or, alternatively, via the internet at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

The comments you submit will be available for public inspection and copying.

DRAFTING INFORMATION

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Guidance for Expatriates Under Sections 877, 2501, 2107 and 6039F

Notice 97–19

PURPOSE

The Health Insurance Portability and Accountability Act of 1996 (the ''Act'') recently amended sections 877, 2107 and 2501 of the Internal Revenue Code (''Code''), and added new information reporting requirements under section 6039F.[1] This notice provides guidance regarding certain federal tax consequences under these sections and section 7701(b)(10) for certain individuals who lose U.S. citizenship, cease to be taxed as U.S. lawful permanent residents, or are otherwise subject to tax in the manner provided by section 877.

This notice has eleven sections. Section I provides background regarding the general application of sections 877, 2107 and 2501. Section II explains how to compute tax under section 877. Section III explains how an individual must determine his or her tax liability and net worth for purposes of sections 877, 2107 and 2501. Section IV explains the procedures that an individual must use to request a private letter ruling that the individual's loss of U.S. citizenship did not have for one of its principal purposes the avoidance of U.S. taxes. Section IV also provides that certain former long-term U.S. residents may use this ruling procedure to request a ruling that cessation of long-term U.S. residency did not have for one of its principal purposes the avoidance of U.S. taxes. Section V provides that certain transactions are treated as exchanges of property under section 877 and explains how to enter into a gain recognition agreement to avoid the immediate recognition of gain on exchanges of property. Section VI provides anti-abuse rules that apply to contributions made to certain foreign corporations. Section VII sets forth annual filing requirements for certain individuals subject to section 877. Section VIII explains how new section 877 interacts with certain U.S. income tax treaties. Section IX explains how to file information statements in accordance with section 6039F and describes the information that must be included on such statements. Section X explains how the transition provision of the Act affects certain individuals who performed an expatriating act prior to February 6, 1995. Section XI explains the application of section 7701(b)(10) and how that section interacts with section 877, as amended by the Act.

Treasury and the Service expect to issue regulations under sections 877 and 6039F, and amend regulations under sections 2107 and 2501, to incorporate the guidance set forth in this notice. Until regulations are issued, taxpayers must comply with the guidance set forth in this notice.

SECTION I. GENERAL APPLICATION OF SECTIONS 877, 2107 and 2501

Section 877 generally provides that a citizen who loses U.S. citizenship or a long-term resident who ceases to be taxed as a U.S. resident (collectively, individuals who ''expatriate'') within the 10-year period immediately preceding the close of the taxable year will be taxed on all of his or her U.S. source income (as modified by section 877(d)) for such taxable year, unless such loss or cessation did not have for one of its principal purposes the avoidance of U.S. taxes.

Section 877(a)(2) provides that a former citizen is considered to have lost U.S. citizenship with a principal purpose to avoid U.S. taxes if the former citizen's tax liability or net worth exceeded certain amounts on the date of expatriation. However, a former citizen will not be considered to have expatriated with a principal purpose to avoid U.S. taxes as a result of the individual's tax liability or net worth if he or she qualifies for an exception under section 877(c). To qualify for an exception, a former citizen must be described in certain statutory categories and submit a ruling request for a determination by the Secretary as to whether the individual's expatriation had for one of its principal purposes the avoidance of U.S. taxes. Section 877(c).

Section 2107(a)(1) generally provides that U.S. estate tax will be imposed on the transfer of the taxable estate of every nonresident decedent if, within the 10-year period ending with the date of death, the decedent lost U.S. citizenship, unless such loss did not have for one of its principal purposes the avoidance of U.S. taxes. Unless a former citizen qualifies for an exception as provided by section 877(c), such individual will be considered to have expatriated with a principal purpose to avoid U.S. taxes for purposes of section 2107 if the individual's tax liability or net worth exceeded certain amounts on the date of expatriation. Sections 2107(a)(2)(A) and (a)(2)(B).

Section 2501(a)(1) generally provides that a tax will be imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or nonresident. Section 2501(a)(2) provides that section 2501(a)(1) will not apply to the transfer of intangible property made by a nonresident not a citizen of the United States. Section 2501(a)(3)(A) provides that this exception does not apply in the case of a donor who, within the 10-year period ending with the date of a transfer, lost U.S. citizenship, unless such loss did not have for one of its principal purposes the avoidance of U.S. taxes. Unless a former citizen qualifies for an exception as provided by section 877(c), such individual shall be treated as having a principal purpose to avoid U.S. taxes for purposes of section 2501 if the individual's tax liability or net worth exceeded certain amounts on the date of expatriation. Sections 2501(a)(3)(B) and (a)(3)(C).

Section 877(e) provides comparable treatment for long-term residents. A long-term resident of the United States will be treated as if such resident lost U.S. citizenship for purposes of sections 877, 2107, 2501 and 6039F if the resident (i) ceases to be a lawful permanent resident of the United States, or (ii) commences to be treated as a foreign resident under the provisions of an income tax treaty between the United States and a foreign country and does

[1] There are currently two provisions of the Internal Revenue Code designated as section 6039F. Treasury intends to seek a technical correction to the Act to redesignate section 6039F, as added by the Act, as section 6039G. All subsequent references to section 6039F in this notice relate to section 6039F as contained in the Act.

not waive the benefits of such treaty applicable to residents of the foreign country.

Section 877(e)(1) defines a long-term resident as a non-U.S. citizen who was 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 in which such individual ceases to be a lawful permanent resident of the United States or commences to be treated as a resident of another country under an income tax treaty and does not waive the benefits of such treaty applicable to residents of the foreign country. For purposes of section 877, an individual is considered a lawful permanent resident in a taxable year if he or she is a lawful permanent resident during any portion of that year.

Section 877(e)(3)(B) provides that property held by a long-term resident on the date that such individual first became a resident of the United States (whether or not a lawful permanent resident) shall be treated for purposes of section 877 as having a basis of not less than the fair market value of the property on such date. A long-term resident may elect not to have this treatment apply. Such an election, once made, is irrevocable.

Sections 877, 2107 and 2501, as amended by the Act, apply to individuals who expatriate after February 5, 1995, and to individuals subject to section 511(g)(3)(A) of the Act (see section X of this notice).

SECTION II. COMPUTING TAX UNDER SECTION 877

Individuals who expatriate with a principal purpose to avoid U.S. taxes will be subject to tax on U.S. source income (as modified by section 877(d)) under sections 1, 55 or 402(d)(1)[2] of the Code (the ''alternative tax''), or under section 871 of the Code, depending on which method results in the highest total tax. Sections 877(a)(1) and (b).

An expatriate is subject to the alternative tax under section 877 only if the total tax imposed thereunder on all items of income for the taxable year exceeds the total tax under section 871 for those same items of income. The following example illustrates how to compute tax under section 877.

Example 1. A, a former U.S. citizen, expatriated with a principal purpose to avoid U.S. taxes on December 31, 1996. In 1997, A earns $100,000 of U.S. source dividend income and $50,000 of U.S. source interest income that qualifies as portfolio interest under section 871(h). After taking into account the deductions and credits allowed under section 877(b)(2), A's net tax liability under section 1 on the dividend and portfolio interest income is $40,000.

The tax imposed under section 871 on A's dividend income is $30,000 (30 percent of $100,000). Section 871(a)(1)(A). No tax is imposed on A's portfolio interest under section 871 because section 871(h)(1) exempts portfolio interest received by a nonresident alien from U.S. tax. Thus, A's tax liability under section 871 is $30,000.

Since A's total tax liability computed under section 1 exceeds A's total tax liability computed under section 871, A must pay the higher tax. Thus, A must report $40,000 of U.S. tax on his 1997 U.S. income tax return (Form 1040NR) as a result of section 877.

SECTION III. TAX LIABILITY AND NET WORTH TESTS

Background. Section 877(a)(2) provides that a former citizen is considered to have expatriated with a principal purpose to avoid U.S. taxes if (i) the individual's average annual net U.S. income tax (as defined in section 38(c)(1)) for the five taxable years prior to expatriation is greater than $100,000 (the ''tax liability test''), or (ii) the individual's net worth on the date of expatriation is $500,000 or more (the ''net worth test''). The $100,000 and $500,000 amounts are subject to cost-of-living adjustments determined under section 1(f)(3) for calendar years after 1996. An individual who does not satisfy the tax liability or net worth test, but expatriates with a principal purpose to avoid U.S. taxes, is also subject to section 877.

Section 2107(a)(2)(A) provides that an individual shall be treated as having a principal purpose to avoid U.S. taxes for purposes of section 2107 if such individual satisfies either the tax liability test or the net worth test under section 877(a)(2). Likewise, section 2501(a)(3)(B) provides that an individual shall be treated as having a principal purpose to avoid U.S. taxes for purposes of section 2501 if such individual satisfies either the tax liability test or the net worth test under section 877(a)(2). The tax liability and net worth tests also apply for purposes of determining whether a former long-term resident is subject to sections 877, 2107, and 2501. Section 877(e)(1).

Determination of tax liability. For purposes of the tax liability test, an individual's net U.S. income tax is determined under section 38(c)(1). An individual who files a joint income tax return must take into account the net income tax that is reflected on the joint income tax return for purposes of the tax liability test.

