

Part III - Administrative, Procedural, and Miscellaneous

Election to Continue To Treat Trust as a United States Person

Notice 98-25

SECTION 1. PURPOSE

This notice provides guidance regarding the election under § 1161 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997) (Taxpayer Relief Act). Section 1161(a) provides that to the extent prescribed in regulations by the Secretary of the Treasury or his delegate, a trust that was in existence on August 20, 1996 (other than a trust treated as owned by the grantor under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code of 1986), and that was treated as a United States person on August 19, 1996, may elect to continue to be treated as a United States person notwithstanding § 7701(a)(30)(E). The Internal Revenue Service and the Department of the Treasury will incorporate the guidance contained in this notice in regulations. Accordingly, trusts should follow the procedures set forth in this notice.

SECTION 2. BACKGROUND

Prior to the Small Business Job Protection Act of 1996, Pub. L. 104-188, 110 Stat. 1755 (1996) (SBJP Act), the status of a trust as domestic or foreign turned upon the subjective determination of whether the trust was more comparable to a resident or a nonresident alien individual. See Rev. Rul. 60-181, 1960-1 C.B. 257, citing B.W. Jones Trust v. Commissioner, 46 B.T.A. 531 (1942), aff'd, 132 F.2d 914 (4th Cir. 1943) (prior

law).

Section 1907(a) of the SBJP Act amended § 7701(a)(30) and (31) of the Code to provide more objective criteria for determining the status of a trust. New § 7701(a)(30)(E) provides that a trust will be treated as a domestic trust if: (1) a court within the United States is able to exercise primary supervision over the administration of the trust, and (2) one or more United States persons¹ have the authority to control all substantial decisions of the trust. New § 7701(a)(31) provides that a foreign trust is any trust that is not a domestic trust.

New § 7701(a)(30) and (31) apply in determining the status of a trust for taxable years beginning after December 31, 1996. A trust may, however, elect pursuant to § 1907(a)(3)(B) of the SBJP Act to have the new criteria apply to the first taxable year of the trust ending after August 20, 1996 (the date of enactment of the SBJP Act).

A trust that qualified as a domestic trust under prior law could fail to qualify as a domestic trust under new § 7701(a)(30)(E). Thus, solely due to the change in law, a domestic trust could become a foreign trust as of the first day of its first taxable year beginning after December 31, 1996. Such a change may have significant adverse tax consequences. A nongrantor trust whose status changed from domestic to foreign

¹ As originally enacted by the SBJP Act, new § 7701(a)(30)(E)(ii) required one or more United States fiduciaries to have the authority to control all substantial decisions of the trust. The Taxpayer Relief Act substituted the word "persons" for the word "fiduciaries."

prior to August 5, 1997 (the effective date of the repeal of § 1491), was treated for purposes of § 1491 as having transferred, upon becoming a foreign trust, all of its assets to a foreign trust, and therefore may have been subject to the § 1491 excise tax. A nongrantor trust whose status changed from domestic to foreign on or after August 5, 1997 (the effective date of § 684) is treated as having transferred all of its assets to a foreign trust and must recognize as gain the excess of the fair market value of the property transferred over its adjusted basis under § 684.

To avoid the change from domestic to foreign status, a domestic trust needed to amend its provisions to meet the definition set forth in new § 7701(a)(30)(E) by the first day of its first taxable year beginning after December 31, 1996. To assist domestic trusts that may have had difficulty conforming to the new domestic trust criteria, the Service published Notice 96-65, 1996-2 C.B. 232. That notice permits a domestic trust in existence on August 20, 1996, to continue to file tax returns as a domestic trust for taxable years beginning after December 31, 1996, notwithstanding the status of the trust under new § 7701(a)(30)(E), if certain conditions are satisfied. See also § 1601(i)(4) of the Taxpayer Relief Act. To obtain the relief provided in Notice 96-65, a trust is required to: (1) initiate modification of the trust to conform to new § 7701(a)(30)(E) by the due date (including extensions) for filing the trust's income tax return for its first taxable year

beginning after December 31, 1996; (2) complete the modification within two years of that date; and (3) attach a statement to the trust's income tax return, as described in Notice 96-65.

Subsequent to the publication of Notice 96-65, Congress enacted § 1161 of the Taxpayer Relief Act. Section 1161 allows a trust that was in existence on August 20, 1996 (other than a trust treated as owned by the grantor), and that was treated as a domestic trust on August 19, 1996, to elect to continue treatment as a domestic trust, regardless of the result of the application of new § 7701(a)(30)(E) to the trust.

SECTION 3. TRUSTS ELIGIBLE TO MAKE THE ELECTION

.01 Basic Rule.

A trust that was in existence on August 20, 1996, and that was treated as a domestic trust on August 19, 1996, as provided in section 3.02, may elect to continue treatment as a domestic trust notwithstanding § 7701(a)(30)(E). This election is not available to a trust that was wholly-owned by its grantor under subpart E, part I, subchapter J, chapter 1, of the Code on August 20, 1996. (Wholly-owned grantor trusts may, however, follow the procedures in Notice 96-65.) The election is available to a trust if only a portion of the trust was treated as owned by the grantor under subpart E on August 20, 1996. If a partially-owned grantor trust makes the election, the election is effective for the entire trust. Also, a trust may not make the election if the trust has made an election pursuant to § 1907(a)(3)(B) of the SBJP Act to apply the new trust criteria to the first taxable

year of the trust ending after August 20, 1996, because that election, once made, is irrevocable.

