"FEDERAL TAX PLANNING OPPORTUNITIES AND PITFALLS FOR U.S. CITIZENS LIVING AND WORKING OVERSEAS"

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Jerald David August's practice is limited to Federal and state income taxation, including the taxation of corporations, including members reporting under the consolidated group regulations, and pass-thru entities, including S corporations, limited liability companies and partnerships. He frequently advises clients on structuring a desired tax-free formation of a business entity, as well as a subsequent issuance of equity to a new partner or shareholder, or a purchase, sale or exchange of ownership interests in corporations or partnerships, including a planned merger or acquisition. He has also advised clients on the tax consequences attendant to workouts and debt restructurings of leveraged real estate and troubled business enterprises. Mr. August has worked on bankruptcy tax issues involving corporations and partnerships as well as tax credit and tax accounting matters. He also has frequently been involved in tax planning for service providers (and/or service recipients) such as deferred compensation arrangements, qualified or non-qualified stock options or phantom stock arrangements, foreign based compensation matters, and issues relevant to structuring compensation arrangements for service partners in a partnership, including hedge fund managers or managers of private equity concerns. Jerald August has advised clients on the deductibility of compensatory related payments including the potential application of parachute payment and excise tax provisions attendant to a change of control event. In addition, he also has issued tax opinions on a variety of general tax matters as well as in assessing contingent tax liabilities of a corporation under ASC 7401-10 (FIN 48) and related filings of “uncertain tax positions” with the Internal Revenue Service.

In international tax matters, Mr. August has advised business organizations and owners on planning alternatives and structures for engaging in foreign business or investment activities, as well as advising non-U.S. persons and individuals on the tax consequences of making investments in the U.S. His work in this area extends to tax planning with respect to intangibles, and tax compliance issues including transfer pricing, withholding and FACTA provisions in the Internal Revenue Code and/or applicable tax treaty.

In addition to his work on federal income tax matters, Jerald also has substantial experience in estate planning for high net worth residents as well as non-residents that frequently requires the assessment of the potential U.S. transfer and/or foreign gift or estate or inheritance tax impact in transferring wealth from one generation to the next generation(s). He also has advised clients on the benefits/detriments to “expatriation” either as a U.S. citizen or “long-term, U.S. resident” as well as the problems faced from both a tax and compliance standpoint by dual citizens or residents.

On the tax controversy and tax litigation side, Mr. August has substantial experience in representing clients before the internal Revenue Service and other tax authorities, including trials before the United States Tax Court , the Court of Federal Claims, federal district court and the Eleventh Circuit Court of Appeals on a variety of tax matters. He has frequently worked with client’s other business and tax advisors, as special tax counsel, in addressing one or more matters of concern that already have or may in the future may be challenged by the Internal Revenue Service. He has also been frequently involved in pre-indictment criminal tax investigations arising out of an audit or referral to the Criminal Investigation Divisions of the IRS and has worked with criminal defense counsel in such cases.

Mr. August is a frequent speaker and author on federal tax matters on a variety of topics including, international joint ventures, mergers and acquisitions of privately owned companies by private equity firms, foreign tax credits, the attorney-client privilege and work product doctrine in tax controversies and trials, the use of defective entities in tax planning, partnership formations, cost-sharing arrangements, ASC 740-10 (FIN 48) and UTP issues, and other subjects. He is a frequent moderator and speaker for the American Law Institute as well as the New York University Institute on Federal Taxation. For over a dozen years he has chaired the Closely-Held Business Program for the Annual NYU Institute on Federal Taxation and has served as Program Chair of the NYU Annual Fed. Tax. Institute on two occasions. He has served as the Program Chair for the past 10 years of the New York University Institute on Federal Wealth Taxation. He also Chaired the First and Second Annual Wallace-Lyon National Graduate Tax Law Workshops of the NYU School of Law Master's in Taxation Program. He has lectured at other national and regional programs sponsored by the American Bar Association, American Law Institute, the University of Miami's Phillip E. Heckerling Institute on Estate Planning, the Southern California Tax Institute and, as a visiting professor on corporate income taxation at the Graduate Tax Program of the University of Florida School of Law.

Prior to joining the Firm, from May 2005 until May, 2015, Mr. August was a partner and the Co-Chair of the Taxation and Wealth Planning Department of Fox Rothschild LLP, a 22 office, full service law firm. He also was the Chair of the Tax Opinions Committee. While at Fox Rothschild LLP, he spent the majority of his time working out of the firm's Philadelphia office and also worked out of the West Palm Beach office. Prior to joining Fox Rothschild LLP, Mr. August was the majority shareholder in the tax law firm of August, Kulunas, Dawson & Siegel, P.A., West Palm Beach, Florida, which he started in 1988 after serving as Co-Chair of the Tax Department of the Miami based firm of Steel Hector & Davis.

Mr. August is also admitted to practice before the United States Supreme Court and has represented the Tax Section of The Florida Bar in writing and filing an amicus curiae brief with the Court in a landmark tax case, Commissioner v. Estate of Hubert, 520 U. S. 93 (1997). He served as Vice-Chair (Publications) of the American Bar Association, Section of Taxation, and the Editor-in-Chief of the Tax Lawyer, Vols. 58 and 59. He previously served as Chair of the Tax Section's Committees on S Corporations and Continuing Legal Education. He served as Chair of the Tax Section's Pass-Through Entity Integration Task Force and was appointed to the blue ribbon Task Force on Wealth Transfer Tax Reform and wrote a significant portion of the White Paper that the Task Force submitted to Congress and the Treasury.

Jerald is a member of the New York, Florida and Pennsylvania Bar Associations. He is also a member of the American College of Tax Counsel, the American College of Trust and Estate Counsel, the American Tax Policy Institute, a Sustaining Member (25 years) of the American Law Institute and has long served as the Editor-in-Chief of Business Entities, a bi-monthly tax publication which is published by Thomson Reuters and is carried on Westlaw in which he has published numerous articles on federal taxation. He was recently named a columnist on partnership taxation by Tax Notes, the weekly Tax Analysts publication.

Mr. August received a B.S. and B.A. degree from the Wharton School of the University of Pennsylvania (1974). He earned his Juris Doctorate from the University of Pittsburgh School of Law (1977) and was awarded an LL.M. in Taxation from the New York University School of Law (1980).

He is AV+ rated by Martindale-Hubbell and a "band one" designee in taxation by Chambers. He is also listed as prominent in his field by Best Lawyers and Super Lawyers.

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"Federal Tax Planning Opportunities and Pitfalls for U.S. Citizens Living and Working Overseas"[1]

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I. Federal Income Taxation of U.S. Citizens

A. In General.

A U.S. citizen or resident alien individual generally pays U.S. income tax on that individual's worldwide income, regardless of where the income is earned. Treas. Reg. §1.1-1(b); Treas. Reg. §1.871-1(a)(resident alien individual are, in general, taxable in the same manner as U.S. citizens). See also §§1, 55, 62, 67, 68 162, 212, 465, 469, 851, 904. **Sections 871 through 898, limit the scope of U.S. income taxation on foreign persons and by definition only apply to nonresident alien individuals and foreign corporations**. eeSalem Fin., Inc. v. U. S., 2013-2 USTC (CCH) ¶ 50,517 (Fed. Cl. 2013); Joseph D. Specking, 117 T.C. 95, 101-102 (2001), aff'd sub nom. Haessly v. Comm'r, 2003-2 USTC ¶ 50,626 (unpub. opin.), and aff'd sub nom. Umbach v. Comm'r, 357 F.3d 1108 (10th Cir. 2003); Estate of Travis L. Sanders, 144 T.C. No. 5 (2015). For a residency based proposal see Blum and Singer, "A Coherent Policy Proposal for U.S. Residence Based Taxation of Individuals," 41 Vend. J. Transnet's L. 705 (2008). **Most other countries tax their nonresident citizens only on income derived from sources within the country**. See Tedd N. Crow, 85 T.C. 376, 380 (1985)(recognizing unique worldwide tax system of U.S. based solely on citizenship); William D. Rogers, T.C. Memo, ¶ 2013-77 (2013) (most countries employ territorial tax systems).

1. **Who is a U.S.Citizen? The determination of who is a U.S. citizen and the separate question of when such citizenship has been abandoned is determined by the Immigration and Nationality Act, 8 U.S.C. §1401, et seq**. See Treas. Reg. §1.1-1(c). Every person born or naturalized in the United States and subject to its jurisdiction is a citizen. For rules governing loss of citizenship, see §§349 to 357, inclusive, of such Act (8 U.S.C. 1481-1489), Schneider v. Rusk, 377 U.S. 163 (1964), and Rev. Rul. 70-506, C.B. 1970-2, 1. For rules pertaining to persons who

[1] This outline presents a survey of some of the important tax impacts, compliance burdens and wealth planning factors that are part of advising a U.S. citizen or resident that is contemplating re-locating to work and reside in a foreign country or has already obtain such status. As a survey, this outline can not be relied upon in advising clients but serves as a guide for assisting the lawyer or tax advisor on the various factors, filled in with some details, on the issues that must be addressed and considered. While much of the material set forth herein is with respect to provisions in the Internal Revenue Code and Treasury Regulations, advising the migrating client requires a team approach of legal and tax advisors in the pertinent jurisdictions. In advising clients in this area the lawyer and tax advisor must approach the subject with a great degree of deliberation and precision and have a good working relationship with foreign counsel.

are nationals but not citizens at birth, e.g., a person born in American Samoa, see section 308 of 8 U.S.C. 1408. A foreigner who has filed his declaration of intention of becoming a citizen but who has not yet been admitted to citizenship by a final order of a naturalization court is still treated as an alien. See, §7701(a)(30) ("U.S. Person, includes, per §7701(a)(30)(A), a U.S. citizen or resident).

2. Examples. Norman F. Dacey, T.C. Memo ¶92,187 (U.S. citizen author residing in Irelandtaxable at regular rates on worldwide royalty income until he renounced citizenship). See Rev. Rul. 92-109, 1992-2 CB 3 (filing obligations of U.S. citizen residing outside of U.S.); Robert Louis Rusten, T.C. Summary Op. 2008-16 (2008) (U.S. citizen and resident, subject to U.S. self-employment tax with respect to consulting services performed in Canada under totalization agreement between U.S. and Canada despite Canada's improperly imposing its social security tax on such income).See Rev. Rul. 62-179, 1962-2 CB 20 (pension payments received under Canadian Social Security system by resident alien who was Canadian citizen were held includible in gross income under §61).

3. Self-Employment. Rev. Rul.(self-employment tax generally applies on a worldwide basis to a U.S. citizen's or resident alien's net earnings from self-employment.

4. Cook v. Tait, 65 U.S. 47 (1924). Supreme Court upheld the constitutionality of this extraterritorial nature of the federal income tax system as applied to a U.S. citizen who was domiciled in a foreign country. See Joe Buck Coker, P-H T.C. Memo, ¶ 94,129 (1994) (constitutional to tax foreign earned income based on U.S. citizen status); Sudheshna Purushotham, T.C. Summary Op. 2003-164 (2003) (resident alien constitutionally subject to federal income tax; tax deficiency and penalties upheld by court).

   Assume W, a U.S. citizen, moves to Germany and derives no income and retains no assets or other property in the U.S. During the current year, W realizes foreign source capital gains of $500,000 and personal service income of $200,000. All of W's income is currently subject to U.S. income taxation. W is permitted to claim a foreign tax credit under §901, subject to applicable limitation under §904, for foreign pays paid (or accrued) to Germany or other foreign country.

B. Certain Relevant Income Tax Provisions For the U.S. Citizen/Resident Migrating Overseas to Work.

1. Foreign Tax Credits. A U.S. citizen, resident alien individual (or domestic corporation) pays or accrues a foreign income tax (or a foreign tax in lieu of an income tax), is permitted under §901 a credit for the foreign taxes paid or accrued, subject to certain limits such as §904, §909, and §901(m). Alternatively, the taxpayer may elect to deduct the foreign tax in computing taxable income.

2. Foreign Earned Income Exclusion and Exclusion for Qualified Housing Costs.

a. Income Exclusion. Section 911 allows a U.S. citizen or resident alien individual to exclude a certain amount of foreign earned income (currently up to $101,300 of such income), if certain requirements are met. In addition, §911may allow the exclusion of amounts provided by an employer with respect to qualified housing costs. Under §911, where a U.S. citizen lives and works in a foreign country and meets certain requirements, such as either the bona fide foreign residence test or the foreign physical presence test, such qualified individual is generally permitted to elect to exclude up to $70,000 (as increased in subsequent years; presently $118,00 of annual (annualized) compensation, i.e., "foreign earned income" per § 911(b)(1)(A) from being subject to U.S. income taxes, and is permitted an exclusion or deduction for certain housing expenses. §911(b)(2)(A). Bona residence test see §911(d)(1)(A); Foreign physical presence test see §911(d)(1(B). Where an outbound executive makes this election, she cannot take a foreign tax credit or deduction for amounts excluded from gross income.

b. Retention of Abode in United States. Section 911(d)(3) provides that an individual will not be treated as having a tax home in a foreign country for any period for which the individual's "abode" is in the U.S, i.e., an individual whose tax home is tax home is not in a foreign country cannot be a qualified individual. Determining whether the individual's abode is in the United States requires an examination of all the facts and circumstances. Retaining a dwelling unit in the U.S. is not determinative. Instead, the courts evaluate the taxpayer's economic, family and personal ties to the U.S. and the foreign courty in which the taxpayer claims to have an abode. If the taxpayer's ties to the foreing country are transitory or limited, the tax home in a foreign country requirement may not be met James F. Daly, RIA T.C. Memo. ¶ 2013-147 (2013) (Tax Court held that the taxpayer's abode was in the United States because he kept strong ties to his home in Utah while he temporarily worked abroad and his ties to the Iraq and Afghanistan were "severely limited and transitory"). In order for the taxpayer's tax home to be treated as in a foreign country, the taxpayer's stay in the foreign country must be indefinite and not merely temporary. Amad Zaker Eram, RIA T.C. Memo. ¶ 2014-60 (2014) (taxpayer treated as having his tax home in Iraq even though he worked in Iraq under a contract with a specific end date; contract had been extended on more than one occasion and that the taxpayer "intended to stay in Iraq indefinitely with the expectation that the contract would continue to be extended"); James F. Daly, RIA T.C. Memo. ¶ 2013-147 (2013) (taxpayer's abode was in the United States because he kept strong ties to his home in Utah while he temporarily worked abroad and his ties to the Iraq and Afghanistan were "severely limited and transitory").

c. Exclusion for Qualified Housing Costs. Under Section 911(c)(1) the housing cost amount generally equals the excess of the taxpayer's "housing expenses" over the product of 16% of the foreign earned income exclusion The Section 911(a)(2) exclusion applies only to an individual's housing cost amount attributable to employer-provided amounts. In no event may the sum of the foreign housing cost amount exclusion, the foreign earned income exclusion, and the foreign housing cost amount deduction exceed the individual’s foreign earned income for the tax year. If both spouses are qualified individuals, the determination of the foreign housing cost amount exclusion or deduction is more involved. The allowance includes the cost of employer provided housing, foreign real estate or occupancy taxes and utilities (other than phone) and property insurance. The housing expense definition for this purpose does not apply to capital costs, including the purchase price and improvements made to a residence. It does not matter who pays the qualified housing expenses although employer payments may generate tax in the jurisdiction in which the services are rendered. See Pao & Carsalade, “The Increased Costs of Working Abroad,” 37 Tax Adviser 642 (2006); Godfrey & Sullivan, “The Post-TIPRA Foreign Earned Income and Housing Exclusions for Individuals,” 37 Tax Adviser 716 (2006); Sherr & Mattson, “International Provisions of TIPRA,” 37 Tax Adviser 400 (2006); Weinger, “Compensation & Fringe Benefits: Implications of Recent Changes to Internal Revenue Code Section 911 for Multinational Employers,” 34 J. Corp. Tax'n 39 (Jan./Feb. 2007).

d. Effect on Foreign Tax Credits. Where the Section 911 election is made, the U.S. individual cannot claim a FTC or deduction for foreign taxes paid on any amounts excluded from gross income under section 911. See §911(d)(6)(denial of double benefits). See also Rev. Rul. 75-84, 1975-1 CB 236, amplified by Rev. Rul. 76-162, 1976-1 CB 197 (reimbursement of moving expenses); Rev. Rul. 73-181, 1973-1 CB 347 (U.S. citizen employed on fishing vessel operating over continental shelf area adjacent to foreign country’s territorial waters over which that country exercises taxing authority does not meet presence requirement of Section 911(a)(2).

3. Employee of Foreign Government or International Organization. Section 893 permits an alien individual employed by a foreign government or international organization to exclude from gross income compensation for official services rendered provided certain conditions are met. This provision applies to resident alien individuals, but generally does not apply to U.S. citizens (unless the U.S. citizen is also a citizen of the Philippines).

4. U.S. Possession Provisions. U.S. citizens who reside in certain U.S. possessions may not have to pay U.S. taxes on certain income related to those possessions. Those citizens may not also use the foreign tax credit to obtain a double benefit. These provisions give the U.S. possessions the exclusive right to tax the income in question. There is a special tax break in Puerto Rico for U.S. individuals who migrate to Puerto Rico to only be subject to 20% tax on their worldwide income. The details of this provision are beyond the scope of this outline.

5. Foreign Pensions, Employee Benefits. The Code generally allows a U.S. citizen or resident to pay no current taxes on contributions to certain types of retirement trusts and on the income of those trusts. A foreign country may allow similar deferral, but under different rules. A treaty may allow a U.S. citizen or resident to defer income for U.S. purposes until income from a foreign retirement plan arises under foreign law.The taxpayer may benefit from such deferral if the foreign-source income arises in the same year as the foreign tax on the retirement income. For purposes of the §911 exclusion, pensions or annuity payments are not eligible.

6. Foreign Deferred Compensation Arrangements. The U.S. client located abroad may be a participant under a nonqualified deferred compensation arrangement provided by the employer. The employer may be a large U.S. or foreign multinational corporation. Alternatively, it might be a closely held corporation of which the employee is a significant, perhaps controlling, shareholder. The U.S. citizen or resident having rights in and being paid under a DCA while working overseas will need to assess the foreign jurisdiction's tax law on taxing the deferred compensation payments where the services are rendered if such are rendered in his new home country, or what impact or consequence occurs if part or all of such services are rendered in a different country. Of course, for the U.S. citizen or tax resident, the income is includible in taxable income subject to a credit for forieng taxes paid or withheld. Many foreign counties do not have the strong policing rules on deferred compensation arrangements as in the U.S. such as §409A. Indeed many countries just employ a strict cash method approach. One planning idea that may need to be considered is to have the DCA payments made to a facility outside the country where the services are rendered. Working with local counsel on this type of idea is quite important obviously. Under the U.S. tax rules, deferral of DCA may be achieved where there is no actual or constructive receipt or the funding of an escrow for the benefit of the worker (economic benefit doctrine). See Treas. Reg. §1.451-2(a). Rev. Rul. 60-31, 1960-1 C.B. 174. Consideration must also be given to application of §409A. Note also that in enacting §409A Congress required that all amounts previously deferred under a foreign deferred compensation plan be included in gross income. See §6038D(e) (reporting foreign deferred compensation). The regulations to §6038D require that U.S. individuals report interests in a foreign deferred compensation plan and foreign pension plans. There is also risk that a foreign retirement plan that is funded and holds investment assets, as is typical, may be characterized as an foreign financial asset for purposes of Section 1471 (FACTA rule for "FFI's").

   a. Section 409A In General. In order to comply with § 409A, a plan must provide that distributions from the deferred compensation plan are only allowed at separation from service, death, a specified time (or under a fixed schedule), change in control of a corporation, occurrence of an unforeseeable emergency, or if the participant becomes disabled. The plan may not allow for the acceleration of benefits, except as provided by regulation, and if the employee is electing to defer some of his current salary, the deferral must be made no later than the close of the preceding tax year, or at such other time as provided in final regulations. Compliance is critical because failure to comply is felt by the employee results in current income taxation on the entire deferred amount plus a 20% excise tax and interest if the deferred compensation is taxable in a prior year as a result of the failure to comply.