Determination of net worth. For purposes of the net worth test, an individual is considered to own any interest in property that would be taxable as a gift under Chapter 12 of Subtitle B of the Code if the individual were a citizen or resident of the United States who transferred the interest immediately prior to expatriation. For this purpose, the determination of whether a transfer by gift would be taxable under Chapter 12 of Subtitle B of the Code must be determined without regard to sections 2503(b) through (g), 2513, 2522, 2523, and 2524.

An interest in property includes money or other property, regardless of whether it produces any income or gain. In addition, an interest in the right to use property will be treated as an interest in such property. Thus, a nonexclusive license to use property is treated as an interest in the underlying property attributable to the value of the use of such property.

Valuation of interests in property. In determining the values of interests in property for purposes of the net worth test, individuals must use the valuation principles of section 2512 and the regulations thereunder without regard to any prohibitions or restrictions on such interest. Although individuals must use good faith estimates of values, formal appraisals are not required.

Special rules for determining beneficial interests in trusts. An individual's beneficial interest in a trust must be included in the calculation of that individual's net worth. For this purpose, the value of an individual's beneficial interest in a trust will be determined using a two-step process. First, all interests in property held by the trust must be allocated to beneficiaries (or potential beneficiaries) of the trust based on all relevant facts and circumstances, including the terms of the trust instrument, letter of wishes (and any similar document), historical patterns of trust distributions, and any functions performed by a trust protector or similar advisor. Interests in property held by the trust that cannot be allocated based on the factors described in the previous sentence shall

[2] Section 402(d)(1) of the Code generally provides for 5-year income averaging with respect to certain lump-sum distributions from qualified retirement plans. Section 1401(b)(1) of the Small Business Job Protection Act of 1996 amended section 877(b) by striking ''section 1, 55, and section 402(d)(1)'' and inserting ''section 1 or 55.'' This amendment applies to taxable years beginning after December 31, 1999.

be allocated to the beneficiaries of the trust under the principles of intestate succession (determined by reference to the settlor's intestacy) as contained in the Uniform Probate Code, as amended. Second, interests in property held by a trust that are allocated to the expatriate must be valued under the principles of section 2512 and the regulations thereunder without regard to any prohibitions or restrictions on such interest. The following example illustrates this special rule.

Example 2. B, a former long-term resident, expatriated on December 31, 1996. B is a potential beneficiary of two trusts during his lifetime. Trust 1's sole asset is an apartment building. Under the terms of Trust 1, B is entitled to receive 100 percent of the income generated by the apartment building during B's life. B's brother, C, is the remainderman. For purposes of computing B's net worth, Trust 1's interest in the apartment building is allocated between B and C. B is treated as owning a life interest in the apartment building. The value of the life interest must be determined under the principles of section 2512 and the regulations thereunder.

Trust 2 was established by B's father for the benefit of B and C. Under the terms of Trust 2, the trust income and corpus may be distributed at the trustee's discretion to either B or C. For purposes of determining B's net worth, all of the interests in property owned by Trust 2 must first be allocated to either B or C based on all relevant facts and circumstances. If the facts and circumstances do not indicate how the interest in the trust's property should be allocated between B and C, the trust property will be allocated under the rules of intestate succession (determined by reference to B's father's intestacy) as contained in the Uniform Probate Code. If B's father had died intestate, the Uniform Probate Code would have allocated his property equally between B and C. Thus, for purposes of determining B's net worth, B will be treated as owning half of the interests in property owned by Trust 2. The value of these interests in property will be determined under the principles of section 2512.

SECTION IV. RULING REQUESTS

Background. Section 877(c) provides that a former U.S. citizen who satisfies either the tax liability test or the net worth test will not be considered to have a principal purpose of tax avoidance as a result of one of those tests if that former citizen submits a request for a ruling within one year of the date of loss of U.S. citizenship for the Secretary's determination as to whether such loss had for one of its principal purposes the avoidance of U.S. taxes. To be eligible to request a ruling, an individual must be within one of the following categories: (1) the individual became at birth a citizen of the United States and a citizen of another country and continues to be a citizen of such other country, (2) the individual becomes (not later than the close of a reasonable period after loss of U.S. citizenship) a citizen of the country in which the individual, the individual's spouse or one of the individual's parents was born, (3) the individual was present in the United States for no more than 30 days during each year of the 10-year period ending on the date of expatriation, (4) the individual lost U.S. citizenship before reaching age 18 1/2, or (5) the individual is described in a category prescribed by regulation. For purposes of sections 2107 and 2501, a former citizen who meets the requirements of section 877(c)(1) will not be considered to have expatriated with a principal purpose to avoid U.S. taxes. Sections 2107(a)(2)(B) and 2501(a)(3)(C).

Section 877(e)(3)(A) provides that the exception set forth in section 877(c) with respect to U.S. citizens shall not apply to former long-term residents. However, section 877(e)(4) gives the Secretary the authority to exempt categories of former long-term residents from section 877. In addition, section 877(e)(5) authorizes the Secretary to prescribe appropriate regulations to carry out the purposes of section 877(e).

Additional categories of individuals eligible to submit ruling requests. Treasury and the Service expect to issue regulations that will permit a former long-term resident who is within certain categories to request a ruling under sections 877, 2107 and 2501 as to whether the individual's expatriation had for one of its principal purposes the avoidance of U.S. taxes. Until such regulations are issued, a former long-term resident may request a ruling if:

(1) on the date of expatriation, the individual is a citizen of:

(a) the country in which the individual was born,

(b) the country where the individual's spouse was born, or

(c) the country where either of the individual's parents was born, and

the individual becomes (not later than the close of a reasonable period after the individual's expatriation) fully liable to tax in such country by reason of the individual's residence;

(2) the individual was present in the United States for no more than 30 days during each year of the 10-year period prior to expatriation; or

(3) the individual ceases to be taxed as a lawful permanent resident, or commences to be treated as a resident of another country under an income tax treaty and does not waive the benefits of such treaty applicable to residents of the foreign country, before the individual reaches age 18 1/2.

In addition, former long-term residents and former citizens who narrowly fail to satisfy the criteria of an enumerated category may also submit ruling requests. The Secretary, in his or her sole discretion, may decline to rule on any request if the Secretary determines that the individual does not narrowly fail to satisfy the criteria of one of those categories. If the Secretary declines to rule on an individual's ruling request for this reason, the individual will not be considered to have ''submitted'' a ruling request within the meaning of section 877(c)(1)(B). Accordingly, if that individual satisfies either the tax liability or net worth test, the individual will be considered to have expatriated with a principal purpose to avoid U.S. taxes under section 877(a)(2).

Examples. The following examples illustrate circumstances in which an individual narrowly fails to satisfy the criteria of an enumerated category, and thus eligible to request a ruling.

Example 3. D, a former citizen of the United States by birth, expatriated on February 15, 1997. D satisfied the tax liability test on the date of her expatriation and thus, will be considered to have expatriated with a principal purpose to avoid U.S. taxes unless she qualifies for an exception under section 877(c). D has resided in the United Kingdom since 1985. D is not a citizen by birth of another country and does not plan to become a citizen of a country in which one of her parents or her spouse was born. D did not spend any time in the United States during the 10-year period prior to her expatriation, except for one year when she vacationed in Hawaii for 35 days. D narrowly fails to satisfy the criteria of section 877(c)(2)(B) because she spent only 35 days in the United States during one year of the 10-year period ending on the date of her expatriation. Thus, D is eligible to submit a ruling request.

Example 4. E is a citizen of France and a long-term resident of the United States. E's parents emigrated from Africa to France in 1950 and acquired French citizenship in 1960. E's parents were employed by the French government and often travelled outside of France. In 1965, E was born while E's parents were stationed outside of France on a short-term assignment. By virtue of his parents' French citizenship, E became a citizen of France at birth. E resided in France from age 1 until age 21. E became a lawful permanent resident of the United States at age 21. E is now 31 years old and wishes to relinquish his green card and return to France. E will satisfy the net worth test on the date of his expatriation.

Although E is not a citizen of France by virtue of being born in France, E narrowly fails to satisfy the criteria of an enumerated category because he was born outside of France only because his parents were temporarily absent from France during an overseas assignment for the French government. E is a citizen of France by birth, became a resident of France at age 1, and plans to become a

resident of France after terminating his U.S. residency. Thus, E is eligible to submit a ruling request.

Effect of rulings and pending ruling requests. An expatriate who satisfies the tax liability or net worth test will be subject to new sections 877, 2107 or 2501, unless such individual obtains a favorable ruling, rather than merely submits a request, that the individual did not expatriate with a principal purpose to avoid U.S. taxes. If an individual's ruling request is pending before the Service at the time prescribed for filing the individual's income tax return for a particular year, the individual must report income on his or her U.S. income tax return for that year as if section 877 applied to him or her. If the individual obtains a favorable ruling at a later date, the individual may then amend that previous year's U.S. income tax return accordingly.

Challenging an adverse ruling. An individual who obtains an adverse ruling may challenge the ruling by initiating a refund suit to recover any taxes paid by reason of section 877. See H.R. Conf. Rep. No. 736, 104th Cong., 2d Sess. 325 (1996).

