

## Part III - Administrative, Procedural, and Miscellaneous

### Guidance for Expatriates Under Section 877A

Notice 2009-85

#### **PURPOSE**

Section 301 of the Heroes Earnings Assistance and Relief Tax Act of 2008 (the "Act") added new sections 877A and 2801 to the Internal Revenue Code ("Code"), amended sections 6039G and 7701(a), made conforming amendments to sections 877(e) and 7701(b), and repealed section 7701(n) with respect to individuals who on or after June 17, 2008, relinquish U.S. citizenship or cease to be lawful permanent residents of the United States. This notice provides guidance for individuals who are subject to section 877A. This notice does not provide new guidance regarding section 877, which continues to apply to individuals who relinquished U.S. citizenship or ceased to be lawful permanent residents prior to June 17, 2008. Additionally, this notice does not address new section 2801, which imposes transfer tax on U.S. persons who receive gifts or bequests on or after June 17, 2008, from individuals who are subject to section 877A (but see section 9 of this notice).

#### **SECTION 1. OVERVIEW**

Section 877A(a) generally imposes a mark-to-market regime on expatriates who are covered by section 877A, providing that all property of a covered expatriate is treated as sold on the day before the expatriation date for its fair market value. Section 887A further provides that any gain arising from the deemed sale is taken into account for the taxable year of the deemed sale notwithstanding any other provisions of the Code. Any loss from the deemed sale is taken into account for the taxable year of the deemed sale to the extent otherwise provided in the Code, except that the wash sale rules of section 1091 do not apply. Under section 877A(a)(3), the amount that would otherwise be includible in gross income by reason of the deemed sale rule is reduced (but not to below zero) by \$600,000, which amount is to be adjusted for inflation for calendar years after 2008 (the “exclusion amount”). For calendar year 2009, the exclusion amount as adjusted for inflation is \$626,000. The amount of any gain or loss subsequently realized will be adjusted for gain and loss taken into account under the mark-to-market regime without regard to the amount excluded. Pursuant to section 877A(b), a taxpayer may elect to defer payment of tax attributable to property deemed sold.

Section 877A(c) provides that the mark-to-market regime does not apply to deferred compensation items, specified tax deferred accounts, and interests in a nongrantor trust of which the covered expatriate was a beneficiary on the day before the expatriation date. If the covered expatriate is treated as the owner of any portion of a trust under the grantor trust rules (sections 671 through 679) on the day before the expatriation date, the assets held by that portion of the trust are subject to the mark-to-

market regime (but see section 4 of this notice concerning coordination with section 684).

Section 877A(d) provides alternative tax regimes that apply to “eligible deferred compensation items” and to other deferred compensation items (“ineligible deferred compensation items”). In the case of “eligible deferred compensation items,” section 877A(d)(1)(A) provides generally that the payor must deduct and withhold from any taxable payments to a covered expatriate with respect to such items a tax equal to 30 percent of the amount of those taxable payments. In the case of “ineligible deferred compensation items,” section 877A(d)(2)(A) provides that a covered expatriate generally is treated as having received an amount equal to the present value of the covered expatriate’s accrued benefit on the day before the expatriation date.

Section 877A(e)(1)(A) provides that if a covered expatriate holds any interest in a specified tax deferred account on the day before the expatriation date, such covered expatriate is treated as having received a distribution of the covered expatriate’s entire interest in such account on the day before the expatriation date.

Section 877A(f) provides that in the case of any direct or indirect distribution of property to a covered expatriate from a nongrantor trust of which the covered expatriate was a beneficiary on the day before the expatriation date, the trustee must deduct and withhold from the distribution an amount equal to 30 percent of the taxable portion of the distribution. If the fair market value of the property distributed exceeds its adjusted basis in the hands of the trust, gain shall be recognized to the trust as if the property had been sold by the trust and the proceeds distributed to the covered expatriate.

Section 877A(i) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 877A. The Treasury Department and the Internal Revenue Service (IRS) expect to issue regulations to incorporate the guidance set forth in this notice. Until such regulations are issued, taxpayers may rely on the guidance set forth in this notice.

This notice has nine sections. Section 1 provides background regarding the general application of section 877A. Section 2 provides rules for determining whether an individual is subject to section 877A. Section 3 explains the operation of the mark-to-market regime. Section 4 addresses the interaction of section 877A and certain other Code provisions, including section 877. Section 5 explains the application of section 877A to deferred compensation items. Section 6 explains the application of section 877A to specified tax deferred accounts. Section 7 explains the application of section 877A to interests in nongrantor trusts. Section 8 describes the filing and reporting requirements of expatriates who are covered by section 877A and provides an overview of changes to Form 8854 (Expatriation Information Statement) as well as an introduction to new Form W-8CE (Notice of Expatriation and Waiver of Treaty Benefits). Section 9 states that future guidance will address gifts and bequests subject to a transfer tax under new section 2801.

## **SECTION 2. INDIVIDUALS COVERED**

### **A. Definitions**

*Expatriate.* Section 877A(g)(2) provides that the term “expatriate” means (1) any U.S. citizen who relinquishes his or her citizenship and (2) any long-term resident of the

United States who ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6), as amended). Pursuant to section 877A(g)(5), a long-term resident is an individual who is a lawful permanent resident of the United States in at least 8 taxable years during the period of 15 taxable years ending with the taxable year that includes the expatriation date.

*Covered expatriate.* Section 877A(g)(1)(A) defines the term “covered expatriate” to mean an expatriate who:

(1) has an average annual net income tax liability for the five preceding taxable years ending before the expatriation date that exceeds a specified amount that is adjusted for inflation (\$145,000 in 2009) (the “tax liability test”);

(2) has a net worth of \$2 million or more as of the expatriation date (the “net worth test”); or

(3) fails to certify, under penalties of perjury, compliance with all U.S. Federal tax obligations for the five taxable years preceding the taxable year that includes the expatriation date, including, but not limited to, obligations to file income tax, employment tax, gift tax, and information returns, if applicable, and obligations to pay all relevant tax liabilities, interest, and penalties (the “certification test”). This certification must be made on Form 8854 and must be filed by the due date of the taxpayer’s Federal income tax return for the taxable year that includes the day before the expatriation date. See section 8 of this notice for information concerning Form 8854.

However, section 877A(g)(1)(B) provides that an expatriate will not be treated as meeting the tax liability test or the net worth test of section 877(a)(2)(A) or (B) if--

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

(2) the expatriate relinquishes U.S. citizenship before the age of 18 ½ and has been a U.S. resident for not more than 10 taxable years before the date of relinquishment.

The determination as to whether an individual is a covered expatriate is made as of the expatriation date.

*Expatriation date.* Section 877A(g)(3) defines the term “expatriation date” as the date an individual relinquishes U.S. citizenship or, in the case of a long-term resident of the United States, the date on which the individual ceases to be a lawful permanent resident of the United States within the meaning of section 7701(b)(6).

*Relinquishment of citizenship.* Section 877A(g)(4) provides that a citizen will be treated as relinquishing his or her U. S. citizenship on the earliest of four possible dates:

(1) the date the individual renounces his or her U.S. nationality before a diplomatic or consular officer of the United States pursuant to paragraph (5) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(5)), provided the renunciation is subsequently approved by the issuance to the individual of a certificate of loss of nationality by the United States Department of State,

(2) the date the individual furnishes to the United States Department of State a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an act of expatriation specified in paragraph (1), (2), (3), or (4) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(1)-(4)), provided the voluntary relinquishment is subsequently approved by the issuance to the individual of a certificate of loss of nationality by the United States Department of State,

(3) the date the United States Department of State issues to the individual a certificate of loss of nationality, or

(4) the date a court of the United States cancels a naturalized citizen's certificate of naturalization.

*Cessation of lawful permanent residency.* Under section 7701(b)(6), as amended by the Act, a long-term resident ceases to be a lawful permanent resident if (A) the individual's status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with immigration laws has been revoked or has been administratively or judicially determined to have been abandoned, or if (B) the individual (1) commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country, (2) does not waive the benefits of the treaty applicable to residents of the foreign country, and (3) notifies the Secretary of such treatment on Forms 8833 and 8854.

## **B. Tax Liability and Net Worth Tests**

For guidance on determining whether an individual is a covered expatriate by

reason of the tax liability test or the net worth test, see Section III of Notice 97-19, 1997-1 C.B. 394.

### **SECTION 3. MARK-TO-MARKET REGIME**

#### **A. Identification of a covered expatriate's property and determination of fair market value**

For purposes of the mark-to-market regime, the covered expatriate is deemed to have sold any interest in property that he or she is considered to own under the rules of this paragraph other than property described in section 877A(c). For purposes of computing the tax liability under the mark-to-market regime, a covered expatriate is considered to own any interest in property that would be taxable as part of his or her gross estate for Federal estate tax purposes under Chapter 11 of Subtitle B of the Code as if he or she had died on the day before the expatriation date as a citizen or resident of the United States. Whether property would constitute part of the gross estate will be determined without regard to sections 2010 through 2016. In addition, for this purpose, a covered expatriate also is deemed to own his or her beneficial interest(s) in each trust (or portion of a trust), that would not constitute part of his or her gross estate as described in the preceding sentences. The covered expatriate's beneficial interest(s) in such a trust shall be determined under the special rules set forth in section III of Notice 97-19, 1997-1 C.B. 394.

In computing the tax liability under the mark-to-market regime, a covered expatriate must use the fair market value of each interest in property as of the day before the expatriation date in accordance with the valuation principles applicable for



purposes of the Federal estate tax, except as otherwise provided in this paragraph. Specifically, fair market value will be determined under section 2031 and the regulations thereunder, but without regard to sections 2032 and 2032A, as if the covered expatriate had died as a citizen or resident of the United States on the day before the expatriation date. For these purposes: (a) the provisions of sections 2701 through 2704 will be applied as if the covered expatriate's interests subject to those provisions were being transferred to family members; (b) the covered expatriate's tax liability as a result of section 877A, or otherwise, will not be taken into account; and (c) sections 2055, 2056, 2056A, and 2057 will not be taken into account. A covered expatriate must determine the fair market value of his or her beneficial interest in each trust, other than a nongrantor trust subject to section 877A(f), to the extent the trust would not constitute part of his or her gross estate, in accordance with the Federal gift tax valuation principles of section 2512 and the regulations thereunder without regard to any prohibitions or restrictions on such interest. An interest in a life insurance policy will be valued in accordance with Treas. Reg. § 25.2512-6 as if the covered expatriate had made a gift of the policy on the day before the expatriation date.

#### **B. Allocation of the exclusion amount**

The exclusion amount, as described in section 877A(a)(3), must be allocated among all built-in gain property that is subject to the mark-to-market regime and is owned by the covered expatriate on the day before the expatriation date, regardless of whether the covered expatriate makes an election to defer tax with respect to any such property pursuant to section 877A(b). Specifically, the exclusion amount must first be

allocated pro-rata to each item of built-in gain property (“gain asset”) by multiplying the exclusion amount by the ratio of the built-in gain with respect to each gain asset over the total built-in gain of all gain assets. The exclusion amount allocated to each gain asset may not exceed the amount of that asset’s built-in gain. If the total section 877A(a) gain of all the gain assets is less than the exclusion amount, then the exclusion amount that can be allocated to the gain assets will be limited to the total section 877A(a) gain.

Each individual is eligible for only one lifetime exclusion amount. Thus, if a covered expatriate becomes a U.S. citizen or long-term resident, and then loses such citizenship or ceases to be a lawful permanent resident and thereby becomes a covered expatriate subject again to section 877A, the exclusion amount with respect to the individual on a second expatriation is limited to the unused portion of his or her exclusion amount remaining (if any) after the first expatriation, as adjusted for inflation. For example, if a covered expatriate used one third of the exclusion amount for the first expatriation, he or she will have two thirds of the exclusion amount available, as adjusted for inflation, in the event of a second expatriation.