(i) If a U.S. citizen or resident alien is entitled to deferred compensation, then that deferred compensation may be subject to section 409A regardless of where it was earned;

(ii) If a nonresident alien is entitled to deferred compensation, then that deferred compensation may be subject to section 409A only if the underlying services were performed in the United States; and

(iii) Exemptions. There are several exemptions under section 409A. This requires review of any income tax treaty between the U.S. and the foreign jurisdiction.

b. Foreign Social Security Systems/Totalization Agreement. Section 409A does not apply to benefits paid under a foreign social security system, if the benefits are provided under a government mandated plan or a plan covered by a totalization agreement between the U.S. and the foreign country in which the employee is working.

c. Tax Equalization Agreements Payments. Payments made to an employee under tax equalization agreements are not subject to §409A, if such payments are made no later than the end of the second calendar year beginning after the calendar year in which a U.S. income tax return must be filed (including extensions) for the year to which the tax equalization payment relates.

d. Foreign Separation Pay Plans. Section 409A does not apply to amounts paid pursuant to a foreign separation pay (severance) plan required under the laws of a foreign jurisdiction. The amount exempted under this exception is limited to the foreign earned income from sources within the country that mandates the separation pay.

e. Foreign Earned Income Exemption. Section 409A does not apply to compensation deferred by a U.S. citizen or resident alien working abroad to the extent (i) such deferred compensation would have constituted excludible foreign earned income as defined in §911, had it been paid currently, and (ii) the maximum amount available as excludible foreign earned income for the relevant taxable year is not otherwise used by the taxpayer. This exemption may be of limited value since typically foreign earned income of a U.S. citizen or resident alien working abroad exceeds the §911 exclusion amount.

f. See Section 409A(b)(1). Where assets are set aside in a trust in funding a DCA such assets shall be treated as property as property transfer in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors at the time set aside if such assets or trust are located outside of the U.S. or at the time transferred if such assets or trust are subsequently transferred outside of the U.S. However, "this paragraph shall not apply to assets located in a foreign jurisdiction if substantially all of the services to which the nonqualified deferred compensation relates are performed in such jurisdiction".

g. Potential Use of Rabbi Trust Arrangement. The employer deposits funds equivalent to the deferred compensation amount into a revocable or irrevocable trust. Inasmuch as the employer can retrieve those funds by terminating the trust, or the trust is otherwise treated as a grantor trust, the funds are not treated as escrowed (and thereby received) by the employee. See Rev. Rul. 69-70, 1969-1 CB 182 (a foreign employer creates a trust that must distribute its income to a U.S. beneficiary but U.S. income tax rules classify that trust as a grantor trust, the foreign grantor and not the U.S. beneficiary is the deemed recipient of the trust's income for U.S. tax purposes). Many foreign deferred compensation and retirement plans use trusts to fund benefits for participants that are or would be considered §402(b) trusts and are not subject to the claims of general creditors of the company. For example, the foreign employer grantor could retain one of the prohibited administrative powers per §675; (i) §675(1)(power to deal for less than adequate and full consideration); (ii) §675(2)(power to borrow without adequate interest or security); (iii) §675(3), concerning the power to borrow the trust funds without adequate security; and (iv) §675(4)(c), power to reacquire the trust corpus by substituting property of an equivalent value.

h. The Problem Working for CFC In which a U.S. Individual Is a U.S. Person. If the foreign-based employer is a controlled foreign corporation, the income derived by that trust and belonging to the foreign corporation will ordinarily be foreign personal holding company income and included (as Subpart F income) in the income of the U.S. shareholders.

i. NQSO's. (Non-Qualified Stock Options). Deferring income until date of exercise in accordance with Treas. Reg. §1.83-7. A gift of nonqualified stock options received in exchange for services will not accelerate the recognition of taxable income or gain to the transferor of those options at the time of the gift.When the options are subsequently exercised (including by donative transferees) the employee will recognize compensation income to the extent that the fair market value of the shares received on exercise exceeds the option price paid for the shares. If a foreign corporation is the employer issuing those shares, the availability of a deduction for the amount of the excess of the fair market value of those shares over the exercise price will depend on the income tax laws in the foreign country where the employment occurs.

j. Section 409A Not Applicable to DCA Involving Nonresident Alien. Provided the compensation would not have been subject to U.S. income tax had it been paid to the nonresident alien at the time that the legally binding right to the compensation first arose, of, if later, when the legally binding right was no longer subject to a substantial risk of forfeiture.

7. Foreign Social Security benefits. A foreign government may make Social Security-type payments to a U.S. citizen or resident. Although the United States generally taxes its citizens on their worldwide incomes, a treaty may exempt the payments from U.S. taxes. In such a treaty, the saving clause may allow a U.S. citizen or resident to benefit from the exemption.

8. Totalization Agreements. International coordination is needed to ensure that a worker's wages are not subject to double contributions, that the worker's global history of contributions is not ignored when it comes time for the worker to retire, and that the worker's benefits are not subject to double income taxation upon receipt. In the United States, two types of international agreements are used to achieve coordination of these three spheres. The first, and more traditional instrument, is the tax treaty. The second, introduced more recently, is the totalization agreement, which is in form an "executive agreement"--a legal instrument that differs from a traditional treaty. In order to reduce the risk of subjecting U.S. citizens and residents rendering services in a foreign country to double employment taxes, the United States has entered into totalization agreements with certain foreign countries which allocate social security and other employment taxes paid by workers who would be otherwise subject to employment taxes in both countries. All totalization agreements provide that the United States may use credits from the foreign country to help a person meet the minimum coverage requirements for U.S. benefits. Some agreements provide that the foreign country can count U.S. credits to help a person meet the minimum length-of-work requirement for foreign benefits. However, other agreements do not permit the foreign country to count U.S. quarters of coverage to help an individual qualify for a foreign benefit. Rather, the length-of-coverage requirements for the foreign benefit are simply reduced. Each country determines eligibility for benefits under its own laws (taking account of the worker's coverage in the other country, where necessary) and pays its benefit independently of the other. Although each country may count credits in the other country, credits are not actually transferred from one country to the other. Rather, they remain on the worker's record in the country where they were earned. It is therefore possible for a worker (and his or her family members) to qualify for separate benefit payments from both countries. A claim for benefits under an

agreement may result in: (i) both countries paying totalization benefits based on the agreement; (ii) one country paying regular (non-Totalization) benefits (if the worker is insured under its system) and the other country paying Totalization benefits based on the agreement; (iii) both countries paying regular (non-Totalization) benefits, or (iv) one or both countries denying the claim.

On or after the effective date of the agreement, to the extent that employment or self-employment (or service recognized as equivalent) under the U.S. social security system or foreign system is covered under the agreement, the agreement will provide that the work or equivalent service be subject to payment of contributions or taxes under only one system. The system under which contributions or taxes are to be paid is the system under which there is coverage pursuant to the agreement. A U.S. employer is relieved of its obligation to make payments under a foreign affiliate employee coverage agreement, with respect to services performed by U.S. citizens or residents employed by a foreign affiliate, when it enters into a totalization agreement with the foreign country where such services are performed, under which agreement the wages of such employees working for the foreign subsidiary in the foreign country become subject to taxes for social security purposes under the social security system of the foreign country.

a. See SSA 1977, 317(b)(4), P.L. 95-216 which provides:

> "Notwithstanding any other provision of law, taxes paid by any individual to any foreign country with respect to any period of employment or self-employment which is covered under the social security system of such foreign country in accordance with the terms of an agreement entered into pursuant to section 233 of the Social Security Act shall not, under the income tax laws of the United States, be deductible by, or creditable against the income tax of, any such individual."

b. 42 U.S.C. 433(c)(1)(A). A totalization agreement with another country must allow certain individuals who have contributed to the social security systems of both nations to combine the respective "periods of coverage" under each for purposes of determining entitlement to benefits, which are then prorated. 42 U.S.C. § 433(c)(1)(A), (C). By law, the agreement must also provide: (i) that employment ... or any service which is recognized as equivalent to employment ... under [the subchapter of title 42 governing the federal social security program] or the social security system of a foreign country which is a party to such agreement, shall ... result in a period of coverage under the system established under this subchapter or under the system established under the laws of such foreign country, but not under both, and (ii) the methods and conditions for determining under which system employment ... or other service shall result in a period of coverage... 42 U.S.C. 533(c)(1)(B).

c. Totalization Treaties. The United States currently has totalization agreements in force with 21 countries: Australia, Austria, Belgium, Canada, Chile, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea (South), Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.For a review of this area see Christian, “Taxing the Global Worker: Three Spheres of International Social Security Coordination”, 26 Va. Tax. Rev. 81 (Summer 2006).

d. No U.S. Foreign Tax Credits Allowed For Foreign SSI Payments. Erlich v. U.S., 104 Fed. Cl. 12 (2012).Provides background of totalization agreement between U.S. and France. The case involved a U.S. and French citizen working for a French employer. Erlich wanted to receive FTCs under §901 of the Code for the social security taxes paid (withheld) to France. After working for over 10 years in the U.S. for a U.S. subsidiary of a Dutch Antilles company, Erlich was reassigned to a French subsidiary of the company in late 1997, and since that time plaintiffs have lived in France while Mr. Erlich was employed by either French subsidiaries or the parent company. Erlich’s wife was both a citizen of the US. and Germany and were French residents during the relevant tax years. The Court opined that regardless of the U.S.-French Totalization Agreement (1988), Erlich’s wages in France from these employers would not have been subject to U.S. social security tax as they were wages not performed for an American employer, i.e., a company organized under the laws of any state or the U.S. §§3121(h)(5), 3101(a), 3111(a), 3121(b)(B). Under the totalization agreement, taxes or contributions under the social security laws of either party can be paid (withheld and paid) but not under both. See 42 U.S.C.A. §433 (international agreements). Thus the court ruled that joint filing taxpayers were not entitled to FTCs for taxes paid to France during the three tax years in issue since they were only subject to French social security laws under the applicable totalization agreement between France and the U.S.

e. Not Entitled to Participate Under Totalization Agreement Between U.S. and Greece. Georgiou v. Apfel, 50 F. Supp. 2d 913(199), aff’d, 242 F.3d 374, cert. den. 121 S.Ct. 1977, rehear’g den. 121 S.Ct. 2628. Retiree who had worked in both Greece and United States before retiring in U.S., and who had enough periods of coverage to be insured for regular U.S. retirement benefits, was not eligible for totalization of benefits under totalization agreement between Greece and United States pursuant to Social Security Act, since agreement established eligibility requirements for those who had accumulated specified number of coverage periods but not enough to be eligible for regular benefits.

f. Not Eligible to Participate Under Totalization Agreement Between U.S. and the U.K. Das v. Social Security Administration, 134 F.3d 377, 1998 WL 22064 (9th Cir.1998) (unpublished) where plaintiff argued that he should receive credit for his contributions to the U.K.'s social security system in determining the amount of benefits owed. The court found this to be an incorrect interpretation of the Agreement and the authorizing statute: “The

Agreement is designed to allow contributions to one system to be considered in determining eligibility in the other system." Das had sufficient work quarters in the United States to qualify for United States benefits and thus the Agreement was of no help to him. The [totalization] Agreement sets up eligibility requirements "for the purpose of establishing entitlement to" benefits. It determines the amount of benefits if eligibility has been established. 42 U.S.C. §433(a). Here, plaintiff is fully insured and has sufficient work quarters in the U.S. to qualify for U.S. benefits. The Agreement is of no help to him because he does not qualify for totalization.The Agreement precludes dual coverage.

9. Equalization Agreements. A tax equalization agreement that provides for payments intended to compensate the service provider for the excess of taxes actually imposed by a foreign jurisdiction on the compensation paid (other than payments under the equalization arrangement) to the service provider over the taxes that would be imposed if the compensation were solely subject to U.S. Federal income tax, and provided the payments made may not exceed such excess plus the amounts necessary to compensate for the additional taxes on the amounts paid under the equalization arrangement. Tax equalization payments can be with respect to U.S. Federal, state and city taxes on a foreign resident's compensation income while working in the US. Equalization payments should also be designed to conform with §409A. In this regard a tax equalization agreement does not provide for a deferral of compensation provided that payments under the subject agreement are made no later than the later of (as to foreign service income payments) the second tax year of the service provider beginning after the latest such tax year in which the service provider's foreign tax return or payment is required to be filed or made for the year to which the compensation subject to the tax equalization payment relates. Where the payments arise due to an audit, litigation or similar proceeding, the right to the payments won't be subject to §409A if the payments are scheduled and made in accordance with the provisions of Treas. Reg. §1.409A-3(i)(1)(v) on the timing of tax gross-up payments. Earnings credited on amounts under a tax equalization agreement are also exempted from §409A. See Treas. Reg. §1.409A-1(b)(8)(vi).

C. Determination of U.S. Residence for U.S. Federal Income Tax Purposes.

1. Determination of U.S. Residence-U.S. Domestic Law.

A non-U.S. citizen is considered a resident of the United States where such individual falls within one of two categories; to-wit: (i) where such person has entered the U.S. as a lawful permanent U.S. resident, e.g., the "green card" test; or (ii) is present in the U.S. for 31 or more days during the current calendar year and has been present in the U.S. for a substantial period of time, i.e., 183 or more days over a weighted 3 year period, e.g., the "substantial presence test"). See §7701(b)(definitions of resident and nonresident aliens). This weighted average formula, stated in different terms, results in U.S. residence where the individual is present for 122 or more days over the weighted (average) 3 year period. In addition, where an individual is present in the U.S. for fewer than 183 days during a calendar year, and can further establish that he or she has a "closer connection" with a specific foreign country and maintains a "tax home" in that country for the year, such individual generally is not treated as a U.S. resident under the "substantial presence test". Where an individual is present for 183 or more days during a calendar year, then the "closer connection", "tax home" exception is inapplicable. Where an alien has an application pending to change his or her status to permanent resident or has taken other steps to apply for status as a lawful permanent resident, such person is also ineligible for the closer connection-tax home exception. In applying the substantial presence test, days where an individual is present as an "exempt individual" are not counted. "Exempt individuals" include certain foreign government-related individuals, teachers, trainees, students, and professional athletes temporarily in the United States to complete in charitable sports events. In addition, the substantial presence test does not count days of presence of an individual who is physically unable to leave the United States because of a medical condition that arose while he or she was present in the United States, if the individual can establish to the satisfaction of the Secretary of the Treasury that he or she qualifies for this special medical exception.

2. Determination of U.S. Residence- Under Treaty Tie Breaker Provision.

a. In General - The Dual Resident Problem. In certain instances a foreign person will meet the definition of a U.S. resident while, at the same time, such person is classified as a "resident" of the domestic tax law of another country. This can pose a substantial problem particularly for the individual whose country of nationality does not maintain an income tax treaty with the U.S. However, where such foreign individual is from a country that maintains an income tax treaty with the U.S., then, in order to avoid double taxation, most income tax treaties maintain a set of "tie-breaker" rules which resolve the individual's country of residence for income tax purposes. In general, a dual resident is deemed to be a resident of the country in which such person has a permanent home. If the individual has a permanent home available in both countries, the individual's residence is deemed to be the country with which his or her personal and economic relations are closer, i.e., the "center of vital interests." If the country in which such individual has his or her center or vital interests cannot be determined, or if such individual does not have a permanent home available in either country, he or she is deemed to be a resident of the country in which he or she has a habitual abode. If the individual has a habitual abode in both countries or in neither country, he or she is deemed to be a resident of the country of which he or she is a citizen. If each country considers the person to be its citizen or if he or she is a citizen of neither country, the competent authorities of the countries are to settle the question of residence by mutual agreement, i.e., by resolution of competent authorities.

b. Impact on Treaty Interpretation. The terms "citizen" and "resident" as applied to an individual is quite important. Residency in a contracting state to a bilateral income tax convention entitles, in general, the resident to treaty benefits. Thus, it is possible that a citizen of non-contracting state, i.e., a U.S. citizen, is able to claim relief under a U.S. income tax treaty for example, where such individual qualifies as a resident of one of the Contracting States. Second, citizenship alone generally does not qualify an individual for treaty benefits, other than under the nondiscrimination article of the relevant treaty.Siddiqi v. Comm'r, 70 T.C. 553 (1978)(citizen of Pakistan could not claim benefit under U.S.-Pakistan treaty because he was resident of United States and hence not of Pakistan); Budhwani v. Comm'r, 70 T.C. 287 (1978)(same); Rev. Rul. 75-489, 1975-2 CB 511 (U.S. Social Security payments under French treaty). However, the U.S. Model Treaties include "citizenship" as one of the bases upon which an individual could qualify as a "resident" of a Contracting State. See 1996 U.S. Model Treaty, Article 4(1); 1981 U.S. Model Treaty, Article (4)(1).

c. Treaty Savings Clause. The United States generally prefers to extend U.S. tax treaty benefits to U.S. citizens residing outside of the United States since it taxes its citizens on their worldwide income including where the citizen may be resident elsewhere under a treaty savings clause. A savings clause contained in the treaty preserves the U.S.'s right to tax its own citizens under its domestic laws. Thus, it nullifies application of the treaty to U.S. citizens as their tax treatment is determined under the Internal Revenue Code and not under the treaty. This can result in a U.S. citizen having to file a worldwide income tax return in two jurisdictions, the United States as her country of citizenship, and another treaty country, for example, France, where she is deemed "resident" of France under its domestic law and under the treaty tie-breaker provision. See Andrea Ready, T.C. Summary Opinion 2012-12 (February 1, 2012)(Tax Court held a flight attendant of a U.S. carrier who was a dual U.S.-U.K. citizen and a resident of France was not permitted to exclude from income her wages attributable to services performed in the U.S. and over international airspace under the section 911 foreign income exclusion or the 1994 U.S.-France income tax treaty).

A few U.S. tax treaties have incorporated a definition of "resident" that is substantially similar to that of the U.S. Model treaties. Under those treaties, treaty benefits generally are available to individuals who are citizens of a Contracting State, even though these individuals are not residents of either Contracting State.

d. Disclosure of Treaty-based Return Positions. Treas. Reg. §301.6114-1(a), provides that where a taxpayer takes a return position that a tax treaty overrules or modifies any provision of the Code and thereby effects a reduction of any tax at any time, the taxpayer must disclose that return position, either on a statement attached to the return or on a return filed for the purpose of making such disclosure. The regulations contain several modifications and exemptions from disclosure where disclosure is otherwise made by the taxpayer and for certain levels of foreign source income subject to treaty exemption received by non-individuals. Disclosure of transactions and amounts under § 6114 or §7701(b) on Form 8833 generally will constitute adequate disclosure for the substantial understatement penalty in § 6662(d). See Rev. Proc. 2008-14, § 4.01(4)(b), 2008-1 CB 435, 437. See HR Conf. Ref. 1104, 100th Cong., 2d Sess. 11–12 (1988). The statement must contain the following information: (i) name, TIN (if any), and address, both in the country of residence and in the United States, of the taxpayer; (ii) name, TIN (if it is available to the taxpayer), and U.S. address of the payor of the income, in the case of a FDAP income; (iii) identity of taxpayer, i.e., individual U.S. citizen or resident or a corporation incorporated in U.S.; (iv) statement of facts relied on to support each separate position taken including relevant analysis under the treaty, etc. Other applicable rules are contained in the regulations. Section 6114(b) provides that the Treasury may waive the disclosure requirement in instances where such will not impede tax assessment and collection. Where a taxpayer fails to meet the disclosure requirement under §6114, § 6712(a) imposes a civil penalty of $1,000 for each such failure, but $10,000 for each failure by a C corporation.

D. Foreign Tax Credit Provisions.

To mitigate double taxation to U.S. citizens and residents, §901 permits a foreign tax credit to offset in full the foreign taxes paid or accrued that would otherwise increase such individual's U.S. taxation.

1. Avoidance of Double Taxation. Foreign Tax Credits (over Deductions for Foreign Taxes). Before a U.S. taxpayer may claim a FTC, there are rules of limitation and other conditions contained in the Code, regulations and case law. See, e.g., §§ 901, 902, and 904 and corresponding regulations. As to consolidated returns, special rules apply. See Treas. Regs. §§ 1.1502-4 and -9. An overall limitation on the current use of FTCs, as explained above, is contained in §904(a). This limits the otherwise allowable FTC by multiplying the pre-credit U.S. tax by a fraction, the numerator is foreign source taxable income and the denominator is worldwide taxable income. A second limitation on the current use of FTCs is found in §904(d). Under §904(d), the potentially allowable FTCs are allocated to applied to separate categories or "baskets" of income and generally is designed to prevent the blending of foreign tax rates on different types of income.