Time for submitting ruling requests. Ruling requests must be submitted no later than one year following the date of expatriation. If an individual does not submit a ruling request within this prescribed period and satisfies either the tax liability test or the net worth test, such individual will be treated as having a principal purpose to avoid U.S. taxes. However, an individual subject to new section 877 who expatriated after February 5, 1994, but on or before July 8, 1996, and who wishes to submit a ruling request as to whether such expatriation had for one of its principal purposes the avoidance of U.S. taxes must do so by July 8, 1997.

Ruling requests may be submitted prior to the expected date of expatriation, provided that the individual submitting the request has formed a definite intention to expatriate. The Service will not rule on requests involving alternative plans of proposed transactions or hypothetical situations. See section 7.02 of Rev. Proc. 97–1, 1997–1 I.R.B. 11, 24.

Procedures for submitting ruling requests. Individuals should refer to section 8 of Rev. Proc. 97–1, 1997–1 I.R.B. 11, 25, for general instructions on the proper procedures to follow when submitting ruling requests. Individuals should also consult section 15 of Rev. Proc. 97–1, 1997–1 I.R.B. 11, 46, for information on user fees.

Information that must be included in ruling requests. The burden of proof is on the individual requesting the ruling to establish to the satisfaction of the Secretary that the individual's expatriation did not (or will not) have for one of its principal purposes the avoidance of U.S. taxes under Subtitle A or Subtitle B of the Code. Therefore, individuals should submit any relevant information that will help the Secretary make a determination as to whether the individual's expatriation (or planned expatriation) had (or will have) for one of its principal purposes the avoidance of U.S. taxes. The ruling request must include the following information:

(1) the date (or expected date) of expatriation;

(2) a full explanation of the individual's reasons for expatriating;

(3) the individual's date of birth;

(4) all foreign countries where the individual is a resident for tax purposes and/or intends to obtain residence for tax purposes;

(5) all foreign countries of which the individual is a citizen and/or intends to acquire citizenship after expatriation;

(6) the countries where the individual's spouse (if any) and parents were born;

(7) a description of the individual's ties to the United States and the individual's ties to the foreign country where the individual resides (or intends to reside) for the period that begins five years prior to expatriation and ends on the date that the ruling request is submitted, including the location of the individual's permanent home, tax home (within the meaning of section 911(d)(3)), family and social relations, occupation(s), political, cultural, or other activities, business activities, personal belongings, the place from which the individual administers property, the jurisdiction in which the individual holds a driver's license, the location where the individual conducts routine personal banking activities, the location of the individual's cemetery plot (if any), and any other similar information;

(8) a balance sheet, at fair market value, that sets forth by category (e.g., cash, marketable securities, closely-held stock, business assets, qualified and nonqualified deferred compensation arrangements, individual retirement accounts, installment obligations, U.S. real property, foreign real property, etc.) the individual's assets and liabilities immediately prior to expatriation. The balance sheet must also set forth the following:

(i) the source of income and gain, without applying the source provisions of section 877, that such property would have generated during the 5-year period prior to expatriation and immediately after expatriation,

(ii) the source of income and gain, assuming that the source provisions of section 877 applied (as modified by section V of this notice), that such property would have generated during the 5-year period prior to expatriation and immediately after expatriation, and

(iii) the gain or loss that would be realized if the assets were sold for their fair market values on the date of expatriation.

The individual must separately list (not by category) each partnership in which the individual holds an interest, each trust that the individual is considered to own under sections 671 through 679, each trust that the individual is considered to own under Chapter 12 of Subtitle B of the Code, and each trust in which the individual holds a beneficial interest (as determined under the procedures described in section III of this notice). The individual must also describe the types of assets held by each partnership or trust, and indicate the methodology (as described in section III of this notice) used to determine the individual's beneficial interest in each trust. In addition, the individual should indicate whether there have been (or are expected to be) significant changes in the individual's assets and liabilities for the period that began five years prior to expatriation and ends ten years following the date of expatriation. If so, the individual should attach a statement explaining the changes in the individual's assets and liabilities during such period;

(9) a description of all exchanges described in section 877(d)(2)(B) and all removals of appreciated tangible personal property from the United States (as described in section V of this notice), that:

(i) occurred at any time beginning 5 years prior to expatriation (but not including exchanges that took place prior to February 6, 1995) and ending on the date that the ruling request is submitted, or

(ii) occurred, or are expected to occur, during the 10-year period following expatriation.

If the individual is subject to new section 877 because of section 511(g)(3)(A) of the Act (see section X

of this notice), the individual must also include a description of all exchanges described under section 877(d)(2)(B) that occurred on or after the date of the individual's expatriating act (see section X of this notice) and before February 6, 1995;

(10) a description of all occurrences under section 877(d)(2)(E)(ii) that are treated as exchanges under section 877(d)(2) (as described in section V of this notice) that:

(i) occurred at any time beginning 5 years prior to expatriation (but not including occurrences that took place prior to February 24, 1997) and ending on the date that the ruling request is submitted, or

(ii) occurred, or are expected to occur, during the 10-year period following expatriation;

(11) a statement describing the nature and status of any ongoing audits, disputes or other matters pending before the Internal Revenue Service;

(12) a statement as to whether the individual satisfied his or her U.S. tax liability during the period that he or she was a U.S. citizen or lawful permanent resident of the United States;

(13) copies of the individual's U.S. tax returns for each of the three years prior to expatriation;

(14) a copy of the information statement filed in accordance with section 6039F, as described in section IX of this notice (if such statement has not yet been filed, provide a draft copy of such statement);

(15) in the case of an individual with gross assets that have an aggregate fair market value in excess of $10,000,000, a calculation of the individual's projected U.S. and foreign income tax liability for the taxable year of expatriation (or expected expatriation) and the two taxable years following expatriation under each of the following circumstances:

(i) if it is determined that the individual expatriated with a principal purpose to avoid U.S. taxes under section 877,

(ii) if it is determined that the individual did not expatriate with a principal purpose to avoid U.S. taxes under section 877, and

(iii) if the individual had remained a U.S. citizen or U.S. lawful permanent resident.

The individual must also indicate whether the individual expects a substantial change in the individual's projected U.S. and foreign income tax liability as a result of a change in income for the remainder of the 10-year period following expatriation;

(16) in the case of an individual with gross assets that have an aggregate fair market value in excess of $10,000,000, an actuarial estimate of U.S. and foreign estate and other death taxes that would be owed on the individual's property, calculated based on the assumption that the individual owns the same property on the date of death that the individual owned (or expects to own) on the date of expatriation, under each of the following circumstances:

(i) if it is determined that the individual expatriated with a principal purpose to avoid U.S. taxes under section 2107,

(ii) if it is determined that the individual did not expatriate with a principal purpose to avoid U.S. taxes under section 2107, and

(iii) if the individual had remained a U.S. citizen or U.S. lawful permanent resident domiciled in the United States; and

(17) in the case of an individual with gross assets that have an aggregate fair market value in excess of $10,000,000, a statement as to whether the individual expects to make a gift during any year of the 10-year period following expatriation that would be subject to tax under section 2501 if the individual is determined to have expatriated with a principal purpose to avoid U.S. taxes. If so, the individual should describe the gift, provide an estimate of its fair market value, and indicate when and to whom the individual expects to make the gift.

The foregoing list of information must be provided with ruling requests submitted after March 10, 1997. Although individuals must provide good faith estimates of fair market values, formal appraisals are not required. In processing ruling requests, the Service may ask individuals with gross assets that have an aggregate fair market value of $10,000,000 or less to supply the information described in (15), (16) and (17) above. If an individual fails to provide the aforementioned information or any other information that may be reasonably required, the individual's ruling request may be closed pursuant to section 10.06(3) of Rev. Proc. 97–1, 1997–1 I.R.B. 11, 39. If an individual's ruling request is closed, that individual will not be considered to have ''submitted'' a ruling request within the meaning of section 877(c)(1)(B). Accordingly, if that individual satisfies either the tax liability test or the net worth test, the individual will be considered to have expatriated with a principal purpose to avoid U.S. taxes under section 877(a)(2).

Finally, an individual must attach his or her ruling to the individual's U.S. income tax return for the year in which the individual expatriates. See section 8.05 of Rev. Proc. 97–1, 1997–1 I.R.B. 11, 33. If the individual has already filed a U.S. income tax return for such year, the individual must attach the ruling to the individual's U.S. income tax return for the year in which he or she obtains the ruling.

SECTION V. EXCHANGES AND GAIN RECOGNITION AGREEMENTS

Background. Section 877(d)(1)(A) provides that gains on the sale or exchange of property (other than stock or debt obligations) located in the United States shall be treated as from sources within the United States. Section 877(d)(1)(B) provides that gains on the sale or exchange of stock issued by a domestic corporation or debt obligations of United States persons, or of the United States, a State, a political subdivision thereof, or the District of Columbia, shall be treated as from sources within the United States. Section 877(d)(1)(C) provides that income or gain derived from a foreign corporation will be from sources within the United States if an expatriate owned or is considered to own (under the principles of sections 958(a) and (b)), at any time during the 2-year period ending on the date of expatriation, more than 50 percent of (i) the total combined voting power of all classes of stock entitled to vote of such corporation, or (ii) the total value of the stock of such corporation. The amount of income or gain that is considered U.S. source is limited, however, to the amount that does not exceed the earnings and profits attributable to such stock earned before the date of the individual's expatriation and during periods that the ownership requirements are met.