After allocating the appropriate amount of the exclusion amount among the gain assets, the covered expatriate must report gains and losses on the appropriate Schedules and Forms depending upon the character of each asset. Losses may be taken into account only to the extent permitted by the Code, except that the wash sale rules of section 1091 do not apply. Thus, for example, losses are subject to the limitations of section 1211(b).

*Example 1.* A, a covered expatriate, relinquished his citizenship on November 1, 2009. On October 31, 2009, A owned three assets. As of October 31, 2009, Asset X had a fair market value of \$2,000,000 and an adjusted basis of \$200,000, Asset Y had a fair market value of \$1,000,000 and an adjusted basis of \$800,000, and Asset Z had a fair market value of \$500,000 and an adjusted basis of \$800,000. A must allocate the exclusion amount to each gain asset as follows:

*Step 1.* Determine the built-in gain or loss of each asset by subtracting the asset's adjusted basis from the fair market value of the asset on October 31, 2009.

	Adjusted Basis	FMV	Built-in Gain/(Loss)
Asset X	\$200,000	\$2,000,000	\$1,800,000
Asset Y	\$800,000	\$1,000,000	\$200,000
Asset Z	\$800,000	\$500,000	(\$300,000)

*Step 2.* Determine the portion of the exclusion amount allocable to each gain asset by multiplying the exclusion amount (\$626,000 for 2009) by the ratio of the built-in gain on each gain asset over the total built-in gain on all gain assets subject to section 877A(a).

$$\begin{array}{l} \text{Asset X} \quad \frac{\$1,800,000}{\$2,000,000} \times \$626,000 = \$563,400 \\ \\ \text{Asset Y} \quad \frac{\$200,000}{\$2,000,000} \times \$626,000 = \$62,600 \end{array}$$

*Step 3.* Determine the amount includible in gross income with respect to each gain asset as a result of section 877A(a) by subtracting the exclusion amount allocated to each asset from the amount of built-in gain deemed realized with respect to that asset.

Asset X:	\$1,800,000
	<u>(\$563,400)</u>
	\$ 1,236,600
Asset Y:	\$ 200,000
	<u>(\$62,600)</u>
	\$137,400

A must report the amount includible in gross income as a result of the application of section 877A(a) with respect to Assets X and Y (as determined in Step 3), and A's loss with respect to Asset Z on A's Form 1040 (or other schedule, as provided in Treas. Reg. § 1.6012-1(b)(2)(ii)(b)) for the portion of A's taxable year that includes the day before the expatriation date. This Form 1040 (or other schedule) should be attached as a schedule to A's Form 1040NR for the remainder of that taxable year. Assuming that Assets X and Y are business assets and that Asset Z is a capital asset, in the absence of other capital gains in the year of expatriation, A's use of the capital loss from Asset Z would be limited by section 1211(b), as well as other loss-limiting provisions in the Code. However, A's use of the loss will not be limited by section 1091.

*Example 2.* The facts are the same as in *Example 1*, but assume that as of October 31, 2009, Asset X had a fair market value of \$2,000,000 and an adjusted basis of \$1,700,000. A must allocate the exclusion amount to each gain asset as follows:

*Step 1.* Determine the built-in gain or loss of each asset by subtracting the asset's adjusted basis from the fair market value of the asset on October 31, 2009.

	Adjusted Basis	FMV	Built-in Gain/(Loss)
Asset X	\$1,700,000	\$2,000,000	\$300,000
Asset Y	\$800,000	\$1,000,000	\$200,000
Asset Z	\$800,000	\$500,000	(\$300,000)

The total gain of all the gain assets for 877A(a) purposes is \$500,000. Because the total gain is less than the exclusion amount (\$626,000 for 2009), A can only allocate \$500,000 of the exclusion amount to the gain assets.

*Step 2.* Determine the portion of the exclusion amount allocable to each gain asset by multiplying the allowable exclusion amount (\$500,000) by the ratio of the built-in gain on each gain asset over the total built-in gain on all gain assets subject to section 877A(a).

Asset X	$\frac{\$300,000}{\$500,000}$	X \$500,000 =	\$300,000
Asset Y	$\frac{\$200,000}{\$500,000}$	X \$500,000 =	\$200,000

*Step 3.* Determine the amount includible in gross income with respect to each

gain asset as a result of section 877A(a) by subtracting the exclusion amount allocated to each asset from the amount of built-in gain deemed realized with respect to that asset.

Asset X:	\$300,000
	<u>(\$300,000)</u>
	\$ 0

Asset Y:	\$200,000
	<u>(\$200,000)</u>
	\$ 0

Because all of the gain was excluded under the exclusion amount, A does not recognize any gain as a result of section 877A(a). A must report the loss with respect to Asset Z on A's Form 1040 (or other schedule, as provided in Treas. Reg. § 1.6012-1(b)(2)(ii)(b)) for the portion of A's taxable year that includes the day before the expatriation date. This Form 1040 (or other schedule) should be attached as a schedule to A's Form 1040NR for the remainder of that taxable year. In the absence of other gains for the portion of A's taxable year that includes the day before the expatriation date, A's use of the loss would be limited by the loss-limiting provisions in the Code, including section 1211(b). However, A's use of the loss will not be limited by section 1091.

### **C. Adjustment to basis of property subject to the mark-to-market regime**

Section 877A(a) requires proper adjustments to be made in the amount of any gain or loss subsequently realized with respect to an asset for the amount of gain or loss taken into account under section 877A(a)(2) with respect to that asset. In making such adjustment, the basis of the asset will be adjusted by the amount of gain or loss taken into account under section 877A(a)(2)(A) and (B), without regard to the exclusion amount provided in section 877A(a)(3).

*Example 3.* The facts are the same as in *Example 1*. Assume that Assets X and Z are United States real property interests within the meaning of section 897(c) ("USRPIs"). On October 15, 2013, A, now a resident of country B, sells Asset X for \$3,000,000 and Asset Z for \$700,000. A's taxable gain is determined as follows:

Asset X: A's basis of \$200,000 in Asset X is adjusted by \$1,800,000 (the amount of gain taken into account under section 877A(a)(2) by reason of the deemed sale under section 877A(a) without regard to the amount excluded under section 877A(a)(3)), resulting in a basis of \$2,000,000. The \$1,800,000 adjustment to basis is determined without regard to the \$563,400 exclusion amount allocated to asset X. A recognizes \$1,000,000 of gain (\$3,000,000 amount realized - \$2,000,000 basis) on this subsequent actual disposition of Asset X. Because A is now a nonresident alien individual as defined under section 7701(b), and because Asset X is a USRPI, that gain is subject to section 897.

Asset Z: A's basis of \$800,000 in Asset Z is adjusted downward by \$300,000 (the amount of loss taken into account under section 877A(a)(2) by reason of the deemed sale under section 877A(a)), resulting in a basis of \$500,000. A recognizes \$200,000 of gain (\$700,000 amount realized - \$500,000 basis) on this subsequent actual disposition. Because A is now a nonresident alien individual as defined under section 7701(b), and because Asset Z is a USRPI, that gain is subject to section 897.

#### **D. In-bound step-up in basis for nonresident aliens becoming resident aliens**

Section 877A(h)(2) provides that, solely for purposes of determining the tax imposed by reason of section 877A(a), property that was held by a nonresident alien on the day that individual first became a resident of the United States (within the meaning of section 7701(b)) will be treated as having a basis on such date of not less than the fair market value of such property on such date. A covered expatriate to whom this basis adjustment rule applies may make an irrevocable election, on a property-by-property basis, not to have such rule apply. The election must be made on Form 8854, which must be filed with the covered expatriate's Federal income tax return for the taxable year that includes the day before the expatriation date. See section 8 of this notice for information concerning Form 8854.

The IRS and Treasury Department intend to exercise their regulatory authority to exclude from this step-up-in-basis rule United States real property interests within the

meaning of section 897(c) ("USRPIs") and property used or held for use in connection with the conduct of a trade or business within the United States. Thus, if on the date the nonresident alien first became a resident of the United States, the nonresident alien held property that was a USRPI or was property used or held for use in connection with the conduct of a trade or business within the United States, then the basis of such property may not be stepped up to fair market value under 877A(h)(2). If, however, prior to becoming a resident of the United States, the nonresident alien was a resident of a country with which the United States had an income tax treaty, and the nonresident alien held property used or held for use in connection with the conduct of a U.S. trade or business that was not carried on through a permanent establishment in the United States under the income tax treaty of such country and the United States, then that property is eligible for a step up in basis to fair market value under 877A(h)(2).

*Example 4.* A first became a resident of the United States when A became a lawful permanent resident (green card holder) on April 1, 1995. On April 1, 1995, A owned Asset S with a basis of \$400X and a fair market value of \$700X and Asset T with a basis of \$500X and a fair market value of \$300X. Neither Asset S nor Asset T is a USRPI or property used or held for use in connection with the conduct of a trade or business within the United States. On June 30, 2010, the fair market value of Asset S is \$1,300X and the fair market value of Asset T is \$800X. On July 1, 2010, A ceases to be a lawful permanent resident and becomes a covered expatriate within the meaning of section 877A(g)(1)(A). A does not make the irrevocable election not to have the rule of section 877A(h)(2) apply. Therefore, Assets S and T will each be treated for purposes of the mark-to-market regime as having a basis of not less than the fair market value on April 1, 1995, so that Assets S and T will be treated as having a basis of \$700X and \$500X, respectively, on June 30, 2010, for purposes of determining the tax under section 877A(a). A will be deemed to realize \$600X ( $\$1,300X - \$700X$ ) of gain with respect to Asset S and \$300X ( $\$800X - \$500X$ ) of gain with respect to Asset T, for a total of \$900X.

*Example 5.* The facts are the same as in *Example 4*. If A makes an irrevocable election on Form 8854 not to have the rule of section 877A(h)(2) apply with respect to

Asset S because A does not want to incur the expense of having an appraisal conducted with respect to Asset S's fair market value on April 1, 1995, A will be deemed to realize \$900X (\$1,300X - \$400X) of gain with respect to Asset S.

#### **E. Deferral of payment of tax under the mark-to-market regime**

*Deferral election.* Section 877A(b) provides that a covered expatriate may make an irrevocable election ("deferral election") with respect to any property deemed sold by reason of section 877A(a) to defer the payment of the additional tax attributable to any such property ("deferral assets"). The deferral election is made on an asset-by-asset basis. In order to make the election with respect to any asset, the covered expatriate must provide adequate security (defined below) and must irrevocably waive any right under any U.S. treaty that would preclude assessment or collection of any tax imposed by reason of section 877A. If the IRS subsequently determines that the security provided for the deferred tax no longer qualifies as adequate security, the deferred tax and interest will become due immediately, unless the covered expatriate corrects such failure within 30 days after the IRS mails notification of such failure to the last known addresses of the covered expatriate and the covered expatriate's U.S. agent.

Subject to the preceding sentence, the time for payment of the tax attributable to a particular deferral asset under the mark-to-market regime is extended until the earlier of the due date (without extensions) of the covered expatriate's income tax return for (a) the taxable year in which the asset is disposed of by sale, non-recognition transaction, gift, or other means, or (b) the taxable year that includes the date of death of the covered expatriate. However, a covered expatriate may pay any tax deferred under section 877A(b), together with accrued interest, at any time.



*Interest accrual.* Section 877A(b)(7) provides that for purposes of section 6601, the last date for the payment of tax will be determined without regard to the deferral election. Interest will be computed at the underpayment rate established under section 6621 from the due date of the return (without extensions) for the taxable year that includes the day before the expatriation date and will compound daily under section 6622 until the date the tax is paid.

*Waiver of treaty benefits.* Section 877A(b)(5) provides that a covered expatriate may not make a deferral election with respect to a particular asset unless the covered expatriate makes an irrevocable waiver of any right under any U.S. treaty that would preclude the assessment or collection of any tax imposed by reason of section 877A. The covered expatriate must make the waiver on Form 8854, which must be filed with the covered expatriate's Federal income tax return for the taxable year that includes the day before the expatriation date. See section 8.C of this notice. Additionally, acknowledgment of such waiver must be noted in the agreement to defer tax with respect to a particular property ("tax deferral agreement") as described below.

