Current Federal Tax Developments

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SECTION: 401
FAILURE TO FOLLOW ANTI-ALIENATION PROVISIONS IN DEALING WITH ACCOUNT BALANCE IN DIVORCE CAUSES DISQUALIFICATION OF ESOP

Citation: Family Chiropractic Sports Injury & Rehab Clinic, Inc. v. Commissioner, TC Memo 2016-10, 1/19/16

Sometimes it's difficult to get clients to understand that when Congress gives a tax break, they impose conditions that must be met to maintain that break. That's especially true with items such as retirement plans where some or all of the funds in there are, in the client's view, my money that can be dealt with just like any other of my property.

In the case of *Family Chiropractic Sports Injury & Rehab Clinic, Inc. v. Commissioner*, TC Memo 2016-10, the taxpayer's failure to respect the requirements to maintain a qualified retirement plan proved fatal to the hoped for tax benefits.

One of the key protections provided to qualified retirement plans relates to the anti-alienation rules. The good news is that such rules effectively insulate the assets inside the plan from the claims of creditors. But the plan must have provisions that require such protections be applied *and* it must actually comply with such requirements in practice.

The plan in question was an employee stock ownership plan (ESOP) for the corporation. The corporation was wholly owned by a chiropractor and both he and his wife were employees of the corporation. Both were covered by the plan and had accounts in the plan.

The plan contained the following provisions regarding protecting employee's benefits via the anti-alienation provisions:

> 11.2 ALIENATION
>
> (a) Subject to the exceptions provided below, and as otherwise permitted by the Code and Act, no benefit which shall be payable out of the Trust Fund to any person (including a Participant or the Participant's Beneficiary) shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, or charge, and any attempt to anticipate, alienate, sell, transfer, assign, pledge, encumber, or charge the same shall be void; and no such benefit shall in any manner be liable for, or subject to, the debts, contracts, liabilities, engagements, or torts of any such person, nor shall it be subject to attachment or legal process for or against such person, and the same shall not be recognized by the Trustee, except to such extent as may be required by law.
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> (b) Subsection (a) shall not apply to a "qualified domestic relations order" defined in Code Section 414(p), and those other domestic relations orders permitted to be so treated by the Administrator under the provisions of the Retirement Equity Act of 1984. The Administrator shall establish a written procedure to determine the qualified status of domestic relations orders and to administer distributions under such qualified orders. Further, to the extent provided under a "qualified domestic relations order," a former spouse of a Participant shall be treated as the spouse or surviving spouse for all purposes under the Plan.

Eventually the marriage soured and the parties were divorced. One of the steps that has to be undertaken when unwinding a marriage is dividing up the property in question, and this is where the problems began for the plan.

As the above provision notes, the only way a participant's benefit can be assigned to a former spouse is via a qualified domestic relations order which meets specific requirements. Unfortunately it does not appear that anyone involved with the plan or the parties' divorce appeared to under that matter—and that was a major oversight.

The Tax Court describes the details of their divorce and how they dealt with the ESOP benefits of the non-chiropractor:

> On April 5, 2007, Richard and Heidi divorced. Pursuant to the final divorce decree filed in the Seventh Judicial District Court, County of Muscatine, State of Iowa, each was awarded 50% of Family Chiropractic's shares of stock, ownership, and management. The decree is silent as to the ESOP.
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> As reflected in several corporate documents, on May 27, 2009, Heidi agreed to "relinquish her retirement value" in the ESOP "in accordance with the divorce decree" and resigned as Family Chiropractic's director, vice president, and secretary. As of June 30, 2009, the ESOP's summary of participant accounts reflected that each ESOP account of Heidi and Richard included 14.95 class B stock shares at a total value of $286,904.53 and that all the shares were 100% vested. Heidi's ESOP shares were subsequently reallocated to Richard's account, as recorded in the June 30, 2010, report, rendering her account with zero shares 0% vested. The June 30, 2010, report reflects that Richard had a $482,851.138 account balance with 29.9 class B stock shares. During its 2010 plan year the ESOP did not distribute any assets to Heidi.