Section 877(d)(2) generally provides that certain property transferred in nonrecognition exchanges by an individual subject to section 877 during the 10-year period referred to in section 877(a) will be treated as sold for its fair market value on the date of the exchange. Thus, any gain must be recognized by the individual in the taxable year of the exchange. Section 877(d)(2) applies to

exchanges that, without regard to section 877, are nontaxable under subtitle A of the Code and involve the exchange of property that would produce U.S. source income or gain for property that would produce foreign source income or gain.

Under section 877(d)(2)(C), however, an individual is not required to immediately recognize gain if the individual enters into an agreement with the Secretary specifying that any income or gain derived from the property acquired in the exchange (or any other property that has a basis determined in whole or in part by reference to such property) during the 10-year period referred to in section 877(a) shall be treated as U.S. source income. In addition, if the transferred property is disposed of by the acquiror, the gain recognition agreement will terminate and any gain not recognized by reason of the agreement must be recognized by the individual as of the date of such disposition.

Section 877(d)(2)(D) provides the Secretary with regulatory authority to substitute the 15-year period beginning five years prior to expatriation for the 10-year period referred to in section 877(a), and to apply section 877(d)(2) to all exchanges that occur during such 15-year period. Section 877(d)(2)(E) also authorizes the Secretary to issue regulations to treat as a taxable exchange the removal of appreciated tangible personal property from the United States, and any other occurrence that results in a change in the source of income or gain from property from U.S. source to foreign source without recognition of gain.

Fifteen-year period and expanded definition of "exchanges". Treasury and the Service expect to issue regulations under sections 877(d)(2)(D) and (E) that extend the 10-year period referred to section 877(a) and provide an expanded definition of exchanges. The regulations will apply to individuals who expatriate after February 5, 1995, and to individuals subject to section 511(g)(3)(A) of the Act (see section X of this notice). Until regulations are issued, taxpayers must comply with the rules set forth below.

Section 877(d)(2) must be applied by substituting the 15-year period beginning five years prior to expatriation for the 10-year period referred to in section 877(a). In addition, removal of appreciated tangible personal property from the United States with an aggregate fair market value in excess of $250,000 within this 15-year period must be treated as an exchange to which section 877(d)(2) applies. Accordingly, any gain derived from removal of property with an aggregate fair market value of $250,000 or less during this 15-year period will not be taxable under section 877. If an individual removes property with an aggregate fair market value in excess of $250,000 during this 15-year period, the individual must recognize a pro rata portion of the gain attributable to the value in excess of $250,000, unless he or she enters into a gain recognition agreement. A pro rata portion of the gain must be calculated by multiplying the total gain on the removed property by a fraction, the numerator of which is the excess of the aggregate fair market values of all removed property over $250,000 and the denominator of which is the aggregate fair market values of all removed property. Removal of appreciated tangible personal property during the 5-year period prior to expatriation (whether or not the fair market values exceed $250,000) will not be treated as an exchange if the removal occurred prior to February 6, 1995.

Any other occurrence (within the meaning of section 877(d)(2)(E)(ii)) within the 15-year period that results in a change of the source of income or gain from U.S. source to foreign source must also be treated as an exchange to which section 877(d)(2) applies. However, an occurrence during the 5-year period prior to expatriation will not be treated as an exchange if the occurrence took place prior to February 24, 1997.

Determination of source of certain gains. The principles of section 877(d)(1) generally apply for purposes of determining whether any exchange of property changes the source of income or gain from U.S. source to foreign source during the 15-year period beginning five years prior to expatriation. Thus, solely for purposes of determining the source of the expatriate's income or gain with respect to any exchange within this 15-year period, (i) the source of any gain on the sale or exchange of tangible personal property will be based on the physical location of the property, (ii) the source of gain from the sale or exchange of stock will be based on the corporation's place of incorporation (except as otherwise provided in section 877(d)(1)(C)), and (iii) the source of gain from the sale or exchange of debt obligations will be based on the residence of the issuer of such obligations. The source of gain on the sale or exchange of an interest in a partnership during the 15-year period will be determined as if the partner directly disposed of his or her share of the partnership's assets. In determining the partner's share of gain recognized from each partnership asset, the gain on the sale or exchange of the partnership interest shall be allocated among the assets of the partnership in proportion to the gain that the partner would have recognized had the partnership sold each asset for its fair market value. In all other cases, the source of an expatriate's income or gain with respect to any other transaction will be determined under the general source provisions of the Code (e.g., sections 861 through 865).

Recognition of gain. Except as otherwise indicated below, an individual must recognize any realized or unrealized gains, but not losses, as a result of any ''exchange'' described in section 877(d)(2)(B), (d)(2)(E)(i), or (d)(2)(E)-(ii), in the year of the exchange unless that individual enters into a gain recognition agreement. If an exchange occurs during the 5-year period prior to expatriation, the individual must recognize any gain from the exchange in the taxable year of the individual's expatriation unless the individual enters into a gain recognition agreement.

Examples. The following examples illustrate transactions that are treated as exchanges under section 877(d)(2) and when gain from such transactions must be recognized.

Example 5. F, a U.S. citizen by birth, enters into a notional principal contract in March 1997. Under the terms of that contract, F is obligated to make specified annual payments to an unrelated party in exchange for specified annual payments from the unrelated party for a period of five years. F is a calendar year taxpayer who uses the cash method of accounting. F moves her tax home to a foreign country in May 1997. F renounces her U.S. citizenship in 1998 with a principal purpose to avoid U.S. taxes.

The source of income from a notional principal contract is generally determined by reference to the residence of the taxpayer. For this purpose, the residence of an individual is the country in which the individual's tax home is located. See Treas. Reg. § 1.863–7(a)(1).

Before F changed her tax home in May 1997, F's income earned under the contract was treated as U.S. source income. After F changed her tax home, the source of this income became foreign source. Because F's change in tax home changed the source of her income from U.S. source to foreign source, it is an occurrence that is treated as an exchange to which section 877(d)(2) applies. Since this occurrence occurred in the 5-year period prior to her expatriation, F must recognize any gain from the contract in 1998 (the taxable year of her expatriation), unless she enters into a gain recognition agreement.

However, if F also owned stock in a foreign corporation, her change in tax home coupled with her expatriation would not be an occurrence that is

treated as an exchange to which section 877(d)(2) applies with respect to such stock. Pursuant to the special source rules described in this notice, the source of gain on the sale or exchange of stock is based on the corporation's place of incorporation. Thus, the gain on the sale or exchange of foreign stock would be foreign source for the entire 15-year period beginning five years prior to expatriation. Accordingly, there would not be an occurrence during this period that would change the source of such gain from U.S. source to foreign source.

Example 6. G is a U.S. citizen by birth. G owns a home in the United States that he uses as his principal residence. In April 1997, G sells his principal residence in the United States at a gain of $1,000,000. In June 1997, G purchases a new principal residence located abroad. G's purchase of the new residence satisfies the requirements of section 1034, and thus G does not recognize the $1,000,000 gain on the sale of his old residence. G expatriates in 1999 with a principal purpose to avoid U.S. taxes.

Under section 861(a)(5), gain from the disposition of a United States real property interest is treated as U.S. source income. A United States real property interest includes real property that is located in the United States. Section 897(c). Gain from the sale or exchange of real property located outside the United States is considered foreign source income. Section 862(a)(5).

Since G is not required to recognize the gain on the sale of his old residence by reason of section 1034, and the source of this gain would change from U.S. to foreign if G sold his new residence, it is an occurrence that is treated as an exchange to which section 877(d)(2) applies. Accordingly, G must recognize the gain from the sale of his old residence in 1999 (the taxable year of his expatriation), unless he enters into a gain recognition agreement.

Example 7. H is a former long-term resident of the United States. H owns a valuable painting that she purchased in 1965 for $500,000. H became a resident of the United States and brought the painting to the United States in 1975. The fair market value of the painting in 1975 was $2,000,000. H became a lawful permanent resident of the United States in 1980. On January 1, 1996, H expatriates with a principal purpose to avoid U.S. taxes. On January 1, 1997, H removes the painting from the United States. On that date, the fair market value of the painting is $5,000,000.

Under section 877(d)(1)(A), H's unrealized gain in the painting is U.S. source so long as the painting is located in the United States. Since the removal of H's appreciated painting from the United States changed the source of the unrealized gain thereon from U.S. source to foreign source, it is considered an exchange to which section 877(d)(2) applies. For purposes of section 877, H's basis in the painting is the painting's fair market value on the date that H first became a U.S. resident (i.e., $2,000,000). Section 877(e)(3)(B). Thus, H's unrealized gain on the painting on the date of removal is $3,000,000 ($5,000,000–$2,000,000).

