougall v. Comm'r, 163 T.C. No. 5

- The IRS asserted that H had made a gift under § 2519, and the children had made a taxable gift to S.
- The Tax Court held, consistent with *Anenberg*, that S had not made any taxable gift, reflecting the fact that the estate of S was not diminished by the trust termination and distribution of the trust assets to S.
- The Court held that the remaindermen had made a gift to S by giving up their remainder interests, valuable property rights, which in fact changed hands as a result of the transfer.

Observations from Anenberg and McDougall

- Trust termination and distribution of trust assets to S does not trigger § 2519
- Consent by remaindermen to trust termination may constitute a taxable gift, depending on valuations and circumstances.
- If the termination requires consent of remainder beneficiaries, they may be making gift to spouse beneficiary
  - Valuation of gift will depend on terms of trust and other facts
- Where a trustee has unlimited discretion to distribute principal to S, so that the consent of the remaindermen is not needed to permit trust termination, no taxable gift occurs. *See* Treas. Reg. § 25.2519-1(e)

Loper Bright Enterprises v. Raimondo, 603 U.S. ___, Including Impact on § 2036 Analysis*

Section 2036(a)

- "The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (***except in case of a bona fide sale for an adequate and full consideration in money or money's worth***), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death:

1. The possession or enjoyment of, or the right to the income from, the property, or
2. The right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom."

Bona Fide Sale for Adequate and Full Consideration

- Note the bona fide sale for adequate and full consideration exception under section 2036(a). This exception has been interpreted extensively in the context of Family Limited Partnership/Family Limited Liability Companies (collectively referred to as "FLPs")
- "The transfers, trusts, interests, rights or powers enumerated and described in sections 2035 through 2038 and section 2041 are not subject to the Federal estate tax if made, created, exercised, or relinquished in a transaction which constituted a bona fide sale for an adequate and full consideration in money or money's worth. To constitute a bona fide sale for an adequate and full consideration in money or money's worth, ***the transfer must have been made in good faith, and the price must have been an adequate and full equivalent reducible to a money value***. If the price was less than such a consideration, only the excess of the fair market value of the property (as of the applicable valuation date) over the price received by the decedent is included in ascertaining the value of his gross estate." 26 CFR § 20.2043-1(a).

Summary of Current Law

- Two prevailing tests under modern case law:
    1. "Arm's Length Transaction Test"
    2. "Nontax Reason Test"
- Of these two tests, the Nontax Reason Test appears to be the dominate trend.

United States v. Byrum (U.S. Supreme Court)

- In *Byrum*, the United States Supreme Court held that the transfer of stock in three closely held corporations to irrevocable trusts was not to be included in the decedent's estate under section 2036(a).
- The decedent had retained the voting control over the gifted stock, among other rights. The Court stated that: "Here, the right ascribed to Byrum was the power to use his majority position and influence over the corporate directors to "regulate the flow of dividends" to the trust. That "right" was neither ascertainable nor legally enforceable, and hence was not a right in any normal sense of that term."
- The corporate trustee alone, not Byrum, had the right to pay out or withhold income, and thereby to designate who among the beneficiaries enjoyed such income.
- There were many other unrelated stockholders. "A majority shareholder has a fiduciary duty not to misuse his power by promoting his personal interests at the expense of corporate interests."
- Byrum has been overruled with respect to its key holding by the enactment of section 2036(b), which by its express terms only applies to corporations. However, the logic of Byrum still applies outside the very narrow construct of section 2036(b).

Estate of Strangi v. Commissioner (5th Circuit)

- In Strangi, Albert Strangi through his agent under a power of attorney, transferred assets to a FLP in exchange for a 99% limited partnership interest.
- Stranco, Inc. was the general partner of the FLP, of which Strangi owned 47% of the corporation and each of his four children owned equal shares of the balance. Strangi, along with four of his children were on the board of directors for Stranco.
- The FLP paid personal expenses of Strangi. Strangi also continued to live in one of the two residences that he transferred to the FLP, only paying rent after his death (by his estate).
- The Court first found that there was an implied agreement between Strangi and his children that the assets transferred to the FLP would be available for his use.

Estate of Strangi cont'd

- The court next looked at whether there was a bona fide sale for full and adequate consideration.
- The court found there was adequate consideration and had to assess whether the sale was “bona fide”. In formulating the test, the court said: “We think that the proper approach . . . is that a sale is bona fide if, as an objective matter, it serves a "substantial business [or] other non-tax" purpose.
- Five proffered non-tax tests were rejected by the Tax Court and upheld by the 5th Circuit.
- *Strangi* emphasizes the importance of having a “significant non-tax purpose” for creating the entity, which seems to be the predominant test among the various courts at the present time. It also highlights the importance of not continuing to use transferred assets (such as residences) without clear and prompt payment of rent.