2. Form of FTCs. The FTC may take the form of either a direct credit by the taxpayer for reporting on such person’s income tax return, or, for domestic corporations owning a certain percentage of stock in a foreign corporation subject to foreign taxes, an indirect credit. See §§901, 902, 960. A direct FTC may be claimed for certain foreign taxes paid or accrued to a foreign country or U.S. possession. §901.

This may occur, for instance, when a taxpayer directly pays or accrues a foreign tax to a foreign country or U.S. possession (e.g., foreign withholding tax). Additionally, a direct credit may be available when the taxpayer owns an interest in an entity that is a flow-through entity (e.g., a partnership or hybrid entity that is treated as a disregarded entity or partnership for U.S. federal tax purposes). An indirect credit may be claimed on dividends received by a domestic corporation that owns 10% or more of the voting stock of a foreign corporation or constructive dividends on subpart F income from a controlled foreign corporation. See §§902, 960(a)(1), 962.

3. Claiming the Credit or Taking the Deduction.

a. Annual Election. The election to credit rather than deduct foreign taxes is, in general, an annual election that applies to all foreign taxes paid or accrued in that year. Under §905(a) the election by a cash basis taxpayer to claim FTCs on an accrual basis is not part of the annual election provision. Once the accrual method claim for FTCs is made by a cash basis taxpayer, the §905(a) election is irrevocable. See §905(c)(2)(special rules for taxes accrued but unpaid after 2 years).Amendments to the §905(c) Temporary Regulations (TD 9362, 11/6/07; the "2007 Temporary Regulations") provide for certain adjustments where there has been a "foreign tax redetermination," i.e., a change in the foreign tax liability that may affect the taxpayer's foreign tax credit. The taxpayer generally must file an amended return for the affected year(s) if, as a result of the foreign tax change, a redetermination of the taxpayer's U.S. tax liability is required.

b. Preference for Foreign Tax Credit Over Deduction for Foreign Taxes. Generally, for U.S. taxpayers, the FTC is significantly more preferable over the deduction approach as it reduces world-wide income taxes on a dollar-for-dollar basis, subject to application limitation. There may be certain instances where, based on the taxpayer's particular tax attributes, the deduction may generate greater tax savings. One example of the latter instance may occur is in an excess FTC position, i.e., where foreign taxes exceed foreign income caused as a result of tax base or sourcing differences. While sacrificing the use of excess FTC carryovers in other taxable years, a deduction over credit approach may be preferable where foreign taxes exceed foreign income since the additional foreign tax deductions will reduce taxable U.S. source income. Deducting foreign taxes may also be more beneficial when the taxpayer has a loss for the year (considering income from both U.S. and foreign sources). In that circumstance, the taxpayer has no pre-credit U.S. tax liability against which to claim a foreign tax credit. While again giving up the FTC carryovers, the taxpayer may prefer deducting foreign taxes in a year in which it has a loss, because the deduction may increase the taxpayer's NOL for §172 purposes and yield a NOL carryback or carryforward.

c. Election Mechanics**:** Forms 1116 (Individuals) 1118 (Corporation). The election to credit or deduct foreign taxes is made by attaching the appropriate form to the taxpayer's annual return. The form for individuals claiming the foreign tax credit is the Form 1116. Individuals that pay less than $300 of foreign taxes (or $600 in the case of a joint return) may not have to file a Form 1116 in certain circumstances. See §904(j). The form for corporations claiming the foreign tax credit is the Form 1118. It is important to note that with respect to any single year, a taxpayer must credit or deduct all foreign taxes paid or accrued during that year. Treas. Reg. §1.901-1(c).

d. Statute of Limitations for Foreign Tax Credits**.** Section 6511(d)(3) extends the normal three-year statute of limitations for refund claims for overpayments of tax, to 10 years in the case of refund claims based on the availability of foreign tax credits. Treas. Reg. §1.901-1(d). The 10 year statute runs from the year in which the taxes, that are sought to have been overpaid by aid of hindsight, were paid or accrued. See CCAs 201136021 and 20111009. Where the FTC election is changed, i.e., reduced, and such change results in additional tax liability in earlier years, statutory interest presumably will be due from the due dates for timely filing returns from such prior years. See Anderson and August, "Foreign Tax Credits: Planning and Pitfalls", ALI CLE/Live Video Webcast (2/24/2014).

E. Special "Look Through" and Special Tax Regimes Applicable to U.S. Citizens and Residents With Respect to Foreign Corporations or Entities Tax as Associations.

1. In General. U.S. citizens and residents are also subject to special income taxation regimes which look through corporate structures that have certain species or classes of foreign source taxable income where certain ownership requirements are met. The use of one or more foreign entities by a U.S. citizen or resident to hold investments or to engage in the active conduct of a trade or business can produce certain immediate outcomes: (i) unintended double taxation; (ii) low taxation of foreign income through a foreign corporation or "blocker", subject to the look thru rules under Subpart F for certain controlled foreign corporations. These rules are the controlled foreign corporation provisions, the passive foreign investment company rules and domestic international sales corporation's rules or "interest-charged DISCs". The use of a controlled foreign corporation may result in the deferral of taxation of foreign source income reflected in accumulated earnings and profits. The CFC rules apply where a small number of U.S. shareholders have control or ownership, directly or by attribution, of the foreign corporation.

2. Hybrid Entities. A single member entity such as a limited liability company with one U.S. citizen or resident as an owner results in the entity being ignored for U.S. income tax purposes unless the owner affirmatively elects with the IRS to treat the entity as an association. Under the check-the-box regulations a hybrid entity is a flow through entity for U.S. tax purposes but in many cases will be taxed as a "company" or corporation under foreign domestic tax law. Foreign tax credits may

also be realized by the U.S. owner of the single member LLC. A partnership is also a flow through entity and passes through its items of income, deduction, loss or credit to its partners. A partnership or LLC taxable as a partnership may elect to be treated as an association taxable as a corporation. Under certain circumstances, §894(c) denies treaty benefits to so-called “hybrid entities,” where three conditions are met, Section 894(c)(1) denies to a foreign person the benefits of a reduced rate of withholding tax under a U.S. income tax treaty with a foreign country with respect to an income item derived through an entity that is treated as a partnership (or is otherwise treated as fiscally transparent) for purposes of the Code. First, such item of income is not treated for purposes of the foreign treaty country's tax laws as an income item of the foreign person. Second, the U.S. income tax treaty does not have a provision addressing the applicability of the treaty in the case of an income item derived through a partnership. Third, the foreign treaty country does not impose tax on a distribution of such income item from the entity to the foreign person. Section 894(c)(2) gives the Treasury regulatory authority to address the availability of treaty benefits in situations involving hybrid entities but that are not covered by §894(c)(1)

3. Trusts, Including Grantor Trusts and Foreign Trusts. Other special rules (Sections 671-679) apply to certain trusts deemed to be owned by the grantor or other person by the retention of certain rights or powers with respect to such trust held by the grantor and/or a “non-adverse” party (a “grantor trust”). In that case, the deemed owner must include in income the items of income and deduction (and credits against tax) of the portion of such trust deemed to be owned by such person. Except to the extent a trust is a grantor trust, a transfer of property by a U.S. person to a foreign estate or trust is treated (under Section 684) by the transferor as if the property had been sold to such estate or trust. Section 684(a) generally treats the transfer as a sale or exchange with recognition of gain measured by the excess of fair market value over the transferor’s adjusted basis as determined for gain purposes. See former §1451, §1057. If gain is recognized under Section 684(a), the trust will acquire a FMV basis. The same result applies where a domestic trust becomes a foreign trust.

   a. Foreign Trusts. A foreign trust, in general, is subject to U.S. income taxation only with respect to its U.S. source income and effectively connected income. Treas. Reg. §301.7701-7(a)(3). Without additional provision in the law, U.S. persons could avoid U.S. taxation by creating foreign trusts with foreign beneficiaries, and defer if not permanently avoid U.S. taxation.

   b. U.S. Grantor of Foreign Trust. As mentioned, a U.S. person who transfers property to a foreign trust is treated under §679(a) as of the owner of the transferred property for U.S. tax purposes if the trust has or acquires a U.S. beneficiary. This result also applies to trusts with foreign grantors who become U.S. residents within 5 years of a transfer to the trust and also applies to a domestic trust that becomes a foreign trust while the U.S. grantor is alive. §§679(a)(4), 679(a)(5). Exception is provided for transfers at death and sales of property for FMV in which the gain is fully recognized by the transferor. §679(a)(2). See also §679(a)(3).

4. Accumulation Distributions From Foreign Non-Grantor Trusts. Accumulation distributions to U.S. beneficiaries from non-grantor, foreign trusts are subject to tax at special rates and increased by an interest factor to reflect the deferral of U.S. taxation during the period the income of the foreign trust has accumulated. See §677,678. Any "loan" or use of trust property from a foreign trust to a U.S. grantor or beneficiary may be treated as a trust distribution. See §643(i).

a. Examples from Regulations. Treas. Reg.§1.684-1(d).

(i) Example (1). Transfer to Foreign Trust(FT). A transfers property that has a FMV of $1000X to FT. A's adjusted basis in the property is $400X. FT has no U.S. beneficiary within the meaning of Treas. Reg. §1.679-2, and no person is treated as owning any portion of FT. Under Section 684(a)(1), A's gain at the time of the transfer will be $600X.

(ii) Example (2). Transfer of Multiple Properties to Foreign Trust. A transfers property Q, with a FMV of $1000X, and property R, with a fair market value of $2000X, to a FT. At the time of the transfer, A's adjusted basis in property Q is $700X, and A's adjusted basis in property R is $900X. FT has no U.S. beneficiary within the meaning of Treas. Reg. §1.679-2, and no person is treated as owning any portion of FT. Under section 684(a)(1), A recognizes $300X of gain attributable to property Q. Under section 684(a)(2), A does not recognize the $200X of loss as to property R and cannot offset the gain with respect to property Q by the loss realized (but not recognized) with respect to property R. Treas. Reg. §1.684-1(d)(2).

(iii) Example (3). Transfer of Property to Foreign Trust Which Then Sells Property to Unrelated Party for Less Than Fair Market Value. A transfers property with FMV of $1000X to FT to an unrelated party for $400X of cash. A's adjusted basis in the property is $200X. FT has no U.S. beneficiary within the meaning of Treas. Reg. §1.679-2, and no person is treated as owning any portion of FT. Under section 684(a)(1), A recognizes gain at the time of the transfer of $800X. Treas. Reg. §1.684-1(d)(3).

(iv) Example (4) . Exchange of Property For Private Annuity. A transfers property with FMV $1000X to FT in exchange for FT's obligation to pay A $50X per year for the rest of A's life. A's adjusted basis in the property is $100X. FT has no U.S. beneficiary within the meaning of Treas. §1.679-2, and no person is treated as owning any portion of FT. A is required to recognize gain equal to $900X immediately upon transfer of the property to the trust. This result applies even though A might otherwise have qualified to defer recognition of gain under another applicable provision. Treas. Reg. §1.684-1(d)(4).

(v) Example (5). Transfer of Property to Related Foreign Trust in Exchange for Qualified Obligation. A transfers property with FMV 1000X to FT in exchange for FT's obligation to make payments to A during the next four years. FT is related to A per Treas. Reg. §1.679-1(c)(5). The obligation is a "qualified obligation" per Treas. Reg. §1.679-4(d), and no person is treated as owning any portion of FT. A's adjusted basis in the property is 100X. A is required to recognize gain equal to 900X immediately upon transfer of the property to the trust. This result applies even though A might otherwise have been allowed to defer recognition of gain under another provision. Treas. Reg. §1.684-3(d) provides rules relating to transfers for fair market value to unrelated foreign trusts. More specifically, gain is not recognized under §684 on a transfer to an unrelated foreign trust in exchange for assets which have a fair market value equal to the value of the transferred assets. See Treas. Reg. §1.684-3(g), Ex. 4. See also Treas. Reg. §1.684-1(d)(5).

5. Controlled Foreign Corporation Provisions.

a. In General. Under the controlled foreign corporation (CFC) rules, which are contained in Sections 951 through 964, a FC is a CFC if for an uninterrupted period of 30 days or more during any taxable year, every person who is a U.S. shareholder (per §951(b)) of the FC and who owns (within the meaning of §958(a)) stock in such corporation on the last day, in such year, on which such corporation is a CFC shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation, his proportionate share of the CFC's (undistributed) subpart F income. See §951(a)(1). In other words, a U.S. shareholder of a CFC is currently required to include in gross income such individual's proportionate share of the undistributed earnings of the CFC of the corporation's subpart F income. A U.S. shareholder, defined in Section 951(b), is any U.S. person per Section 957(c), who, directly or indirectly, owns 10% or more of the voting stock of a foreign corporation. A CFC is a foreign corporation, including an unincorporated entity which makes an election under the check-the-box regulations to be taxed as an "association" for U.S. income tax purposes, where more than 50% of the stock of such corporation, either by voting power or value, is owned by U.S. shareholders.

b. Purpose of the CFC Rules on Subpart F Income. Designed to prevent U.S. shareholders from using foreign corporations to defer U.S. taxes from certain types of "tax haven" operations. Where a CFC earns income in a U.S. business subject to U.S. taxation at regular rates with the result that no

U.S. taxes are being deferred, there is no policy reason to tax the U.S. shareholders on deemed income. §952(b). See §952(a)(definition of "subpart F income").

c. Role of CFC Earnings and Profits Under Section 952(c). A CFC's corporation's earnings and profits of course has a direct impact to either reduce, limit or even create subpart F income. As a starting point, under §952(c)(1)(A) subpart F income of a CFC for any taxable year may not exceed the earnings and profits of such corporation for such year. See Treas. Reg. §1.952-1(c)(1). Certain prior year deficits in earnings and profits from a "qualified deficit" are permitted to be taken into account. Pursuant to Section 951(a)(1)(A)(i) and Treas. Reg. §1.951-1, a United States shareholder of such controlled foreign corporation must include his pro rata share of such subpart F income in his gross income for his taxable year in which or with which such taxable year of the foreign corporation ends. See Section 952(a). However, see paragraph (a) of Treas. Reg. §1.957-2 for special rule limiting the subpart F income to the income derived from the insurance of United States risks in the case of certain controlled foreign corporations described in section 957(b).

d. CFC Avoidance Game Playing? See, e.g., Notice 2009-7, 2009-3 IRB 312, 12/29/2008 (Service identified transaction and substantially similar ones as "transactions of interest" under Treas. Reg.§ 1.6011-4(b)(6), and for the material advisor and list maintenance rules under Sections 6111 and 6112 where U.S. taxpayer, which owns CFCs that hold stock of lower-tier CFC through domestic partnership, takes position that subpart F income of lower-tier CFC or amount determined under §956(a) related to U.S. property held by lower-tier CFC doesn't result in §951(a) income inclusions for U.S. taxpayer. In Notices 2009-7, 2009-3 IRB 312, and Notice 2010-41, 2010-22 IRB 715, a U.S. taxpayer owned all the stock of two CFCs which, in turn, owned all the interests in a U.S. partnership. That partnership, in turn, owned all the stock of a third CFC. The U.S. taxpayer took the position that the placement of the U.S. partnership in the chain of ownership shielded or blocked the U.S. taxpayer from the section 951(a)(1) inclusions attributable to the third CFC. In response, the Service said that it would adopt regulations to treat what would otherwise be a domestic partnership as a foreign partnership solely for purposes of determining which U.S. shareholders must include amounts under section 951. The regulations will apply to taxable years of domestic partnerships that end on or after May 14, 2010.

Notice 2009-7, supra, stated that regulations will be issued that, under certain circumstances, will classify an otherwise domestic partnership as foreign solely for purposes of identifying the United States shareholders of a CFC required to include in gross income the amounts determined under section 951(a) with respect to such CFC. Specifically, the regulations to be issued will treat a domestic partnership as foreign for this purpose if the following conditions are satisfied: (i) the partnership is a U.S. shareholder of a CFC per §§ 957(a) or 953(c); and (ii) were the partnership treated as foreign: (a) that CFC would continue to be a CFC; and (b) at least one U.S. shareholder of the CFC would be treated under §958(a) as indirectly owning stock of the CFC owned by the partnership that is indirectly owned by a foreign corporation; and would be required to include an amount in gross income under § 951(a) with respect to the CFC. The regulations to be issued will provide similar results in the case of tiered-partnership structures. See Jackel, "IRS Notice Wrongly Treats Domestic Partnerships as Foreign," 127 Tax Notes 1021 (May 31, 2010); and Cummings, "The Subpart F Blocker and Manifest Incompatibility," Daily Tax Rep. (BNA) No. 106, at J-1 (June 4, 2010).

Notice 2010-41, 2010-22 IRB 715, states that the IRS will issue Regulations that would classify certain domestic partnerships that owned stock in a controlled foreign corporation (CFC) that generated Subpart F income as foreign partnerships. The Regulations would apply to the tax years of a domestic partnership ending on or after May 14, 2010.

e. Subpart F Income; The Cornerstone of the CFC Rules. Subpart F is comprised of several categories or species of income which Congress was particularly concerned with generated by U.S. controlled corporations to inappropriately defer current taxation, which planning would also include the use of lower tax jurisdictions or tax havens. The use of a C corporation to warehouse foreign source income without paying dividends on a current basis did pose the opportunity for tax deferral until repatriation or deemed repatriation of the earnings of the C corporation "blocker". Subpart F income includes passive forms of investment income, income from goods purchased from or sold to related persons, service income for services performed for or on behalf of a related person, certain insurance income from insuring risks outside of the CFC's country of incorporation, foreign shipping income and income from processing, transporting or distributing oil and gas and certain illegal bribes or kickbacks as well as participation in an international boycott. §952(a). There are various important concepts and terms to be applied in determining what subpart F income is and making the necessary computations. One important area is the "chain deficit rules". Under this rule, a CFC is allowed to reduce its subpart F income by an earnings and profits deficit of another CFC provided: (i) the other CFC is a "qualified chain member"; (ii) the deficit was incurred in a taxable year ending with or within the current taxable year of the CFC; (iii) the income and deficit arise from the same type of activity; (iv) the income is not "disqualified" income; and (v) the taxpayer CFC elects to apply the rule. See §952(c)(1)(C)(i). A CFC is a qualified chain member if it is organized under the laws of the same foreign country as the taxpayer CFC and the taxpayer CFC owns all of the stock of the other CFC or the other CFC own all of the taxpayer CFC's stock. In either case, directors' qualifying shares are ignored, and the shares can be held directly or indirectly through other corporations (but not through the common parent). When the chain deficit rule applies, each CFC first reduces its subpart F income by its deficits from prior years under the offset rule, and a deficit of a qualified chain member may only be applied against any subpart F income remaining after the CFC's prior deficits have been fully used. When a CFC's deficit is used to reduce current subpart F income of another CFC, the deficit may not be carried forward to offset the CFC's subpart F income for a subsequent year. §952(c)(1)(C)(iii).

f. Guarding For Application of Section 1248. Where stock of a U.S. person in a CFC is sold or disposed of in a taxable transaction, gain recognized is treated as a dividend taxable as ordinary income to the extent of the shareholder's share of the accumulated earnings and profits of the CFC attributable to the period of time that the U.S. shareholder held the stock. See §1248. See also §§964(e)(1), 964(e)(3). Note that the "same country exception for dividends from a foreign subsidiary to a foreign parent (both subject to the CFC rules), which would be non-taxable, are still taxable with respect to gain recognized on the sale of the parent foreign corporation's stock. §964(e)(2). See also § 904(d)(2)(E)(i)(as to application of § 902 dividend gross up rule). See also §§960 and 962. See PLR 201201016 (1/06/12)(gain attributable to goodwill and goingconcern value of an active financing company does not constitute FPHCI and should not result in a disqualification under IRC §954(h)(2).