Because the value of H's painting on the date of removal exceeds $250,000, H must recognize a pro rata portion of the gain attributable to the value in excess of $250,000, unless she enters into a gain recognition agreement. The pro rata portion of such gain is $2,850,000, determined by multiplying the total gain ($3,000,000) by a fraction, the numerator of which is the excess of the fair market value of the painting over $250,000 ($4,750,000) and the denominator of which is the fair market value of the painting ($5,000,000). Thus, H must recognize $2,850,000 in 1997 (the taxable year of the removal) unless she enters into a gain recognition agreement.

Example 8. J, a U.S. citizen by birth, expatriates on January 1, 1999, with a principal purpose to avoid U.S. taxes. On the date of J's expatriation, J owns appreciated stock in a domestic corporation. On January 1, 2000, J creates a foreign trust, FT, and contributes the stock to FT. Under the terms of the trust instrument, the income and corpus from FT may be distributed at the discretion of the trustee to J, J's spouse, or J's children.

If J had directly disposed of the domestic stock instead of contributing it to FT, the gain realized thereon would be treated as U.S. source income. Section 877(d)(1)(B). However, if FT disposed of the stock, the gain realized would be foreign source because FT is not a resident of the United States. See sections 865(a)(2) and (g)(1)(B). If FT then distributed the proceeds to J, his gain would also be foreign source.

Since J's contribution of the domestic stock to FT is nontaxable under subtitle A of the Code and changed the source of gain on the stock from U.S. to foreign, it is an occurrence that is treated as an exchange to which section 877(d)(2) applies. For this purpose, J's beneficial interest in FT is treated as property acquired in the exchange, and the stock contributed to FT is treated as property transferred in the exchange. Therefore, J must recognize the pre-contribution gain on the appreciated stock in 2000 (the taxable year of the exchange), unless he enters into a gain recognition agreement.

Guidance on gain recognition agreements. An individual who wishes to enter into a gain recognition agreement with the Secretary with respect to any exchange described in section 877(d)(2) must submit the agreement with the individual's U.S. income tax return (normally Form 1040NR) for the taxable year of the exchange. If an exchange occurred during the 5-year period prior to expatriation, the individual must submit a gain recognition agreement with his or her U.S. income tax return for the taxable year of the individual's expatriation. If an exchange occurred before the individual's 1996 taxable year, the individual must submit a gain recognition agreement with his or her 1996 Form 1040NR to avoid the recognition of gain.

The gain recognition agreement will be triggered if the individual disposes of the property to which the gain recognition agreement applies. In addition, any disposition of the transferred property by the acquiror of such property will also trigger gain, even if the disposition is otherwise part of a nonrecognition transaction. For purposes of the gain recognition agreement, property removed from the United States and property the source of income or gain from which changed from U.S. to foreign will be treated as property acquired in an exchange.

All gain recognition agreements must be signed under penalties of perjury and set forth the following information:

(1) a description of all property subject to the agreement, (i.e., a description of property both transferred and acquired in an exchange, a description of any appreciated tangible personal property that was removed from the United States, and/or a description of all property affected by an occurrence that changed the source of income or gain from the property from U.S. source to foreign source);

(2) a good faith estimate of the relevant fair market values of the property transferred and acquired in the exchange (formal appraisals are not required), their adjusted basis for U.S. tax purposes, and a calculation of the gain not recognized by reason of the gain recognition agreement (the ''deferred gain'') on a property-by-property basis;

(3) a statement that the individual agrees to recognize, under section 877, any income or gain during the 15-year period that begins five years prior to expatriation as U.S. source income if it is derived from property that was acquired in an exchange (as described in this notice);

(4) a statement that the individual agrees to recognize, under section 877, a proportionate amount of the deferred gain as U.S. source income as of the date of disposition if the acquiror of the transferred property disposes of all or a portion of the property in any manner during the 15-year period beginning five years prior to expatriation;

(5) a statement that the individual agrees to file a U.S. income tax return (normally Form 1040NR) for each year of the 10-year period following expatriation (whether or not such individual is otherwise required to file a return) that includes an annual certification each year describing any income or gain that is taxable pursuant to the gain recognition agreement. If the individual did not derive any income or gain that is taxable pursuant to the gain recognition agreement, the certification must provide a statement to that effect;

(6) if an exchange to which the gain recognition agreement applies occurred during the 5-year period prior to expatriation, a certification describing any income or gain during this 5-year period that is taxable pursuant to the gain recognition agreement. If the individual did not derive any income or gain that is taxable pursuant to the gain recogni-

tion agreement during this period, the certification must provide a statement to that effect;

(7) a representation that all records relating to the property to which the gain recognition agreement applies, including those of the acquiror (if any), will be made available for inspection by the Service during the period that ends 3 years from the date on which a U.S. income tax return is filed for the year(s) in which any income or gain that is taxable pursuant to the gain recognition agreement is recognized;

(8) a statement that the individual agrees to furnish a bond or other security that satisfies the requirements of Treas. Reg. § 301.7701–1 if the District Director determines that such security is necessary to ensure the payment of tax upon the deferred gain and any other income or gain that is taxable pursuant to the gain recognition agreement; and

(9) if applicable, the name, address, and U.S. taxpayer identification number (if any) of the acquiror of any property subject to the agreement.

If, during the period that the agreement is in force, the individual disposes of the property acquired in the exchange in a transaction in which gain or loss is not recognized under U.S. income tax principles, then the individual shall not be required to recognize gain, provided that the individual notifies the Secretary of the transfer with his or her next annual certification and modifies the gain recognition agreement accordingly.

Example. The following example illustrates how to enter into a gain recognition agreement.

Example 9. Assume the same facts as in example 8 above. To avoid the immediate recognition of gain on the contribution of stock to FT, J must attach a gain recognition agreement to his U.S. tax return for the year 2000 (the taxable year of the exchange). As part of such agreement, J must agree to recognize any income or gain that J derives from his beneficial interest in FT as U.S. source income during the remainder of the 10-year period following expatriation. J must also agree to recognize the pre-contribution gain on the transferred stock as U.S. source income if FT directly or indirectly disposes of the stock. In addition, J must agree to file an annual certification for each year of the remaining 10-year period following expatriation that indicates whether J derived any income or gain from his beneficial interest in FT and whether FT disposed of the stock. J must represent that all records relating to the transferred stock, including the trust's records, will be made available for inspection by the Service for the period ending 3 years from the date on which J files a U.S. income tax return for the year in which he recognizes the deferred gain as a result of a direct or indirect disposition of the stock by FT. J must also represent that all records relating to his beneficial interest in FT will be made available for inspection by the Service for the period ending 3 years from the date(s) on which J files a U.S. income tax return for the year(s) in which he recognizes any income or gain from his beneficial interest in FT.

SECTION VI. CONTRIBUTIONS TO CONTROLLED FOREIGN CORPORATIONS

Background. Section 877(d)(4) generally provides that when an expatriate contributes U.S. source property (''contributed property'') to a corporation that would be a controlled foreign corporation (as defined in section 957) and the individual would be a United States shareholder (as defined in section 951(b)) but for the individual's expatriation, then any income or gain on such property (or any other property that has a basis determined in whole or in part by reference to such property) received or accrued by the corporation during the 10-year period following expatriation shall be treated as received or accrued directly by the individual and not by the corporation. If the individual disposes of any stock in the corporation (or other stock that has a basis determined in whole or part by reference to such stock) during the 10-year period referred to in section 877(a) and while the contributed property is held by the corporation, the individual is taxable on the gain that would have been recognized by the corporation had it sold a pro rata share of the property (determined by comparing the value of the stock disposed of to the value of the stock held by the individual immediately prior to the disposition) immediately before the disposition. Section 877(d)(4)(D) provides that the Secretary may prescribe such regulations as may be necessary to prevent the avoidance of the purposes of section 877(d)(4), including where the property is sold to the corporation and where the contributed property is sold by the corporation. Section 877(d)(4)(E) provides that the Secretary shall require such information reporting as is necessary to carry out the purposes of section 877(d)(4).

Anti-abuse rules and reporting requirement. Treasury and the Service intend to issue regulations under sections 877(d)(4)(D) and (E) that extend the 10-year period referred to in section 877(d)(4), set forth reporting requirements, and provide anti-abuse rules intended to prevent individuals from utilizing controlled foreign corporations to hold or dispose of property that would otherwise produce income or gain from sources within the United States. The regulations will provide that if an individual acts with a principal purpose to avoid section 877(d)(4), then the Commissioner may redetermine the U.S. tax consequences of that action as appropriate to achieve the purposes of section 877(d)(4). The regulations will apply to individuals who expatriate after February 5, 1995, and to individuals subject to section 511(g)(3)(A) of the Act (see section X of this notice).

Until regulations are issued, individuals must comply with the rules set forth below. Individuals must apply section 877(d)(4) by substituting the 15-year period beginning five years prior to expatriation for the 10-year period referred to in section 877(d)(4). However, section 877(d)(4) will not apply to any contribution during the 5-year period prior to expatriation if the contribution occurred prior to February 24, 1997.