*Adequate security/Tax deferral agreement.* Section 877A(b)(4)(A) provides that, in order to make a deferral election with respect to any asset, the covered expatriate must provide adequate security with respect to such asset. Section 877A(b)(4)(B) defines the term "adequate security" as (1) a bond that is furnished to, and accepted by, the Secretary, that is conditioned on the payment of the tax (and interest thereon), and that meets the requirements of section 6325, or (2) another form of security for such payment (including letters of credit) that meets such requirements as the Secretary may

prescribe.

Each covered expatriate who makes a deferral election must enter into a tax deferral agreement with the IRS. Execution of the agreement by the IRS will constitute acceptance by the Secretary of the security as adequate security. A template of a tax deferral agreement is provided in Appendix A of this notice. Any covered expatriate who wishes to enter into a tax deferral agreement under this notice must submit to the following address a request to enter into a tax deferral agreement (“deferral request”) by the due date of his or her return for the taxable year that includes the day before the expatriation date:

Internal Revenue Service  
PO Box 331  
Drop Point S607-F8854  
Bensalem, PA 19020

The deferral request must include (1) two signed copies of the template agreement provided in Appendix A of this notice, (2) a description of the asset(s) with respect to which the covered expatriate is electing to defer tax, (3) an attachment showing the calculation of the tax attributable to such asset(s) under the method set forth below, (4) documentation of the proposed security offered to secure the deferral of tax, (5) a copy of an agreement with a U.S. agent, as described below, and (6) a copy of the covered expatriate’s return for the taxable year that includes the day before the expatriation date. Provided that the security offered by the covered expatriate is determined to be adequate to secure the tax being deferred, the IRS will sign the tax deferral agreement and provide one copy to the covered expatriate.

Additionally, the covered expatriate must attach a copy of the deferral request to his or her return for the taxable year that includes the day before the expatriation date. The covered expatriate may file the deferral request simultaneously with his or her tax return.

The tax deferral agreement must be periodically renewed according to the terms provided in the agreement. If the agreement is not renewed within the time frame specified in the agreement, the collateral will be applied to the tax liability and interest.

*Appointment of U.S. agent.* In order to make a deferral election, a covered expatriate must appoint a U.S. person to act as the covered expatriate's limited agent for purposes of accepting communication related to the tax deferral agreement from the IRS on behalf of the covered expatriate, the timely enforcement of the terms of the tax deferral agreement between the covered expatriate and the IRS, and applying section 7602 and all related procedural provisions of the Code with respect to a request by the IRS to examine records, for the production of testimony, or for a summons by the IRS for such records or testimony related to the enforcement of the tax deferral agreement.

In order to authorize a U.S. person to act as an agent, the covered expatriate and the agent must enter into a binding agreement that is substantially similar in form to the agreement provided in Appendix B of this notice. The agreement must be executed by the covered expatriate and the agent and must be submitted as part of the deferral request. The authorization must remain in effect for as long as the tax deferral agreement remains in effect.

If the U.S. agent resigns, liquidates, or terminates its responsibility as an agent of the covered expatriate, the covered expatriate must, within 90 days, notify IRS-Advisory (Telephone: 954-423-7344, Fax: 954-423-7809) in writing at the following address:

Advisory  
7850 SW 6th Court  
Mail Stop 5780  
Plantation, FL 33324-3202

This notification must contain the name, address, and TIN of the new U.S. agent (if any). If no new agent is appointed, then the tax deferral agreement will be in default and the collateral will be applied to the deferred tax and interest attributable to all of the deferral assets.

*Determination of tax attributable to particular assets.* Deferral of tax is made on an asset-by-asset basis, and a covered expatriate who elects to defer the tax attributable to one or more assets must determine the amount of tax imposed by reason of section 877A(a) attributable to each asset deemed sold pursuant to section 877A(a). The tax imposed by reason of section 877A(a) is the difference between (a) the covered expatriate's tax liability for the portion of the taxable year that includes the day before the expatriation date as reflected on a Form 1040 with respect to that portion of the taxable year and that includes the net taxable gain resulting from all deemed sales under section 877A(a) and (b) the covered expatriate's tax liability for the portion of the taxable year that includes the day before the expatriation date as reflected on a Form 1040 with respect to that portion of the taxable year but that does not include the net taxable gain resulting from all deemed sales under section 877A(a).

The amount of tax imposed by reason of section 877A(a) that is attributable to each asset is determined by multiplying the amount of tax imposed by reason of section 877A(a) by the ratio of (a) the gain, if any, includible in gross income under section 877A(a) with respect to that particular asset to (b) the gain includible in gross income by reason of section 877A(a) with respect to all gain assets deemed sold pursuant to section 877A(a). The tax attributable to that particular asset, computed as described in the preceding sentence, is the amount of tax that that a covered expatriate may elect to defer under section 877A(b) with respect to that asset. The effect of such election is to reduce the amount of tax currently due and payable by the amount of the tax attributable to the asset with respect to which the election is made.

*Example 6.* The facts are the same as *Example 1*, except that A elects to defer the tax attributable to Assets X and Y. Assume that A's taxable income for the portion of the taxable year that includes the day before the expatriation date without regard to section 877A is \$1,300,000, and that the tax liability on that taxable income is \$300,000. Also assume that A's taxable income for that same period, including the \$1,100,000 net gain resulting from all deemed sales under section 877A(a) (and taking into account the amount excluded pursuant to section 877A(a)(3)), is \$2,400,000, and that A's total tax liability with respect to that taxable income as reflected on a Form 1040 is \$500,000.

*Step 1.* Determine the amount of tax imposed by reason of section 877A(a) by subtracting A's tax liability for the portion of the taxable year that includes the day before the expatriation date computed without taking into account section 877A(a) (\$300,000) from A's tax liability for that period including the taxable gain resulting from all deemed sales under section 877A(a) (\$500,000). The amount of tax that must be allocated among the assets deemed sold pursuant to section 877A(a) is \$200,000.

*Step 2.* Determine the portion of tax attributable to each asset deemed sold by multiplying the amount of tax determined under Step 1 by the ratio of the amount includible in gross income with respect to each gain asset (as determined in Step 3 of *Example 1*, with the amount with respect to assets with a built-in loss being zero) to the total amount includible in gross income with respect to all gain assets.

Asset X	$\frac{\$1,236,600}{\$1,374,000}$	X \$200,000 =	\$180,000
Asset Y	$\frac{\$137,400}{\$1,374,000}$	X \$200,000 =	\$20,000
Asset Z	$\frac{\$0}{\$1,374,000}$	X \$200,000 =	\$0

For the portion of the taxable year that includes the day before the expatriation date, A has a total tax liability of \$500,000, but, due to A's deferral elections with respect to Assets X and Y, A will report and pay only \$300,000 with A's return for that portion of the year. Of the \$200,000 deferred tax, \$180,000 is attributable to Asset X and \$20,000 is attributable to Asset Y. If instead of electing to defer the tax attributable to Asset X and to Asset Y, A had elected to defer only the tax attributable to Asset X (\$180,000), A would have been required to pay \$320,000 of tax with A's return for that portion of the year (the total tax otherwise due of \$500,000 less the \$180,000 of tax attributable to Asset X which tax A has elected to defer).

#### **SECTION 4. COORDINATION WITH CERTAIN CODE PROVISIONS**

*Termination of deferrals.* Section 877A(h)(1)(A) provides that, notwithstanding any other provision of the Code, any time period for acquiring property that would result in the reduction of gain recognized with respect to property disposed of by a covered expatriate terminates on the day before the expatriation date. This rule applies to certain incomplete transactions such as deferred like-kind exchanges and involuntary conversions. In addition, section 877A(h)(1)(B) provides that, notwithstanding any other provision of the Code, any extension of time for payment of tax ceases to apply on the day before the expatriation date, and the unpaid portion of such tax becomes due and payable at the time and in the manner prescribed by the Secretary. Accordingly, the tax shall be due and payable on the earlier of the date the tax would become due and payable without regard to section 877A and the due date of the covered expatriate's

return for the taxable year that includes the day before the expatriation date.

*Section 367(a).* Regulations under section 367(a) regarding gain recognition agreements (GRAs) provide that if an individual U.S. transferor loses U.S. citizenship or ceases to be a lawful permanent resident of the United States, the individual shall be treated as disposing of all the stock of the transferee foreign corporation received in the initial transfer as of the day before the loss of such status. This disposition shall constitute a triggering event with respect to the GRA and require the recognition of gain under the GRA (and the payment of applicable interest with respect to any additional tax due); this disposition shall not terminate or reduce the amount of gain subject to the GRA. Gain recognized under the GRA as a result of this disposition, and any basis adjustments resulting from such gain recognition, shall be taken into account prior to any gain or loss that is required to be taken into account under section 877A on the deemed sale of the stock of the transferee foreign corporation under section 877A(a).

*Section 684.* Section 877A(h)(3) provides that if the expatriation of any individual would result in recognition of gain under section 684, the provisions of section 684 apply before the provisions of section 877A. Section 684(a) and the regulations thereunder generally require immediate recognition of gain when a U.S. person directly, indirectly, or constructively transfers appreciated property to a foreign trust of which the U.S. person is not treated as the owner under the grantor trust rules (sections 671 through 679). Section 672(f) limits the circumstances in which a foreign person may be treated as the owner of a trust under the grantor trust rules. A covered expatriate's expatriation may cause a domestic trust of which the covered expatriate was treated as the owner

on the day before the expatriation date to become a foreign trust under the rules of section 7701(a)(31)(B) and § 301.7701-7. If a covered expatriate's expatriation also causes the covered expatriate to cease to be treated as the owner of the trust, appreciated property held by the trust will generally be subject to the gain recognition rules of section 684. Gain that is subject to tax under the rules of section 684 will not also be subject to tax under the mark-to-market regime.

*Section 897.* If a covered expatriate holds a USRPI on the day before the expatriation date, the USRPI is generally subject to tax under the mark-to-market regime in the same manner as other property of the covered expatriate. As provided in section 3.C of this notice, the covered expatriate's basis in the USRPI will be adjusted to reflect the gain or loss taken into account under the mark-to-market regime. Section 897 will not apply to the gain or loss recognized as a result of the mark-to-market regime, because the covered expatriate will not be a nonresident alien within the meaning section 7701(b) on the day before the expatriation date. However, as illustrated in Example 3, above, section 897 will apply when the covered expatriate subsequently disposes of the USRPI.

*Expatriations subject to section 877.* An individual whose expatriation date occurred before June 17, 2008, continues to be covered by the rules of sections 877 and 6039G as in effect on the individual's expatriation date. An individual whose expatriation date occurred after June 3, 2004, but before June 17, 2008, continues to be subject to the provisions of section 7701(n) (as in effect prior to June 17, 2008). In such case, the 10-year period described in section 877(a) commences on the date the U.S.



citizen or long-term resident complies with the provision of section 7701(n) (as in effect prior to June 17, 2008).

*Example 7.* A, a U.S. citizen, relinquishes U.S. citizenship on June 10, 2008, but does not file Form 8854 until December 12, 2009. A is subject to the rules of section 877 and the reporting and notification provisions of sections 6039G and 7701(n), as in effect prior to June 17, 2008. The ten-year period described in section 877(a) commences on December 12, 2009.

*Example 8.* A is a long-term resident who commences to be treated as a resident of a foreign country pursuant to an income tax treaty between the United States and the foreign country. A qualifies under the treaty to be treated as a resident of the foreign country as of January 1, 2008. A is subject to the rules of section 877 and the reporting and notification provisions of sections 6039G and 7701(n), as in effect prior to June 17, 2008.