6. Passive Foreign Investment Company. In the Tax Reform Act of 1986, Congress enacted the passive foreign investment company rules (PFIC) to apply to tax U.S. investors under a special tax regime which offers the investor several options in reporting income.

a. Definition of PFIC. Section 1296(a) defines a PFIC as any FC which: (i) derives 75% or more of gross income from "passive income", defined in section 1296(b)(1), or (ii) 50% of the value of its assets are passive assets. No percentage of ownership requirement is imposed as in the CFC rules. Where the PFIC rules overlap with the CFC provisions, the Taxpayer Relief Act of 1997 provided that the CFC rules control. See §1297(e). P.L. No. 105-34, 105th Cong., 1st Sess., §1121.

b. Interest Toll Charge on Deferred Income. Under section 1291, a U.S. shareholder of a PFIC is subject to an interest toll charge on the deferred income realized upon the disposition of the PFIC stock. This method of reporting PFIC income results in a deferral of reporting income until the stock is disposed in a taxable transaction. The interest charge technically is calculated based on the amounts received and is not limited to dividend income.

c. QEF Election Under Section 1295. A U.S. shareholder of a PFIC may permanently elect to be taxed under §1295 under the qualified elective fund (QEF) approach, which requires that the U.S. shareholder be taxed currently on its pro rata share the current year's undistributed earnings of the PFIC. §1293. The U.S. shareholder is permitted to defer payment of the tax on undistributed earnings by election under §1294. Losses, however, do not pass through to shareholders. Failure to elect QEF treatment per section 1295 denies a stepped up in stock basis at death under section 1291(e) and section 1014. See also §1246(e).

d. Mark-to-Market Election. A third model method for U.S. shareholder reporting under the PFIC rules was added also in 1997 making it possible for a U.S. shareholder to elect a "mark-to-market" reporting system for stock held in a publicly traded PFIC. Where the mark-to-market regime is elected, annual year end gains are taxed as ordinary income. Losses, to the extent of previously included gains, are permitted to be taxed as ordinary losses. Stock basis is adjusted for the amount of gains and losses reported. Source is determined under the usual sale of personal property rules (i.e., residence of seller), and the election is a binding one.

7. Domestic International Sales Corporations. U.S. companies, may use the domestic international sales corporation, or "interest charged" DISC or ICDISC to engage in foreign sales activities. Under §992, an IC-DISC election results in both a deferral of tax on qualified foreign sales income and a reduced taxed rate (as to individuals only). IC-DISCs are not subject to tax per section 991. Instead, the IC-DISC's shareholders are subject to taxation on the IC-DISC's income (the rules provide a form of flow-through for the shareholders). Shareholders are taxed on deemed distributions from the IC-DISC to the extent that the taxable income of the IC-DISC from qualified export receipts exceeds $10 million. Corporate shareholders are additionally taxed on 1/17th on the remaining taxable income of the IC-DISC. An interest charge equal to the average investment yield of T-bills with one-year maturity dates sold over a one-year period is imposed on the deferred tax liability. Essentially, this interest charge is imposed on retained IC-DISC income that is not distributed within one year following the close of the IC-DISC's tax year.

The benefit of a reduced rate arises because the deemed distribution is treated as a dividend under§ 995(b)(1), resulting in availability of the preferential dividend rate provided in Section 1(h) for individuals. Distributions of previously taxed IC-DISC income are not again taxed. See, in general, August and Antaramian, "Choice of Entity for Engaging in Business Operations Outside the United States," Business Entities (WG&L), Mar/Apr 2008.

II. Potential For and Mitigation of Double Taxation.

Since the U.S. can impose income tax on the worldwide income of its U.S. citizens and residents, there is always the potential for such individuals who live and work overseas to be subject to double taxation. There are various provisions and statutes that are directed to mitigate the adverse impact of double taxation**.**

A. Bilateral Income Tax Treaties. The United States has entered into income tax treaties which have the purpose, inter alia, of relieving residents of each contracting state from double taxation. This is achieved by a residence tie-breaker provision which determines which jurisdiction can treat the individual as "resident". However, a U.S. citizen living in a tax treaty jurisdiction can not relieve his or her obligation to pay U.S. income tax on worldwide income even if under the treaty provision the same individual is treated as resident of the other contracting state. See e.g., Norman F. Dacey, TC Memo. ¶ 92,187 (1992) (U.S. citizen-author residing in Ireland ineligible for royalty income exemption in Irish treaty).In such instance the individual must apply for Competent Authority relief (to avoid double taxation).

Residence Tie Breaker Provision**.**In general, a tax treaty contains many separate articles that limit the power of the United States to tax foreign persons on specific types of income. A second equally important principle of a tax treaty is to avoid double taxation. Typically, a treaty provision on income provides that an item of income derived by a "resident" of the foreign treaty country. Canada-U.S., Art. 10(2)(limits U.S. tax on dividend paid by corporation in the U.S. to shareholder (owner) "resident" of Canada. The resident of a treaty country may qualify for treaty benefits for dividends and interest even if the resident has a custodian in another country hold the underlying stocks and bonds. See Rev. Rul. 68-230, 1968-1 CB 629.(proper . See also New York Guandong Fin., Inc. v. Comm'r, 588 F.3d 889 (5th Cir. 2009) , aff'g RIA TC Memo. ¶ 2008-62 (2008) (interest paid by a domestic corporation on a loan from a foreign corporation was subject to withholding tax and not eligible for exemption under the U.S. tax treaty with China; payee corporation was not a resident of China because it was a Hong Kong corporation and Hong Kong was not part of China for the tax years in issue; Hong Kong subsidiary corporation was not an agent or conduit for its Chinese parent corporation and that the loan from the Hong Kong subsidiary corporation was not in substance a loan from the Chinese parent corporation).

1. Definition of Residence Under Tax Treaties. While a tax treaty may contain a savings clause which would limit or disqualify an individual (or person) from treaty benefits, another problem is that the courts (and IRS) may not respect certain formalistic arrangements or transactions designed to qualify for treaty benefits. In general, the resident of the treaty country must be the beneficial owner of the income in question and must not otherwise violate the anti-treaty shopping.[4]

a. Definition of the term "Resident". Each treaty generally contains its own definition of the term "resident." Japan-U.S. Tax Treaty, Article 3; U.K.-U.S. Tax Treaty, Article 4. The Service's position is that it ordinarily will not rule whether the recipient of payments is or has been a resident of a treaty country.Rev. Proc. 2015-7, §4.01(15), 2015-1 IRB 231, 232. A taxpayer has the burden of proving residence.. Simenon v. Comm'r, 44 T.C. 829 (1965)(1965). But see, Rev. Rul. 200-59, 2002-2 C.B. 593 (two foreign investment companies and foreign trust were residents of a foreign country).

b. Dual resident: Tie-breaker rules. See Canada-U.S. Treaty, Article 4(2); Japan, Article 3(3); U.K.-U.S. Treaty, Article 4(2). See Stephen D. Podd, T.C. Memo ¶98,231 (1998), supplmt'd T.C. Memo ¶98,418(taxpayer failed to show dual residence with Canada (and U.S. based on greencard). See Zink, "Canadian Taxpayer's Residency Questioned Based on 'Center of Vital Interest,'" 31 Tax Adviser 87 (2000). The meaning of "resident" under a tax treaty may depend on the local law of each country that enters into the treaty. /

c. Loss of Former Treaty Protection Under Dual Residence Tie Breaker. Where a citizen of a treaty country moves to another foreign country treaty protection may be lost. See, e.g., Iqbal Quidwai, P-H T.C. Memo. ¶ 84,042 (1984) (taxpayer failed to qualify as Pakistani resident temporarily present in United States to study); Amirali Budhwani, 70 T.C. 287 (1978) (taxpayer with full-time U.S. job failed to qualify as Pakistani resident temporarily present in U.S. to study); Maclean, 73 T.C. 1045 (1980) (taxpayer could not exclude service income under former U.K. treaty); Douglas J. Lemery, 54 T.C. 480 (1970) (under former Canadian treaty , Canadian citizen was taxable in United States on capital gains because of citizen's U.S. residence). An individual who is resident of one country may attempt to change residence to obtain more favorable tax treatment. In some instances, the change in residence will not be respected. See Johansson v. U.S., 336 F.2d 809 (5th Cir. 1965), aff'g in part, remd'g in part 62-1USTC ¶9130 (SD Fla. 1961).

d. Tax Residence of Companies/Corporations. As to the residence of a artificial entity taxable on its income, e.g., a corporation or company.Some jurisdictions like the U.K. treat a company as resident either in its jurisdiction of organization or place of management. For U.S. tax purposes the place where the corporation was organized establishes residence. See, e.g., Switzerland-U.S., Article 2(1)(f). For an example of a treaty that looks to the country of management, see, e.g., United Kingdom art. 4(1)(a)(ii). Japan arts. 2(1)(e)(ii) , 3(1)(a) , includes in the definition of "resident" a juridical person that has its head or main office in Japan. See also Botai Corp., P-H TC Memo. ¶ 90,475 (1990), aff'd w/o pub. opin., 935 F.2d 1280 (3d Cir. 1991) (Netherlands Antilles corporation did not qualify for treaty benefits under United Kingdom treaty with respect to sale of U.S. real property interests; corporation did not have assets or employees in United Kingdom, and any activity that it may have had in United Kingdom was at the direction or control of a non-United Kingdom resident; hence, corporation was neither managed nor controlled in United Kingdom). Some treaties look to the country of incorporation and others look to the country of management. If a corporation is formed in a treaty country that looks to the place of incorporation and is managed in a treaty country that looks to the place of management, the corporation may qualify under two treaties. If so, the Service allows the corporation to choose the treaty that produces the better result. Rev. Rul. 73-564, 1973-2C.B. 435 (managed in both U.K. and formed in Switzerland could choose either treaty for taxation of U.S. source interest income). Rev. Rul. 72-378, 1972-2 C.B 662 (management in UK of U.K. branch of Swiss corporation did not permit use of U.K. treaty; head office in Switzerland). The mere management of a branch, however, may not allow the corporation to qualify under the treaty of the country in which the branch is located. A transparent entity such as a hybrid entity may qualify for treaty benefits under a U.S. income tax treaty provided certain conditions are met. See Rev. Rul. 2004-76, 2004-2 CB 111. See §7874 (controversial corporate inversion rules).

2. Treaty Savings Clauses. See discussion above. The U.S. has a "savings clause in each tax treaty whereby each contracting state reserves the right to tax its residents and citizens as if the treaty had not come into effect. See Richard L. Doernberg & Kees van Raad, “The Forthcoming U.S. Model Income Tax Treaty and the Saving Clause”, 5 Tax Notes Int'l 775 (Oct. 12, 1992). Since the U.S. taxes its citizens and residents on their worldwide income, a savings clause allows the United States to use domestic tax law to tax its citizens as if the treaty were not in effect. The savings clause is not a treaty override but instead is part of the treaty.

3. Treaty Overridden by Change in Domestic Tax Law. See §7852(d). Domestic tax law enacted after prior treaty provision is entered into force overrides the treaty provision. See <u>Cook v. U.S.</u>, 288 U.S. 102, 120 (1933) (holding that “[a] treaty will not be deemed to have been abrogated or modified by a later statute unless such purpose on the part of Congress has clearly been expressed.”); <u>Trans World Airlines v. Franklin Mint Corp</u>., 466 U.S. 243, 252 (1984). It has been conceded by Congress that such conflict cannot always be anticipated

4. Anti-Treaty Shopping Rules under Domestic Law/Limitation of Benefits Treaty Provision. The U.S. has one of the most restrictive domestic rules regarding limits on the improper and abusive use of conduit companies in international transactions. The "anti-conduit" rules are set forth in §7701(l) and Treas. Regs. §§1.881-3 and 4. See <u>Aiken Industries, Inc. v. Comm'r</u>, 56 T.C. 925 (1971). There is also the limitation of benefits" clauses in the U.S. Model Treaty, Article 22 that avoids the improper invocation of treaty benefits by a party deemed ineligible to make such claim. Treaty shopping efforts are designed by certain individuals or person to benefit by using an entity by forming it or causing it to be resident in a country in which such individuals or person do not reside, the interposed company has minimal economic activity in the jurisdiction in which it is located and the income is subject to minimal (if any) tax in the country of residence of the interposed or inserted company. See Jones, "The David R. Tillinghast Lecture: Are Tax Treaties Necessary?", 53 Tax L. Rev. 1, 3-8 (1999).

a. Limitation of Benefits Clause in Article 22 of 2006 US Model Treaty. First, residents are entitled to benefit only if such person is a "qualified resident" as defined in Article 22. Second, Article 22(2) sets out a list of required attributes of a qualified resident which if any one of the five are met, allows the person to have the benefits of the trust. This is referred to as the "ownership/base erosion Test". The first test (the “ownership test”) prescribes that a qualified resident has to own at least fifty percent of each class of the company's shares during half of the days (or more) of the taxable year.The second test (the “base erosion test”) requires that “less than fifty percent of the person's gross income for the taxable year... is paid or accrued,” directly or indirectly, to persons who are not qualified residents of the state or U.S. citizens in the form of payments that are deductible for tax purposes in the entity's state of residence. Third, there is an alternative test for a person who is not a qualified resident. Treaty benefits may still be provided where some requirements are met such as "an active conduct of a trade or business" in the residence state. Regulations issued under §367(a) may be referred to by the Competent Authority for the definition of the term “trade or business,” i.e., “a specific unified group of activities that constitute or could constitute an independent economic enterprise carried on for profit.” Fourth, treaty eligibility can be granted by discretionary relief or decision of the competent authorities. The 2006 Model Convention includes this discretionary provision in that there may be cases where significant participation by third country residents in a Contracting State's enterprise is warranted by sound business practice or long-standing business structures and do not necessarily indicate a motive of attempting to derive unintended Convention benefits. Fifth, provides a definition of terms for use in Article 22.

b. Example. Remember Ingemar Johannson? Johansson v. U.S., 336 F.2d 809, 911-13 (5th Cir. 1964). In Johansson, a Swedish boxer incorporated a company in Switzerland and allegedly worked for a Swiss paper corporation, in order to claim the exemption of compensation income under U.S.-Swiss tax treaties, which were applicable to employees of Swiss corporations for services performed while temporarily in the United States. The court did not accept this argument and felt the employment relationship was a sham. As the sole shareholder of the Company he did not qualify under the employee (temporarily abroad) exemption under the treaty.

c. Example. Cascading Royalties. In Rev. Rul. 80-362, 1980-2 C.B. 208, a resident of a non-treaty country licensed a patent to a Dutch corporation which sublicensed the patent to a U.S. corporation for exploitation in the U.S. Royalties paid from the U.S. sublicensee to the Dutch corporation were exempt from withholding under the Netherlands-U.S. income tax treaty. The Service rejected the scheme and ruled that the royalties paid from the Netherlands to the nontreaty jurisdiction were U.S. source royalties per

§861(a)(4) since they were paid in consideration for the privilege of using a patent in the US. and were subject to 30% withholding.

5. Mutual Cooperation Provision/ Request for Treaty Relief. See U.S. Model Treaty (2006) Article 26. See also Rev. Proc. 2015-40 and Rev. Proc. 2015-41 (August 2015) which modified and superseded Rev. Proc. 2006-54; Rev. Proc. 2008-31 and Rev. Proc. 2006-9.

a. Competent Authority. Where a person considers that the actions of one or both of the Contracting States result or will result for such person in taxation not in accordance with the provisions of this Convention, it may, irrespective of the remedies provided by the domestic law of those States, and the time limits prescribed in such laws for presenting claims for refund, present its case to the competent authority of either Contracting State. The Competent Authority is the person that the tax treaty designates to be in charge of the administrative aspects of the treaty. This is the Secretary of the Treasury, the Commissioner of the Internal Revenue, their delegates and for treaty partners, the appropriate ministers or delegates. U.S. Model Treaty (2006), Art. 3 and Technical Explanation. Currently authority has been delegated to the LB&I Deputy Commissioner (International) who interprets and applies the operative provisions of tax treaties and exchange of information agreements, subject to the concurrence of Associate Chief Counsel (International) in matters of interpretation. Treasury Order No. 150-10 (4/22/1982). The Competent Authority primarily deals with the provisions governing mutual agreement, exchange of information, and administrative assistance in collection.

b. Competent Authorities Working Together. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention. In particular the competent authorities of the Contracting States may agree: (a) to the same attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State; (b) to the same allocation of income, deductions, credits, or allowances between persons; (c) to the settlement of conflicting application of the Convention, including conflicts regarding: i) the characterization of particular items of income; ii) characterization of persons; iii) the application of source rules with respect to particular items of income; iv) the meaning of any term used in the Convention; v) the timing of particular items of income; (d) to advance pricing arrangements; and (e) to the application of the provisions of domestic law regarding penalties, fines, and interest in a manner consistent with the purposes of the Convention.

c. The competent authorities also may agree to increases in any specific dollar amounts referred to in the Convention to reflect economic or monetary developments.

d. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

6. Powers of Competent Authority. See Rev. Procs. 2015-40 and 2015-41.

a. Competent Authority Process. After a taxpayer requests relief under a tax treaty, the U.S. competent authority will attempt to address and resolve double taxation situations and provide further necessary relief for taxpayers who have been denied the benefits of the treaty. The Competent Authority is permitted to reach agreements to the extent authorized by substantive or procedural provisions of the applicable treaty. Such agreements may cut across the usual application of the Code and produce results different from those in purely domestic situations.

b. Initiation of Cases. While taxpayers generally initiate the Competent Authority procedure, the U.S. Competent Authority may take unilateral action to initiate negotiations in any situation in order "to protect U.S. interests." Under Rev. Proc. 2006-54, the U.S. Competent Authority is not required to advise an affected taxpayer of its plans to initiate negotiations or to give the affected taxpayer an opportunity to refuse assistance and bear any double taxation. It is generally understood that the U.S. Competent Authority rarely initiates cases. Rev. Proc. 2006-54, §2.03, 2006-49 I.R.B. 1035.

c. Typical MAP Situations. Transfer pricing; limitation of benefits cases (double taxation); sourcing issues.

d. Competent Authority Agreements. Taken from IRS website:

www.irs.gov/Individuals/International-Taxpayers/Competent-Authority-Agreements

A Competent Authority Agreement is a bilateral agreement between the United States and the treaty partner to clarify or interpret treaty provisions.

Country	Agreement
Australia	Competent Authority Arrangement Between the Competent Authorities of The United States of America and Australia (PDF)
Austria	U.S. - Austria: Tax Treatment of Certain Scholarships. March 1, 2005 (PDF) U.S. - Austria : Taxing Deferred Payments to U.S. Citizens Residing in Austria. August 27, 2003 (PDF)

"Federal Tax Planning Opportunities and Pitfalls for U.S. Citizens Living and Working Overseas", Jerald David August, Esq., Kostelanetz & Fink, LLP / Estate Planning Council of Delaware, Inc., Hotel DuPont, Wilmington, Delaware (3/1/2016).