Estate of Powell v. Comm'r, 148 T.C. No. 18 (March 18, 2017)

- The court found that assets transferred by Nancy H. Powell (through her son as her agent under a power of attorney) in exchange for a 99% limited partnership interest in a FLP was includable in her estate for estate tax purposes under section 2036(a).
- The decedent's son was the general partner of the FLP. As general partner, her son had the sole discretion to determine the amount and timing of partnership distributions, but the partnership's dissolution would require the written consent of all partners.
- Decedent's son transferred her 99% interest in the FLP to a charitable lead annuity trust, which the court found was an ineffective transfer as either void or revocable, because the power of attorney only permitted gifts up to the annual exclusion amount. Under section 2035, the assets would come back into the estate if section 2036 would have applied because the transfer occurred less than three years (actually only a week) prior to the decedent's death

Estate of Powell cont'd

- The court found that the decedent effectively retained two “strings” under section 2036(a).

i. First, she could, in conjunction with others, as a partner of the FLP vote on dissolving the FLP and in effect return the assets back to herself.

ii. Second, the decedent, through her son as power of attorney, effectively controlled distributions from the FLP both as to timing and amount. Since her agent owed her fiduciary duties and she was the sole limited partner, the duties were deemed to be illusory.

Estate of Powell cont'd

- In addition to its ruling on section 2036, the court *sua sponte* opined on a calculation of how to include the value of the assets in the taxable estate under section 2043(a).
- The takeaway is that if there were appreciation in the assets between the date of contribution and the date of death, the appreciation of the assets could be taxed twice under the court’s 2043(a) formula.
- Extreme caution is warranted with this type of planning!

Planning Considerations – Existing Entities

- If the entity was organized for a “significant nontax reason”, such as an active business, then no further action likely needs to be taken. The “full and adequate consideration exception” to section 2036(a) likely applies here based on current case law.
- Further, if the entity engages in an active business, it is likely that the Arm’s Length Transaction Test would also be satisfied.
- Generally, planning with entities that engage in an active business does not implicate section 2036(a).
- Questions arise when there is not an active business component, or perhaps that status is questionable.

Planning Considerations – New Entities

- If the entity was organized for a reason other than an active business, an analysis needs to be performed as to the risk associated with making the transfer. There are a few of different planning options in this case:

1. Rely on the Nontax Reason Test to demonstrate that the entity is not created primarily with intent to obtain tax benefits. This is very fact specific and carries risk due to the subjective nature of the "nontax reasons".

2. A more conservative approach to simply relying on the Nontax Reason Test is, in addition to having a significant nontax reason, is to give voting control over dissolution and distribution decisions to an independent third party.
   - This can take the form of a "Special Manager" or "Special General Partner" whose sole role is to decide, unilaterally, all decisions with respect to liquidation and dissolution decisions and whose consent would be required to amend the partnership agreement or operating agreement with respect to the same. This Special Manager/General Partner should have affirmative and legitimate fiduciary duties to the other partners/members. ***Note—this has never been tested in any published court cases and there is no authority for relying on such a structure.***
   - Beware of implied agreements!

3. Give all of the interests (including any manager or general partnership interests) away. If there are no retained interests and the grantor does not retain control or use of the assets, then section 2036(a)(2) would not apply. This is a very conservative option, which also likely negates the benefits of obtaining discounts.

Section 2701 – Overview

- Section 2701 applies to a direct or indirect transfer of an equity interest in a corporation or partnership made to or for the benefit of a member of the transferor's family if an applicable retained interest is retained by the transferor or an applicable family member immediately after the transfer.
- Section 2701 generally values any applicable retained interest held by the transferor (or an applicable family member) at a zero value, unless the applicable retained interest takes the form of a qualified payment.
- Section 2701 does not apply if**:**
    1. The applicable retained interest is a marketable security. Section 2701(a)(2)(A); Treas. Reg. § 25.2701-1(c)(1)&(2).
    2. The applicable retained interest is of the same class as the transferred interest. Section 2701(a)(2)(B); Treas. Reg. § 25.2701-1(c)(3).
    3. The applicable retained interest and the transferred interest are proportionally the same, without regard to non-lapsing differences in voting power or, for a partnership, differences with respect to management and limitations on liability. Section 2701(a)(2)(C); Treas. Reg. § 25.2701-1(c)(4).