## **SECTION 5. DEFERRED COMPENSATION ITEMS**

### **A. In general**

Section 877A(c)(1) provides that the tax under the mark-to-market regime provided in section 877A(a) does not apply to any deferred compensation item, as defined below. Instead, alternative tax regimes apply to “eligible deferred compensation items” and “ineligible deferred compensation items.” In the case of an “eligible deferred compensation item,” section 877A(d)(1)(A) provides generally that the payor must deduct and withhold a tax equal to 30 percent of any taxable payment to a covered expatriate with respect to such an item. In the case of “ineligible deferred compensation items,” section 877A(d)(2)(A) provides that a covered expatriate generally is subject to taxation on the ineligible deferred compensation item as if received by the covered expatriate on the day before the expatriation date.

Sections 5.B(2) and 5.B(3) of this notice provide definitions for “eligible deferred

compensation items” and “ineligible deferred compensation items,” respectively.

Sections 5.C and 5.D of this notice provide guidance on the taxation of “eligible deferred compensation items” and “ineligible deferred compensation items,” respectively.

## **B. Definitions**

The following definitions apply for purposes of section 877A and this notice.

(1) *Deferred compensation item* means:

- a. Any interest in a plan or arrangement described in section 219(g)(5), which means:
  - i. a plan described in section 401(a) that includes a trust exempt from tax under section 501(a),
  - ii. an annuity plan described in section 403(a),
  - iii. a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, but excluding an eligible deferred compensation plan (within the meaning of section 457(b)),
  - iv. an annuity contract described in section 403(b),
  - v. a simplified employee pension (within the meaning of section 408(k)),
  - vi. a simplified retirement account (within the meaning of section 408(p)), or
  - vii. a trust described in section 501(c)(18);

- b. Any interest in a foreign pension plan or similar retirement arrangement or program;
- c. Any item of deferred compensation, as defined in section 5.B(4) of this notice; or
- d. Any property, or right to property, that the individual is entitled to receive in connection with the performance of services to the extent not previously taken into account under section 83 or in accordance with section 83. Until further guidance is issued, a deferred compensation item described in this section 5.B(1)d means property that has been transferred (as defined in § 1.83-3(a)) to the covered expatriate, or a right to property that the covered expatriate, as of the expatriation date, has a legally binding right to receive, in connection with the performance of services (whether or not such property or right to property is substantially vested), but only to the extent the covered expatriate has not taken such item into account under, or in accordance with, section 83. For this purpose, the following generally constitute property or a right to property: statutory and nonstatutory stock options (see sections 421 through 424 and § 1.83-7); stock and other property; stock-settled stock appreciation rights; and stock-settled restricted stock units. A covered expatriate will be considered to have taken property or a right to property into

account under section 83 or in accordance with section 83 to the extent that: (A) on or before the expatriation date, there has been a transfer of property to or on behalf of the covered expatriate in connection with the performance of services with respect to such property or right to property within the meaning of section 83(a) and the regulations thereunder; (B) on or before the expatriation date, either (i) such transferred property has become substantially vested or (ii) the covered expatriate has made a valid election under section 83(b) with respect to such transferred property; and (C) the covered expatriate has filed a Federal income tax return for the appropriate taxable year or years accurately reporting the full amount (if any) includible in such covered expatriate's income with respect to such transferred property for such year or years and has paid all taxes due with respect to such return or returns, or, if such tax return is due after the expatriation date, the income with respect to such transferred property has been subject to appropriate tax withholding.

(2) *Eligible deferred compensation item* means any deferred compensation item with respect to which: (i) the payor is either a U.S. person or a non-U.S. person who elects to be treated as a U.S. person for purposes of section 877A(d)(1) and (ii) the covered expatriate notifies the payor of his or her status as a covered expatriate and irrevocably waives any right to claim

any withholding reduction under any treaty with the United States. See section 8 of this notice for the applicable filing and reporting requirements. Separate guidance will be issued under section 877A(d)(3)(A) providing rules for a non-U.S. person to elect to be treated as a U.S. person for purposes of section 877A(d)(1).

(3) *Ineligible deferred compensation item* means any deferred compensation item that is not an eligible deferred compensation item. See section 8 of this notice for the applicable filing and reporting requirements.

(4) *Item of deferred compensation* means any amount of compensation if, under the terms of the plan, contract, or other arrangement providing for such compensation (compensation arrangement), the covered expatriate has a legally binding right as of the expatriation date to such compensation, the compensation has not been actually or constructively received on or before the expatriation date, and pursuant to the compensation arrangement the compensation is payable to (or on behalf of) the covered expatriate on or after the expatriation date, but such term does not include any deferred compensation item that is described in section 5.B(1)a, 5.B(1)b, or 5.B(1)d of this notice. An item of deferred compensation generally includes an amount (other than a deferred compensation item described in sections 5.B(1)a, 5.B(1)b, or 5.B(1)d of this notice), whether or not substantially vested, that constitutes nonqualified deferred compensation for purposes of section 404(a)(5) (determined without regard to § 1.404(b)-1T, Q&A 2),

including a cash-settled stock appreciation right, a phantom stock arrangement, a cash-settled restricted stock unit, an unfunded and unsecured promise to pay money or other compensation in the future (other than such a promise to transfer property in the future), and an interest in a trust described in section 402(b)(1) or (4) (commonly referred to as a secular trust).

(5) *Property* has the meaning set out in § 1.83-3(e).

(6) *Stock appreciation right* means a right to compensation based on the appreciation in value of a specified number of shares of stock or other property during a specified period (such as a period beginning on the date of grant or some other specified date and the date of exercise of such right). A stock appreciation right is a stock-settled stock appreciation right to the extent that the compensation payable under such right is in the form of a transfer of shares of stock or other property or a right to receive property in the future. A stock appreciation right is a cash-settled stock appreciation right to the extent that it is not a stock-settled stock appreciation right.

(7) *Restricted stock unit* means a right to receive compensation in cash, shares of stock, or other property, as defined in section 5.B(5) of this notice, following the satisfaction of a specified vesting condition. A restricted stock unit is a stock-settled restricted stock unit to the extent that the compensation payable under such restricted stock unit is in the form of a transfer following the satisfaction of such vesting condition of shares of stock

or other property or a right to receive property in the future. A restricted stock unit is a cash-settled restricted stock unit to the extent that it is not a stock-settled restricted stock unit.

(8) *Substantially vested* has the meaning set out in § 1.83-3(b).

### **C. Taxation of eligible deferred compensation items**

If a deferred compensation item qualifies as an eligible deferred compensation item, the payor must deduct and withhold a tax equal to 30 percent of any taxable payment to a covered expatriate with respect to such an item. Section 877A(d)(1)(B) provides that a taxable payment is any payment to the extent it would be includible in gross income of the covered expatriate if such person continued to be subject to tax as a citizen or resident of the United States. Because the covered expatriate must waive his or her right to claim treaty benefits with respect to an eligible deferred compensation item, the 30 percent withholding tax cannot be reduced or eliminated by treaty. See section 5.E of this notice for rules with respect to an amount of deferred compensation attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States. See section 5.F of this notice for information concerning the application of the withholding rules.

### **D. Taxation of ineligible deferred compensation items**

With respect to any ineligible deferred compensation item described in section 5.B(1)a, 5.B(1)b, and 5.B(1)c of this notice, an amount equal to the present value of the covered expatriate's accrued benefit is treated as having been received by the covered expatriate on the day before the expatriation date as a distribution under the plan and

must be included on the covered expatriate's Form 1040 (or other schedule, as provided in Treas. Reg. § 1.6012-1(b)(2)(ii)(b)) for the portion of the taxable year that includes the day before the expatriation date.

Within 60 days of the receipt of a properly completed Form W-8CE, the payor of the ineligible deferred compensation item must advise the covered expatriate of the present value of the covered expatriate's accrued benefit in the deferred compensation item on the day before the expatriation date. See section 8 of this notice for more information concerning Form W-8CE.

In the case of a defined contribution plan described in section 5.B(1)a, until further guidance is issued, the present value of the covered expatriate's accrued benefit is the account balance. In the case of a defined benefit plan described in section 5.B(1)a, until further guidance is issued, the present value of the covered expatriate's accrued benefit is determined using the method set forth in section 4.02 of Rev. Proc. 2004-37, 2004-1 C.B. 1099, determined as of the day before the expatriation date. See section 5.E of this notice with respect to an amount of deferred compensation attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States.

With respect to any ineligible deferred compensation item not described in section 5.B(1)a or 5.B(1)d of this notice, until further guidance is issued, the present value of the covered expatriate's accrued benefit is determined by applying principles in Prop. Treas. Reg. § 1.409A-4, except as provided herein. Where such proposed regulations provide for a determination to be made as of the end of the taxable year,



such determination shall be made as of the day before the expatriation date. For the purposes of this section 5.D, the present value of the covered expatriate's accrued benefit is determined without regard to any substantial risk of forfeiture. See section 5.E of this notice with respect to an amount of deferred compensation attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States.

With respect to any ineligible deferred compensation item described in section 5.B(1)d of this notice, the rights of the covered expatriate to such item will be treated as becoming transferable (within the meaning of Treas. Reg. § 1.83-3(d)) and not subject to a substantial risk of forfeiture (within the meaning of Treas. Reg. § 1.83-3(c)) on the day before the expatriation date. Thus, for example, in the case of property transferred to or on behalf of the covered expatriate in connection with the performance of services that has not become substantially vested as of the expatriation date, such as restricted stock, to the extent that the covered expatriate has not previously taken into account under section 83 or in accordance with section 83 with respect to such transfer, generally such property will be treated as having become substantially vested for purposes of section 83 on the day before the expatriation date. Consequently, the fair market value of such property (determined without regard to any lapse restriction as defined in Treas. Reg. § 1.83-3(i)), reduced by the amount (if any) the covered expatriate paid for the property, generally will be includible in the covered expatriate's income for Federal income tax purposes as of such date.

With respect to a right to a transfer of property in the future (such as a stock-

settled stock appreciation right or a stock-settled restricted stock unit), such right will be treated as substantially vested as of the day before the expatriation date and, under the cash-equivalency doctrine (see Cowden v. Commissioner, 289 F.2d 20 (5<sup>th</sup> Cir. 1961)), the value of such right generally will be includible in the income of the covered expatriate as of such date. Until further guidance is issued, the value of such right is determined by applying principles similar to Prop. Treas. Reg. § 1.409A-4, except that where such proposed regulations provide for a determination to be made as of the end of the taxable year, such determination shall be made as of the day before the expatriation date.

Under section 877A(d)(2)(B), no early distribution tax will be imposed by reason of the treatment resulting from section 877A(d)(2)(A). For purposes of this notice, an early distribution tax is any additional tax that would be imposed under sections 72(t), 220(e)(4), 223(f)(4), 409A(a)(1)(B), 529(c)(6), or 530(d)(4) if the amounts required to be included in the income of the covered expatriate under section 877A(d)(2) had actually been paid or transferred to the covered expatriate on the day before the expatriation date.

Section 877A(d)(2)(C) provides that appropriate adjustments shall be made to subsequent distributions from the plan to reflect the tax imposed by section 877A(d)(2). Thus, when the covered expatriate receives distributions, the amount that was includible in his or her gross income under section 877A(d)(2) will be treated as investment in the contract for purposes of section 72 in cases where such section would apply to such amounts.

In other cases, the covered expatriate may make an appropriate adjustment to the amount that would otherwise be includible in the covered expatriate's income to prevent amounts previously taxed under section 877A(d)(2) from being includible in income and subject to Federal income tax a second time. With respect to ineligible deferred compensation items to which Prop. Treas. Reg. § 1.409A-4 would apply, such adjustment will be made pursuant to principles similar to Prop. Treas. Reg. § 1.409A-4. With respect to any ineligible deferred compensation items to which section 72 does not apply and Prop. Treas. Reg. § 1.409A-4 would not apply, until further guidance is issued, taxpayers may use any reasonable method to determine the amount of such adjustment, so long as such method: is consistently applied to all such ineligible deferred compensation items with respect to the covered expatriate; does not reduce the amount includible in the covered expatriate's income with respect to any ineligible deferred compensation item below zero; and does not result in an aggregate amount of such adjustments that, when combined with amounts treated as investment in the contract for purposes of section 72 and pursuant to principles similar to Prop. Treas. Reg. § 1.409A-4, exceeds the amount included in the covered expatriate's income pursuant to section 877A(d)(2)(A).