The taking of the balance from Heidi and transferring it to Richard was the big problem here, since that transfer did not take place pursuant to a qualified domestic relations order—rather they just decided to transfer it over.

The IRS revoked the plan's tax exempt status based on this transaction. The IRS justified this by noting:

- The 2010 reallocation of shares from Heidi's ESOP account to Richard's ESOP account caused the ESOP to fail the section 401(a)(13) requirements for its 2010 plan year and for all subsequent plan years;
- By transferring Heidi's ESOP benefit to Richard at her termination, the ESOP failed to follow its written terms in operation and therefore failed to be a qualified plan within the meaning of section 401(a) for its 2010 plan year and for all subsequent plan years

Retirement plans must both have proper documentation that provides it will meet the requirements (generally found in IRC §401(a)) to be a qualified plan and then it must actually operate in accordance with those documents. As the Court explains:

> A qualified plan must meet the section 401(a) requirements in both form and operation. *Ludden v. Commissioner*, 620 F.2d 700, 702 (9th Cir. 1980), aff'g 68 T.C. 826 (1977); sec. 1.401-1(b)(3), Income Tax Regs. A form failure occurs when a plan document does not contain required language or terms. See *Michael C. Hollen, D.D.S., P.C. v. Commissioner*, T.C. Memo. 2011-2. An operational failure occurs when: (1) a plan, in operation, does not meet the section 401(a) requirements, see *Martin Fireproofing Profit-Sharing Plan & Tr. v. Commissioner*, 92 T.C. 1173 (1989), and (2) a plan fails to follow the terms of the plan document, see *Michael C. Hollen, D.D.S., P.C. v. Commissioner*, T.C. Memo. 2011-2. A plan that does not follow the terms of the plan document is not a "definite written program" as required by section 1.401-1(a)(2), Income Tax Regs.

As well, once a plan suffers a disqualification event, the impact goes forward into all future years. As the Court notes:

> In general, a qualification failure pursuant to section 401(a) is a continuing failure because allowing a plan to requalify in subsequent years would be to allow a plan "to rise phoenix-like from the ashes of such disqualification and become qualified for that year." *Pulver Roofing Co. v. Commissioner,* 70 T.C. 1001, 1015 (1978); see also *Martin Fireproofing Profit-Sharing Plan & Tr. v. Commissioner*, 92 T.C. at 1184-1189.

As the Court noted, the plan simply wasn't operated in accordance with either the requirements of the law or the plan document:

> Pursuant to the May 27, 2009, corporate documents, and relying upon the divorce decree, Heidi transferred 100% of her ESOP shares and relinquished any rights she had under the ESOP. The ESOP's June 30, 2009 and 2010, reports reflect that 100% of the shares allocated to Heidi on June 30, 2009, were reallocated to Richard's account as of June 30, 2010.
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> Before April 5, 2007, Richard and Heidi, husband and wife, were also Family Chiropractic's sole employees and ESOP participants. Although the 2007 divorce decree dissolved the Leavitt marriage, it is insufficient to allow the transfer of plan assets that transpired in this case. See, e.g., *Rodoni v. Commissioner*, 105 T.C. 29 (1995). Transferring the vested shares from Heidi's account to Richard's caused Heidi's ESOP account to become alienated from her after it became fully vested. By violating section 401(a)(13), the plan ceased to be qualified. Accordingly, we hold that respondent did not abuse his discretion in disqualifying the ESOP for its 2010 plan year and for subsequent plan years.

Clients may have a tough time understanding the result. After all, nowhere was it alleged that Heidi objected to the transfer of her interest to Richard—but that's not the issue.

Rather the taxpayers availed themselves of a significant tax benefit by setting up the qualified plan where a deduction was allowed to the corporation for transfers made for their benefit, but they did not have to personally pay tax at the time of the transfer. In exchange for that benefit, Congress required strict compliance with the rules—and, in this case, that simply didn't happen.