Moreover, an individual who makes a contribution described in section 877(d)(4)(A)(i) must attach the following information to the individual's U.S. tax return for the year in which such contribution occurs (whether or not the individual is otherwise required to file a U.S. tax return):

(1) the date of the contribution;

(2) a description of the property contributed, including a good faith estimate of its fair market value (formal appraisals are not required) and a statement of its adjusted basis for U.S. tax purposes on the date of the contribution;

(3) a description of the foreign corporation to which the property is contributed, including its name, address, place of incorporation, and its U.S. employer identification number, if any; and

(4) a description of the percentage interest, by vote and by value, owned or treated as owned by the individual under section 958 (determined as if such individual were a U.S. person).

If a contribution occurs prior to expatriation, this statement must be attached to the individual's U.S. income tax return for the taxable year of the individual's expatriation. If a contribution occurred prior to 1996, the individual must attach this statement to the individual's 1996 U.S. tax return (whether or not the individual is otherwise required to file a U.S. tax return).

SECTION VII. ANNUAL INFORMATION REPORTING

Background. Section 6001 generally provides that the Secretary may require any person, by notice upon such person

or by regulations, to make such returns, render such statements, or keep such records as the Secretary deems sufficient to show whether or not the person is liable for tax under the Code. Section 6011(a) generally provides that any person who is liable for tax imposed by the Code, or with respect to the collection thereof, shall make a return or statement according to forms and regulations prescribed by the Secretary. Section 6012(a)(1) generally provides that every individual whose gross income for the taxable year equals or exceeds the exemption amount must file a U.S. income tax return for such year. Section 6012(a)(1) further provides, in part, that nonresident individuals subject to tax imposed by section 871 may be exempted from making returns under section 6012 subject to conditions, limitations, and exceptions and under such regulations as may be prescribed by the Secretary. Treas. Reg. § 1.6012–1(b)(2)(i) generally provides, in part, that a nonresident alien individual who was not engaged in a trade or business in the United States during a taxable year is not required to file a return for such year if the nonresident's tax liability for the year is fully satisfied by the withholding of tax at the source under Chapter 3 of the Code.

Section 874(a) generally provides that a nonresident alien individual will receive the benefit of deductions and credits allowed to him by Subtitle A of the Code only if such individual files a true and accurate return, including all the information that the Secretary may deem necessary for the calculation of such deductions and credits.

Annual reporting of income. Because an individual who is liable for U.S. taxes is generally required to file a return and other such statements as the Secretary may prescribe, Treasury and the Service intend to issue regulations under section 877 that will require expatriates who are liable for tax to annually report certain information for the 10-year period following expatriation. Until the issuance of such regulations, taxpayers must report information in compliance with the rules set forth below and any other information that the Secretary may require at a later date. At such time that Form 1040NR is modified to reflect the rules described below, taxpayers must report information in accordance with the instructions to Form 1040NR instead of the procedures described below. The rules below apply to expatriates who are subject to section 877 as in effect before the Act, as well as those subject to section 877 as revised by the Act.

Beginning with the 1996 taxable year, an individual who expatriated with a principal purpose to avoid U.S. taxes under section 877 as in effect before the Act must annually file a U.S. income tax return (Form 1040NR), with the information described below, for each year of the remaining 10-year period following expatriation if such individual is liable for U.S. tax under any provision of the Code (e.g., section 871(a)) for such year. An individual who expatriated with a principal purpose to avoid U.S. taxes under section 877 as amended by the Act must also annually file a U.S. income tax return (Form 1040NR), with the information described below, for each year of the 10-year period following expatriation if such individual is liable for U.S. tax under any provision of the Code (e.g., section 871(a)) for such year.[3]

The return must bear the statement ''Expatriation Return'' across the top of page 1 of Form 1040NR. In addition, a statement must be attached to the return that sets forth by category (e.g., dividends, interest, etc.) all items of U.S. and foreign source gross income (whether or not taxable in the United States). The statement must identify the source of such income (determined under section 877 as modified by section V of this notice) and those items of income subject to tax under section 877. In addition, any expatriate who has not previously filed an information statement under section 6039F should also attach to his or her first nonresident return a statement containing the information described in section IX of this notice.

Treasury and the Service intend to amend Treas. Reg. § 1.6012–1(b)(2)(i) in accordance with the rules of this notice. Until the regulation is modified, an expatriate who is otherwise required to report information in accordance with this section of the notice must attach a statement to Form 1040NR, even if the individual has fully satisfied his or her tax liability through withholding of tax at source.

An expatriate who fails to furnish a complete statement in any year for which he or she is liable for any U.S. taxes will not be considered to have filed a true and accurate return. Therefore, such an individual will not be entitled to the benefit of any deductions or credits if the individual's tax liability for that year is later adjusted. See section 874(a).

An individual who is required to file the above statement for the taxable year that begins in 1995 will be considered to have timely filed his or her statement for that year if the individual files such statement by the due date (including extensions) for filing the individual's U.S. income tax return for the taxable year that begins in 1996.

SECTION VIII. INTERACTION WITH TAX TREATIES

Background. The legislative history of the Act indicates that Congress believed that section 877, as amended, is generally consistent with the underlying principles of U.S. income tax treaties to the extent that section 877 provides for a foreign tax credit for items taxed by another country. To the extent that there is a conflict with U.S. income tax treaties in force on August 21, 1996 (the date of enactment of section 877), Congress intended that ''the purpose of section 877, as amended...[is] not to be defeated by any treaty provision.'' H.R. Rep. No. 496, 104th Cong., 2d Sess. 155 (1996). See also, H.R. Conf. Rep. No. 736, 104th Cong., 2d Sess. 329 (1996). However, any conflicting treaty provisions that remain in force 10 years after August 21, 1996, will take precedence over section 877, as revised. Id.

Coordination with tax treaties. In accordance with Congressional intent, Treasury and the Service will interpret section 877 as consistent with U.S. income tax treaties. To the extent that there is a conflict, however, all provisions of section 877, as amended, prevail over treaty provisions in effect on August 21, 1996. This coordination rule is effective until August 21, 2006, and applies to those provisions of section 877 that were amended by the Act as well as those that were not amended by the Act. In addition, Treasury and the Service will interpret all treaties, whether or not in force on August 21, 1996, that preserve U.S. taxing jurisdiction with respect to former U.S. citizens or former U.S. long-term residents who expatriate with a principal purpose to avoid U.S. taxes as consistent with the provisions of section 877, as amended.

[3] Individuals should refer to Treas. Reg. § 1.6012–1(b)(2)(ii) for guidance on how to file a U.S. income tax return for the taxable year of the individual's expatriation.

SECTION IX. INITIAL INFORMATION REPORTING

Background. Section 6039F(a) requires each individual who loses U.S. citizenship to provide an information statement to the U.S. Department of State or a federal court, as applicable. The information reporting requirements of section 6039F apply to individuals who expatriate after February 5, 1995, and to individuals subject to section 511(g)(3)(A) of the Act (see section X of this notice).

Section 6039F(a)(1) requires that this information must be provided not later than the earliest date on which such individual (1) renounces the individual's U.S. nationality before a diplomatic or consular officer of the United States, (2) furnishes to the U.S. Department of State a statement of voluntary relinquishment of U.S. nationality confirming an act of expatriation, (3) is issued a certificate of loss of U.S. nationality by the U.S. Department of State, or (4) loses U.S. nationality because the individual's certificate of naturalization is cancelled by a U.S. court (collectively, the ''reporting date'').

Section 6039F(b) requires a former citizen to report his taxpayer identification number, mailing address of principal foreign residence, foreign country in which the individual is residing, foreign country of citizenship, information on the individual's assets and liabilities if such individual's net worth exceeds $500,000 (as adjusted by section 1(f)(3) for taxable years after 1996), and such other information as the Secretary may prescribe. Section 6039F(f) requires long-term residents who expatriate after February 5, 1995, to provide a similar statement with their U.S. tax returns for the taxable year of expatriation.

If a former citizen fails to provide the required information statement, section 6039F(d) generally provides that the individual will be subject to a penalty equal to the greater of (1) five percent of the tax required to be paid under section 877 for the taxable year ending during such year, or (2) $1,000. The penalty will be assessed for each year during which such failure continues for the 10-year period beginning on the date of loss of citizenship. The penalty will not be imposed if it is shown that such failure is due to reasonable cause and not willful neglect. Section 6039F(f) also applies this penalty to former long-term residents.

Information Statements. Until such time that a form is issued for providing the statement required by section 6039F, individuals must file an information statement that includes the information set forth below.

(1) A former U.S. citizen whose reporting date is on or before March 10, 1997, must provide the information statement to the Internal Revenue Service, 950 L'Enfant Plaza SW, Washington, D.C. 20224, ATTN: Compliance Support & Services, by June 8, 1997. Former U.S. citizens who furnished the information enumerated in section 6039F(b) to the appropriate entity prior to February 24, 1997, are not required to provide an additional statement.

(2) A former U.S. citizen whose reporting date is after March 10, 1997, and on or before June 8, 1997, must provide the information statement to (i) the American Citizens Services Unit, Consular Section, of the nearest American Embassy or consulate, (ii) Office of Policy Review and Interagency Liaison (CA/OCS/PRI), Room 4817, Department of State, Washington D.C., 20520–4818, or (iii) a federal court (if the expatriate's certificate of nationality was cancelled by such court), on or before June 8, 1997.