#### **E. Services performed outside the United States**

Section 877A(d)(5) provides that the rules of sections 877A(d)(1) and (2) shall not apply to any deferred compensation item to the extent attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States. Thus, in the case of an eligible deferred compensation

item, the amount of a taxable payment under section 877A(d)(1)(A) with respect to such item will not include the portion of such item that is attributable to services performed outside the United States before or after the expatriation date while the covered expatriate was not a citizen or resident of the United States.

To the extent that a portion of an ineligible deferred compensation item is attributable to services performed outside the United States before or after the expatriation date while the covered expatriate was not a citizen or resident of the United States, the amount includible in income under section 877A(d)(2)(A) with respect to such item will not include such portion.

Until further guidance is issued, taxpayers may use any reasonable method that is consistent with existing guidance (including Treas. Reg. § 1.861-4(b)(2), Revenue Ruling 79-388, and Revenue Procedure 2004-37) and is based upon a reasonable, good faith interpretation of section 877A(d)(5) to determine the portion of a deferred compensation item that is attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States.

#### **F. Application of withholding rules**

Section 877A(d)(6) provides that the tax that is imposed on taxable payments from eligible deferred compensation items by section 877A(d)(1) is imposed under section 871, but that the payment is subject to withholding under section 877A(d)(1) and not under section 1441 or Chapter 24. Any amount due under section 871 that is not paid by means of withholding must be reported on the income tax return filed by the covered expatriate for the relevant taxable year. Section 877A(d)(6)(A) provides that

rules similar to the rules of sections 1461 through 1464 apply for purposes of section 877A(d). Thus, a payor is liable for the tax as stated under section 1461. The covered expatriate must notify the payor of his or her covered expatriate status by submitting Form W-8CE to the trustee on the earlier of (1) the day prior to the first distribution on or after the expatriation date or (2) 30 days after the expatriation date.

Section 877A(g)(1)(C) provides that in the case of any covered expatriate who is subject to tax as a citizen or resident of the United States for any period beginning after the expatriation date, such individual will not be treated as a covered expatriate during such period for purposes of the 30 percent withholding tax on a taxable payment from an eligible deferred compensation item. Thus, the taxable payment would not be subject to tax under section 871, but would be subject to the tax imposed on payments to a citizen or resident of the United States.

This notice does not address certain withholding issues with respect to deferred compensation items. Pending further guidance, employers and plans need not withhold income taxes with respect to amounts deemed received under section 877A(d)(2)(A). Instead, the covered expatriate should report ineligible deferred compensation items on his or her Form 1040 (or other schedule, as provided in Treas. Reg. § 1.6012-1(b)(2)(ii)(b)) for the portion of the taxable year that includes the day before the expatriation date. Also pending further guidance, the FICA and FUTA taxation of deferred compensation items should be determined without regard to section 877A. The IRS and Treasury Department invite public comments on these issues and expect to provide future guidance on such withholding requirements.

## G. Examples

*Example 9.* On January 3, 2006, Corporation Y, a U.S. corporation, granted B, an employee of Corporation Y, 10 stock-settled stock appreciation rights and 10 cash-settled stock appreciation rights in connection with B's performance of services. B can exercise the stock appreciation rights at any time from January 3, 2006, through January 2, 2016. Each stock-settled stock appreciation right entitles B to receive upon exercise a number of shares of the common stock of Corporation Y equal to the difference between the value of a share of Corporation Y common stock on the date B exercises the right over the value of a share of such stock on the date of grant, divided by the value of a share of such stock on the date of exercise. Each cash-settled stock appreciation right entitles B to a cash payment upon exercise equal to the excess of the value of a share of Corporation Y stock on the date of exercise over the value of a share of such stock on the date of grant. The stock appreciation rights do not provide for a deferral of compensation under section 409A, in accordance with Treas. Reg. § 1.409A-1(b)(5). On January 3, 2006, the per share price of the Corporation Y stock was \$10. As of November 18, 2009, B had not exercised any of the stock appreciation rights and the value of a share of the Corporation Y stock was \$20. On November 19, 2009, B ceases to be a lawful permanent resident of the United States and becomes a covered expatriate. During B's employment with Corporation Y, B performed all services for Corporation Y in the United States.

The stock-settled stock appreciation rights are deferred compensation items within the meaning of section 877A(d)(4)(D). Pursuant to section 877A(d)(2)(A)(ii), the stock-settled stock appreciation rights are treated as substantially vested on November 18, 2009, and their value is includible in B's income on that date. Pursuant to Prop. Treas. Reg. § 1.409A-4(b)(6), B is required to include \$100 in income on that date with respect to such rights.

The cash-settled stock appreciation rights are deferred compensation items within the meaning of section 877A(d)(4)(C). Under section 877A(d)(2)(A)(i), B is treated as having received on November 18, 2009, an amount equal to the present value of the cash-settled stock appreciation rights. Pursuant to Prop. Treas. Reg. § 1.409A-4(b)(6), B is required to include \$100 in income with respect to such rights.

*Example 10.* Assume the same facts as in Example 9, except that, with respect to all of B's stock appreciation rights, B timely notifies Corporation Y of her status as a covered expatriate and irrevocably waives any right to claim any withholding reduction under any treaty with the United States. On January 15, 2010, when the value of a share of Corporation Y stock is \$25, B exercises all of her stock appreciation rights.

The stock appreciation rights are eligible deferred compensation items within the meaning of section 877A(d)(3). B has no income inclusion on November 18, 2009, with

respect to the stock appreciation rights.

With respect to the stock-settled stock appreciation rights, on January 15, 2010, B is required to include \$150 in income. Corporation Y is required to deduct and withhold a tax equal to \$45 from the \$150 of income recognized by B on January 15, 2010 (30% of the amount included in B's gross income). With respect to the cash-settled stock appreciation rights, Corporation Y is required to deduct and withhold a tax equal to \$45 from the \$150 that is includible in B's income on January 15, 2010.

*Example 11.* C relinquishes his citizenship on December 17, 2009 and becomes a covered expatriate. On December 16, 2009, C was an employee of Corporation Z, a U.S. corporation. During C's employment with Corporation Z, C performed all services for Corporation Z in the United States.

On December 16, 2009, C had stock-settled restricted stock units that entitle C to 100 shares of Corporation Z's common stock if C continues to provide substantial services to Corporation Z until December 16, 2013. Corporation Z granted C the restricted stock units on December 16, 2008, in connection with C's performance of services. Under Treas. Reg. § 1.409A-1(b)(4), the restricted stock units do not provide for a deferral of compensation for purposes of section 409A. On December 16, 2009, the fair market value of a share of Corporation Z stock was \$30.

The stock-settled restricted stock units are deferred compensation items within the meaning of section 877A(d)(4)(D). Pursuant to section 877A(d)(2)(A)(ii), the stock-settled restricted stock units are treated as substantially vested on December 16, 2009, and the value of such units is includible in C's income on December 16, 2009. Pursuant to Prop. Treas. Reg. § 1.409A-4(b)(6), C is required to include \$3,000 in income on December 16, 2009, the amount of the fair market value of Corporation Z's stock on that date multiplied by the number of shares covered by the restricted stock units (\$30 x 100).

*Example 12.* Assume the same facts as in Example 11, except that, on December 16, 2009, with respect to the restricted stock units, C timely notifies Corporation Z of his status as a covered expatriate and irrevocably waives any right to claim any withholding reduction under any treaty with the United States. C continues to perform services for Corporation Z outside the United States and, on December 16, 2013, C fulfills the requirements of the vesting schedule and receives 100 shares of Corporation Z's common stock when the share price of Corporation Z stock is \$50.

The restricted stock units are eligible deferred compensation items within the meaning of section 877A(d)(3). C has no income inclusion on December 16, 2009, with respect to the restricted stock units.

Pursuant to section 5.E of this notice, C reasonably determines that 80% of the value of the stock transferred to C on December 16, 2013 pursuant to the restricted stock units is attributable to services performed outside the United States while C was not a citizen or resident of the United States. Therefore, \$1,000 (20% of \$5,000) will be includible in C's gross income and Corporation Z is required to deduct and withhold a tax equal to \$300.

*Example 13.* D has been a U.S. citizen since birth. D relinquishes her citizenship on November 19, 2009 and becomes a covered expatriate. On November 18, 2009, the day before D's relinquishment of citizenship, D was an employee of Corporation W, a U.S. corporation. After November 18, 2009, D performs services for Corporation W outside the United States.

On November 18, 2009, D had 1,000 shares of restricted common stock of Corporation W that Corporation W granted to D on November 18, 2008, in connection with D's performance of services. Under the terms of the award, D will forfeit all of the restricted shares if D ceases to be employed by Corporation D before November 18, 2013. D's shares of restricted stock become substantially vested on November 17, 2013. D did not make an election pursuant to section 83(b) with respect to the shares of restricted stock and paid nothing for them. On November 18, 2009, the fair market value of Corporation W's stock was \$100 per share.

The shares of restricted stock are deferred compensation items within the meaning of section 877A(d)(4)(D). Pursuant to section 877A(d)(2)(A)(ii), D's rights to the shares of restricted stock are treated as substantially vested on November 18, 2009. Accordingly, D is required to include in income \$100,000 ( $\$100 \times 1,000$ ) on that date.

*Example 14.* Assume the same facts as in Example 13, except that, with respect to the restricted stock, D timely notifies Corporation W of her status as a covered expatriate and irrevocably waives any right to claim any withholding reduction under any treaty with the United States. On November 18, 2013, D's shares of restricted stock become substantially vested and the fair market value of Corporation W's stock is \$200.

Corporation W is required to deduct and withhold a tax equal to 30% from any income that would be includible in D's gross income as a result of D being treated as a citizen or resident of the United States. Pursuant to section 5.E of this notice, D reasonably determines that 80% of the value of the restricted stock on November 18, 2013, is attributable to services performed outside the United States while D was not a citizen or resident of the United States. Therefore, on November 18, 2013, \$40,000 (20% of \$200,000) is includible in D's gross income, and Corporation W is required to deduct and withhold a tax equal to \$12,000.

*Example 15.* E, a covered expatriate, relinquishes his citizenship on November



19, 2009, and becomes a resident of Country N. Country N does not have a tax treaty with the United States. Until November 19, 2009, while a citizen of the United States, E performed services as an employee for Corporation V, a U.S. corporation, in and outside the United States. After November 18, 2009, E performs services for Corporation V solely outside the United States.

On November 18, 2009, E participates in an account balance nonqualified deferred compensation plan. E's account balance under the plan is deemed to be invested in a specified predetermined actual investment. The value of the deemed investment under E's account balance plan is \$1,000,000 on that date. Under the plan, Corporation V is required to pay E an amount equal to E's account balance under the plan on November 30, 2012. E's account balance plan complies with the requirements of section 409A at all relevant times and no amounts are set aside in a trust or otherwise to pay amounts due under the plan.

The account balance plan is an item of deferred compensation within the meaning of section 877A(d)(4)(C). Pursuant to section 877A(d)(2)(A)(i) and Prop. Treas. Reg. § 1.409A-4(b)(3), E is treated as having received \$1,000,000 on November 18, 2009. If, on November 30, 2012, the value of the deemed investment in the account balance plan is \$1,500,000 and that amount is includible in E's gross income on that date, then, pursuant to section 877A(d)(2)(C) and Prop. Treas. Reg. § 1.409A-4, an appropriate adjustment is made as a result of E's treatment as having received \$1,000,000 on November 18, 2009. Accordingly, only \$500,000 is includible in E's gross income on November 30, 2012.