SECTION: 409A
STOCK COVERED BY NONQUALIFIED OPTION IMPROPERLY VALUED, IRS ARGUES COVERED BY DEFERRED COMPENSATION PROVISIONS OF §409A

Citation: Chief Counsel Advice 201603025, 1/15/16

In Chief Counsel Advice 201603025 the IRS Chief Counsel's office addressed whether a nonqualified stock option plan in question ran afoul of the provisions of IRC §409A and therefore required an inclusion in income on the date of grant. The question turned on the proper valuation of the options in question, including whether the stock in question was readily tradable on an established securities market.

If stock is readily tradable on an established securities market, Reg. §1.409A-1(b)(5)(iv)(A) provides the following in part:

> For purposes of paragraph (b)(5)(i) of this section, in the case of service recipient stock that is readily tradable on an established securities market, the fair market value of the stock may be determined based upon the last sale before or the first sale after the grant, the closing price on the trading day before or the trading day of the grant, the arithmetic mean of the high and low prices on the trading day before or the trading day of the grant, or any other reasonable method using actual transactions in such stock as reported by such market.

Per Reg. §1.409A-1(b)(5)(i)(A) a nonstatutory option is excluded from the definition of deferred compensation if all of the following conditions are met:

> (A) Nonstatutory stock options not providing for the deferral of compensation.
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> An option to purchase service recipient stock does not provide for a deferral of compensation if --
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>> (1) The exercise price may never be less than the fair market value of the underlying stock (disregarding lapse restrictions as defined in § 1.83-3(i)) on the date the option is granted and the number of shares subject to the option is fixed on the original date of grant of the option;
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>> (2) The transfer or exercise of the option is subject to taxation under section 83 and § 1.83-7; and

(3) The option does not include any feature for the deferral of compensation other than the deferral of recognition of income until the later of the following:

(i) The exercise or disposition of the option under § 1.83-7.

(ii) The time the stock acquired pursuant to the exercise of the option first becomes substantially vested (as defined in § 1.83-3(b))

If the option does not met these requirements, then the program must meet all of the requirements imposed generally on nonqualified deferred compensation arrangements under IRC §409A or the value must be includable in income immediately by the recipient.

In this case there were contracts to purchase the underlying stock, and not the stock itself, could be purchased on the when-issued, over-the-counter market on the date the options were granted. The option price was less than the price for such contracts to purchase on the grant date. The IRS argued that with the price of the options set at a lower amount than the price for a contract to purchase, these options could not be excluded from the definition of a nonqualified deferred compensation arrangement.

The taxpayer disagreed. As the memo noted the taxpayer argued that since the actual stock was not currently being traded, it was not "readily tradable" stock and the price of those contracts did not fix the fair value of the stock. No actual shares of stock were traded at that time on a market.

However the National Office did not agree with assertion. The memo holds:

> …[T]he rule does not require that the Common Stock must actually exchange hands on the trading date, but rather only that there are "actual transactions in such stock" on the trading date. Transactions in stock generally mean either the sale or transfer of stock. Even assuming that only contracts to purchase the Common Stock were actually purchased on the Grant Date, the contracts provided for the transfer of the Common Stock. The buyers were contractually obligated to complete their when-issued purchases of the Common Stock if the * * * occurred. The * * * had already occurred * * * on the Grant Date before the over-the-counter market opened for that trading date. Moreover, the buyers were contractually obligated to pay the auction price that applied at the time that they purchased the Common Stock on the Grant Date regardless of the auction prices of the Common Stock on the settlement date. Thus, there is no basis for treating the when-issued purchases of the Common Stock as anything other than "actual transactions in such stock" reported by the established securities market.
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> Because the Common Stock was readily tradable on an established securities market on the Grant Date, § 1.409A-1(b)(5)(iv)(A) applies to determine the fair market value of the Common Stock on the Grant Date. The closing auction price per share of Common Stock on the over-the-counter market on the Grant Date was * * * more than the Exercise Price. Under § 1.409A-1(b)(5)(iv)(A), the Exercise Price was therefore less than the fair market value per share of the Common Stock on the Grant Date.