Section 2701 - General Definitions

- Qualified payment:
  - A dividend payable at least annually under any cumulative preferred stock (or a comparable payment under any partnership interest) to the extent that such dividend (or comparable payment) is determined at a fixed rate. Sec. 2701(c)(3); Treas. Reg. § 25.2702-1(b)(6).
  - Any distribution right for which an election has been made. Sec. 2701(c)(3)(C)(ii); Treas. Reg. § 25.2702-1(b)(6)&(c).
- Member of the family:

  A. the transferor's spouse,

  B. a lineal descendant of the transferor or the transferor's spouse, and

  C. the spouse of any such descendant.

  Sec. 2701(e)(1); Treas. Reg. § 25.2701-1(d)(1).
- Applicable family member:

  A. the transferor's spouse,

  B. an ancestor of the transferor or the transferor's spouse, and

  C. the spouse of any such ancestor.

  Sec. 2701(e)(2); Treas. Reg. § 25.2701-1(d)(2).

Section 2701 - General Definitions, Con't

- Applicable retained interest:
  A. a distribution right, but only if, immediately before the initial transfer, the transferor and applicable family members hold control of the entity, or
  B. a liquidation, put, call, or conversion right (an extraordinary payment right).

  Sec. 2701(b)(1); Treas. Reg. § 25.2701-2(b)(1)-(3).
- Distribution right:
  - a right to receive a distribution with respect to equity in a corporation or partnership;
  - does not include (1) the right to distributions from any interest that is the same class as or junior to the rights of the transferred interests or (2) any right to receive a guaranteed payment under Section 707(c) of a fixed amount.

  Sec. 2701(c)(1); Treas. Reg. § 25.2701-2(b)(3)&(4).
- Control:
  - at least 50% of the vote or value of a corporation or of capital and profits interest in a partnership.
  - in a limited partnership, holding a general partner interest constitutes control.
  - In determining control, "applicable family member" includes any lineal descendant of any parent of the transferor or the transferor's spouse.

  Sec. 2701(b)(2); Treas. Reg. § 25.2701-2(b)(5).

Section 2701 – What Constitutes a Transfer

- Certain Indirect transfers:
  - Contributions to capital
  - Redemptions
  - Recapitalization
  - Other changes in the capital structure of a corporation or partnership

  Sec. 2701(e)(5); Treas. Reg. § 25.2701-1(b)(2)(i).
- The termination of an indirect holding in an entity if the property is held in trust as to which the indirect holder is treated as the owner under the grantor trust rules. Treas. Reg. §§ 25.2701-1(b)(2)(i)(C)(1); 25.2701-6(a)(4).
- Section 2701 may apply to not only gifts but also transfers for full and adequate consideration. Treas. Reg. § 25.2701-1(b)(2).

Section 2704(a)

- Section 2704(a) applies to a lapse of a voting right or liquidation right in a corporation or partnership if the individual holding the right prior to the lapse and the members of the individual's family hold control of the entity both before and after the lapse. Treas. Reg. § 25.2704-1(a).
    - A voting right is defined as a right to vote with respect to "any matter of the entity." Treas. Reg. § 25.2704-1(a)(2)(iv).
    - A liquidation right is a right or ability to compel the entity to acquire all or a portion of the holder's equity interest in the entity, including by reason of aggregate voting power, whether or not its exercise would result in the complete liquidation of the entity. Treas. Reg. § 25.2704-1(a)(2)(v).
    - "Member of the family" is defined broadly as the individual's spouse, any ancestor or lineal descendant of the individual or the individual's spouse, any brother or sister of the individual, and any spouse of the foregoing. Treas. Reg. §§ 25.2704-1(a)(2)(ii); 25.2702-2(a)(1).
- The lapse of a voting right or liquidation right occurs when a presently exercisable right is restricted or eliminated. It does NOT occur if the right continues with respect to a transferred equity interest because the right itself has not been eliminated, rather, the holders of the right have changed. Treas. Reg. § 25.2704-1(c).
- The lapse is treated as a taxable transfer for gift, estate, and GST tax purposes.
    - The amount of the transfer equals the pre-lapse value of the interests held immediately before the lapse by the holder, subtracted by the fair market value of the same interests after the lapse.