*Example 16.* Assume the same facts as in Example 15, except that, with respect to the account balance plan, E timely notifies Corporation V of his status as a covered expatriate and irrevocably waives any right to claim any withholding reduction under any treaty with the United States.

The account balance plan is an eligible deferred compensation item within the meaning of section 877A(d)(3). E has no income inclusion on November 18, 2009, with respect to the account balance plan. On November 30, 2012, \$1,500,000 is includible in E's gross income as a result of E being treated as a citizen or resident of the United States, and Corporation V is required to deduct and withhold a tax equal to \$450,000 from the amount it pays to E pursuant to the account balance plan.

*Example 17.* F relinquishes his citizenship on November 11, 2009, and becomes a covered expatriate. On November 10, 2009, the day before F's relinquishment of citizenship, F was a participant in a plan described in section 401(a) that includes a trust exempt from tax under section 501(a). F complies with the procedures prescribed in section 8 of this notice for notifying the payor of his status as a covered expatriate and making an irrevocable waiver of any right to claim treaty benefits with respect to

withholding on the payment. Therefore, F's interest in the plan is an eligible deferred compensation item and tax will not be due under section 877A until F receives taxable payments from the plan. When F receives taxable payments from the plan, the payor will be required to withhold 30 percent of the gross amount of each taxable payment pursuant to section 877A(d)(1).

*Example 18.* G relinquishes her citizenship on November 12, 2009, and becomes a covered expatriate. On November 11, 2009, the day before G's relinquishment of citizenship, G was a participant in a plan described in section 401(a) that includes a trust exempt from tax under section 501(a). G does not comply with the prescribed procedures for notifying the payor of her status as a covered expatriate and making an irrevocable waiver of any right to claim treaty benefits with respect to withholding on the payment. Therefore, G's interest in the plan is an ineligible deferred compensation item. Under section 877A(d)(2), G is treated as having received on November 11, 2009, an amount equal to the present value of her accrued benefit in the plan determined in accordance with section 5.D of this notice and is required to report this amount on her federal income tax return for the taxable year that includes November 11, 2009. G will not be subject to any tax on early distributions that might otherwise be payable.

When G receives distributions from the plan, the amount that G includes in her gross income for her taxable period ending on November 12, 2009, will be treated as investment in the contract for purposes of section 72. Thus, a portion of each distribution will constitute investment in the contract and will not be taxed again.

*Example 19.* H relinquishes his citizenship on November 13, 2009, and becomes a covered expatriate. On November 12, 2009, the day before H's relinquishment of citizenship, H is a participant in a foreign pension plan that provides benefits pursuant to a trust described in section 402(b)(4) and that does not provide for a deferral of compensation under Treas. Reg. § 1.409A-1(b)(6). The trustee of the trust under the foreign pension plan does not comply with the procedures for electing to be treated as a U.S. person for purposes of section 877A(d)(1). Therefore, H's interest in the plan is an ineligible deferred compensation item even if H complies with the prescribed procedures for notifying the payor of his status as a covered expatriate and makes an irrevocable waiver of any right to claim treaty benefits with respect to withholding on the payment. Under section 877A(d)(2), on November 12, 2009, H is treated as having received an amount equal to the present value of his accrued benefit in the plan determined in accordance with section 5.D of this notice and is required to report such amount (other than his investment in the contract) on his federal income tax return for the taxable year that includes November 12, 2009.

**SECTION 6. SPECIFIED TAX DEFERRED ACCOUNTS**

The mark-to-market regime does not apply to specified tax deferred accounts. Instead, section 877A(e)(1)(A) provides that if a covered expatriate holds any interest in a specified tax deferred account (defined below) on the day before the expatriation date, such covered expatriate is treated as having received a distribution of his or her entire interest in such account on the day before the expatriation date. Within 60 days of receipt of a properly completed Form W-8CE, the custodian of a specified tax deferred account must advise the covered expatriate of the amount of the covered expatriate's entire interest in his or her account on the day before his or her expatriation date. See section 8 of this notice for more information concerning Form W-8CE.

Section 877A(e)(1)(B) provides that no early distribution tax will apply by reason of the tax imposed by section 877A(e)(1)(A). Section 877A(g)(6) provides that the term "early distribution tax" means any increase in tax imposed under sections 72(t), 220(e)(4), 223(f)(4), 409A(a)(1)(B), 529(c)(6), or 530(d)(4).

Section 877A(e)(1)(C) provides that appropriate adjustments must be made to subsequent distributions to take into account the previously taxed amount under section 877A. Thus, in the case of distributions that are taxable under the rules of section 72, the amount that the covered expatriate includes in gross income pursuant to section 877A(e)(1) will be treated as investment in the contract for purposes of section 72.

Section 877A(e)(2) provides that the term "specified tax deferred account" means an individual retirement plan (as defined in section 7701(a)(37)), a qualified tuition plan (as defined in section 529), a Coverdell education savings account (as defined in

section 530), a health savings account (as defined in section 223), and an Archer MSA (as defined in section 220). However, simplified employee pensions (within the meaning of section 408(k)) and simplified retirement accounts (within the meaning of section 408(p)) of a covered expatriate are treated as deferred compensation items and not as specified tax deferred accounts. See section 5 of this notice for rules pertaining to deferred compensation items.

## **SECTION 7. INTERESTS IN NONGRANTOR TRUSTS**

### **A. In general**

The mark-to-market regime does not apply to any interest in a nongrantor trust. For this purpose, section 877A(f)(3) provides that the term "nongrantor trust" means the portion of any trust, whether domestic or foreign, of which the covered expatriate is not considered the owner under subpart E of Part I of subchapter J, determined as of the day before the expatriation date. Section 877A(f) provides that in the case of any direct or indirect distribution of property (including money) to a covered expatriate from a nongrantor trust of which the covered expatriate was a beneficiary on the day before the expatriation date, the trustee must deduct and withhold from the distribution an amount equal to 30 percent of the taxable portion of the distribution. Section 877A(f)(2) provides that the term "taxable portion" means, with respect to any distribution, the portion of the distribution that would have been includible in the covered expatriate's gross income if the covered expatriate had continued to be subject to tax as a citizen or resident of the United States.

For purposes of determining whether a covered expatriate is a beneficiary of a nongrantor trust on the day before the expatriation date, a beneficiary is a person (a) who is entitled or permitted, under the terms of the trust instrument or applicable local law, to receive a direct or indirect distribution of trust income or corpus (including, for example, a distribution in discharge of an obligation of that person), (b) with the power to apply trust income or corpus for his or her own benefit, or (c) to whom the trust income or corpus could be paid if the trust or the current interests in the trust were then terminated.

If a trust that is a nongrantor trust immediately before the expatriation date subsequently becomes a grantor trust of which the covered expatriate is treated as the owner, directly or indirectly, then the conversion is deemed to be a taxable distribution under section 877A(f)(1) to the covered expatriate to the extent of the portion of the trust of which the covered expatriate is then treated as the owner.

Section 877A(f) does not apply to any distribution from a trust forming part of a plan an interest in which is treated as a deferred compensation item to which section 5 of this notice applies or part of a specified tax deferred account to which section 6 of this notice applies.

#### **B. Recognition of gain by trust**

Section 877A(f)(1)(B) provides that if the fair market value of property distributed from a trust described in section 7.A of this notice exceeds its adjusted basis in the hands of the trust, gain must be recognized to the trust as if such property had been sold to the covered expatriate at its fair market value.

*Example 20.* On Date 1, Trustee of a complex, nongrantor trust, distributes a painting to A, a covered expatriate who was a beneficiary of the trust on the day before A's expatriation date. The painting is a capital asset and has a basis of \$100,000 and a fair market value of \$400,000. The trust is a domestic trust that excludes gains from the sale or exchange of capital assets from its distributable net income (DNI) under section 643(a)(3). On Date 1, the trust is deemed to have recognized capital gain of \$300,000 under section 877A(f)(1)(B). The trust must include the \$300,000 of capital gain in its gross income and may not deduct that amount under section 661 in computing its taxable income under section 641. The trust is taxable on the \$300,000 capital gain (reduced by the applicable exemption amount under section 642(b) and any applicable deductions) and is not required to deduct and withhold any amount pursuant to section 877A(f)(1)(A). A is not taxable on the \$300,000 capital gain.

*Example 21.* The facts are the same as in *Example 20* except that the trust is a foreign trust that includes capital gain in DNI pursuant to section 643(a)(6)(C). Although the trust must include the \$300,000 of capital gain in its gross income, it may deduct that amount under section 661 in computing its taxable income under section 641. If A, now a nonresident alien, had continued to be subject to tax as a citizen or resident of the United States, the capital gain of \$300,000 would have been includible in A's gross income pursuant to section 662. Accordingly, the trust is required to deduct and withhold \$90,000 (30 percent of \$300,000) pursuant to section 877A(f)(1)(A).

### **C. Withholding**

Section 877A(f)(4)(A) provides that rules similar to the rules of section 877A(d)(6) shall apply. Thus, the tax that is imposed by section 877A(f) is imposed under section 871, but the payment is subject to withholding under section 877A(f)(1)(A) and not under section 1441. Any amount due under section 871 that is not paid by means of withholding must be reported on the income tax return filed by the covered expatriate for the relevant taxable year. In addition, rules similar to the rules of section 1461 through 1464 apply. Thus, the trustee, as the person required to deduct and withhold the tax, is liable for such tax as stated under section 1461. The covered expatriate must notify the trustee of his or her covered expatriate status by submitting Form W-8CE to the trustee on the earlier of (1) the day prior to the first distribution on or after the expatriation date

or (2) 30 days after the expatriation date. For more information about Form W-8CE, see section 8 of this notice.

Section 877A(g)(1)(C) provides, in part, that in the case of any covered expatriate who is subject to tax as a citizen or resident of the United States for any period beginning after the expatriation date, such individual will not be treated as a covered expatriate during such period for purposes of the 30 percent withholding tax on the taxable portion of a distribution from a nongrantor trust. Thus, the taxable portion of the distribution would not be subject to tax under section 871, but would be subject to the tax imposed on distributions to a citizen or resident of the United States.

#### **D. Interaction with treaties**

Section 877A(f)(4)(B) provides that a covered expatriate shall be treated as having waived any right to claim any reduction under any treaty with the United States in withholding on any distribution to which section 877A(f)(1)(A) applies unless the covered expatriate agrees to such other treatment as the Secretary determines appropriate. Until further guidance is issued, a covered expatriate may preserve his or her right to claim a treaty benefit with respect to a distribution to which section 877A(f)(1)(A) applies by electing on Form 8854 to be treated as having received the value of his or her interest in the trust as determined for purposes of section 877A, on the day before the expatriation date.

In order to make the election described in the previous paragraph, the covered expatriate must obtain a letter ruling from the IRS as to the value, if ascertainable, of his

or her interest in the trust as of the day before the expatriation date by following the procedures set out in Revenue Procedure 2009-4, 2009-1 I.R.B. 118 (or any subsequent publication that replaces Revenue Procedure 2009-4). Until the trustee receives a copy of the letter ruling from the covered expatriate and a certification signed under penalties of perjury that the tax due on the value of the interest in the trust has been paid to the IRS, the trustee must withhold as provided in section 877A(f)(1). The amount of tax due on the value of the interest in the nongrantor trust as of the day before the expatriation date will be adjusted by the amount of any tax withheld on or after the expatriation date and prior to receipt of the letter ruling. The covered expatriate may not make the election if the IRS determines that his or her interest in the trust does not have an ascertainable value as of the day before the expatriation date.