(3) A former U.S. citizen whose reporting date is after June 8, 1997 must provide the information statement to the (i) American Citizens Services Unit, Consular Section, of the nearest American Embassy or consul, or (ii) a federal court (if the expatriate's certificate of nationality was cancelled by such court) on or before such reporting date.

(4) A former long-term resident who expatriated after February 5, 1995, and before January 1, 1996, must attach the information statement to either a 1996 Form 1040NR (whether or not the individual is otherwise required to file a U.S. tax return) or an amended 1995 U.S. income tax return. To comply with new section 877, an individual whose 1995 tax liability changed as a result of new section 877 must amend the individual's 1995 return accordingly and include the information statement with that amended return. A former long-term resident who expatriated in the 1995 taxable year will be deemed to have timely furnished the information statement if a statement is filed by the due date (including extensions) for filing the individual's 1996 return. A former long-term resident who expatriated after 1995 must attach an information statement to the former resident's U.S. income tax return for the year of expatriation. Former long-term residents who have already furnished the information enumerated in section 6039F(b) to the Internal Revenue Service prior to February 24, 1997, are not required to provide an additional statement.

Former citizens and former long-term residents must include the following information in their information statements:

(1) name;

(2) date of birth;

(3) taxpayer identification number;

(4) mailing address prior to expatriation;

(5) address where the individual resided prior to expatriation, if different from (4) above;

(6) mailing address of principal foreign residence, if any;

(7) address where the individual expects to reside after expatriation, if different from (6) above;

(8) all foreign countries of which the individual is a citizen and the dates and methods by which such citizenship was acquired;

(9) the number of days (including vacation and nonwork days) that the individual was physically present in the United States during the year of expatriation (up to and including the date on which the information statement is filed) and each of the two preceding taxable years;

(10) in the case of an individual whose average annual net U.S. income tax (as defined in section 38(c)(1)) for the five taxable years prior to expatriation exceeded $100,000, the net U.S. income tax for each of these years (rounded to the nearest $50,000). If the individual's average annual net U.S. income tax liability for the preceding five taxable years did not exceed $100,000, the individual must provide a representation to that effect;

(11) in the case of an individual with gross assets that have an aggregate fair market value in excess of $500,000, a balance sheet, using good faith estimates of fair market values (formal appraisals are not required), that sets forth by category (e.g., cash, marketable securities, closely-held stock, business assets, qualified and nonqualified deferred compensation arrangements, individual retirement accounts, installment obligations, U.S. real property, foreign real property, etc.) the individual's assets and liabilities immediately prior to expatriation. The balance sheet must also set forth the following:

(i) the source of income and gain, without applying the provisions of section 877, that such property would have generated during the 5-year period prior to expatriation and immediately after expatriation,

(ii) the source of income and gain, assuming that the provisions of section 877 applied (as modified by section V of this notice), that such property would have generated during the 5-year period prior to expatriation and immediately after expatriation, and

(iii) the gain or loss that would be realized if the assets were sold for their fair market values on the date of expatriation.

The individual must separately list (not by category) each partnership in which the individual holds an interest, each trust that the individual is considered to own under sections 671 through 679, each trust that the individual is considered to own under Chapter 12 of Subtitle B of the Code, and each trust in which the individual holds a beneficial interest (as determined under the procedures described in section III of this notice). The individual must also describe the types of assets held by each partnership or trust, and indicate the methodology (as described in section III of this notice) used to determine the individual's beneficial interest in each trust. In addition, the individual should indicate whether there have been significant changes in the individual's assets and liabilities for the period that began five years prior to expatriation and ends on the date that the information statement is filed. If so, the individual should attach a statement explaining the changes in the individual's assets and liabilities during such period;

(12) in the case of a former long-term U.S. resident, a representation as to whether the former resident was treated as a resident of a foreign country under a U.S. income tax treaty for any year in the preceding 15 years. If so, the individual must list the foreign countries and years when this occurred. The individual must also list any year(s) that the former resident waived the benefits of that treaty; and

(13) a representation, signed under penalties of perjury by the individual, that the facts contained in the information statement are true, correct and complete to the best of the individual's knowledge and belief.

An individual who timely files a statement in accordance with the above guidelines will not be subject to the penalties described in section 6039F(d). All individuals whose reporting dates occur after such time that a form is issued for reporting information under section 6039F must complete and submit that form to comply with their reporting requirements under section 6039F.

SECTION X. TRANSITION PROVISION

Background. Sections 877 and 6039F generally apply to individuals who expatriate after February 5, 1995. However, section 511(g)(3)(A) of the Act provides a special transition provision in the case of a former citizen who performed an expatriating act 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)) before February 6, 1995, but who did not on or before such date furnish to the U.S. Department of State a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of such act. Such an individual would not come within the general effective date of the amendments to sections 877 and 6039F because, under the provisions for determining the date of loss of citizenship (which were not modified by the Act), the date of loss of citizenship is retroactive to the date of the expatriating act (i.e., prior to February 6, 1995). See Treas. Reg. § 1.1–1(c).

The transition provision states that section 6039F and the amendments made to section 877 by the Act shall apply to such an individual, except that the 10-year period referred to in section 877(a) shall not expire before the end of the 10-year period beginning on the date the signed statement of voluntary relinquishment is furnished to the U.S. Department of State. Thus, such an individual is subject to new section 877 as of the date of loss of citizenship and the 10-year period referred to in section 877(a) shall not expire before the end of the 10-year period beginning on the date the signed statement of voluntary relinquishment is furnished to the U.S. Department of State.

Section 511(g)(3)(B) of the Act states that the transition provision of section 511(g)(3)(A) will not apply if the individual establishes to the satisfaction of the Secretary of the Treasury that the individual's loss of U.S. citizenship occurred before February 6, 1994. Accordingly, section 6039F will not apply to such an individual and he will be subject to section 877 as in effect before the amendments made by the Act.

Example. The following example illustrates the application of section 511(g)(3)(A) of the Act.

Example 10. K joined a foreign army on October 1, 1994, with the intent to relinquish his U.S. citizenship, but did not furnish a statement of voluntary relinquishment of citizenship to the U.S. Department of State until October 1, 1995. K is subject to new section 877 beginning on October 1, 1994, the date that K performed the expatriating act. However, the 10-year period referred to in section 877(a) will not expire before the end of the 10-year period beginning on the date that K furnished a statement of voluntary relinquishment of citizenship to the U.S. Department of State. K furnished this statement on October 1, 1995. Thus, K is subject to new section 877 for the period that began on October 1, 1994, and ends on September 30, 2005.

Special rule for individuals who claim to be within the exception under section 511(g)(3)(B) of the Act. An individual who (i) furnished a signed statement of voluntary relinquishment of U.S. nationality to the U.S. Department of State after February 5, 1995, and (ii) claims that new section 877 does not apply because of the exception to the transition provision in section 511(g)(3)(B) of the Act, must (whether or not the individual is otherwise required to file a U.S. tax return) attach a statement to Form 1040NR for the year in which the signed statement of voluntary relinquishment is furnished to the U.S. Department of State (or to the individual's 1996 Form 1040NR if the statement of voluntary relinquishment was furnished during 1995). The return must bear the statement ''Expatriation Return'' across the top of page 1 of such return. The statement attached to the return must include the nature and date of the expatriating act, the date the signed statement of voluntary relinquishment was furnished to the U.S. Department of State, and a copy of the individual's certificate of loss of nationality. An individual who does not file a statement in the manner prescribed above will not be considered to have established to the satisfaction of the Secretary of the Treasury that the individual lost U.S. citizenship before February 6, 1994.

SECTION XI. INTERACTION WITH SECTION 7701(b)(10)

Background. Section 7701(b)(10) applies to an alien individual who was treated as a resident of the United States during any period that includes at least three consecutive calendar years (the ''initial residency period'') and ceased to be treated as a U.S. resident, but subse-

quently becomes a U.S. resident before the close of the third calendar year beginning after the initial residency period. Under section 7701(b)(10), such an individual will be taxed in the manner provided by section 877(b) for the period after the close of the initial residency period and before the date on which the individual subsequently becomes a U.S. resident. This provision applies only if the tax imposed pursuant to section 877(b) exceeds the tax imposed under section 871.

Application of section 7701(b)(10). An individual described in section 7701(b)(10) will be subject to tax on U.S. source income in the manner provided by section 877(b) (as modified by section 877(d)) for the period after the close of the initial residency period and before the date on which the individual subsequently becomes a U.S. resident (the ''intervening period''). Because the tax imposed by reason of section 7701(b)(10) applies regardless of whether the individual had a principal purpose to avoid U.S. taxes, sections 877(a), (c), and (f), as amended, do not apply to an individual who is subject to tax in the manner provided by section 877(b) solely by reason of section 7701(b)(10).