The memo then goes on to note that even if the shares weren't "readily tradable on an established securities market" the valuation simply wasn't reasonable and, thus, there was an inherent discount which provided value to the employee. That is, the price at which the contracts were being sold had to be taken into consideration in determining the value of the stock at the date of grant.

The memorandum notes:

> If stock is not readily tradable on an established securities market, § 1.409A-1(b)(5)(iv)(B) provides that the determination of the fair market value of the stock must be based on the reasonable application of a reasonable valuation method. Whether a valuation method is reasonable,3 or whether an application of a valuation method is reasonable, is based on the facts and circumstances as of the valuation date. A valuation method is not reasonably applied if it is not revised to take into account information that becomes available after the valuation is calculated that may materially affect the value of the corporation.

> Because recent arm's length transactions involving the sale or transfer of the stock must be considered under a reasonable valuation method, such transactions must also be taken into account after a valuation is calculated. This principle is further reflected under § 1.409A-1(b)(5)(iv)(B)(3), which provides that a reasonable method using actual transactions in the stock as reported by the established securities market must be used once a stock becomes readily tradable on an established securities market. These rules reflect that the fair market value of stock is most accurately determined on the basis of contemporaneous arm's length transactions in the stock. Thus, contrary to Taxpayers' interpretation of § 1.409A-1(b)(5)(iv)(B)(3), the exercise price is properly established as of the grant date of an option only if it takes into account all information that may materially affect the value of the corporation as of the grant date.

In a footnote the memorandum goes on to explain

> This principle reflects the basic common law definition for the determination of fair market value, as stated, for example, under § 1.170A-1(c)(2) and § 20.2031-1(b) and in Rev. Rul. 59-60, 1959-1 CB 237: "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Rev. Rul. 59-60 also provides that "the prices of stocks which are traded in volume in a free and active market by informed persons best reflect the consensus of the investing public as to what the future holds for the corporations and industries represented."

The memorandum is a bit short on details, but presumably the employer had brought in someone to perform a business valuation and was attempting to rely upon that even though buyers were being lined up to be the shares at issue. Very likely if there had not been the sales of contracts to purchase that would have been "good enough" unless the valuation had major clear flaws.

But valuation does not operate in a vacuum and certainly it seems reasonable that regardless of the formulas and methods used, the best evidence of value would generally be what the market in general is willing to pay to get hands on the shares. Certainly at the very least the valuation would need to explain why that value was not appropriate.

SECTION: 506
IRS DELAYS DATES FOR NEW §501(C)(6) ORGANIZATIONS TO FILE NOTIFICATION TO IRS UNTIL AT LEAST 60 DAYS AFTER REGULATIONS ISSUED

Citation: Notice 2016-9, 1/19/16

The IRS in Notice 2016-9 gave social welfare organizations additional time to notify the IRS of their intent to operate under IRC §501(c)(4) under IRC §506 that was added by the Protecting Americans from Tax Hikes Act of 2015 (PATH). This new requirement applies to §501(c)(4) social welfare organizations established after December 18, 2015 and certain other organizations already in existence.

The due date for notifications of intent to operate under IRC §501(c)(4) will be no earlier than 60 days after the publication of regulations that will prescribe the manner in which such organizations must notify the IRS. At that point they will submit the information required by IRC §506.

No penalties for failure to file the required information will be imposed during this period before the first due date. It is important to note that this only gives new organizations additional time, but does not exempt them from having to eventually file the necessary information with the IRS.

This notification to the IRS does not amount to determination by the IRS that the organization qualifies for tax exempt status. Rather, the organizations may, at their option, separately request a determination that it qualifies for tax-exempt status under IRC §501(c)(4).