Country	Agreement
Barbados	Competent Authority Arrangement Between the Competent Authorities of the United States of America and Barbados (PDF)
Belgium	Announcement Concerning Mutual Agreement Procedure Arbitration under the Recent Income Tax Treaty Between the United States and Belgium Memorandum of Understanding Between the U.S. and Belgium-2009 Arbitration Board Guidelines-2009 US-Belgium Limitation on Benefits - Equivalent Beneficiary. October 15, 2009 (PDF) US-Belgium Agreement identifying Pensions for Treaty benefits. April 9, 2010 (PDF) US-Belgium Tax Treatment of Fellowships. July 14, 2010 (PDF) U.S.-Belgium Agreement Regarding Taxes Imposed by Belgian Municipalities - May 2011 Belgium Competent Authority Agreement - Profit Attribution - 7-16-13 (PDF) Competent Authority Arrangement between the Competent Authorities of the United States and Belgium (PDF)
Canada	Memorandum of Understanding Between the Competent Authorities of Canada and The United States of America (PDF) Arbitration Board Operating Guidelines (PDF)
Cayman Islands	Competent Authority Arrangement Between the Competent Authorities of the Cayman Islands and the United States of America (PDF)
China	US - China MAP agreement Treaty Article 19-Professors and Teachers. November 24, 2010 (PDF)
Costa Rica	Competent Authority Arrangement between the Competent Authorities of the United States of America and Republic of Costa Rica (PDF)
Czech Republic	Competent Authority Arrangement between the Competent Authorities of the United States of America and the Czech Republic (PDF)
Denmark	Competent Authority Arrangement Between the Competent Authorities of the United States of America and Kingdom of Denmark (PDF)
Finland	Competent Authorities of the United States of America and Republic of Finland (PDF)
Germany	Arbitration Board Operating Guidelines Memorandum of Understanding between the U.S. and Germany US-Germany Agreement on Pensions - signed March 19, 2012 U.S. - Germany Mutual Agreement Regarding Taxation of Certain Consular Employees October 1, 2009 (PDF) Competent Authority Arrangement between the Competent Authorities of the United States of America and Germany (PDF)
Gibraltar	Competent Authority Arrangement Between the Competent Authorities of the United States of America and Gibraltar
Guernsey	Competent Authority Arrangement between the Competent Authorities of the United States and Guernsey

Country	Agreement
Honduras	Competent Authority Arrangement Between the Competent Authorities of the United States of America and the Republic of Honduras (PDF)
Hungary	Competent Authority Arrangement between the United States of America and Hungary (PDF)
Iceland	Competent Authority Arrangement between the Competent Authorities of the United States of America and Iceland (PDF)
India	U.S. - India: Memorandum Of Understanding Regarding Deferment Of Assessment And/Or Suspension Of Collection Of Taxes During Mutual Agreement Procedure. September 25, 2002 (PDF) Competent Authority Arrangement Between the Competent Authorities of The United States of America and The Republic of India (PDF)
Ireland	Competent Authority Arrangement between the Competent Authorities of the United States of America and Ireland (PDF) U.S. - Ireland: Competent Authority Agreement regarding the income received by Irish unit holders in a Common Contractual Fund - February 9, 2006.
Isle of Man	Competent Authority Arrangement Between the Competent Authorities of the United States of America and the Isle of Man (PDF)
Italy	Competent Authority Arrangement Between the Competent Authorities of the United States of America and the Republic of Italy (PDF)
Jamaica	Competent Authority Arrangement Between the Competent Authorities of the United States of America and Jamaica (PDF)
Japan	U.S. - Japan: Guidance regarding the Commencement of Application of the new Tax Convention between the United States and Japan. June 23, 2004 (PDF) U.S. - Japan: The Competent Authorities of the United States and Japan Agree to the following Guidelines concerning the meaning of the term Investment Bank. December 27, 2005 (PDF) U.S. - Japan: Memorandum of Understanding - First Publication Concerning Notification of Self-Certification of U.S. and Japanese Resident Investment Banks. March 3, 2006 (PDF)
Latvia	Competent Authority Arrangement Between the Competent Authorities of the United States of America and the Republic of Latvia (PDF)
Liechtenstein	Competent Authority Arrangement between the Competent Authorities of the United States of America and the Principality of Liechtenstein (PDF)
Luxembourg	U.S. – Luxembourg: Interpretation of Tax Treaty's Transition Rules. November 09, 2001 (PDF) Competent Authority Arrangement between the Competent Authorities of the United States of America and the Grand Duchy of Luxembourg (PDF)
Malta	Competent Authority Arrangement between the Competent Authorities of the United States of America and Republic of Malta (PDF)
Mauritius	Competent Authority Arrangement between the Competent Authorities of the United States of America and the Republic of Mauritius (PDF)

Country	Agreement
Mexico	U.S. - Mexico: Mutual Agreement Regarding Eligibility of Fiscally Transparent Entities to Benefits. August 26, 2005 (PDF) U.S. - Mexico: Mutual Agreement Regarding Eligibility of Fiscally Transparent Entities to Benefits. December 22, 2005 (PDF) Competent Authority Arrangement between the Competent Authorities of the Department of the Treasury of the United States of America and the Ministry of Finance and Public Credit of the United Mexican States (PDF)
Netherlands	U.S. - Netherlands Agreement Regarding Dutch Limited Funds for Mutual Account - May 21, 2012 (PDF) U.S. - Netherlands: Updated Agreement Identifying Pensions for Treaty Benefits August 13, 2007 (PDF) U.S. - Netherlands: Administrative Arrangements for Mutual Agreement Procedure. October 7, 2003 (PDF) U.S. - Netherlands: Pensions Investing Through Hybrid entities. March 21, 2003 (PDF) U.S. - Netherlands - Pensions Agreement modified to eliminate Dutch "Qualification" Certification. March 30, 2010 (PDF) Competent Authority Arrangement between the Competent Authorities of the United States and Netherlands (PDF)
New Zealand	U.S. - New Zealand: Mutual Agreement Regarding Treatment of Income Derived Through Certain Fiscally Transparent Entities. February 10, 2005 (PDF) Competent Authority Arrangement between the Competent Authorities of the United States of America and New Zealand (PDF) U.S. - New Zealand Competent Authority Arrangement Regarding Meaning of the Term "Resident in New Zealand" under the IGA for a Financial Institution that is a Trust (other than a Unit Trust) (PDF)
Norway	U.S. - Norway - Agreement Regarding Offshore Activities - February 2013 (PDF) U.S. - Norway - Eligibility of Fiscally Transparent Entities for Treaty Benefits - January 2013 (PDF) U.S. - Norway - Source of Remuneration for Government Services and Social Security Payments - December 2012 (PDF) Competent Authority Arrangement Between the Competent Authorities of the United States of America and the Kingdom of Norway (PDF)
Republic of Estonia	Competent Authority Arrangement between the United States of America and the Republic of Estonia (PDF)
Romania	Competent Authority Arrangement Between the Competent Authorities of the United States of America and Romania (PDF)
Slovenia	Competent Authority Arrangement between the Competent Authorities of the United States of America and the Republic of Slovenia (PDF)
Spain	U.S.- Spain Agreement Regarding Eligibility of Benefits to Fiscally Transparent Entities. February 15, 2006 (PDF) Competent Authority Arrangement Between the Competent Authorities of the United States of America and the Kingdom of Spain (PDF)

"Federal Tax Planning Opportunities and Pitfalls for U.S. Citizens Living and Working Overseas", Jerald David August, Esq., Kostelanetz & Fink, LLP / Estate Planning Council of Delaware, Inc., Hotel DuPont, Wilmington, Delaware (3/1/2016).

Country	Agreement
South Africa	Competent Authority Arrangement between the Competent Authorities of the United States of America and the Republic of South Africa (PDF)
Sweden	Competent Authority Arrangement Between the Competent Authorities of the United States of America and Sweden (PDF)
Switzerland	U.S. - Swiss: Pension Plans for Tax Treaty Benefits. December 10, 2004 (PDF) US - Swiss: Guidance on Treaty Benefits. August 22, 2003 (PDF)
United Kingdom	U.S. - U.K. agreement defining the term "First Notification" under Treaty Article 26(1) - September 12, 2007 (PDF) U.S. - U.K. Agreement Regarding Dual Consolidated Loss Rules. October 6, 2006 (PDF) U.S. - U.K.: Agreement Identifies U.K. Pension Arrangements for Tax Treaty Benefits. April 13, 2005 (PDF) U.S. - U.K.: New Administrative Arrangements for Mutual Agreement Procedure. November 13, 2000 (PDF) Competent Authority Arrangement Between the Competent Authorities of the United States of America and United Kingdom of Great Britain and Northern Ireland (PDF)

III. International Estate Planning Environment.

A. U.S. Citizens. Subject to U.S. transfer tax system regardless of residence and regardless of country of domicile at time of death.

B. U.S. Residents. An individual moving back to their country of nationality or to a different country but becomes a resident of that jurisdiction may, if a "long term resident" for 7 or more consecutive years, be treated as a "covered expatriate" and be subject to §877A (and §2801). Don't relinquish the greencard perhaps is one answer to this problem, but will that work when there is a treaty tie-breaker that goes the other way?

1. General Factors.

a. Income Tax Profile. Is the country in which the client lives have an income tax treaty with the United States. Under the treaty will the client be a "resident" of the foreign country despite being a U.S. citizen and subject to worldwide tax. Consideration of filing for Competent Authority relief. Continued requirement of U.S. compliance filings, including FBARs and FACTA compliance.

(i) CFC Risk.

(ii) PFIC Risk.

b. Assessing Foreign Country's Tax System.

(i) Income. Worldwide or territorial.

(ii) Social Security.

(iii) Taxation of Deferred Compensation, including pension assets. Impact of foreign inheritance taxes.

c. Taxation of Donative Transfers and Transfers At Death.

(i) Estate tax or inheritance tax.

(ii) Limitation based on assets deemed to be sitused in the country where the gift was made or the U.S. citizen died.

C. Other Foreign Country Limitations.

1. Ownership of Real Estate. Many countries have laws that prohibit ownership of real estate by noncitizens.

2. Forced Heirship Rules. Countries with forced heirship laws required property within or otherwise subject to its jurisdiction force the property to go from the U.S. owner to a surviving spouse and/or children based on prescribed percentages. A country under Islamic law will have subject assets divided among heirs at law.

a. Planning to avoid having property subject to forced heirship. One approach is not to have any assets situated in the foreign jurisdiction where the U.S. citizen or resident working overseas will have assets subject to forced heirship.

b. Use of trusts. In general, the provisions of a trust will override the forced heirship laws as long as the property held in the trust is not considered to be "owned" by the U.S. settlor. See, e.g., §§2035-2038, 2041.

c. Use of insurance, annuities, etc. situated outside of the foreign country of residence. Note again that life insurance and annuity policies with cash value are reportable as "specified foreign financial accounts" on Form 8938. Life insurance policies are also reportable for FBAR purposes. 31 CFR § 1010.350(c)(3)(ii). Based on the laws of the particular country with forced heirship laws, rights to such payments may avoid the forced heirship laws. With foreign insurance policies, be satisfied that the policy will meet the definition of "insurance" for U.S. tax law purposes. Consider the U.S. estate tax impacts.

d. Joint tenancies with rights of survivorship. Based on the law of the particular country having forced heirship laws, the passing of ownership to the surviving spouse should avoid forced heirship.

3. Respecting Validity of Foreign Will. It will be important to assess in advance whether the U.S. client migrating overseas to work will need to have a "foreign will" because a U.S. will may not be respected or may not meet the requirements for admissibility. What about the language used in a will? Suppose client has foreign will done while working in China and then moves to Thailand. In the event of death, will Taiwan respect the will written in Chinese? If so, is the backup of the U.S. will being available going to work? What if the terms of the U.S. will are different than the terms of the will executed in China.

   a. Different Wills Based on Asset Situs. Will the U.S. client migrating overseas to work be properly advised to have a U.S. will for U.S. assets and a foreign will for foreign based assets based on situs? What if the client returns to the U.S. for a visit and then dies while in the U.S.? Two administrations or possibly multiple administrations?

   b. Avoid Multiple Wills. The legal advisory team comprised of "stateside" legal counsel and legal counsel in the jurisdiction of the new residence as well as other assets, may advise that there be one U.S. will but that there also be trusts established with respect to foreign situs assets to avoid a foreign probate(s).

   c. Use of Trusts.

   d. Use of Foundations.

   e. Use of Foreign Corporations. Foreign real property owned by a localcorporation or business entity which in turn is owned by an offshore corporation situated in a favorable jurisdiction, including a U.S. corporation.

4. Estate Planning Points.

   a. Section 2014 Credit. Section 2014 allows a credit for death taxes paid to any foreign country with respect to property situated in that country and included in the decedent's gross estate. The amount or even the allowance of the credit is also affected by any estate tax treaty between the U.S. and the foreign country imposing the tax. See also Article XXIX-B(7) of the U.S.-Canada Income Tax Treaty which allows U.S. decedents to credit the Canadian income taxes paid by reason of death (Canadian inheritance or succession taxes).

   b. Transfers to a Noncitizen Spouse. Section 2056(d)(1) does not allow the marital deduction for transfers to a surviving spouse otherwise qualified if the surviving spouse is not a U.S. citizen. However, the marital deduction is allowed if the surviving spouse was a U.S. resident at all times following the decedent's death and becomes a citizen before the decedent's estate tax return is filed. See also §2056A(b)(12) to avoid application of §2056A if the surviving spouse later becomes a citizen. The second exception is under the QDOT rule contained in §2056(A) which requires: (i) at least one trustee be an individual citizen of the United States or a domestic corporation and (ii) no distribution (other than income) be made unless the trustee who is a citizen of the United States or a domestic corporation has the right to withhold from the distribution the tax on distributions imposed by § 2056A. Under Treas. Reg. § 20.2056A-3(a), a QDOT election must be made on the last estate tax return filed before the due date, including extensions, or, if a timely return is not filed, on the first return filed after the due date. The election must be made in the manner provided on the estate tax return, including the instructions. Once made, the QDOT election is irrevocable.

D. U.S. Bilateral Estate and Transfer Tax Treaties. The United States has 15 bilateral estate tax treaties with other countries. A few of these treaties also have provisions relating to gift tax and generation skipping transfer tax. A number of these treaties also address gift and generation-skipping transfers. The U.S.-Sweden Estate Tax Convention was terminated effective January 1, 2018. Under Article 15, the treaty continues for estates of decedents dying before such date. The Income Tax Treaty with Canada addresses U.S. transfer tax and Canadian deemed dispositions on death. There are considerably fewer such bilateral death tax treaties than income tax treaties entered into by the United States.

Chart on List of U.S. Estate Tax Treaties From IRS Website

Country	Separate Estate	Separate Gift	Combined E&G	Other	Signed	Transfers made on or after:	Comments	
Australia	No	Yes	No	No	5305	12/14/53		PR-UC
Australia	Yes	No	No	No	5305	01/07/54	old *	PR-UC
Austria	No	No	Yes	No	8206	07/01/83	new *	
Belgium	Yes	No	No	No	5405	not yet	old	no effect
Canada	No	No	No	1995 Protocol	9503	11/09/95 **	estate tax only	PR-UC
Denmark	No	No	Yes	No	8304	11/07/84	new	
Finland	Yes	No	No	No	5203	12/18/52	old	PR-UC
France	No	No	Yes	No	7811	10/01/80	new	PR-UC (Protocol)
Germany	No	No	Yes	No	8012	01/01/79	new	PR-UC (Protocol)
Greece	Yes	No	No	No	5002	12/30/53	old	PR-UC
Ireland	Yes	No	No	No	4909	12/20/51	old	
Italy	Yes	No	No	No	5503	10/26/56	old	PR-UC
Japan	No	No	Yes	No	5404	04/01/55	old	PR-UC
Netherlands	Yes	No	No	No	6907	02/03/71	new	
Norway	Yes	No	No	No	4906	12/11/51	old	PR-UC

Country	Separate Estate	Separate Gift	Combined E&G	Other	Signed	Transfers made on or after:	Comments	
South Africa	Yes	No	No	No	4704	07/15/52	old	
Sweden	No	No	Yes	No	8306	09/05/84 (through 12/31/07)	new (terminated 01/01/08)	
Switzerland	Yes	No	No	No	5107	09/17/52	old	PR-UC
U.K.	No	No	Yes	No	7810	11/11/79	new	

***** old or new refers to whether the treaty has the "old" situs rules, or the "new" provisions that generally restrict the U.S. to taxing nonresident aliens’ U.S. real estate and business property.

****** the 1995 Protocol had retroactive effect to TAMRA. Claims for refund based upon the treaty had to be filed by 11/09/96.

"**PR-UC**" in comments section above refers to a pro-rata unified credit provision. (The pro-rata unified credit provisions in the German and French treaties apply only to estate tax, not to gift tax.)

E. Risk of Double Taxation.

1. Where the U.S. and other (taxing) country each jurisdiction imposes taxes on the basis of domicile or residence of the U.S. citizen or donor;

2. Where the U.S. and other taxing country each jurisdiction imposes estate tax both on the basis of citizenship of the decedent or the donor.

3. Where the U.S. taxes based on the situs of assets within the U.S. and the other country taxes on the basis of the center of contact, domicile or citizenship with that other country.

4. Where the foreign country taxes based on the situs of the assets and the U.S. taxes on the basis of either citizenship or domicile of the decedent or donor which for U.S. citizens will invariably be the case.

5. Where both countries tax on the basis of situs of assets each concluding that the subject assets are situated in its country.

6. Where the foreign country taxes on inheritance rather than based on the taxable estate. But see §2801 (U.S.C.) as to donative transfers by expatriates.

F. Situs-Type Treaties. In an effort to avoid double taxation, the situs based treaty attempts to allocate property of a decedent (donor, where applicable) to a particular jurisdiction. The treaty will operate to resolve disputes on the situs of asset, preferring location or situs over personal attributes. However, where the situs jurisdiction does not tax the particular asset involved, the personal attribute jurisdiction (citizenship, domicile, residence) may have the right under the treaty (or under its domestic law) tax the subject asset. See U.S.-Finland

Treaty, Art. III(2)(i). Still, the non-situs country may still tax on some other basis such as domicile, residence or citizenship. Again, the personal attribute jurisdiction will have to allow a credit for the tax imposed by the situs country.

Example. Fred dies a citizen and domiciled in the U.S. He had been working in a country Z which has a estate tax treaty with the U.S. Fred owned through a single member LLC, 40 acres of farm land in the foreign country which imposes a death tax. The U.S. under the treaty is required to grant a credit against U.S. transfer tax for tax imposed by country Z on the farmland.

1. Situs Type Treaty Factors.

   a. Generally limited to death taxes, e.g., U.S. federal estate tax.

   b. Non-application to gift tax. Exception Japan. The Internal Revenue Code does not provide a FTC for gift taxes paid to another country. Compare, §2014.

   c. Non-application to GST taxes. The exception is Japan which has a GST. See Shikuma, "International Transfer Tax Planning in the Asia Pacific Region," Tax Notes Int'l (May, 2001).

   d. Non-application to state, provincial and local taxes. This means there could be double taxation where there is provincial tax (and no credit is provided). But see U.S.-Finland Treaty, Art. II (1)(e)(Finland's communal tax): U.S.-Swiss Estate Tax Convention (1951)(Swiss cantonal taxes and political subdivisions, no national death tax). Situs treaties do not apply to the states. See, e.g., Rev. Rul. 55-381, 1955-1 C.B. 464. For decedents dying after 2004, the U.S. replaced the state death tax credit with a state death tax deduction allowable in determining a nonresident alien's taxable estate. §§2106(a)(4), 2058.

   e. Non-application to income taxes. Exception. U.S.-Finland Treaty Art. I (1)(b)(treaty applicable to communal tax which is an income tax).

   f. Limitation of Benefits Type Provision. "Relevant Affiliation". A specified affiliation between the two jurisdictions needs to be present before a situs-type treaty is implicated. The treaty otherwise does not apply despite there being property in either or both of the countries. Generally the decedent must have been a citizen or domiciliary of the U.S. or, alternatively, a domiciliary or a resident of the treaty country. Where the only affiliation with the other treaty country is citizenship and there is no citizenship or domicile in the U.S. the treaty will not apply.

   g. Example: Fred, a U.S. citizen, is domiciled in Venezuela which has no treaty with the U.S. He owns lands in Country W, which has a situs-type tax treaty with the U.S. The treaty is applicable to avoid double taxation by the U.S. on the basis of citizenship and country W since the situs of the property is in W.