Section 2704(b)

- Section 2704(b) applies to disregard an applicable restriction in an interest in a corporation or partnership when:
  - that interest is transferred to a member of the transferor's family and
  - the transferor and members of the transferor's family have control over the entity immediately before the transfer.
- An "applicable restriction" includes a restriction that effectively limits the ability of the corporation or partnership to liquidate (as opposed to the ability to redeem an interest in the entity), if either
  - the restriction lapses, in whole or in part, after the transfer; or
  - the transferor or any member of the transferor's family, alone or jointly, has the right to remove the restriction in whole or in part after the transfer takes place.

  Sec. 2704(b)(2); Treas. Reg. § 25.2704-2(b).
- An applicable restriction does not include any restriction imposed by federal or state law. Sec. 2704(b)(3)(B).

Restructuring FLPs/LLCs to remove control from parent and avoid Section 2036

- Potential gift under Sec. 2704(a)
  - Ex: Redemption of interest which included a right to liquidate the interest.

  Treas. Reg. § 25.2704-1(f), Ex. 5
- Potential gift under Sec. 2704(b)
  - Ex: Transferring by gift or sale to family an interest that restricts the right to dissolve the FLP

  Treas. Reg. § 25.2704-1(f), Ex. 6
- Avoid potential gift exposure by granting non-family member or charity an interest in the FLP/LCC so that the family loses control over the entity for purposes of Sec. 2704.

Tax Controversy Involving Section 2036 - Overview

- Unlike other tax returns, which are generally subject to an audit "lottery," ALL estate tax returns will be individually reviewed (*i.e.*, classified) to determine revenue potential and identify the key issues for an examination
  - "Begin with the end in sight" through proper planning and implementation of that planning
  - One issue that is regularly examined is whether an interest in a FLP that was purportedly transferred by a decedent is nevertheless includible in the decedent's gross estate under section 2036
  - Certain sub-issues emerge with regularity
    - Implied agreements to retain possession
    - Rights to designate enjoyment of property or income from property
    - Bona fide sale for adequate and full consideration
- Estate and gift tax auditors ("auditors"), who are usually attorneys, are specially trained in estate and gift tax matters
  - Various strategies apply to an estate or gift tax audit that do not necessarily apply to other audits. These strategies are not discussed here, as the focus is on section 2036

Tax Controversy Involving Section 2036 – Standard Information Requests

- Estate and gift tax attorneys typically request documents, and may conduct interviews, to determine whether a purportedly transferred interest in a FLP is includible in the decedent's gross estate under section 2036
- Standard requests implicating section 2036:
  - Whether partners received FLP interests that were proportionate to the value of the property transferred;
  - Whether an implied agreement existed between the decedent and the transferee concerning the possession or enjoyment of, or the right to income from, the property;
  - Whether there was a failure to transfer legal title to property such that the decedent retained the possession or enjoyment of, or the right to income from, the property;
  - Whether the purportedly transferred interest was reported for gift tax purposes; and
  - Where spouses transfer community property and each retains a life estate in the property, whether the transferred property is includible under section 2036 due to a retained interest (*i.e.*, whether section 2036 requires inclusion of one-half of the value of transferred community property in the gross estate of each spouse).

See Internal Revenue Manual, pts. 4.25.5.2.12(7) (July 28, 2020), 4.25.5.2.13 (July 28, 2020), 4.25.5.2.7(8) (July 28, 2020).

Tax Controversy Involving Section 2036 – Implied Agreements to Retain Possession

- Background
  - Recall that section 2036 requires inclusion in the decedent's gross estate if there was an express or implied agreement at the time of a transfer that the decedent would retain one or more of the purportedly transferred rights
  - In *Estate of Strangi v. Commissioner*, 85 T.C.M. (CCH) 1331, 1338 (2003) (quoting Estate of Strangi v. Commissioner, 115 T.C. 478, 486 (2000)), aff'd, 417 F.3d 468 (5th Cir. 2005), the Tax Court explained:

> To avoid characterization as a retained interest, the decedent must have 'absolutely, unequivocally, irrevocably, and without possible reservations' parted with all of her title, possession, and enjoyment of the transferred assets.