If the covered expatriate provides the trustee with a copy of the letter ruling and a certification written under penalties of perjury that the tax due on the value of the interest in the trust has been paid to the IRS, then the tax imposed under section 877A(f) with respect to the trust will be deemed to have been fully satisfied. Accordingly, no subsequent distribution from the trust to the covered expatriate will be subject to 30 percent withholding under section 877A(f)(1)(A), and the covered expatriate will not be precluded by section 877A(f)(4)(B) from claiming treaty benefits with respect to any distribution from the trust under the appropriate article of an applicable treaty.



## **SECTION 8. FILING AND REPORTING REQUIREMENTS**

### **A. In general**

*Background.* Section 301(e) of the Act amended section 6039G to impose a requirement on any individual to whom section 877A applies for any taxable year, to provide a statement that includes certain information as provided in section 6039G, including details of the individual's income, assets, and liabilities. The Treasury Department and the IRS intend to issue regulations under section 877A that will require covered expatriates who are liable for tax under section 877A to report certain information in connection with their expatriation. Until the issuance of such regulations, covered expatriates must report information in compliance with the rules set forth in this notice and any other information that the IRS may require.

### **B. Income tax returns**

*Initial filing obligations for the year of expatriation.* A covered expatriate must file a dual-status return if he or she was a U.S. citizen or long-term resident for only part of the taxable year that includes the day before the expatriation date. A dual-status return requires the covered expatriate to file a Form 1040NR with a Form 1040 attached as a schedule. See Treas. Reg. § 1.6012-1(b)(2)(ii)(b), Treas. Reg. § 1.871-13, and chapter 6 of IRS Publication 519 for the requirements for filing a dual-status return. If the covered expatriate's expatriation date is January 1, then he or she will not be required to file a dual-status return.

*Filing obligations for subsequent years.* A covered expatriate must file Form 1040NR in accordance with Treas. Reg. §1.6012-1(b). If the covered expatriate is fully

withheld upon at source for a particular taxable year and has no income effectively connected with the conduct of a trade or business in the United States for that year, then he or she will not be required to file a Form 1040NR for that year. See Treas. Reg. §1.6012-1(b)(2).

### **C. Form 8854**

*Certification of compliance with tax obligations for preceding five years.* All U.S. citizens who relinquish their U.S. citizenship and all long-term residents who cease to be lawful permanent residents of the United States (within the meaning of section 7701(b)(6)) must file Form 8854 in order to certify, under penalties of perjury, that they have been in compliance with all federal tax laws during the five years preceding the year of expatriation. Individuals who fail to make such certification will be treated as covered expatriates within the meaning of section 877A(g) whether or not they also meet the tax liability test or the net worth test. For more information about the tax liability test, the net worth test, and the certification test, see section 2 of this notice.

*Initial waiver of treaty benefits for eligible deferred compensation items and annual reporting requirements.* A covered expatriate who wishes to treat a deferred compensation item as an eligible deferred compensation item must make an irrevocable election on Form 8854 for the taxable year that includes the day before the expatriation date to waive any right to claim any withholding reduction under any treaty with the United States with respect to the eligible deferred compensation item. See section 5.B(2) of this notice. The covered expatriate must make a separate election for each deferred compensation item that he or she wishes to treat as an eligible deferred

compensation item. The covered expatriate must also annually file Form 8854 to certify that no distributions have been received from his or her eligible deferred compensation item(s) or to report the distributions received.

*Interest in a nongrantor trust.* A covered expatriate with any interest in a nongrantor trust on the day before his or her expatriation date must file Form 8854 annually to certify that no distributions have been received or to report the distributions received. However, if a covered expatriate makes an election on Form 8854 to be treated as having received the value of his or her entire interest in the trust as determined for purposes of section 877A (thereby preserving his or her right to claim a treaty benefit with respect to a distribution to which section 877A(f)(1)(A) applies), follows the procedure set forth in section 7.D of this notice for obtaining a letter ruling from the IRS, and pays the tax due, the covered expatriate will not be required to report subsequent distributions with respect to his or her interest in the trust on Form 8854. The election, once made, cannot be revoked except with the consent of the Commissioner.

*Election not to apply in-bound step-up in basis rule.* A covered expatriate who wishes to make an election described in section 3.D of this notice, with respect to assets that the covered expatriate held when he or she first became a resident of the United States, must make the election on Form 8854 for the taxable year that includes the day before the expatriation date.

*Time and manner of filing initial Form 8854.* A covered expatriate must file Form 8854 with the covered expatriate's Form 1040NR or Form 1040, whichever is

applicable, for the covered expatriate's taxable year that includes the day before the expatriation date. A covered expatriate who is required to file Form 8854 for such taxable year will be considered to have timely filed Form 8854 if it is filed by the due date of the original Form 1040NR or Form 1040 (including extensions) for such taxable year. Covered expatriates who are U.S. citizens or long-term residents for only part of the taxable year that includes the day before the expatriation date must file a dual-status return. See section 8.B of this notice.

*Example 22.* A relinquishes his citizenship on December 1, 2009. Under section 877A(a)(1), A is deemed to have sold all of A's property on November 30, 2009, the day before the expatriation date. A must certify on a Form 8854 filed with Form 1040NR for the 2009 taxable year that A has complied with all of A's federal tax obligations for 2004 through 2008. For the portion of the taxable year that includes the day before the expatriation date, A must attach a Form 1040 (or other schedule, as provided in Treas. Reg. § 1.6012-1(b)(2)(ii)(b)) to his Form 1040NR. If A does not file Form 8854, A will be treated as a covered expatriate even if A does not meet the tax liability test or the net worth test.

*Individuals electing to defer the tax imposed by section 877A.* A covered expatriate who makes a deferral election under section 877A(b) and section 3.E of this notice must list all deferral assets on Form 8854 for the taxable year that includes the day before the expatriation date, as well as the amount of deferred tax attributable to each deferral asset, and make an irrevocable election on such Form 8854 to waive any right under any treaty of the United States that would preclude assessment or collection of any tax imposed by reason of section 877A. The covered expatriate also must file Form 8854 annually for taxable years up to and including the taxable year in which the full amount of deferred tax and interest is paid. These annual filings will permit the IRS to monitor compliance with the terms of the covered expatriate's tax deferral agreement.

See section 3.E of this notice for guidance on the types of events that will trigger the payment of the deferred tax. The Form 8854 must be attached to a timely filed Form 1040NR (or, if applicable, Form 1040). If the covered expatriate is not otherwise required to file Form 1040NR (or Form 1040), Form 8854 must be submitted to the address provided in the instructions to the form by the due date (had the covered expatriate otherwise been required to file) of Form 1040NR plus extensions, and must contain such information as required by the instructions to Form 8854.

*2008 tax year.* For purposes of complying with section 877A for the 2008 tax year, Form 8854 and the request for the deferral of tax will be timely filed if these documents are filed by the due date of the return plus extensions (or 30 days after publication of this notice, if later). However, interest will be imposed on tax that is paid after the due date of the return (without regard to extensions granted).

#### **D. Form W-8CE**

A covered expatriate who has a deferred compensation item, a specified tax deferred account, or an interest in a nongrantor trust must file Form W-8CE with the relevant payor on the earlier of (1) the day prior to the first distribution on or after the expatriation date or (2) 30 days after the covered expatriate's expatriation date as defined in section 877A(g)(3)). However, if the expatriation date was prior to the publication date of Form W-8CE, the covered expatriate must file Form W-8CE with the relevant payor on the earlier of (1) the date prior to the first distribution on or after the expatriation date or (2) 30 days after the date of publication of this notice.

*Eligible deferred compensation item.* In the case of an eligible deferred

compensation item described in section 5.B(2) of this notice, Form W-8CE provides notice to the payor that the individual is a covered expatriate who has waived treaty benefits with respect to the eligible deferred compensation item, with the result that taxable payments will be subject to 30 percent withholding under section 877A(d)(1). See section 5.C of this notice.

*Ineligible deferred compensation item.* In the case of an ineligible deferred compensation item described in section 5.B(3) of this notice, Form W-8CE provides notice to the payor that the individual is a covered expatriate who is treated as receiving an amount equal to the present value of his or her accrued benefit on the day before the expatriation date and with respect to which appropriate adjustments must be made to subsequent distributions to reflect the tax imposed by reason of such treatment. See section 5.D of this notice. Within 60 days of receipt of Form W-8CE, the payor must provide a written statement to the covered expatriate setting forth the present value of the covered expatriate's accrued benefit on the day before the expatriation date.

*Specified tax deferred account.* In the case of a specified tax deferred account, Form W-8CE provides notice to the payor that the individual is a covered expatriate who is treated as receiving a distribution of his or her entire interest in the account on the day before his or her expatriation date and with respect to which appropriate adjustments must be made to subsequent distributions to reflect the tax imposed by reason of such treatment. See section 6 of this notice. Within 60 days of receipt of Form W-8CE, the payor must provide a written statement to the covered expatriate setting forth the amount of the covered expatriate's account balance on the day before

the expatriation date.

*Interest in nongrantor trust.* In the case of an interest in a nongrantor trust of which the covered expatriate was a beneficiary on the day before the expatriation date, Form W-8CE provides notice to the trustee that the individual is a covered expatriate. The covered expatriate will be deemed to have waived treaty benefits with respect to future distributions from the trust unless the covered expatriate checks a box on Form W-8CE certifying that he or she will elect on Form 8854 to pay tax currently on the value of his or her interest in the trust as determined for purposes of section 877A and will request a letter ruling from the IRS as to the value of his or her interest in such trust, as provided in section 7.D of this notice. If the box is checked, the trustee must, within 60 days of receipt of Form W-8CE, provide the covered expatriate with the information needed to calculate the value of his or her interest in the trust as of the day before the expatriation date. The covered expatriate will be subject to 30 percent withholding under section 877A(f)(1)(A) on the taxable portion of each distribution from the trust on or after the expatriation date until such time as the trustee receives a copy of the letter ruling and the covered expatriate's certification in writing under penalties of perjury that the tax owed on the value of the interest in the trust has been paid to the IRS. See section 7.D of this notice.

## **SECTION 9. GIFTS OR BEQUESTS**

Gifts or bequests from a covered expatriate on or after June 17, 2008, are subject to a transfer tax under new section 2801. Separate guidance will be issued for U.S. persons who receive gifts or bequests on or after June 17, 2008, from expatriates

who are subject to the rules of this notice. Satisfaction of the reporting and tax obligations for covered gifts or bequests received will be deferred, pending the issuance of guidance. That guidance will provide a reasonable period of time between the issuance of that guidance and the date prescribed for such reporting and tax payments.

### **REQUEST FOR COMMENTS**

The Treasury Department and the IRS invite public comments on the guidance provided in this notice. All materials submitted will be available for public inspection and copying.

Comments may be submitted to Internal Revenue Service, CC:PA:LPD:PR (Notice 2009-85), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Couriers Desk at 1111 Constitution Avenue, NW, Washington, DC 20224, Attn:CC:PA:LPD:PR (Notice 2009-85), Room 5203.

Submissions may also be sent electronically via the internet to the following email address: [Notice.comments@irsounsel.treas.gov](mailto:Notice.comments@irsounsel.treas.gov). Include the notice number (Notice 2009-XX) in the subject line.

### **EFFECTIVE DATE**

Regulations to be issued incorporating the guidance set forth in this notice will apply to individuals whose expatriation date is on or after October 15, 2009. Until such regulations are issued, such individuals may apply the rules described in the notice in their entirety. Individuals whose expatriation date is on or after June 17, 2008, and before October 15, 2009, may apply the rules described in this notice in their entirety.



**DRAFTING INFORMATION**

The principal drafters of this notice are Willard W. Yates and Lara A. Banjanin of the Office of Associate Chief Counsel (International). For further information regarding this notice generally, contact Willard W. Yates or Lara A. Banjanin on (202) 622-3880 (not a toll-free number). For further information regarding deferred compensation items, contact Ilya E. Enkishev on (202) 622-6030 (not a toll-free number).