Example: Rick, a citizen of Country W, is domiciled in Venezuela and owns property in the U.S. The U.S. tax treaty with Country W is a situs type treaty. As is customary, a situs type treaty applies when the decedent was a citizen or domiciliary of the U.S. or Country W. Rick is neither. Therefore the treaty does not apply.

h. Treaty Situs Rules. In general, situs-type treaties do not assign a situs to particular assets or all assets. There could be conflicting situs determinations. See, e.g., U.S.-Japan Treaty art. III(K) (situs determined by country taxing on the basis of situs, and, if neither is taxing on that basis, then each country determines situs independently). There are other solutions as well, such as an arbitrary assignment of a situs to the country taxing on the basis of situs, and if neither country is doing so, then to the country of domicile. See, e.g., U.S.-Finland Treaty art. III(2)(i). Under the U.S.-Italy Treaty art. III(i), situs is automatically assigned to the domicile at death of the decedent. It is the goal of the treaty to resolve the varying domestic law situs rules so that double taxation can be avoided and that the non-situs country will allow a credit for the full amount of the tax imposed in the situs jurisdiction.

i. Example of Uncertainty on Situs Rules: Treatment of Partnership Interests. Unless the treaty provides, the situs of a partner's interest in a partnership is where the partnership business is carried on. See Rev. Rul. 55-701, 1955-2 C.B. 836. Still, it is possible that a partnership interest will be characterized as an intangible personal property interest and is not situs where the business or property of the partnership is located. There may be opportunities, unfortunately, of double taxation with respect to such assets.

j. See U.S. Germany Tax Treaty. Although a domicile-type treaty, it includes a specific situs rule in Article 8 with respect to partnerships where the situs country may tax. This rule takes a look thru approach to the situs of the underlying assets. See Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances, and Gifts, Dec. 3, 1980, T.I.A.S. 11082 (hereafter "U.S.-Germany Treaty").

k. Interests in LLCs, LLPs and Similar Entities. Uncertain. See Gold, "United States Estate and Gift Taxation of Nonresident Aliens: Troublesome Situs Issues, "51 Tax Law, 109, 125-130 (1977).

2. Domicile Type Tax Treaty. A domicile based treaty is generally going to include coverage of gift taxes and GST taxes. The fundamental principal of a domicile type

treaty is that the treaty country of domicile has the exclusive taxing jurisdiction. The non-domicile jurisdiction defers and agrees not to exercise its jurisdiction to tax based on situs. There are some exceptions provided in these types of treaties preserving situs taxation.

3. The U.S. is a domicile (citizenship also) based estate and transfer tax. Section 2014 provides a foreign tax credit for certain death taxes paid to the U.S. and a foreign country. There is no analogue with respect to the gift tax. The treaties that include gift taxes, i.e., U.S.-Japan, afford a treaty credit to avoid double taxation. As to GST taxes see Treas. Reg. §26.2663-2 which provides that a nonresident alien transferor will be subject to the GST tax if he would be subject to the tax under chapter 11 (estate tax) or chapter 12 (the gift tax). None of the situs type treaties have any provision for GST tax. Domicile treaties, except the US-Netherlands Treaty, refer to GST taxes. Questions arise with respect to the U.S.-France Treaty which states that it applies to GST. Art.2(1)(a). There is no other operative language. But France does not have a GST tax so there may not be a double tax problem where the U.S. would impose the GST on a French citizen for making a GST taxable transfer of U.S. property. Article 8 of the U.S.-France Treaty states that a treaty country can tax only if the decedent or donor was a citizen of or was domiciled in that state. It leaves to the respective country the ability to apply its own situs rules.

4. Competent Authority. What if there is a double domicile problem, i.e., each jurisdiction under the tax treaty takes the position that the decedent was domiciled in its jurisdiction at death. Is the treaty non-operational so to speak because it doesn't resolve the "tie"? Or, is there a procedure within the treaty to resolve double domicile determinations? Enter the competent authorities to determine fiscal domicile. See, e.g., U.S.-France Treaty, Art. 4(2)(e). Where competent authority is set out in the treaty it is mandatory but still the countries may not agree. There could also be domestic constitutional impacts or later enacted states or regulations. Even for treaties which do not have a competent authority provision as to domicile, there may be a mutual agreement procedure. See, e.g., U.S.-German Treaty, Art. 13(1).

IV. United States Citizens and Residents Compliance and Reporting for Foreign Assets and Entities.

A. Foreign Financial Assets.

1. Section 6038D. Owner of Specified Foreign Financial Assets. An individual who holds an "interest in a specified foreign financial asset" at any time during the taxable year must include a statement about the subject assets on his income tax return where the aggregate value of all such assets exceeds $50,000. The term "U.S. person" for purposes of includes citizens and residents of the United States, domestic corporations and partnerships, and nonforeign estates and trusts. §7701(a)(30). The term "foreign entity" includes corporations and partnerships organized under the laws of any jurisdiction other than the United States, a U.S.

state, or the District of Columbia, and foreign trusts and estates. §§1473(5), 7701(a)(30)

2. Others Subject to Section 6038D. While §6038D generally only applies to individuals, Service may require reporting by domestic entities formed or availed of for purposes of holding specified foreign financial assets, directly or indirectly. §6038D(f). See Prop. Treas. Reg. §1.6038D-6 (stating conditions under which domestic entity will be required to report under §6038D).

3. Specified Foreign Financial Asset. Any financial account maintained by a foreign financial institution such as any "stock or security issued by a person other than a U.S. person, "any financial instrument or contract held for investment" if the "issuer or counterparty" is not a U.S. person, and any other "interest in a "foreign entity". The term "specified foreign financial asset" includes any financial account maintained by a foreign financial institution. It also includes "any stock or security issued by a person other than" a U.S. person, "any financial instrument or contract held for investment" if the "issuer or counterparty" is not a U.S. person, and any other "interest in a foreign entity."

4. Form 8938. Statement of Specified Foreign Financial Assets. Filed with income tax return. Guidance issued by Service under temporary regulations. TD 9567 (12/19/2011). In the required statement, an individual must identify (1) each account by stating the name and address of the financial institution in which it is maintained and the account number; (2) a stock or security by providing the name and address of the issuer and information sufficient to identify the class or issue of which it is a part; and (3) any other instrument, contract, or interest by identifying the instrument, contract, or interest and stating the names and addresses of all issuers and counterparties.In each case, the individual must indicate the maximum value of the asset during the taxable year.Form 8938. The reporting threshold is $50,000 on the last day of the tax year or $75,000 at any time during the tax year for single and married filing separately and $100,000 on the last day of the tax year or $150,000 at any time during the year for married filing jointly. Treas. Regs. §§1.6038D-1, -2,-3.

FATCA enacted § 6038D, which requires individuals holding "any interest in a specified foreign financial asset" to disclose such assets in their Form 1040 if the assets' aggregate value exceeds $50,000 during "any taxable year." This reporting requirement took effect with 2011 income tax returns. Section 6038D(b) defines a "specified foreign financial asset" as follows: (i)any financial account . . . maintained by [an FFI] . . ., and (2) any of the following assets which are not held in an account maintained by a financial institution: (A) any stock or security issued by a person other than a United States person, (B) any financial instrument or contract held for investment that has an issuer or counterparty which is other than a United States person, and (C) any interest in a foreign entity.

Under § 6038D(h)(1), the IRS can also create exceptions to these reporting requirements to avoid duplicative disclosures. Lederman & Hirsh, "The American Assault on Tax Havens-Status Report," 44 Int'l Law. 1141, 1142 (2010) (IRS can create exceptions to "passive foreign investment company (PFIC) and controlled foreign corporation stock ownership reporting").

Threshold for Reporting by U.S. Individuals and Residents in Specified Foreign Financial Assets. Failure to file results in a penalty of $10,000 which can be increased to $50,000 for each failure. The penalty can be waived for reasonable cause and not willful neglect. Other penalties include an accuracy related penalty of up to 40%, an extended statute of limitations for assessment and for assessing penalties. The chart provides the filing thresholds based on status.

Filing Status	**Individual Living**	**Aggregate Value of Specified Non-U.S. Assets Exceeds:**	
		On Last Day of Year	At Any Time During Year
Single or Married Filing Separate Return	In U.S.	$50,000	$75,000
Married Filing Joint Return	In U.S.	$100,000	$150,000
Single or Married Filing Separate Return	Outside U.S.	$200,000	$300,000
Married Filing Joint Return	Outside U.S.	$400,000	$600,000

An individual is considered to be living outside the United States for this purpose if he or she meets the requirements to claim the foreign earned income exclusion under Section 911.

5. Penalties. An individual failing to furnish all of this information is liable for a penalty of $10,000. §6038D(1). Where the IRS mails a notice to the individual of the failure and the individual does not provide the information within 90 days after the day of mailing, the individual is liable for an additional penalty of $10,000 for each 30-day period (or portion thereof) during which the failure continues after the 90-day period, except that the additional penalties may not exceed $50,000. §6038D(d)(2). The penalty may be waived in the failure to file or file accurately is "due to reasonable cause and not due to willful neglect," but the "fact that a foreign

jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause." §6038D(g).

B. FBAR Report.

FinCEN Form 114. A U.S. person with a financial interest in or signatory authority over one or more foreign financial accounts must file an FBAR if the aggregate value of such accounts exceeded $10,000 at any time during the calendar year. Filing is required to be made under current law.A 2008 version of the FBAR Form required filing by foreign persons "doing business in the United States." Form TD F 90-22.1 (Rev. Oct. 2008). For example, it required a U.S. "branch of a foreign entity" to report foreign accounts that it held, even if the branch was "not separately incorporated under U.S. law." Prior versions of the form only required filing by U.S. citizens and residents and entities organized under the laws of U.S. jurisdictions. Responding to complaints, the IRS suspended the filing requirement for non-U.S. persons for 2009 and earlier years. IRS Announc. 2010-16, 2010-11 IRB 450. The current regulations, which apply for 2010 and later years, only require filing by U.S. persons.

1. Financial Account. Includes any "bank, securities, or other financial account in a foreign country". 31 CFR § 1010.350(a). See <u>US v. Clines</u>, 958 F.2d 578 (4th Cir.), cert. denied, 505 U.S. 1205 (1992) (profit share recorded on ledger of company used to transmit funds in arm's deal was "account").

a. Bank Account. Includes a time, demand, checking or any other account maintained with a banking business. 31 CFR §1010.350(c)(1).

(i) Insurance or annuity policy with a cash value issued by a foreign person where purchased outside of the U.S.

(ii) Commodities accounts with a person who acts as a broker or dealer on a commodity exchange.

(iii) Mutual fund or similar pooled assets.

(iv) IRS considers "financial account" to include noncash assets such as gold. Internal Revenue Service, FAQs Regarding Report of Foreign Bank and Financial Accounts (FBAR)—Financial Accounts Q&A 3.

(v) Exception. Bonds, notes and stocks of foreign issuers held directly by a reporting individual or person are not financial accounts. Q&A1.

b. Financial Interest. The reporting requirement applies to any person having a "financial interest in" or signature authority over a foreign account. A person has a financial interest in an account of which the person is "the owner of record or has legal title whether the account is maintained for his own benefit or for the benefit of others. 31 CFR §1010.350(e)(1). Where an account is in the name of more than one person, each U.S. person named has a financial interest in the account.

(i) Financial Interest In Account of Another Where.

(ii) Corporation. Where the U.S. person directly or indirectly owns more than 50% of the corporation's stock, voting or voting. 31 CFR § 1010.350(e)(2)(ii).

(iii) Partnership. Where U.S. person is a partner with interest in capital or profits in excess of 50%.

(iv) Grantor Trust. Where U.S. person is treated as an owner over any portion of the trust under the grantor trust rules. 31 CFR §1010.350(e)(2)(iii).

(v) Beneficiary of Trust. Where U.S. person has a present beneficial interest in more than 50% of the assets or receives more than 50% of the current income. 31 CFR § 1010.350(e)(2)(iv). The term "present beneficial interest" does not include an interest as a "discretionary beneficiary" of a discretionary or a "remainder interest." RIN 1506-AB08, 76 Fed. Reg. 10,234, 10,240 (Feb. 24, 2011).

(a) Reporting by Trustee. A beneficiary is not, however, required to report a foreign financial account of the trust if the trust, its trustee, or an agent of the trust is a U.S. person and files an FBAR disclosing the trust's foreign financial accounts. 31 CFR § 1010.350(g)(5). A participant or beneficiary in a qualified pension, profit-sharing, stock bonus, or annuity trust or an owner of an individual retirement account (IRA) is not required to file an FBAR with respect to a foreign financial account held by or on behalf of the plan or IRA. 31 CFR § 1010.350(g)(4).

(vi) Ownership in Corporation, Partnership or Trust. Where the U.S. person owns directly or indirectly, more than 50% of the voting power, total value of the equity interest or assets, or interests in profits. 31 CFR § 1010.350(e)(2)(ii).

Example. Jerry, a U.S. citizen, owns 60% of J Corp., a U.S. corporation. J Corp is the sole shareholder of F Corp., a corporation organized in France and is doing business there. If F Corp. maintains bank accounts in country F for use in its business, it is not required to file FBARs with respect to the accounts because it is not a U.S. person. However, J Corp., based on its > 50% ownership of F Corp. stock, must file FBARs with respect to F Corp's accounts, and Jerry, as owner of > of J Corp. stock and indirect owner of more than 50% of F Corp's stock, must also file FBARs with respect to F Corp's foreign accounts, as well as D's accounts

3. Signatory Authority (Only). Still required to report on the foreign financial account based on signature or other authority over it. 31 CFR § 1010.350(a). Only an individual can have such authority, and it exists if an individual has "authority…(alone or in conjunction with another) to control the disposition of money, funds or other assets held in a financial account by direct communication (whether in writing or otherwise) to the person with whom the financial account is maintained." Special rules and exceptions apply with respect to officers or employees having signature authority over accounts owned or maintained by the employer in which the officer or employee has no financial interest with respect to certain categories of employers.

4. Filing Deadline. The FBAR is a calendar year report and must be filed on or before June 30 of the year following the calendar year being reported. Effective July 1, 2013, the FBAR must be filed electronically through FinCEN's BSA E-Filing System. The FBAR is not filed with a federal tax return. When the IRS grants a filing extension for a taxpayer's income tax return, it does not extend the time to file an FBAR. There is no provision for requesting an extension of time to file an FBAR.The recently enacted Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 changes the standard FBAR due date to April 15 beginning with the 2016 calendar year reports, which are due in 2017. The FBAR deadline for calendar year 2015 reports remains June 30, 2016 (with no extensions allowed).

5. Penalties for Failure to File FBAR. A civil penalty not to exceed $10,000 per violation for nonwillful violations that are not due to reasonable cause. For willful violations, the penalty may be the greater of $100,000 or 50% of the balance in the account at the time of the violation, for each violation. Criminal violations, knowing failure or purposeful failure, may also result in criminal prosecution.

C. Returns and Information Reporting Related to Foreign Corporation.

1. U.S. Corporate Income Tax Return Form 1120F. With respect to U.S. source income or income from the conduct of a trade or business in the United States.

2. Property Transfers to Foreign Corporations. §6038B. With respect to transfers to a foreign corporation under §351. Section 6038B(a) requires information reporting to the extent required in regulations. Treas. Reg. §1.6038B-1 and Temp. Reg §1.6038B-1T. See alsoTreas. Reg. §1.367(a)-1(a). Provision should also apply where §367(c)(2) treats a capital contribution as an exchange for stock. Filing is made on Form 926 which is filed the tax return for the taxable year of transfer. The regulations set forth in detail the reporting of information required. See also §367(d).

a. Transfers of Cash. A taxpayer must report a transfer of cash to a foreign corporation where: (i) after the transfer, the taxpayer holds, directly or indirectly, 10% or more of the voting power or value of the stock for the foreign corporation; or (ii) the amount of cash transferred by the taxpayer or any related person to the foreign corporation during on the prior 12 month period ending on the date of transfer exceeds $100,000.

b. Exceptions for Certain Transfers of Stock or Securities. Special exceptions from filing Form 926 apply to transfers of stock or securities by less than 5% shareholders, transfers of stock or securities where U.S. person owns 5% or more of the stock of the foreign corporation but has entered into a gain recognition agreement (Treas. Reg. § 1.6038B-1(b)(2)(i)(B)(1)); transfers where the U.S. person is a tax exempt organization and the income is not UBIT; under certain conditions where the transfer was taxable and timely reported or if the transfer is made to a foreign corporation solely because of a regulation under §83 and the value of property transferred did not exceed $100,000.

c. Penalty. Failure to file can result in a penalty of 10% of the value of the property exchanged, unless the failure was due to reasonable cause and not willful neglect. Filing under §6038B where required triggers the start of the statute of limitations for any deficiency resulting from §§367(a) or 367(d). Where no return is filed, the statute of limitations is tolled with respect to a potential deficiency under §367. §6501(c)(8); Treas. Reg. §1.6038B-1(f). Failure to file the required information may cause the U.S. transfer to recognize gain on the transfer. This is because the active foreign business exception of §367(a)(3) will not apply where a person fails to file the required information. Temp. Reg. § 1.367(a)-2T(a)(2); Treas. Reg. § 1.6038B-1(f)(1)(i).

3. Reporting by U.S. Persons That Control Foreign Corporations or Are U.S. Shareholders of Controlled Foreign Corporations. Form 5471.

a. General Rule. Section 6038 requires information reporting by a U.S. person who controls a foreign corporation, ownership of stock over 50% of the voting power or value of all the stock of a foreign corporation. A U.S. person includes, for this purpose a nonresident alien spouse who elects to be taxed as a resident. Treas. Reg. §1.6038-2(d). See §§6013(g), 6013(h). There are stock attribution rules under §318 which are applied with certain modifications.

b. CFC. Where a foreign corporation is a CFC, as defined, the Treasury may require reporting by any person that is a U.S. shareholder. §6038(a)(4). As mentioned above, a CFC for this purpose (and for purposes of Subpart F) is a foreign corporation more than 50% of the combined voting power or value is owned by 10% (or more) U.S. shareholders on any day of the taxable year.

A U.S. shareholder under §951(b) is a U.S. person (§7701(a)(30)), citizen or resident, domestic partnership or corporation or a nonforeign trust or estate that owns 10% or more of the corporation’s combined voting power. Constructive stock ownership rules are set forth under §958. Note that a foreign corporation can be wholly owned by U.S. citizens without becoming a CFC (e.g., if the stock is equally divided among eleven or more unrelated individuals); the ownership rules require not only that more than 50% of the voting power or value be U.S.-owned but also that ownership be concentrated in a limited number of hands. Moreover, a true 50-50 joint venture by a U.S. corporation and an unrelated foreign corporation does not result in CFC status for the foreign subsidiary, because §957 requires more than 50% control (or value) to be held by the U.S. shareholders.

c. Form 5471. Section 6038 requires information from a U.S. person that controls a foreign corporation where such U.S. person has control “for an uninterrupted period of 30 days or more” during the foreign corporation's annual accounting period. More than one person may be required to report the same information on separate Forms 5471 although in certain instances the Treasury will accept a single filer. See §6038(d).

d. Information Required to be Reported: (i) name, business, place of business, incorporation; (ii) post-1986 accumulated earnings and profits; (iii) year end balance sheet and profit and loss statement; (iv) transactions with related persons; and (v) description of classes of stock outstanding and names of U.S. persons owning 5% or more of the stock. The information is reported in U.S. dollars. See §988. Form 5471 must be attached to the taxpayer’s regular income tax return and filed by the due date (including extensions). Treas. Reg. §1.6038-2(i).

e. Penalties. There are three sanctions applicable if the Form 5471 is required to be filed and is not filed. First, there may be a criminal violation of the law. §6038(f)(1) (refers to §7203);Treas. Reg. §1.6038-2(k)(4)(refers to §§7203, 7206, and 7207). Second, civil fine of $10,000 can apply for each violation. §6038(b)(1); Treas. Reg. §1.6038-2(k)(1)(i). Third, there can be a reduction in allowable FTCs. §6038(c); Treas. Reg. §1.6038-2(k)(2).

f. Defenses to Penalties. Failure was not due to willful neglect and there was reasonable cause for such failure. Applied to each form of sanction. Treas. Reg. § 1.6038-2(k)(3)(ii). Taxpayer has the burden of proof.

g. Statute of Limitations Affected. Where a From 5471 CFC is not filed where required the Service may assess tax with respect to any “event or period” to which such information relates and such statute of limitations does not run before the date that is 3 years after the date on which the Service is furnished the required information. §6501(c)(8).

4. Section 6046: Reporting by Certain Directors, Officers and Shareholders of Foreign Corporations.

   a. Officers and Directors. Section 6046 applies to U.S. citizen or resident who becomes an officer/director in a foreign corporation that has 10% or more of its stock, by value, owned by a U.S. person. §§6046(a)(1)(A), 6046(a)(2).

   b. Certain 10% Shareholders. In a foreign corporation where a U.S. person acquires 10% or more of the stock of a foreign corporation.

   c. U.S. Shareholders of Captive Foreign Insurance Companies. Section 6046 applies that §953(c) treats as a U.S. shareholder with respect to a foreign captive insurance company.

   d. Required Filing and Information. See Treas. Reg. §1.6046-1; Form 5471 (Dec. 2011). TD 9650, 2014-3 IRB 394, revised Treas. Reg. §1.6046-1 and added Temp. Reg. §1.1291-1T(e)(5). The filing obligation under §6046 is, in general, within 90 days after the liability to file arises subject to guidance in the regulations.

   e. Penalty For Non-compliance. Civil penalty provided under §6679. A criminal violation may apply in an egregious case. See §6046(f)(cross references to §§7203, 7206 and 7207).