As the notice explains:

> Although an organization may apply to the IRS for recognition that the organization qualifies for section 501(c)(4) tax-exempt status, there is no requirement to do so (except as provided in section 6033(j)(2) for organizations that fail to file required information returns or notices). Accordingly, an organization described in section 501(c)(4) that files the required annual information return or notice, as applicable, need not seek an IRS determination of its qualification for tax-exempt status.

The downside of not requesting the determination is that the IRS may determine that the organization never actually did qualify for tax-exempt status. Obviously there could be a significant negative tax impact of such a situation, which is why organizations are allowed to request such a ruling.

The new notification provision in the IRC is described in the notice:

> Section 506 requires an organization described in section 501(c)(4), no later than 60 days after the organization is established, to notify the Secretary (in the manner prescribed by regulations) that it is operating as a section 501(c)(4) organization. For certain existing organizations, the notification is due no later than June 15, 2016, 180 days after the date of enactment of the PATH Act. Section 506(b) provides that the notification must include: (1) the name, address, and taxpayer identification number of the organization; (2) the date on which, and the State under the laws of which, the organization was organized; and (3) a statement of the purpose of the organization. Section 506(c) requires the Secretary to send the organization an acknowledgement of the receipt of its notification within 60 days. Section 506(d) permits the Secretary to extend the 60-day notification period for reasonable cause. Section 506(e) provides that the Secretary shall impose a reasonable user fee for submission of the notification. Finally, section 506(f) provides that, upon request by an organization to be treated as an organization described in section 501(c)(4), the Secretary may issue a determination with respect to treatment as a section 501(c)(4) organization, and that the organization's request will be treated as an application for exemption from taxation under section 501(a) subject to public inspection under section 6104.
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> Section 405(b) of the PATH Act amended section 6033(f) to require a section 501(c)(4) organization submitting the section 506 notification to include with its first annual information return filed thereafter any additional information prescribed by regulation that supports the organization's treatment as an organization described in section 501(c)(4).
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> Section 405(c) of the PATH Act amended section 6652(c) to impose penalties for failure to file the notification by the date and in the manner prescribed in section 506 (and implementing regulations). In particular, section 6652(c)(4)(A) imposes a penalty on an organization that fails to submit the notification equal to $20 per day for each day the failure continues, up to a maximum of $5,000. Additionally, section 6652(c)(4)(B) imposes a similar penalty on persons who fail to timely submit the notification in response to a written request by the Secretary.
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> Section 405(f) of the PATH Act provides that, in general, the section 506 notification requirement and the related amendments to sections 6033 and 6652 apply to organizations described in section 501(c)(4) that are established after December 18, 2015, the date of enactment of the PATH Act. Section 405(f)(2) of the PATH Act provides that these provisions also apply to any other section 501(c)(4) organization that had not, on or before the date of enactment: (1) applied for a written determination of recognition as an organization described in section 501(c)(4) (using Form 1024, "Application for Recognition of Exemption Under Section 501(a)"); or (2) filed at least one annual information return or notice required under section 6033(a)(1) or 6033(i) (that is, a Form 990, "Return of Organization Exempt From Income Tax," or, if eligible, Form 990-EZ, "Short Form Return of Organization Exempt From Income Tax" or Form 990-N (e-Postcard)). Existing organizations described in section 405(f)(2) of the PATH Act have until June 15, 2016 (180 days after the date of enactment) to submit the section 506 notification.

Under these rules the IRS will acknowledge the receipt of the notice, but this is **not** a determination that the organization actually qualifies to be a §501(c)(4) tax-exempt organization. Rather, as the notice provides:

> …[S]ection 506(f) provides that an organization seeking IRS recognition of its tax-exempt status may separately request such a determination. Section 506(f) provides that such a request will be treated as an application for exemption from taxation under section 501(a) and therefore will be subject to public inspection under section 6104. Until further guidance is issued, organizations requesting IRS recognition of exempt status under section 501(c)(4) should continue to use the Form 1024. The filing of Form 1024 is optional and will not relieve an organization of the requirement to file the section 506 notification.