- Prevalence in Litigation
  - Much of the litigation concerning section 2036 has concerned implied agreements under section 2036(a)(1) and the bona fide sale exception

Tax Controversy Involving Section 2036 – Implied Agreements to Retain Possession (cont'd)

- Factors
  - In deciding whether a decedent impliedly retained the right to possess or enjoy purportedly transferred assets, courts typically consult the following factors:
    - Direct evidence of an implied agreement;
    - The decedent's failure to observe formalities in order to access the purportedly transferred assets to satisfy the decedent's personal needs;
    - The use of the transferred assets to pay the decedent's personal expenses;
    - The decedent's relationship to the assets before and after the transfer;
    - Commingling of funds;
    - Consistency in tax reporting as between the estate tax returns, gift tax returns, income tax returns, capital accounts, and FLP's books and records;
    - A history of disproportionate distributions;
    - Testamentary characteristics of the arrangement;
    - The extent to which the decedent transferred nearly all of his or her assets;
    - The unilateral formation of the FLP;
    - The type of assets transferred; and
    - The decedent's personal situation.

Tax Controversy Involving Section 2036 – Implied Agreements to Retain Possession (cont’d)

- Takeaways
  - When drafting estate plans, be mindful of the above-referenced factors
  - Consistency between a well-crafted plan and the implementation of that plan is key to success

Tax Controversy Involving Section 2036 – Right to Designate

- Background
  - Recall that section 2036 requires inclusion in the decedent's gross estate if there was "the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the purportedly transferred property or the income therefrom."
  - In *United States v. Bynum*, 408 U.S. 125, 136 (1925), the United States Supreme Court explained that inclusion in a decedent's gross estate under section 2036(a)(2) is limited to situations in which the decedent had "an ascertainable and legally enforceable power."
    - In other words, when a right to determine distributions is ascertainable and legally enforceable, it violates section 2036(a)(2) and inclusion in the decedent's gross estate is appropriate. By contrast, when a power is attenuated or not legally enforceable, the right should not require inclusion in the decedent's gross estate under section 2036(a)(2)
- Prevalence in Litigation
  - The right to designate enjoyment of property or income from property under section 2036(a)(2) is litigated less frequently than implied agreements under section 2036(a)(1), but the IRS does raise the issue, most typically when a taxpayer retains power over an asset as a trustee, general partner, or managing member

Tax Controversy Involving Section 2036 – Right to Designate (cont'd)

- Takeaways
  - In order to avoid application of section 2036(a)(2), it is generally advisable to not allow a client to assume a management position giving her the right to designate enjoyment of property or income from property
  - If the client insists on managing the entity, then:
    - The client should not have the power to vote stock, which would require inclusion in the decedent's gross estate under section 2036(b) ; and
    - The power must be limited in the governing document (*e.g.*, the FLP operating agreement) by a legally enforceable, ascertainable standard in the governing document for all important decisions during the lifecycle of a business (*e.g.*, distributions, liquidation, dissolution, amendments)

Tax Controversy Involving Section 2036 – Bona Fide Sale for Adequate and Full Consideration

- Background
  - Recall that section 2036 does not apply in the case of a bona fide sale for an adequate and full consideration in money or money's worth. In other words, any transfer made in a bona fide sale for an adequate and full consideration in money or money's worth is excepted from inclusion in the decedent's gross estate under section 2036. This so-called "bona fide sale exception" consists of two distinct elements:
    - Whether there was a bona fide sale; and
    - Whether the sale was made for adequate and full consideration in money or money's worth.
- Prevalence in Litigation

Tax Controversy Involving Section 2036 – Bona Fide Sale for Adequate and Full Consideration (cont'd)

- Element 1: Bona Fide Sale
  - Nontax reason test dominant
  - As articulated by the Tax Court in *Estate of Bongard v. Commissioner*, 124 T.C. 95, 118 (2005), that test provides:

    > In the content of family limited partnerships, the bona fide sale for adequate and full consideration exception is met where the record establishes the existence of a legitimate and significant nontax reason for creating the family limited partnership, and the transferors received partnership interests proportionate to the value of the property transferred . . . . The objective evidence must indicate that the nontax reason was a significant factor that motivated the partnership's creation . . . . A significant purpose must be an actual motivation, not a theoretical justification. By contrast, the bona fide sale exception is not applicable where the facts fail to establish that the transaction was motivated by a legitimate and significant nontax purpose.

  - Factors consulted in connection with determining an implied agreement also consulted
  - Memorializing nontax reasons
    - Asset protection
    - The need for an active and centralized management of underlying assets
    - Restructuring for a discrete purpose (*e.g.*, to provide liquidation for an anticipated public offering)

Tax Controversy Involving Section 2036 – Bona Fide Sale for Adequate and Full Consideration (cont'd)

- Element 2: Adequate and Full Consideration
  - In order for a price to constitute "adequate consideration in money or money's worth," the price

    > must have been an adequate and full equivalent reducible to a money value. If the price was less than such consideration, only the excess of the fair market value of the property (as of the applicable valuation date) over the price received by the decedent is included in ascertaining the value of his gross estate.