5. Reporting As To Passive Foreign Investment Companies Including Qualified Electing Funds. See Section 1298(f). Treas. Reg. §1.1298-1T (TD 9640, 2014-3 IRB 394). Form 8621,foreign corporation qualifies as a PFIC where at least 75% of the gross income is passive or at least 50% of its asset produce passive income. §§1297(a), (b). See discussion of PFICs supra.

   a. General Rule. A U.S. person who is a shareholder in a PFIC must file an annual report with the Service, subject to exceptions. This is done on Form 8621. This obligation is triggered by direct ownership in the PFIC or indirect ownership through one or more foreign entities or through a special type of "indirect shareholder" such as a grantor of a grantor trust. Taxpayers who make the mark-to-market election under §1296 also must file Form 8621.

   b. Indirect Shareholder. Owning an interest in a PFIC through one or more U.S. persons must also file Form 8621 for the PFIC where, during the indirect shareholder's tax year, the indirect shareholder is: (i) treated as having received an "excess distribution" from the PFIC; (ii) recognized gain treated as an excess distribution as a result of a disposition of the PFIC; (iii) required to include income under §1293(a), i.e., a QEF inclusion; (iv) required to include an amount of income under §1296(a) relating to a mark-to-market inclusion; or (v) required to report the status of a §1294 election as to the PFIC. The filing requirements under (iii) or (iv) are not required for an indirect shareholder of a PFIC where another shareholder thru which the indirect shareholder owns an interest in the PFIC timely files Form 8521. This exception does not apply for a PFIC owned by an indirect shareholder under §1293(a)QEF inclusions where no QEF election is made thru a domestic partnership or S corporation. See Temp. Reg. §1.1298-1T(b).

Example. U.S. citizen owns an interest in a domestic partnership, which, in turn, owns an interest in a PFIC. The domestic partnership must file an annual report because the domestic partnership is the U.S. person that is at the lowest tier in the ownership chain. In addition, the U.S. citizen must file an annual report as to the PFIC when such person is treated as receiving an excess distribution or as recognizing gain that is treated as an excess distribution relating to the PFIC.

D. Required Information.

Reporting For U.S. Persons Owning Interests in Foreign Partnerships. Form 8865.For definition of "foreign partnership" see §7701(a)(5); Treas. Reg. §1.6038-3(b)(7). A U.S. person may be required to file an information return with respect to a foreign partnership. For example, a return is required to be filed where a U.S. person acquires or disposes of an interest in a foreign partnership or the person's "proportional interest' in the partnership "changes substantially." §6046A. An information return is also required if a U.S. person either (1) is a "controlling fifty-percent partner" of a foreign partnership or (2) holds an interest of at least 10% in the partnership while the partnership is controlled by U.S. persons with 10% or greater interests. Treas. Reg. §1.6038-3(a)(1). Finally, a U.S. person may be required to file an information return reporting with respect to transfers to a foreign partnership. All such filing obligations are to be reported on Form 8865 (Return of U.S. Person With Respect to Certain Foreign Partnerships).

1. Section 6046A. Returns As to Interests in Foreign Partnerships. Under §6046(a) any U.S. person, unless otherwise provided to the contrary in the regulations, who (i) acquires any interest in a foreign partnership; or (ii) disposes of any portion of his interest in a foreign partnership; or (iii) whose proportional interest in a foreign partnership changes substantially, is required to file a return. While this provision was enacted into law in 1982, the service had not issued regulations, issued a required form and does not comment on the requirement in the instructions to Form 1065. That ended with T.D. 8851 that was issued on 12/28/1999 where regulations were issued under Treas. Reg. §§1.6046-1, 1.6046A-1(j). Reporting regulations are set forth in Treas. Reg. §1.6038B-2.

2. Under Treas. Reg. §1.6046A-1(a)(1), where a U.S. person has a reportable event, as defined in (b)(1), during the tax year, the U.S. person is required to file Form 8865 for each foreign partnership. A reportable event under the regulations is again defined with respect to "acquisitions", "dispositions" and "changes in proportional interests" in a foreign partnership. The 10% threshold ownership interest is

identified in the regulations. A simple example of a reportable event would be a U.S. person acquires an interest in a foreign partnership and that person did not own a 10% or greater direct interest in the partnership and therefore, as a result of the acquisition, owns a 10% or greater direct interest. Treas. Reg. §1.6046A-1(b)(1)(i)(A).

3. Category of Filers. As with the CFC filing requirements for Form 5471, certain categories of US. persons having an interest in a foreign partnership are required to file Form 8865. §§6038, 6038B, 6046A.

   a. Category 1. A U.S. person who directly or indirectly owns at least 50% of the capital, profits or items of income or loss of the foreign partnership during the partnership's tax year. A Category 1 filer is treated as controlling the foreign partnership.

   b. Category 2. A U.S. person who at any time during the tax year of the foreign partnership owned at least 10% of the capital, profits or tax items of the foreign partnership while the partnership was controlled by U.S. persons, each owning at least a 10% interest. Treas. Reg. §1.6038-3(b)(3).

   c. Category 3. U.S. person contributed property under §721 in exchange for a partnership interest where such person owned, directly or indirectly, 10% or more of the foreign partnership immediately after the contribution or the value of the property contributed to the foreign partnership by the U.S. person or a person related to the U.S. person exceeded $100,000. Treas. Reg. §1.6038B-1(a)(1).

   d. Category 4. U.S. person having a reportable event based on a 10% ownership threshold for direct acquisitions, dispositions or proportionate change in interest of at least 10%.

   e. Complex Indirect and Constructive Ownership Rules, Exemptions Provided in Regulations. The application of this complex area of the filing requirements is beyond the scope of this outline and presentation.

4. Penalties. Section 6046A(e) cross references to §§6679 and 7203 which notes that there are civil penalties and possibly, in an egregious case, criminal penalty for not complying with the provision. Where, for example, the U.S. person fails to furnish all of the required information timely on Form 8865, a penalty of $10,000 for each accounting period may be imposed for such failure. See §6038(b)(1). Where the failure continues for more than 90 days after the taxpayer is notified of the failure, an additional penalty of $10,000 for each 30 day period or fraction thereof during which such failure continues may be imposed up to $50,000. §6038(b)(2). Under §6038(c)(1) if there is a "category2" type failure, i.e., failure to produce within 90 days after notice is provided per §6038(b)(2), then the FTCs allowable from such partnership per §901 are reduced by 10% and with respect to §§902 and 960, a

similar reduction in the gross up for FTC for dividends from a foreign corporation. Section 6038(c)(2) limits the reduction in the FTC to $10,000 as to each failure to furnish or the income of the foreign business entity for its annual accounting period with respect to which the failure occurs, *whichever is greater!*

E. Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts.

1. In General. U.S. persons and personal representatives of estate of U.S. decedents must file Form 3520 with respect to certain events or relationships. First, §6048(a)(1) provides that on or before the 90th day (or such later date as the Service may provide) after a “reportable event”, the “responsible party” shall provide written notice of such event to the Service. See IRS Notice 97-34, 1997-1 C.B. 422, superseded in part by Notice 2003-75, 2003-50 IRB 1204.

2. Notice Requirements. Under §6048(a)(2), a required notice must set forth: (i) the amount of money or other property transferred to the foreign trust in connection with a reportable event, and (ii) the identity of the trust and of each trustee and beneficiary (or class thereof) of the trust.

3. Reportable Event. Section 6048(a)(3)(A) defines “reportable event” as: (i) the creation of any foreign trust by a U.S. person; (ii) the transfer of any money or property (directly or indirectly) to a foreign trust by a U.S. person, including a transfer by reason of death; and (iii) the death of a citizen or resident of the U.S. provided (a) the decedent was treated as the owner of any portion of a foreign trust under the grantor trust rules; or (b) any portion of a foreign trust was included in the gross estate of the decedent.

4. Exceptions. Section 6048(a)(3)(B) provides that the reportable event rule does not apply to any transfer of property to a trust in exchange for consideration of at least the FMV of the transferred property. Consideration other than cash is taken into account at FMV and §679(a)(3) shall apply. Furthermore as to deferred compensation and charitable trusts, the reportable event rules do not apply for purposes of §6048.

5. Responsible Party. Includes the grantor of an inter vivos trust, the transferor in the case of a reportable event other than a transfer by reason of death and the executor of the decedent’s estate in any other case.

6. U.S. Owner of Foreign Trust. Section 6048(b)(1) provides that if at any time during the taxable year a U.S. person is treated as the owner of any portion of a foreign trust under the grantor trust rules, such U.S. person must report such information with respect to such trust and shall be responsible to ensure that: (i) such trust makes a return for such year setting forth a full and complete accounting of all trust activities and operations for the year, the name of the U.S. agent for such trust and other information as is required to be submitted; and (ii) such trust furnished such

information as may be required to each U.S. person who is treated as the owner of any portion of the trust or who receives, directly or indirectly, any distribution from the trust. A U.S. owner of any portion of a foreign trust can appoint a limited U.S. agent to accept service of process or respond to IDRs or summonses with respect to the items of the trust.

a. Trusts Not Having U.S. Agent. See Section 6048(b)(2). A foreign trust may appoint a U.S. agent. However, if a foreign trust does not elect to appoint a U.S. agent, and if adequate records are not provided to determine the proper treatment of any foreign trust distribution, the distribution will be includable in the gross income of the U.S. distribute and will be treated as an accumulation distribution from the middle of the year in computing the interest charge. §6048(c)(2).

7. Reporting by U.S. Beneficiaries of Foreign Trusts. Under §6048(c)(1), where any U.S. person receives, directly or indirectly, during the tax year any distribution from a foreign trust, such person shall make a return (Form 3520) with respect to such trust including: (i) the name of the trust; (ii) the aggregate amount of distributions received in such year; and (iii) such other information as is required. Where adequate records are not provided as to the proper treatment and characterization of any distribution froma foreign trust, such distribution will be treated, per §6048(c)(2)(A), as an accumulation distribution includible in the gross income of the distribute. Mid-year convention treatment for interest on the accumulation distribution (1/2 of the number of years the trust has been in existence). See §6048(c)(2)(B).

A person required to file with respect to two or more foreign trusts must file a separate Form 3520 for each trust.

8. Foreign Trust Reporting Penalties. See Section 6677 for civil penalty for failure to file information with respect to certain foreign trusts required to be filed under §6048. If a notice or return required by §6048 is not filed when due or is filed without all of the required information, the person required to file is liable for a penalty keyed to the “gross reportable amount,” which may be: (i) the value of the property transferred to the foreign trust (for failure to file Form 3520) by not reporting the creation of or a transfer to a foreign trust; (ii) the value (on the last day of the year) of the portion of a grantor trust owned by a U.S. person who fails to file Form 3520 as to the trust or fails to cause the trust to file its U.S. income return and report required information to U.S. owners and distributees of the trust; or (iii) the amount distributed to a distribute who fails to file a Form 3520 reporting distributions. §6677(c).

9. Reporting Large Gifts From Foreign Persons. A U.S. person receiving “foreign gifts” exceeding a threshold amount during any taxable year must give notice to the IRS of the gifts by filing Form 3520 with his or her income tax return for the year. The annual threshold is $100,000 for gifts from nonresident aliens and foreign

estates and $10,000 (adjusted for inflation) for gifts from foreign corporations and partnerships. The $100,000 threshold is separately applied to gifts and bequests from each nonresident alien donor or foreign estate, while the $10,000 threshold applies to the aggregate of all gifts received during the year from all foreign corporations and partnerships. Thus, a U.S. person is required to report gifts and bequests from a particular nonresident alien individual or foreign estate if receipts from that donor or estate exceed $100,000 during the taxable year.

a. Foreign Gift. A foreign gift is an amount received from other than a U.S. person which the recipient treats as a gift or bequest. A "foreign gift" does not include a distribution from a foreign trust that the taxpayer "properly" discloses on Form 3520 as a distribution. See §§6039F(b), 6048(c). Also, a foreign person's transfer of property to a trust, domestic or foreign, is considered a gift to a U.S. beneficiary for this purpose only if the beneficiary is considered owner of the trust or for some other reason is "treated as receiving the contribution in the year of the transfer." See Notice 97-34, 1997-1 C.B 422, §VI.A. However, a domestic trust, as a U.S. person, is required to report receipt of a gratuitous transfer from a foreign person unless the trust is considered owned by another person under the grantor trust rules. The trust is required to report the receipt of a contribution to the trust from a foreign person as a gift under § 6039F. Note that a domestic trust owned by a foreign person is not required to report gratuitous transfers from any foreign person, a U.S. person's receipt of a distribution from such a trust is a gift from a foreign person that must be reported under Form 3520.

b. Penalties. If the U.S. person does not timely report the gifts, without reasonable cause for such failure, the IRS may determine the tax treatment of the gifts. Judicial review of the IRS determination will be under an arbitrary and capricious standard. The U.S. person is subject to a penalty equal to 5% of the amount of the gift for each month that the failure continues, with the total penalty not to exceed 25% of the amount.The rule applies to amounts received after August 20, 1996. See §§6039F(b), 6039F(c). It is the gross (not "net") value of the gift that is the base for thepenalty.

F. Foreign Account Tax Compliance Act (FATCA).

Much of the material which follows was sourced from Dhanawade, "I Got 99 Problems and They're All FATCA", Comment, 35 Nw.J. Int'l L. & Bus. 139 (Fall, 2014). Mr. Dhanawade, in the part of his Comment that sets out the FACTA provisions in general, to Lederman & Hirsch, "The American Assault on Tax Havens-Status Report, " 44 Int'l Law. 1141 (2010).

1. In General. On March 18, 2010, as part of the Hiring Incentives to Restore Employment (HIRE) Act, P.L. 111-147, Congress enacted into law an intrusive and complex set of reporting obligations that exceed the territorial limits of the U.S.

proper and impose on certain foreign financial institutions (FFIs) and non-U.S. entities that are not foreign financial institutions (NFFIs) obligations to report on the extent to which there are U.S. account holders present and report such information directly to the IRS. §1471(b)(1) (FFIs). NFFEs are in general required to provide information on whether there are certain U.S. owners, those holding an interest greater than 10% in the NFFE, to the withholding agents. Where an FFI or NFFE does not comply with the requirements under new chapter 4 of the Code, there is an automatic 30% withholding with respect to distributions that may represent the proceeds from the sale or other dispostion of property or repayment of debt. Other withholding rules on FDAP (fixed or determinable annual or periodical income that is U.S. sourced) as well as partnership withholding (§1446), FIRPTA withholding, continue to apply.

a. FFI. An FFI includes banks and similar deposit type institutions but further includes foreign mutual funds, hedge funds, private equity funds, investing, administering or managing funds, money or financial assets on behalf of others, certain insurance companies that issue cash value or annuity contracts, etc. See §1471(d)(5), Treas Reg. §1.1471-5(e). FFIs are required to: (i) report on information U.S. accounts to the IRS on an annual basis; (ii) exercise due diligence in confirming or ascertaining the identity of their account holders; (iii) comply with IRS requests for information; (iv) where necessary, obtain a waiver of any applicable non-U.S. law restrictions on confidentiality of account information or close the account if no waiver is obtained; and (v) deduct and withhold a 30% tax on any pass thru payments made to accounts that do not comply with the FFI's information requests, even if all the account holders may in fact be non-U.S. persons, and by NFFEs. Certain entities are excluded from the definition of an FFI. Treas. Reg. §1.1471-5(e)(5).

b. Participating FFIs. For FFIs required to report, i.e., "participating FFIs" or "PFFIs" are subject to a set of requirements that become binding obligations that are entered into directly with the United States or through their home country. More particularly, a PFFI is an FFI that:(i) has agreed to comply with the requirements of an FFI agreement per Treas. Reg. §1.1471-4; (ii) has entered into a Model 2 IGA that has agreed to comply with the requirements of an FFI agreement; and (iii) an FFI that is a qualified intermediary (QI) branch of a U.S. financial institution unless the branch is a reporting Model 1 FFI. Treas. Reg. §1.1471-1T(b)(9).

(i) Registration with IRS. FFI must register with the IRS and execute an FFI agreement to obtain the status of a PFFI. This can be done by executing an FFI agreement which can be done online under the IRS FFI registration web-site or portal or by filing Form 8957, Foreign Account Tax Compliance Act (FATCA) Registration. Financial institutions are able to register and, as appropriate, agree to comply with their obligations as PFFIs, sponsoring FFIs, limited FFIs, or registered deemed-compliant FFIs. Once a financial institution has registered, the IRS will approve its registration. Upon such approval, the IRS will issue a global intermediary identification number (GIIN) to each PFFI and registered deemed-compliant FFI.

c. Non-participating FFIs ("NPFFIs"). An NPFFI is subject to the 30% withholding tax under Section 1471(a) on certain income and other payments they beneficially own and payments for which they act as intermeiaries.

d. Withholding of 30% of “Withholdable Payments” to FFIs (and non-FFIs).

(i) Separate Withholding Regime. The FACTA 30% withholding required on any “withholdable payment” is a separate withholding regime to US. sources payments to FFIs and certain Non-FFIs, withholding on certain U.S. source income, for example, applies only to payments made to non-resident aliens and foreign corporations. See also FIRPTA and foreign partnership withholding rules under §§1445 (FIRPTA withholding) and 1446 (withholding on foreign partner’s share of ECI). It should also be noted that FACTA effectively overrides tax treaties of the U.S. which allows the U.S. to “super-withhold” on “withholdable payments” beyond permitted boundaries of treaty withholding. But see §1445(c)(1)(C). It is also obvious that FACTA has transcended local bank secrecy laws. More specifically FATCA requires FFIs and foreign banks to deny accounts to U.S. citizens if they cannot comply with its reporting requirements. See Behrens, Comment, “Using a Sledgehammer to Crack a Nut: Why FATCA Will Not Stand”, 2013 Wisc. L. Rev. 205, 207 (2013) (citing Dean, “More Cooperation, Less Uniformity: Tax Deharmonization and the Future of the International Tax Regime”, 84 Tul. L. Rev. 125, 132 (2009)). The pass thru provision under FATCA still imposes a burden on foreign banks and FFIs to ensure that all non-U.S. funds comply with FATCA’s reporting requirements. Regulations have delayed withholding passthru payments until 2017 at the earliest. See generally Notice 2013-43 (revised timeline and other guidance on FACTA implementation): http://www.irs.gov/pub/irs-drop/n-13-43.pdf.

(ii) Defining FFI. Section 1471(d)(4) defines FFI as “any financial institution which is a foreign entity” but not including financial institutions organized under U.S. law or the law of a U.S. possession. FFIs therefore include foreign banks, trust companies, brokerage firms, mutual funds, hedge funds and private equity funds.

(iii) Defining Withholdable Payments From FFI. Interest, dividends, rents, salaries, wages, premiums, annuities, compensation, emoluments and FDAP (see §871, §881) from sources from within the US. and any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources from within the U.S.

(iv) Withholding Agent. Under §1473, a "withholding agent" includes "all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of any withholdable payment". FFI withholding can extend to distributions that are not otherwise U.S. source income.

(v) Mitigating The Potential Impact of FATCA. Under §1471(b) the 30% withholding under §1471 can be avoided where: (i) the FFI identifies their U.S. accounts; (ii) complies with due diligence and verification procedures regarding possible U.S. accounts; (iii) annually reports information about FFIs to the IRS (or through an IGA or TIEA agreement); (iv) withholds the 30% FATCA tax or be withheld upon on passthru payments to other FFIs that did not enter into FFI agreements with the IRS, or on payments to non-compliant account holders who fail to supply information regarding U.S. account ownership; (v) complying with any IRS requests for additional information about U.S. accounts; and (vi) if foreign law prevents disclosure, seeking a waiver of the law or closing the account in question if a waiver cannot be obtained.