SECTION: 877A
ENTIRE GAIN ON INSTALLMENT SALE TAXED TO FORMER LEGAL PERMANENT RESIDENT ON DATE HE FORMALLY GAVE UP STATUS

Citation: Topsnik v. Commissioner, 146 TC No. 1, 1/20/16

Gerald Topsnik is now 0 for 2 in the Tax Court (there are other cases outside the Tax Court as well) in his battle with the IRS regarding whether he owes various taxes, though both cases resulted in published opinion—so arguably he's an important loser. After an earlier loss in his 2014 case (*Topsnik v. Commissioner,* 143 TC No. 12, referred to as *Topsnik IV* in the current opinion) that dealt with failure to properly give up his permanent resident status for federal tax purposes, he was subject to U.S. tax as a resident until 2010.

In the current case (*Topsnik v. Commissioner*, 146 TC No. 1) the question arose regarding whether he owed tax in 2010 on an installment sale of stock in a U.S. corporation. He entered into the agreement in 2004 and was to receive payments through 2013.

Mr. Topsnik asserted that he was a German resident during 2010 and that his income was therefore exempt under the Germany-U.S. tax treaty. The IRS argues that this is not the case.

The taxpayer argues that his contacts with Germany in 2010 made him a German resident. As the Court notes "[p]etitioner's German contacts include a German driver's license and a German passport. He also contends that he owned the inn."

But the Tax Notes that these contacts aren't relevant to the matter unless they subjected him to tax by Germany on his worldwide income:

> Petitioner's recitation of his contacts with Germany during 2010 is not relevant to his status as a German resident during that year except insofar as they served to subject him to German taxation of his worldwide income. Petitioner does not allege that he is subject to German taxation on his worldwide income, and the evidence in the record is uniformly to the contrary.

In fact, the Court notes, Mr. Topsnik had actually claimed to be a nonresident for purposes of German taxation and did not file a return with Germany:

> The information obtained by the German competent authority from the German tax authority reveals that (1) for tax year 2010 petitioner was registered in Germany as a person subject to taxation as a nonresident; (2) petitioner did not file a German tax return for 2010; (3) petitioner was not registered in the German township of Oerlenbach, Freiburg City, or Bruchsal in 2010, nor did he have a registered residence or habitual abode in Germany in 2010; and (4) since 2000 petitioner has, on occasion, resided in a room at Hans and Ingenborg Topsnik's house in Freiburg free of charge. There is no evidence in the record to refute the information obtained by the German competent authority. We find that petitioner was not a "resident" of Germany in 2010 as defined by article 4, paragraph 1, of the U.S.-Germany Tax Treaty. Accordingly, petitioner's monthly installment payments were taxable by the United States.

As was noted earlier (and in the earlier case), Mr. Topsnik did formally end his permanent resident alien status with the United States in 2010. Unforunately, during the time period between when Mr. Topsnik actually thought he had ended his tax U.S. permanent resident alien status and when he actually did, Congress passed the Heroes Earnings Assistance and Relief Act of 2008 which added the tax on those seeking to expatriate at IRC §877A.

So now the question expands beyond simply whether Mr. Topsnik was going to pay tax on the gain allocable to the 11 payments he received in 2010 but also to whether, due to his change in status, he would be subject to the tax on expatriates when he left the country. To begin to make this determination, the Court first must determine if he qualified as a "long-term resident."

As the Court notes, IRC §877A(g)(5) provides a cross reference to IRC §877(e)(2) that defines a "long-term resident" as:

> [A]ny individual (other than a citizen of the United States) who is a lawful permanent resident of the United States in at least 8 taxable years during the period of 15 taxable years ending with the taxable year * * * [of expatriation]. For purposes of the preceding sentence, an individual shall not be treated as a lawful permanent resident for any taxable year if such individual is treated as a resident of a foreign country for the taxable year under the provisions of a tax treaty between the United States and the foreign country and does not waive the benefits of such treaty applicable to residents of the foreign country.