.02 Determining Whether a Trust was Treated as a Domestic Trust on August 19, 1996

(1) Trusts Filing Form 1041 for the Taxable Year that Includes August 19, 1996

For purposes of the election, a trust is considered to have been treated as a domestic trust on August 19, 1996, if: (i) the trustee filed a Form 1041, U.S. Income Tax Return for Estates and Trusts, for the trust for the period that includes August 19, 1996 (and did not file a Form 1040NR, U.S. Nonresident Alien Income Tax Return, for that year); and (ii) the trust had a reasonable basis (within the meaning of § 6662) under the prior law for reporting as a domestic trust for that period.

(2) Trusts Not Filing a Form 1041

Some domestic trusts are not required to file Form 1041. For example, group trusts described in Rev. Rul. 81-100, 1981-1 C.B. 326, are not required to file Form 1041. Also, a domestic trust whose gross income for the taxable year is less than the amount required for filing an income tax return and that has no taxable income is not required to file a Form 1041. Section 6012(a)(4).

For purposes of the election, a trust that filed neither a Form 1041 nor a Form 1040NR for the period that includes August 19, 1996, will be considered to have been treated as a domestic trust on August 19, 1996, if the trust had a reasonable basis (within the meaning of § 6662) under prior law (i) for being

treated as a domestic trust for that period and (ii) for filing neither a Form 1041 nor a Form 1040NR for that period.

SECTION 4. PROCEDURE FOR MAKING THE ELECTION

.01 Required Statement.

To make the election, a statement must be filed with the Service in the manner and time described in this notice. The statement must be entitled "Election to Remain a Domestic Trust under § 1161 of the Taxpayer Relief Act of 1997," be signed under penalties of perjury by at least one trustee of the trust, and contain the following information:

(1) A statement that the trust is electing to continue to be treated as a domestic trust under § 1161 of the Taxpayer Relief Act of 1997;

(2) A statement that the trustee had a reasonable basis (within the meaning of § 6662) under prior law for treating the trust as a domestic trust on August 19, 1996. (The trustee need not explain the reasonable basis on the election statement);

(3) A statement either that the trust filed a Form 1041 treating the trust as a domestic trust for the period that includes August 19, 1996, (and that the trust did not file a Form 1040NR for that period), or that the trust was not required to file a Form 1041 or a Form 1040NR for the period that includes August 19, 1996, with an accompanying brief explanation as to why a Form 1041 was not required to be filed; and

(4) The name, address, and employer identification number of the trust.

.02 Filing the Required Statement with the Service

Except as provided below, the trust must attach the statement to a Form 1041. The statement may be attached to either the Form 1041 that is filed for the first taxable year of the trust beginning after December 31, 1996 (1997 taxable year), or to the Form 1041 filed for the first taxable year of the trust beginning after December 31, 1997 (1998 taxable year). The statement, however, must be filed no later than the due date for filing a Form 1041 for the 1998 taxable year, plus extensions. The election will be effective for the 1997 taxable year, and thereafter, until revoked or terminated. If the trust has already filed a Form 1041 for the 1997 taxable year without the statement attached, the statement should be attached to the Form 1041 filed for the 1998 taxable year.

If the trust has insufficient gross income and no taxable income for its 1997 or 1998 taxable year, or both, and therefore is not required to file a Form 1041 for either or both years, the trust must make the election by filing a Form 1041 for either the 1997 or 1998 taxable year with the statement attached (even though not otherwise required to file a Form 1041 for that year). The trust should only provide on the Form 1041 the trust's name, name and title of fiduciary, address, employer identification number, date created, and type of entity. The statement must be attached to a Form 1041 that is filed no later than October 15, 1999.

If the trust files a Form 1040NR for the 1997 taxable year

based on application of new § 7701(a)(30)(E) to the trust, and satisfies Section 3.01 of this notice, in order for the trust to make the election the trust must file an amended Form 1040NR return for the 1997 taxable year. The trust must note on the amended Form 1040NR that it is making an election under § 1161 of the Taxpayer Relief Act of 1997. The trust must attach to the amended Form 1040NR the statement required by this notice and a completed Form 1041 for the 1997 taxable year. The items of income, deduction and credit of the trust must be excluded from the amended Form 1040NR and reported on the Form 1041. The amended Form 1040NR for the 1997 taxable year, with the statement and the Form 1041 attached, must be filed with the Philadelphia Service Center no later than the due date, plus extensions, for filing a Form 1041 for the 1998 taxable year.