    Treas. Regs. § 20.2043-1(a)
  - Proving "adequate consideration"
    - Values should be corroborated with reliable evidence of the property's value on the date of sale (e.g., with a valuation report);
    - The interests received by the participants in the FLP should be proportionate to the value of the property each participant contributed to the entity;
    - The respective assets contributed to the FLP should be properly credited to the respective capital accounts of the transferors;
    - Distributions from the FLP should be required a negative adjustment in the distributee's capital account; and
    - There should be a legitimate and significant nontax reason for engaging in the transaction.

Tax Controversy Involving Section 2036 – Impact of *Loper Bright*

- <u>The Historical Landscape</u>
  - Treasury Regulations under section 2036 adopt an expansive interpretation of already broad wording contained in the statute
  - Most courts have historically simply examined the facts of a case to determine whether inclusion under section 2036 was required under the statute's broad language
  - Some courts have also relied upon specific regulatory provisions to support inclusion under section 2036
    - *See, e.g.*, *Estate of Bongard v. Commissioner*, 124 T.C. 95, 146 n.7 (2005).
- <u>A Change in the Landscape?</u>
  - In *Loper Bright Enters. v. Raimondo*, 603 U.S. __ (2024), the Supreme Court said that deferring to an agency's interpretation of a statute when resolving statutory ambiguities is misguided and inconsistent with the Administrative Procedure Act (the "APA"). Rather, the Court reasoned that the APA requires courts to exercise independent judgment in deciding whether an agency has acted within its statutory authority. The Court ultimately concluded that, when a court resolves statutory ambiguities, courts may not simply defer to an agency's interpretation of the law.

Tax Controversy Involving Section 2036 – Impact of *Loper Bright* (cont'd)

- Key Takeaways as it Relates to Section 2036
  - The standard to be used by courts in resolving statutory ambiguity has changed – it is now to look at the totality of the matter, including the statute and its legislative history, to determine whether the agency's interpretation of a statute is "reasonable"
  - Given the broad language in section 2036, regulatory challenges in this area may be difficult
  - If the IRS's position in a controversy relies upon a regulatory provision or caselaw referencing a regulatory provision, that regulation must be scrutinized for conformity with the plain language of the statute, the law's legislative history, and compliance with the APA
    - Taxpayers should be motivated to challenge questionable administrative interpretations of the Code

Evolution of Tax Law and Chief Counsel Advice 202352018

- On November 28, 2023, the IRS issued Chief Counsel Advice 202352018, which was released on December 29, 2023, opining that trust beneficiaries who consent to add to the terms of a grantor trust a discretionary power held by an independent trustee to reimburse the grantor for income tax paid by the grantor on the income of the trust have thereby made a gift.

- Note change from general understanding, as previously indicated by Revenue Ruling 2004–64, 2004–27 I.R.B. 7 (7/6/2004).

- Note value of gift, IRS saying that the beneficiaries "each have made a gift of a portion of their respective interest in income and/or principal" of the trust.

Evolution of Tax Law and Chief Counsel Advice 202352018 cont'd

- Note broad statement: " The result would be the same if the modification was pursuant to a state statute that provides beneficiaries with a right to notice and a right to object to the modification and a beneficiary fails to exercise their right to object.

- The CCA represents a litigation posture of the IRS; is not an official ruling by the IRS , the broad application of these statements is concerning- failure to retain counsel and object in a standard proceeding may result in an unintended gift.

- The Relationship Between CCA 202352018 and Rev. Rul. 2004–64, 2004–27 I.R.B. 7 (7/6/2004): this reversal of the position previously taken by the IRS in Revenue Ruling 2004-64 may require a taxpayer creating an intentionally defective grantor trust ("IDGT") to commit to an obligation to pay income taxes for the life of the trust.

- The CCA evidences evolving approach on the part of the IRS, as well as the Tax Court, as previously discussed, to broaden the circumstances in which assets, despite having been transferred by the grantor and having thereby been treated as a completed gift, may nevertheless be included in the estate of the grantor for estate tax purposes or may result in a taxable gift by the recipients, although the actions taken would not have led to inclusion or a taxable gift under prior law.