Section 877(e) also does not generally apply to an individual who is subject to tax in the manner provided by section 877(b) solely by reason of section 7701(b)(10). However, to treat former residents who are subject to tax by reason of section 7701(b)(10) in a similar manner as former long-term residents who are subject to section 877, all property held by an individual on the date that such individual first became a resident of the United States shall be treated solely for purposes of section 7701(b)(10) as having a basis of not less than the fair market value of the property on such date, unless the individual elects not to have this treatment apply.

Reporting requirements for individuals subject to section 7701(b)(10). An individual who is liable for U.S. tax by reason of section 7701(b)(10) during any year of the intervening period must file U.S. income tax returns (Form 1040NR) reporting such tax liability for each of those years by the due date (including extensions) for filing the individual's U.S. income tax return for the year that the individual subsequently becomes a U.S. resident. If tax returns for the years of the intervening period have already been filed, the individual must amend those returns accordingly to comply with section 7701(b)(10).

An individual described in section 7701(b)(10) who is liable for U.S. taxes under any provision of the Code during the intervening period (e.g., section 871(a)) must attach a statement to his or her U.S. tax return that sets forth, by category (e.g., dividends, interest, etc.), all items of U.S. and foreign source gross income (whether or not taxable in the United States) derived during each year of the intervening period. Such statement must identify the source of such income (determined under section 877 as modified by section V of this notice), the items of income subject to tax in the manner provided by section 877(b), and any other information that the Secretary may prescribe at a later date.

The statement must be filed even if the individual has fully satisfied his or her U.S. tax liability for a taxable year through withholding at source. As discussed in section VII of this notice, Treasury and the Service expect to modify Treas. Reg. § 1.6012–1(b)(2)(i) in accordance with rules of this notice.

Any individual who fails to furnish a complete statement, as described above, for the years of the intervening period will not be considered to have filed a true and accurate return. Therefore, such an individual will not be entitled to the benefit of any deductions or credits if the individual's return is later adjusted. See section 874(a).

An individual who is required to file the above statement for the taxable year that begins in 1995 will be considered to have timely filed his or her statement for that year if the individual files such statement by the due date (including extensions) for filing the individual's U.S. income tax return for the taxable year during which the individual subsequently becomes a U.S. resident.

Exchanges under section 877(d)(2) and contributions under section 877(d)(4). An individual subject to tax by reason of section 7701(b)(10) must recognize any gain realized during the intervening period on exchanges of property described in section 877(d)(2), unless the individual enters into a gain recognition agreement in accordance with section V of this notice. The gain recognition agreement must be submitted with the individual's U.S. income tax return (Form 1040NR) for the year of the exchange. The gain recognition agreement and the return must be filed by the due date (including extensions) for filing the individual's U.S. income tax return for the year during which the individual subsequently becomes a U.S. resident. If a tax return for the year of the exchange has already been filed, the individual must amend that return and attach a gain recognition agreement to the amended return to comply with section 7701(b)(10).

The period of such a gain recognition agreement will be for the intervening period, and not the 15-year period beginning five years prior to expatriation. Moreover, annual certification is not required. Rather, the individual must submit with the gain recognition agreement a certification that the acquiror (if any) has not disposed of the transferred property, and that the individual did not dispose of the property acquired in the exchange (or any other property that has a basis determined in whole or in part by reference to such property). In addition, the certification must also state whether the individual derived any income or gain from the property acquired in the exchange during the intervening period.

If any property to which the gain recognition applies was disposed of during any year of the intervening period, the individual must recognize gain for the year of disposition. Any income or gain derived during the intervening period from a contribution described under section 877(d)(4) must also be recognized for the relevant year. However, section 7701(b)(10) will not cause an individual to recognize any income or gain with respect to any exchange under section 877(d)(2) or contribution of property under section 877(d)(4) that occurred prior to the beginning of the individual's initial residency period or after the date on which the individual subsequently becomes a U.S. resident.

Example. The following example illustrates how section 7701(b)(10) interacts with section 877 and when income that arises by reason of section 7701(b)(10) must be recognized.

Example 11. L was a resident alien of the United States in 1994, 1995 and 1996 because she satisfied the substantial presence test of section 7701(b)(3) for each of those years. In 1997 and 1998, L was not a resident of the United States. In 1999, L re-establishes residency in the United States. L is subject to tax in the manner provided by section 877(b) by reason of section 7701(b)(10). On February 1, 1997, L contributed property to a ''controlled foreign corporation'' in a transaction described in section 877(d)(4).

Any income or gain derived from the property that L contributed to the foreign corporation during the intervening period is subject to tax in the manner provided by section 877(d)(4). Thus, L

must report such income or gain by filing income tax returns for 1997 and 1998 by the due date (including extensions) for filing her 1999 U.S. income tax return. If income tax returns for 1997 and 1998 have already been filed, L must amend those returns to comply with section 7701(b)(10). Any income or gain derived after the intervening period is not taxable under section 877(d)(4).

Coordination with income tax treaties. The rules of section VIII (interaction with tax treaties) of this notice do not apply to an individual who is subject to tax in the manner provided by section 877(b) solely by reason of section 7701(b)(10). Accordingly, such an individual may claim benefits under a U.S. income tax treaty for transactions that occur during the intervening period if such individual is otherwise eligible for benefits as a foreign resident under the terms of such treaty.

Effective date. New section 877 will apply to an individual subject to tax thereunder by reason of section 7701(b)(10) if the individual's initial residency period ended after August 20, 1996.

REQUEST FOR COMMENTS

Treasury and the Service invite public comments on the guidance provided in this notice. Comments should be submitted by June 8, 1997, to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Attn: CC:CORP:T:R, (Notice 97–19)
Room 5228
Washington, D.C. 20044;

or, alternatively, via the internet at:

http://www.irs.ustreas.gov/prod/tax_regs/comments.html

The comments you submit will be available for public inspection and copying.

DRAFTING INFORMATION

The principal authors of this notice are Trina L. Dang and Michael Kirsch of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Ms. Dang or Mr. Kirsch at (202) 622–3860 (not a toll-free call).

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 1545–1531.

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 collection of information related to the submission of ruling requests is required to help the Secretary make a determination as to whether an individual expatriated with a principal purpose to avoid U.S. taxes. The collections of information related to gain recognition agreements, initial information reporting and reporting of information with respect to contributions to certain foreign controlled foreign corporations are prescribed by statute. The collection of annual reporting information is necessary to monitor compliance with the provisions of section 877, as amended. The collections of information for individuals subject to section 7701(b)(10) are necessary to administer the provisions of section 7701(b)(10) that interact with section 877. This information will be used by the Service for tax administration purposes.

The respondents will be individuals who lose U.S. citizenship, cease to be taxed as lawful permanent residents of the United States, or cease to be taxed as residents of the United States. The estimated total annual burden for all respondents is 6,300 hours. The estimated annual burden per respondent varies from 0.5 hour to 2.5 hours, depending on individual circumstances, with an estimated average of 31 minutes. The estimated number of responses is 12,300. The estimated annual frequency of responses is annually or on occasion.

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 of the Code.

Waiver of Certain Limitations on Obtaining Automatic Consent To Change an Accounting Period and Elect To Be an S Corporation Effective January 1, 1997

Notice 97–20

SUMMARY: The Internal Revenue Service waives certain limitations on a corporation's ability to automatically change its annual accounting period in order to elect to be an S corporation under § 1362(a) of the Internal Revenue Code effective for the taxable year beginning January 1, 1997.

BACKGROUND: Pursuant to § 1378, an S corporation generally must have a calendar year as its tax year. However, a corporation may not automatically change its annual accounting period to a calendar year if it attempts to elect to be an S corporation effective for the taxable year immediately following the short period required to effect the change. *See* § 1.442–1(c)(2)(v) of the Income Tax Regulations; Rev. Proc. 92–13, 1992–1 C.B. 665, section 4.01(5). In addition, a corporation is precluded under § 1.442–1(c)(2)(i) from automatically changing its annual accounting period if the corporation has changed it within the last ten calendar years, and under Rev. Proc. 92–13, section 4.01(2), if the corporation has changed it within the last six calendar years.

The Small Business Job Protection Act of 1996 (SBJPA), Pub. L. No. 104–188, 110 Stat. 1755, significantly amended Subchapter S of the Code, expanding eligibility to elect to be an S corporation. These amendments generally are effective for taxable years beginning after December 31, 1996, and are intended to allow more corporations to elect to be S corporations as of January 1, 1997.

WAIVER OF LIMITATIONS: Consistent with this intent, the Service waives the limitations of §§ 1.442–1(c)(2)(i) and (c)(2)(v), and of sections 4.01(2) and 4.01(5) of Rev. Proc. 92–13, on a corporation's ability to automatically change its annual accounting period to a calendar year effective for the short period ending December 31, 1996, provided that the corporation:

(1) is otherwise eligible to change its annual accounting period under either § 1.442–1(c) or Rev. Proc. 92–13;

(2) timely and otherwise validly elects to be an S corporation effective for the taxable year beginning on January 1, 1997; and

(3) follows the special filing procedures set forth below.

FILING PROCEDURES: A corporation that relies upon this notice to change its annual accounting period under either § 1.442–1(c) or Rev. Proc. 92–13 must:

(1) properly complete a Form 2553, Election by a Small Business Corporation;