**PAPERWORK REDUCTION ACT**

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-2123. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The first collection of information requirement in this notice is in section 8 of the notice, as required by section 877A(a)(1). The collection of information relates to the requirement that the covered expatriate obtain the fair market value appraisal of his or her property and report such value to the IRS. This collection of information is necessary for the proper performance of the function of the IRS in the collection of the mark-to-market tax imposed by section 877A(a)(1).

The statement must be attached to the final Form 1040 filed by the covered expatriate setting forth the fair market value of all assets the covered expatriate owns along with the basis of such assets. We estimate that annually approximately 100 taxpayers will expatriate who will be subject to 877A, and that it will take approximately

4 hours to prepare the documentation. The total reporting burden is estimated to be 400 hours.

The second collection requirement in the notice is also in section 8 of the notice, as required by section 877A(b)(4)(B). This collection of information is necessary for the proper performance of the function of the IRS because it notifies the IRS that the covered expatriate is electing to defer a tax that is owed and allows for insuring that the tax owed is eventually paid.

A bond, letter of credit, or adequate security statement must be furnished to the appropriate SBSE Advisory Office by the covered expatriate for each item the covered expatriate wishes to defer the tax. We estimate that annually approximately 10 taxpayers will elect to defer the payment of tax, and that it will take approximately 2 hours to prepare the documentation. The total reporting burden is estimated to be 20 hours.

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

**APPENDIX A****DEPARTMENT OF THE TREASURY – INTERNAL REVENUE SERVICE****AGREEMENT ON DEFERRAL OF TAX  
IMPOSED UNDER I.R.C. § 877A**

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Under § 877A of the Internal Revenue Code of 1986, as amended (“I.R.C.”), the Taxpayer (as identified on the signature page of this agreement by Taxpayer’s name and address) (herein referred to as “Taxpayer”) and the Commissioner of Internal Revenue (the “Commissioner”) enter into the following agreement to defer tax with respect to the property(ies) identified below (this “Agreement”):

**WHEREAS**, I.R.C. § 877A(a) imposes tax on covered expatriates, as defined in I.R.C. § 877A(g), by deeming such individuals to have sold all of their property for its fair market value on the day before their expatriation date (“mark-to-market tax”), as provided in **Notice 2009-85, IRB 2009-45**, and any subsequent guidance, and

**WHEREAS**, I.R.C. § 877A(b) provides that a covered expatriate may make an election to defer payment of the mark-to-market tax imposed on the deemed sale of property, on a property-by-property basis, if adequate security is provided with respect to such property, as provided in **Notice 2009-85, IRB 2009-45**, and any subsequent guidance,

**IT IS HEREBY DETERMINED AND AGREED THAT:**

- (1) Taxpayer is a covered expatriate, as defined in I.R.C. § 877A(g), who renounced (his/her) (U.S. citizenship/ceased to be a lawful permanent resident of the United States) on [date].
- (2) Taxpayer is liable for the tax imposed by I.R.C. § 877A(a) by reason of his/her covered expatriate status.
- (3) By signing this Agreement, Taxpayer consents to the assessment and collection of the liabilities for tax, interest, additions to tax, and penalties determined by or resulting from the determinations of this agreement, waiving all defenses against and restrictions on the assessment and collection of those liabilities including any defense based on the expiration of the period of limitations on assessment or collection.
- (4) Pursuant to I.R.C. § 877A(b), Taxpayer is making an irrevocable election to defer

payment of the mark-to-market tax imposed with respect to the property(ies) identified in an attachment to this Agreement and in an amount reflected on such attachment in accordance with the instructions in section 3.E of [Notice 2009-85, IRB 2009-45](#).

**THEREFORE**, based on the above information and material submitted by the Taxpayer it is determined that:

- (1) Taxpayer has furnished a bond or other security (“collateral”) that is acceptable to the Commissioner, conditioned upon payment of the amount of tax due.
- (2) Interest on the amount of the deferred tax will be charged for the period that payment of the tax is deferred (in other words, from the due date for the payment of the tax, determined without regard to the election, to the date on which payment of such tax is received) at the rate established under I.R.C. § 6621 that is applicable to individual underpayments as computed under I.R.C. § 6622.
- (3) The Commissioner may accept collateral other than a letter of credit or bond in his sole discretion. If the collateral is not a letter of credit or bond, Taxpayer is required to verify to the satisfaction of the Commissioner the existence, location, and value of the collateral.
- (4) If Taxpayer elects to defer the tax and supplies security that the Commissioner determines is not adequate and Taxpayer fails to correct such failure within 30 days of written notice, the tax owed will not be deemed to have been deferred and penalties will be imposed under I.R.C. § 6651(a)(2) for failure to pay the tax owed.
- (5) By signing this agreement, Taxpayer hereby certifies that he/she has irrevocably waived, on Form 8854 (Expatriation Information Statement), any right under any treaty of the United States that would preclude assessment or collection of any tax imposed by reason of I.R.C. § 877A.
- (6) Subject to the provisions of paragraphs 8 through 11 of this Agreement, the time for payment of the additional tax attributable to the property that is the subject of this Agreement shall be extended until the due date of the return for the taxable year in which each such property is disposed of either by sale, gift, disposal in a transaction in which gain is not recognized in whole or in part, or by Taxpayer’s death.
- (7) If any of the tax that is the subject of this Agreement remains unpaid at the time of Taxpayer's death, such tax is due and payable by Taxpayer’s estate no later than the due date of the return for the year of Taxpayer’s death. If such payment is not received by such due date, the collateral will be applied to the tax liability and interest.
- (8) If, in his sole discretion, the Commissioner determines that the collateral provided

with respect to any property that is the subject of this Agreement no longer provides adequate security, and Taxpayer fails to correct such failure within 30 days after the IRS mails notification of such failure to the last known addresses of the covered expatriate and the covered expatriate's agent, the deferred tax and the interest with respect to such property will be immediately due, and this Agreement will be defaulted and the collateral will be applied to the tax liability and interest.

(9) This Agreement shall be effective for [# of years] years from the date it is executed by Taxpayer and the Commissioner. At the expiration of [# of years] years, this Agreement will be terminated and the deferred tax and interest will be immediately due, unless Taxpayer renews this Agreement by providing any amended or replacement collateral that may be required under paragraph 10 of this Agreement and certifying in writing that none of the property that is the subject of this Agreement has been disposed of by sale, gift, disposal in a transaction in which gain is not recognized in whole or in part, or by Taxpayer's death. If this Agreement is renewed, it will remain in effect for another [# of years] years. Taxpayer may continue to renew this Agreement every [# of years].

(10) Ninety days prior to the termination date of this Agreement, the Commissioner will notify Taxpayer that amended or replacement collateral is required to reflect the tax and projected interest in order to renew this Agreement. If amended or replacement collateral is not received by the Commissioner 30 days before the termination date of this Agreement, the collateral will be applied to the tax liability and interest.

(11) In order to renew this Agreement, Taxpayer must ensure such renewal is effected 30 days prior to the stated termination date of this Agreement by complying with the requirements prescribed in paragraphs 9 and 10 of this Agreement. If such a renewal is not received in writing by the Commissioner 30 days prior to the stated termination date of this Agreement, Taxpayer will not be eligible to renew this Agreement and the collateral will be applied to the tax liability and interest.

(12) If Taxpayer does not notify the Commissioner in writing of any change of address within 30 days of such change, this Agreement will be terminated and the collateral will be applied to the tax liability and interest.

(13) As a condition for entering into this Agreement, all returns due from Taxpayer for the five taxable years preceding the taxable year that includes the expatriation date must be timely filed and must be true, accurate, and complete; otherwise this agreement will be null and void.

(14) For all matters pertaining to this Agreement, Taxpayer should contact the following office:

Advisory  
7850 SW 6th Court  
Mail Stop 5780  
Plantation, Florida, 33324-3202  
Telephone: 954-423-7344  
Fax: 954-423-7809

(15) All notices, instructions, and other communications ("Notices") required or permitted to be given, forwarded, or transmitted hereunder shall be in writing and shall be deemed to have been duly given if: (a) within the continental United States, delivered personally or mailed by first class mail (postage prepaid, by registered or certified mail, return receipt requested); (b) outside of the continental United States, sent by a private delivery service designated in Notice 2004-83, 2004-52 I.R.B. 1030 (or any subsequent publication that replaces Notice 2004-83); or (c) regardless of place of origination, sent by cable, telex, telegram or facsimile transmission (e.g., telecopier) subsequently confirmed by letter.

(16) If the Commissioner determines that any material fact represented by Taxpayer is erroneous or inaccurate, the restrictions and obligations imposed on the Commissioner by this Agreement shall be null and void.

(17) This Agreement and all of its terms and conditions shall inure to the benefit of, and be binding upon all parties to the Agreement and their respective successors and assigns.

(18) This Agreement may not be amended, modified, superseded or canceled, and none of the terms hereof may be waived, except by a written instrument executed by the Commissioner, and the other party or parties hereto sought to be charged thereby.

(19) This Agreement shall be governed, construed, and enforced in accordance with the laws of the United States of America.

(20) This Agreement shall not be binding upon any signatory hereto until it has been signed by the Commissioner, and the Commissioner has received counterparts thereof duly executed by each of the signatories whose names appear at the foot of this Agreement.

(21) As a condition for entering into this Agreement, and prior to its execution, Taxpayer must appoint a U.S. person to act as Taxpayer's limited agent for purposes of accepting communication related to this Agreement from the Commissioner on behalf of Taxpayer. This includes, but is not limited to, acting as Taxpayer's limited agent for the timely enforcement of the terms of this Agreement, for applying I.R.C. § 7602 and all related procedural provisions of the I.R.C. with respect to a request by the

Commissioner to examine records, for the production of testimony, or for a summons by the Commissioner for such records or testimony, and for the acceptance of service of process for an enforced collection suit, if necessary. Taxpayer must enter into a binding agreement with the agent, and the authorization under such agreement must remain in effect for as long as this Agreement remains in effect. If the agent resigns, liquidates or terminates its responsibility as Taxpayer's agent, Taxpayer must, within 90 days, notify Advisory at the following address:

Advisory  
 7850 SW 6th Court  
 Mail Stop 5780  
 Plantation FL 33324-3202  
 Telephone: 954-423-7344  
 Fax: 954-423-7809

This notification must contain the name, address, and TIN of the new U.S. agent (if any). If no new agent is appointed, then this Agreement is in default and the collateral will be applied to the deferred tax and interest attributable to all of the deferral assets.

**WHEREAS**, the determinations set forth above are hereby mutually agreed to by Taxpayer and the Commissioner.

**IN WITNESS WHEREOF**, the above parties have subscribed their names to these presents, in triplicate.

\_\_\_\_\_  
 (Name of Taxpayer)

\_\_\_\_\_  
 Date

Taxpayer Identification Number: \_\_\_\_\_

Address in country of residence:

Commissioner of the Internal Revenue Service

By \_\_\_\_\_  
 (Title)

\_\_\_\_\_  
 Date

**APPENDIX B**

AUTHORIZATION OF AGENT

[Name of covered expatriate] hereby expressly authorizes [name of U.S. agent] to act as his or her agent solely for purposes of accepting communication related to the Tax Deferral Agreement from the Internal Revenue Service on behalf of [covered expatriate], the timely enforcement of the terms of the Tax Deferral Agreement between [covered expatriate] and the IRS, and applying section 7602 and all related procedural provisions of the Internal Revenue Code with respect to any request to examine records or produce testimony or with respect to a summons for such records or testimony related to the enforcement of the Tax Deferral Agreement.

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Signature of [covered expatriate] (date)

Type or print your name below

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TIN



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Address

[Name of agent] accepts this appointment to act as agent for [covered expatriate] for the above purpose. I certify that I have the authority to execute this authorization of agent to act on behalf of [covered expatriate] and agree to accept communications and service of process on behalf of [covered expatriate] for the above purposes.

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Signature of agent (date)

Type or print your name below

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TIN

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Address