Chief Counsel Advice 202352018

- In the CCA, an irrevocable trust authorized an independent trustee- not "related or subordinate" to the grantor under section 672(c), to distribute principal or income of the trust to the grantor's child in the "trustee's absolute discretion" and on the death of the child the remainder was payable to the child's then living issue, per stripes.
- The trust was a grantor trust under section 671, but the assets of the trust would not be included in the estate of the grantor, i. e. an "IDGT" or "intentionally defective grantor trust." This trust instrument did not require or permit the trustee to reimburse the grantor for income tax paid by the grantor on the income of the trust and there was no power to reimburse the under relevant state law.

Chief Counsel Advice 202352018 cont'd

- The trustee petitioned the court for permission to modify the trust to add a provision permitting the trustee to reimburse the grantor for income taxes paid by the grantor on the income of the trust in the discretion of the trustee. A state statute permitted this modification if the interested beneficiaries, in this case, the grantor's child and adult grandchildren, consented to the modification, which they did. The court approved the petition and ordered the proposed modification.

- The Office of the Chief Counsel concluded that the modification resulted in a gift by each of the beneficiaries "of a portion of their respective interest in income and/or principal" of the trust.

- Rev. Rul. 2004–64 established parameters regarding reimbursement of the grantor for income tax paid on the income of a grantor trust, relied upon by practitioners for almost 2 decades, that a grantor is not considered to have made a gift to the beneficiaries by paying income tax on the income of a trust which is a grantor trust under section 671 because the liability for the income tax is imposed on the grantor. This follows long-standing rules, such as those set forth in Rev. Rul. 1985–13 holding a grantor is liable for income tax on the income of a trust if certain powers are retained by the grantor over the trust.

Chief Counsel Advice 202352018 cont'd

- Rev. Rul. 2004–64 also held that the discretionary right to reimburse the grantor for income taxes paid by the grantor on the income of the trust "would not alone cause inclusion of the trust in [the grantor's] gross estate … However, such discretion combined with other facts, including…an understanding… between [the grantor] and the trustee regarding the trustee's exercise at this discretion; a power retained by [the grantor] to remove the trustee and name [the grantor] as successor trustee; or applicable local law subjecting the trust assets to the claims of [the grantor's] creditors), may cause inclusion of [the trust's] assets in the grantor' gross estate for federal estate tax purposes.

- Moreover, Rev. Rul. 2004-64 clarified that if the terms of the trust require the grantor to be reimbursed for income tax payments then the grantor has retained to have the property of the trust expended in discharge of the legal obligations of the grantor and that would cause inclusion of the value of the trust assets in the grantor's gross estate under section 2036(a)(1).

- Thus, note that the holding by the IRS in Rev. Rul. 2004-64 relates to section 2036, which is now indirectly challenged by the recent CCA, consistent with the evolving Tax Court case law in this area, more broadly applying the application of section 2036 to the facts of a trust.

Chief Counsel Advice 202352018 cont'd

- Finally, Rev. Rul. 2004-64 went on to say that reimbursement of the grantor for payment of income tax on the trust income under a discretionary standard "is not a gift by the trust beneficiaries" leaving open if that would also be true even if there was a prearranged understanding that a reimbursement would be available to the grantor.

- CCA 202352018 attempts to distinguish Rev. Rul. 2004–64 on the basis that the discretionary authority in the revenue ruling to reimburse the grantor was set forth "under the terms of the original governing instrument, "as opposed to being created pursuant to a modification consented to by the beneficiaries", as in the CCA.

Chief Counsel Advice 202352018 cont'd

- Repudiation of Letter Ruling 201647001. The CCA acknowledges that it represents a change of position from an earlier letter ruling, 201647001, released on November 18, 2016, which concluded that the modification of a trust to add a discretionary power in the trustee to reimburse the grantor for income tax "did not result in a change of beneficial interests in the Trust." The CCA merely states that "these conclusions no longer reflect the position of this office." The 2016 ruling provided context that "unforeseen and unanticipated circumstances [had made] payment by the grantor of the income taxes on the Trust income… unduly burdensome.

- The 2016 Ruling combined with Rev. Rul. 2004-64 has for decades led practitioners to understand that a discretionary power to reimburse the grantor for income taxes when these taxes become unduly burdensome is acceptable as long as it is not required to be made and does not reflect a prearranged understanding – these reimbursements have been made on an ad hoc basis, at different times and in different amounts.

CCA 202233014

- CCA 202233014 repudiating previous PLR.