The Court finds Mr. Topsnik clearly meets that test:

> Petitioner was an LPR of the United States beginning on February 3, 1977, the date he received his green card. If petitioner expatriated in 2010, as we find and discuss below, then to be a long-term resident he would have to be an LPR for 8 of the 15 tax years beginning with tax year 1996. In Topsnik IV we held that petitioner was an LPR of the United States during tax years 2004-09. We further held that petitioner was not a resident of Germany during tax years 2004-09. Id. at 261. We held above that petitioner was not a German resident in 2010. Those years constitute 7 of the 8 years necessary for petitioner to fit under the definition of long-term resident of the United States. Petitioner argues that he has been a resident of Germany since 1999. Even if we accept that he is correct for the tax years 1999-2003, he does not argue, and has presented no evidence to suggest, that he was not an LPR of the United States for the three years from 1996-98. Taken together with our holding in *Topsnik IV*, this means that petitioner was an LPR for at least 10 out of the 15 years before formally abandoning his LPR status. Therefore, petitioner is treated as a "long-term resident of the United States" for the purposes of section 877A.

Next the Court looked to determine if he is a "covered expatriate" under these rules—and it finds he is. Among other ways one can become a "covered expatriate" is if an expatriate fails to certify, in accordance with IRS regulations, that he/she was in compliance with the Internal Revenue Code for five years preceding his/her expatriation. While the IRS has not issued such regulations, it has issued Notice 2009-85 to guide taxpayers in complying with this rule, requiring such individuals to file Form 8854 in order to make this certification, under penalties of perjury.

Mr. Topsnik both failed to file Form 8854 and, in fact, was not in compliance with the law since (as was noted in the first Tax Court case) he had not filed returns for all of those years and had not paid all taxes due.

Now the problem arises—as a covered expatriate he is treated as having sold all of his property on the day before his expatriation date. Thus he is deemed to have sold the installment obligation, triggering the recognition and taxation of all remaining gain. As the Court has previously held that he remained subject to the U.S. tax until he formally abandoned the status in 2010, his expatriation date was in 2010.

The Court rejected his claim that no tax could be imposed on the installment obligation because it was entered into before §877A became part of the law. The Court notes that the tax is on property held as of the date of his expatriation, measured using similar rules that apply for estate tax purposes. The fact that his basis happens to be less than the face value of the note simply means he would have a gain if sold—and, thus, the Court decided there was no impermissible retroactive application of the law.

The Court also found that the IRS had properly computed his gain for the installment obligation under the mark-to-market rules, noting:

> In computing a tax liability under the mark-to-market regime, a covered expatriate must use the fair market value of each interest in property as of the day before the expatriation date in accordance with the valuation principles applicable for purposes of Federal estate tax, without regard to sections 2032 and 2032A (relating to alternate valuation dates or the valuation of certain farm or real property). Notice 2009-85, supra. Section 20.2031-4, Estate Tax Regs., provides guidance for valuing installment notes for purposes of including the value in the value of a decedent's gross estate. It states: "The fair market value of notes, secured or unsecured, is presumed to be the amount of unpaid principal, plus interest accrued to the date of death, unless the executor establishes that the value is lower or that the notes are worthless." See Estate of Robinson v. Commissioner, 69 T.C. 222 (1977). On November 19, 2010, the day before petitioner expatriated, petitioner's right to receive monthly installment payments is presumed to have had a fair market value of $1,373,374 on the basis of the amount of unpaid principal and accrued interest.
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> Section 453B(b) provides that a taxpayer's basis in an installment obligation is the excess of the face value of the obligation (the remaining principal amount) over an amount equal to the income which would be returnable were the obligation satisfied in full (the portion of the payments which would be included in the taxpayer's income). Petitioner's basis in his right to receive monthly installment payments is $189,388, the excess of the face amount of the right, $1,373,374, over an amount equal to the income which would be returnable were the right satisfied in full, $1,183,986.