If a trust has made estimated tax payments as a foreign trust based on application of new § 7701(a)(30)(E) to the trust, but has not yet filed a Form 1040NR for the 1997 taxable year, when the trust files its Form 1041 for the 1997 taxable year it must note on its Form 1041 that it made estimated tax payments based on treatment as a foreign trust. The Form 1041 must be filed with the Philadelphia Service Center (and not with the service center where the trust ordinarily would file its Form 1041).

If a trust forms part of a qualified stock bonus, pension, or profit sharing plan, the election provided by this notice must be made by attaching the statement to the plan's annual return

required under § 6058 (information return) for the first plan year beginning after December 31, 1996, or to the plan's information return for the first plan year beginning after December 31, 1997. The statement must be attached to the plan's information return that is filed no later than the due date for filing the plan's information return for the first plan year beginning after December 31, 1997, plus extensions. The election will be effective for the first plan year beginning after December 31, 1996, and thereafter, until revoked or terminated.

Any other type of trust that is not required to file a Form 1041 for the taxable year, but that is required to file an information return (for example, Form 5227) for the 1997 or 1998 taxable year must attach the statement to the trust's information return for the 1997 or 1998 taxable year. However, the statement must be attached to an information return that is filed no later than the due date for filing the trust's information return for the 1998 taxable year, plus extensions. The election will be effective for the 1997 taxable year, and thereafter, until revoked or terminated.

A group trust under Rev. Rul. 81-100, 1981-1 C.B. 326, (and any other trust that is not described above and that is not required to file a Form 1041 or an information return) need not attach the statement to any return and should file the statement with the Philadelphia Service Center. The trust must make the election provided by this notice by filing the statement by October 15, 1999. The election will be effective for the 1997

taxable year, and thereafter, until revoked or terminated.

.03 Failure to File the Statement in the Required Manner and Time.

If a trust fails to file the statement in the manner or time provided in Section 4.01 and 4.02, the trustee may provide a written statement to the district director having jurisdiction over the trust setting forth the reasons for failing to file the statement in the required manner or time. If the district director determines that the failure to file the statement in the required manner or time was due to reasonable cause, the district director may grant the trust an extension of time to file the statement. Whether an extension of time is granted shall be in the sole discretion of the district director. However, the relief provided by this notice is not ordinarily available if the statute of limitations for the trust's 1997 taxable year has expired. Additionally, if the district director grants an extension of time, it may contain terms with respect to assessment as may be necessary to ensure that the correct amount of tax will be collected from the trust, its owners, and its beneficiaries.

SECTION 5. REVOCATION OR TERMINATION OF THE ELECTION AND PUBLIC COMMENTS

Section 1161(a) of the Taxpayer Relief Act authorizes the Secretary to prescribe regulations regarding the election to remain a domestic trust. The regulations will incorporate the rules contained in this notice and provide guidance with respect to when the occurrence of certain significant changes in

circumstances related to the trust will terminate the election (for example, changes in the trustees from United States persons to foreign persons). The regulations will also contain procedures for revoking the election. The Service and the Treasury Department request comments on the rules in this notice and, in particular, the change in circumstances that would cause a termination of the election.

Comments should be submitted by June 30, 1998 to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044, Attn: CC:DOM:CORP:R (Notice 98-25 CC:DOM:P&SI:2), Room 5226. Submissions may be hand-delivered between the hours of 8 a.m. and 5 p.m. to: Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC, Attn: CC:DOM:CORP:R (Notice 98-25 CC:DOM:P&SI:2), Room 5226. Alternatively, taxpayers may submit comments electronically at

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

(the Service's internet site). All comments submitted will be available for public inspection and copying. Please identify the comments as relating to this Notice 98-25.

SECTION 6. EFFECT OF THIS NOTICE ON NOTICE 96-65

A trust that otherwise qualifies for the relief under this notice has the option of proceeding under the provisions of Notice 96-65 or this Notice 98-25, or both. If the trustee has begun conforming a trust's provisions under Notice 96-65 to meet the definition set forth in new § 7701(a)(30)(E), the trustee may discontinue conforming the trust's provisions to meet the new

domestic trust criteria if the trustee proceeds under this Notice 98-25 instead of Notice 96-65.

SECTION 7. EFFECTIVE DATE

This notice applies to an election made for the first taxable year of a trust beginning after December 31, 1996. The provisions of this notice will be incorporated into regulations that will be effective for taxable years beginning after December 31, 1996.

PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget for review in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1600.

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 collections of information in this notice are in section 4 headed Procedure for Making the Election. This information is required by the IRS to assure compliance with the provisions of the Small Business Job Protection Act of 1996 and the Taxpayer Relief Act of 1997. The likely respondents are trusts.

The estimated total annual reporting burden is 250,000 hours.

The estimated average annual burden per respondent is 30 minutes.

The estimated number of respondents is 500,000.

The estimated annual frequency of responses is once.

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

DRAFTING INFORMATION

The principal authors of this notice are Eliana Dolgoff and James A. Quinn of the Office of Assistant Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Ms. Dolgoff or Mr. Quinn on (202) 622-3060 (not a toll-free call). For further information about the international tax consequences of the election that is the subject of this notice contact Trina Dang of the Office of the Associate Chief Counsel (International) on (202) 622-3880.