- Another recent IRS reversal of position was made by CCA 202233014, released on August 19, 2022, which stated that neither a charitable deduction nor a marital deduction would be allowed for a charitable remainder unitrust interest, where the trustee may "sprinkle" the interest between the spouse and charity. The CCA admitted in a footnote that this was contrary to the holding in four previous PLR's, allowing either a marital or charitable deduction in such a case. Here again, the CCA stated that "the position in these earlier rulings no longer reflects the position of this office"

- Although it has long been established that a charitable deduction may be denied where the amount ultimately passing to charity cannot be determined at the moment of the gift or bequest, this reversal of position, combined with more strict interpretation of these tax rules, is consistent with the general evolution of the tax law in this area, giving notice to taxpayers that the application of the statutes is increasingly being applied more broadly.

- Notably, a CCA often consists primarily of a litigation position by the IRS in a specific emerging litigation, which would account for the unusually aggressive stance taken in the CCA.

Procedures for Revocation of a Letter Ruling pursuant to Rev. Proc. 2024–1

- Note that a CCA repudiating a previous position taken in a letter ruling does not constitute the revocation of a ruling. See Rev. Proc. 2024 – 1, 2024 – 1 I. R. B. 1, 64, providing that in order to revoke a letter ruling there must be legislation enacted, ratification of a tax treaty, a decision of United States Supreme Court, temporary or final regulations issued, or the issuance of a revenue ruling, revenue procedure, notice or other statement published in the IRB. Accordingly, the CCA does not constitute revocation of the previous letter ruling.

Litigation Context of CCA

- In light of the probable litigation context of the CCA, it is notable that is addressed to two IRS Associate Area Counsels – Janice B. Geier and Sheila R Pattinson, both of whom have been included in the IRS counsel of record in several notable Tax Court cases, including the *Estate of Strangi v. Commissioner*, 115 T.C. 478 (2000), affirmed in part and reversed and remanded in part, 293 F. 3rd 279 (5th Cir. 2000)., *Nelson v. Commissioner*, T.C. Memo 2020–81, affirmed, 17 F. 4th 556 (5th Cir. 2021), and *Jones v. Commissioner*, T.C. Memo. 2019-101, involving inclusion of property in a decedent's estate that was transferred to a limited partnership, a defined value clause and "tax- affecting "in the valuation of interest in a timber businesses, respectively. Thus, the CCA appears to be part of a broader narrative in the evolving tax law trend in this area.

CCA Conclusion

- The CCA gives rise to a number of concerns involving beneficiaries making gifts by failing to take aggressive action, ignoring the effect of fiduciary duties that have often precluded taxable gifts occurring in the context of actions taken by a trustee in exercising discretion, and the tax related complexities of relinquishing grantor trust status.
- The CCA provides strong evidence of the need for added care by beneficiaries and taxpayers when establishing an IDGT, not only in terms of the reimbursement power, but also in the nature of the control retained by the grantor over the assets transferred to the trust.

(b) *Applicability date*. This section applies to returns and claims for refund filed, and advice provided, on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Douglas W. O'Donnell,

Deputy Commissioner.

Approved: December 23, 2024.

Aviva R. Aron-Dine,

Deputy Assistant Secretary of the Treasury (Tax Policy).

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Too Hot Topics

Estate and Gift Tax Committee

Annual Meeting 2025

Cara Koss and Beth Kaufman, Discussion Leaders

- Do BDITs really work?
- What can you do with QSBS shares without disqualifying them for gain exclusion? (a) Can Founders contribute their QSBS shares to an LLC and then later distribute the shares out to the foundation without disqualification? (b) Can QSBS shares be distributed out of a trust to a beneficiary?
- Is a trust GST exempt if the settlor sells assets to the trust for a note to a trust without having transferred any seed money to the trust?
- Is the death of the grantor of a completed gift grantor trust a recognition event as to any property held in the trust that is subject to debt in excess of basis?
- Do we worry too much about Chapter 14 issues?
- As a matter of practice, should sales to or swaps with a grantor trust be reported as non-gift transactions on a 709?
- Would you be comfortable with a 70-year old client couple giving away $27 million of their $35 million in assets, where at least one spouse is putting their gift into a SLAT?
- If the beneficiary of a 529 account is changed, and the change is subject to gift and/or GST tax, who is the donor/transferor? (a) the account owner? (b) the original donor? (c) the current beneficiary?
- Would you advise a client to give a vacation property or a primary residence to a trust and then rent it back paying fair market value rent?
- If a couple makes a gift splitting election for the year and one gift made is not splitable under the gift tax rules, is that gift split for GST purposes?