(vi) Exceptions to the FFI Rules. Under § 1471(b)(2)(A), an FFI can also avoid the 30% withholding tax if (i) the FFI complies with IRS procedures ensuring that it does not maintain U.S. accounts and meets requirements prescribed by the IRS regarding other FFIs' accounts, (ii) the FFI is a "member of a class of institutions" for which the IRS creates an exception, or (iii) the FFI does not invest in U.S. assets.Note the last exception in particular which has made some of our financial services organizations take note and complain that FACTA can be driving investors away from making U.S. situs investment.

(vii) FFIs Closing Out U.S. Customers. It has been reported that U.S. citizens living abroad that FACTA has made it difficult to establish and maintain foreign bank accounts. Alternatively, if FFIs don't comply with FATCA there could be account closures. There may also be difficulty in U.S. citizens in purchase foreign insurance policies and pension funds. Perhaps expatriation is one avenue to obtain relief but at a heavy tax cost and administrative burden particular for expats with a net worth of $2,000,000 or more or an annual income in excess of $150,000.

(viii) More on FACTA: View From Above. FATCA requires FFIs to determine whether de facto U.S. ownership exists instead of simply relying on clients’ assertions of their tax status or residence.This is a sharp departure from the prior (qualified intermediary or) QI program’s “know your customer” diligence rules that restricted additional investigation to situations where criminal activity seemed probable. FATCA’s exact due diligence requirements negate an FFI’s simple reliance on what a bank account holder states. Moreover, FATCA does not assume that a corporation is the beneficial owner. Instead it requires FFIs to report accounts in which a U.S. citizen holds more than 10% of the equity.

(ix) NFFE. Under Section 1472, witholding agents are required to withold 30% of any "withholdable payments" made to NFFIs unless the NFFE provides certain information regarding its ownership to the IRS or to the withholding agent or is exemption from providing such information. An NFFE that is not exempted from reporting or a so-called "passive NFFE" is required to certify to the withholding agents or to the IRS that it does not have any substantial U.S. owners or if it does, to identify its substantial U.S. owners and provide information about such owners. Among the most notable exceptions to the passive NFFE is the "active NFFE". An NFFE is "active" where less than 50% of its gross income for the preceding taxable year is passive income and if less than 50% of the percentage of assets held by the NFFE (determined quarterly) are held for the production of or produce passive income. See Treas. Reg. §1.1472-1T(c)(1)(iv).

2. Intergovernmental Agreements (IGAs). FFIs, under FATCA, can avoid being withheld upon by registering with the IRS and agreeing to report specified information about U.S. accounts and foreign accounts with substantial U.S. owners to their home country’s tax administrators (or delegate) instead of reporting directly to the IRS. Compliance with the IGA procedures will avoid the 30% withholding on “withholdable payments” under FACTA.

a. Model 1 IGA. This is an agreement between the U.S. and a foreign government concerning FACTA. Treas. Reg. §1.1471-1. Model 1 IGAs are of two types: (i) reciprocal and (ii) non-reciprocal. A Model 1 (reciprocal) IGA requires a mutual exchange of information between the U.S. and the foreign government as to each jurisdiction’s resident account holders. A non-reciprocal Model 1 IGA requires only the foreign country to report foreign financial information as specified about accounts held by U.S. citizens or by foreign entities controlled by U.S. citizens. Such required information includes U.S. taxpayer identification numbers and payments to nonparticipating FFIs.

b. Model 2 IGA. This form of FATCA agreement between the U.S. and a foreign government requires each FFI to still report information directly to the IRS. The foreign government permits or allows its FFIs doing business in its jurisdictionto "register and 'comply with the requirements of an FFI Agreement, including . . . due diligence, reporting, and withholding." FACTA permits FFIs to avoid 30% withholding by entering into an FFI and agree to make the required disclosures. See Rev. Proc. 2014-13 (Final Agreement) which pertains to participating FFIs and FFI's treated as reporting institutions under Model 2 IGAs.

c. Rev. Proc. 2014-13, 2014-29 I.R.B. 131 (2014 WL 2865257). Rev.Proc. 2014-13, supra, updates the FFI Agreement applicable to foreign financial institutions (FFIs) who want to enter into an FFI Agreement with the IRS to be treated as a participating FFI under section 1471(b) of the Code. Rev. Proc. 2014-38 also provides guidance to FFIs and branches of FFIs treated as reporting financial institutions under an applicable Model 2 intergovernmental agreement (IGA) on complying with the terms of the FFI Agreement, as modified by the Model 2 IGA. Rev. Proc. 2014-38 updates the FFI Agreement to reflect the temporary regulations released on February 20, 2014, under chapters 3, 4, and 61 of the Code, and section 3406. Rev. Proc. 2014-38 modifies and supersedes Rev. Proc. 2014-13. The Final Agreement did not address Model 1 IGAs. Therefore, Model 1 IGAs permit FFIs to comply with FATCA's reporting requirements without having to enter into an FFI Agreement with the IRS. On the other hand, Model 2 IGAs require signatory jurisdictions to comply with the terms of an FFI Agreement.

(i) FFI Registration for Participating FFI or Reporting Model 2 (Non-Reciprocal) FFI Status. An FFI may register on Form 8957 (FACTA) on the IRS FACTA website at http://www.irs.gov/fatca to enter into the FFI agreement on behalf of one or more of its branches so that each of such branches may be treated as a participating FFI and receive a global intermediary identification number (GIIN). A reporting Model 2 FFI may also register on the FATCA registration website as to one or more of its branches to obtain a GIIN and to agree to comply with the terms of the FFI agreement, as modified by an applicable Model 2 IGA. A branch of such FFIs that cannot, under the laws of the jurisdiction in which such branch is located, satisfy all of the terms of the FFI agreement will be treated as a limited branch (as defined in the FFI agreement) and will be subject to withholding under §1471 as a non-participating FFI.

(ii) Non-Application to Model 1 FFI. In general, the FFI (final) agreement does not apply to a reporting Model 1 FFI, or any branch of such an FFI, unless the reporting Model 1 FFI has registered a branch located outside of a Model 1 IGA jurisdiction so that such branch may be treated as a participating FFI or reporting Model 2 FFI. In this event the terms of the applicable FFI agreement apply to the operations of such branch. With respect to an FFI (or branch of an FFI) that agrees to the requirements of a participating FFI (including a reporting Model 2 FFI) and that has entered into a Qualified Intermediary (QI) agreement, Withholding Foreign Partnership (WP) agreement, or Withholding Foreign Trust (WT) agreement, the QI, WP, or WT agreement, as applicable, will apply in addition to the requirements of the FFI agreement, unless specifically modified by the QI, WP, or WT agreement.

3. FATCA Withholding on Payments to Nonfinancial Foreign Entities (NFFEs). Section 1472.

a. In General. Subject to transition rules and certain exceptions, §1472(a) requires withholding on withholdable payments beneficially owned by a nonfinancial foreign entity (NFFE) (other than exempt NFFEs) unless the NFFE identifies any substantial U.S. owners or certifies that it has no substantial U.S. owners. An NFFE is any foreign entity which is not a financial institution per §1471(d)(5).

b. Required 30% Withholding to NFFE With Respect to Withholdable Payments. A withholding agent making a withholdable payment to a "non-financial foreign entity" (NFFE) must generally withhold and pay over to the IRS a tax equal to 30% of the payment if the entity or another NFFE is the beneficial owner of the payment.

c. Exception to 30% Withholding to NFFE. Withholding is not required if the following requirements are met: (i) the beneficial owner or payee either (1) certifies to the withholding agent that the beneficial owner has no substantial U.S. owners or (2) provides the withholding agent with the name, address, and taxpayer identification number (TIN) of each substantial U.S. owner of the beneficial owner; (ii) the withholding agent neither knows nor has reason to know that any information so provided to it is incorrect; or the withholding agent reports this information to the IRS "in such manner as [the Treasury] may provide." See §1472(b). The term "substantial U.S. owner" generally includes any U.S. person owning more than 10% of the entity's stock or other equity interests. Where the entity's business is investing or trading in securities, commodities or derivatives, any person owning an equity interest in the entity is a substantial U.S. person, regardless of the size of the interest. See §1473(2).

d. Exemptions from Section 1472 NFFE Withholding. No withholding is required if the payment is beneficially owned by any of the following "exempt NFFEs": (i) a corporation, if its stock is regularly traded on an established securities market or if it is a member of an expanded affiliated group that includes a corporation with stock regularly traded on an established securities market; (ii) an entity that is organized under the laws of a U.S. possession and wholly owned by bona fide residents of the possession; (iii) a foreign government, a political subdivision of a foreign government, an international organization, or (iv) a wholly-owned agency or instrumentality of any of the foregoing; (v) a foreign central bank of issue; or (vi) any class of persons identified by the Treasury as having a low risk of tax evasion. See §1472(c)(1), §1471(c)(2).

FATCA was enacted in 2010 by Congress to target non-compliance by U.S. taxpayers using foreign accounts. FATCA requires foreign financial institutions (FFIs) to report to the IRS information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. For access to the regulations and administrative guidance related to FATCA and to learn about taxpayer obligations please visit the Internal Revenue Service FATCA Page.

Additional FATCA Statements, Notifications of More Favorable Terms and Press Releases (taken from IRS Website).

By Date

Jurisdiction	Status	Intergovernmental Agreement (IGA) & Related Agreements or Exchanges	Understandings	Date Jurisdiction is Treated as having an IGA in Effect
Algeria	Signed	Model 1		6-30-2014
Angola	Signed	Model 1		11-30-2014
Anguilla	Agreement in Substance	Model 1		6-30-2014
Antigua and Barbuda	Agreement in Substance	Model 1		6-30-2014
Armenia	Agreement in Substance	Model 2		6-30-2014
Australia	In Force (6-30-2014)	Model 1		6-30-2014
Austria	In Force (12-9-2014)	Model 2		6-30-2014

Azerbaijan	In Force (11-5-2015)	Model 1		6-30-2014
Bahamas	In Force (9-17-2015)	Model 1		6-30-2014
Bahrain	Agreement in Substance	Model 1		6-30-2014
Barbados	In Force (9-25-2015)	Model 1		6-30-2014
Belarus	In Force (7-29-2015)	Model 1		6-30-2014
Belgium	Signed	Model 1		6-30-2014
Bermuda	In Force (8-19-2014)	Model 2		6-30-2014
Brazil	In Force (6-26-2015)	Model 1		6-30-2014
British Virgin Islands	In Force (7-13-2015)	Model 1		6-30-2014
Bulgaria	In Force (6-30-2015)	Model 1		6-30-2014
Cabo Verde	Agreement in Substance	Model 1		6-30-2014
Cambodia	Signed	Model 1		11-30-2014
Canada	In Force (6-27-2014)	Model 1		6-30-2014
Cayman Islands	In Force (7-1-2014)	Model 1		6-30-2014
Chile	Signed	Model 2		6-30-2014
China	Agreement in Substance	Model 1		6-30-2014
Colombia	In Force (8-27-2015)	Model 1		6-30-2014
Costa Rica	Signed	Model 1		6-30-2014
Croatia	Signed	Model 1		6-30-2014

Curaçao	Signed	Model 1		6-30-2014
Cyprus	In Force (9-21-2015)	Model 1		6-30-2014
Czech Republic	In Force (12-18-2014)	Model 1		6-30-2014
Denmark	In Force (9-30-2015)	Model 1		6-30-2014
Dominica	Agreement in Substance	Model 1		6-30-2014
Dominican Republic	Agreement in Substance	Model 1		6-30-2014
Estonia	In Force (7-9-2014)	Model 1		6-30-2014
Finland	In Force (2-20-2015)	Model 1		6-30-2014
France	In Force (10-14-2014)	Model 1		6-30-2014
Georgia	Signed	Model 1		6-30-2014
Germany	In Force (12-11-2013)	Model 1		6-30-2014
Gibraltar	In Force (9-17-2015)	Model 1		6-30-2014
Greece	Agreement in Substance	Model 1		11-30-2014
Greenland	Agreement in Substance	Model 1		6-30-2014
Grenada	Agreement in Substance	Model 1		6-30-2014
Guernsey	In Force (8-26-2015)	Model 1		6-30-2014
Guyana	Agreement in Substance	Model 1		6-30-2014
Haiti	Agreement in Substance	Model 1		6-30-2014

Holy See	In Force (6-10-2015)	Model 1		11-30-2014
Honduras	In Force (2-19-2015)	Model 1		6-30-2014
Hong Kong	Signed	Model 2		6-30-2014
Hungary	In Force (7-16-2014)	Model 1		6-30-2014
Iceland	In Force (9-22-2015)	Model 1		11-30-2014
India	In Force (8-31-2015)	Model 1		6-30-2014
Indonesia	Agreement in Substance	Model 1		6-30-2014
Iraq	Agreement in Substance	Model 2		6-30-2014
Ireland	In Force (4-2-2014)	Model 1		6-30-2014
Isle of Man	In Force (8-26-2015)	Model 1		6-30-2014
Israel	Signed	Model 1		6-30-2014
Italy	In Force (8-17-2015)	Model 1		6-30-2014
Jamaica	In Force (9-24-2015)	Model 1		6-30-2014
Japan	Signed	Model 2		6-30-2014
Jersey	In Force (10-28-2015)	Model 1		6-30-2014
Kazakhstan	Agreement in Substance	Model 1		11-30-2014
Kosovo	In Force (11-4-2015)	Model 1		6-30-2014
Kuwait	Signed	Model 1		6-30-2014

Latvia	In Force (12-15-2014)	Model 1		6-30-2014
Liechtenstein	In Force (1-22-2015)	Model 1		6-30-2014
Lithuania	In Force (10-7-2014)	Model 1		6-30-2014
Luxembourg	In Force (7-29-2015)	Model 1		6-30-2014
Macao	Agreement in Substance	Model 2		11-30-2014
Malaysia	Agreement in Substance	Model 1		6-30-2014
Malta	In Force (6-26-2014)	Model 1		6-30-2014
Mauritius	In Force (8-29-2014)	Model 1		6-30-2014
Mexico	In Force (4-10-2014)	Model 1		6-30-2014
Moldova	Signed	Model 2		6-30-2014
Montenegro	Agreement in Substance	Model 1		6-30-2014
Montserrat	Signed	Model 1		11-30-2014
Netherlands	In Force (4-9-2015)	Model 1		6-30-2014
New Zealand	In Force (7-3-2014)	Model 1		6-30-2014
Nicaragua	Agreement in Substance	Model 2		6-30-2014
Norway	In Force (1-27-2014)	Model 1		6-30-2014
Panama	Agreement in Substance	Model 1		6-30-2014

Paraguay	Agreement in Substance	Model 2		6-30-2014
Peru	Agreement in Substance	Model 1		6-30-2014
Philippines	Signed	Model 1		11-30-2014
Poland	In Force (7-1-2015)	Model 1		6-30-2014
Portugal	Signed	Model 1		6-30-2014
Qatar	In Force (6-23-2015)	Model 1		6-30-2014
Romania	In Force (11-3-2015)	Model 1		6-30-2014
San Marino	Signed	Model 2		6-30-2014
Saudi Arabia	Agreement in Substance	Model 1		6-30-2014
Serbia	Agreement in Substance	Model 1		6-30-2014
Seychelles	Agreement in Substance	Model 1		6-30-2014
Singapore	In Force (3-28-2015)	Model 1		6-30-2014
Slovak Republic	In Force (11-9-2015)	Model 1		6-30-2014
Slovenia	In Force (7-1-2014)	Model 1		6-30-2014
South Africa	In Force (10-28-2014)	Model 1		6-30-2014
South Korea	Signed	Model 1		6-30-2014
Spain	In Force (12-9-2013)	Model 1		6-30-2014
St. Kitts and Nevis	Signed	Model 1		6-30-2014

St. Lucia	Signed	Model 1		6-30-2014
St. Vincent and the Grenadines	Signed	Model 1		6-30-2014
Sweden	In Force (3-1-2015)	Model 1		6-30-2014
Switzerland	In Force (6-2-2014)	Model 2		6-30-2014
Taiwan*	Agreement in Substance	Model 2		6-30-2014
Thailand	Agreement in Substance	Model 1		6-30-2014
Trinidad and Tobago	Agreement in Substance	Model 1		11-30-2014
Tunisia	Agreement in Substance	Model 1		11-30-2014
Turkey	Signed	Model 1		6-30-2014
Turkmenistan	Agreement in Substance	Model 1		6-30-2014
Turks and Caicos Islands	Signed	Model 1		6-30-2014
Ukraine	Agreement in Substance	Model 1		6-30-2014
United Arab Emirates	Signed	Model 1		6-30-2014
United Kingdom	In Force (8-11-2014)	Model 1		6-30-2014
Uzbekistan	Signed	Model 1		6-30-2014
TOTAL JURISDICTIONS	*112*			

*Consistent with the Taiwan Relations Act, the parties to the agreement would be the American Institute in Taiwan and the Taipei Economic and Cultural Representative Office in the United States.

Model Intergovernmental Agreements

Following the enactment of FATCA, Treasury published the Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA.

Model Agreements for Jurisdictions that Reached an Agreement in Substance on or before June 30, 2014:

- Reciprocal Model 1A Agreement, Preexisting TIEA or DTC (updated 6-6-2014)
- Nonreciprocal Model 1B Agreement, Preexisting TIEA or DTC (updated 6-6-2014)
- Nonreciprocal Model 1B Agreement, No TIEA or DTC (updated 6-6-2014)
- Model 2 Agreement, Preexisting TIEA or DTC (updated 6-6-2014)
- Model 2 Agreement, No TIEA or DTC (updated 6-6-2014)
- Annex I to Model 1 Agreement (updated 6-6-2014)
- Annex I to Model 2 Agreement (updated 6-6-2014)
- Annex II to Model 1 Agreement (updated 11-4-2013)
- Annex II to Model 2 Agreement (updated 11-4-2013)

Model Agreements for Jurisdictions that Reached an Agreement in Substance on or after July 1, 2014:

- Reciprocal Model 1A Agreement, Preexisting TIEA or DTC(updated 11-30-2014)
- Nonreciprocal Model 1B Agreement, Preexisting TIEA or DTC(updated 11-30-2014)
- Nonreciprocal Model 1B Agreement, No TIEA or DTC(updated 11-30-2014)
- Model 2 Agreement, Preexisting TIEA or DTC(updated 11-30-2014)
- Model 2 Agreement, No TIEA or DTC (updated 11-30-2014)
- Annex I to Model 1 Agreement(updated 11-30-2014)
- Annex I to Model 2 Agreement(updated 11-30-2014)
- Annex II to Model 1 Agreement(updated 11-30-2014)
- Annex II to Model 2 Agreement(updated 11-30-2014)

V. Expatriation Provisions For Federal Income Tax Purposes. See, in general, August "Expatriation of U.S. Citizens and Long-Term U.S. Residents", ALI March 31, 2015 (WESTLAW).

A. Heroes Earnings Assistance and Relief Tax Act of 2008 ("Heroes Act"), Pub. L. No. 110-245, §301 (2008). Introduction of Mark-to-Market Regime. For those individuals who terminated citizenship or long-term residency after June 16, 2008 and meet certain tests, all of his or her property or assets is treated as sold in a taxable disposition on the day before the expatriation date for its fair market value. § 877A(a)(1). This system applies to U.S. citizens and long-term residents who expatriate after June 16, 2008. IRC § 877(h) (§ 877 does not apply to individual whose expatriation date is after June 16, 2008). Unlike the 10 year phase out rule under former section 877, expatriation status of a covered expatriate individual is permanent. The enactment of § 877A, which is generally effective from June 17, 2008, when President Bush signed the legislation into law, changes the tax consequences of expatriation by U.S. persons as governed by a deemed realization income tax event, i.e., mark-to-market rules, and an inheritance or succession transfer tax regime. The U.S. broadening the impact of expatriation spurred the enactment of limited expatriation tax provisions in a number of other countries, including France, Germany and the Netherlands.

1. Mark-to-Market Generally. Covered expatriates are subject to income tax on the net unrealized gain in their property as if the property had been sold for its fair market value on the day before the expatriation or residency termination ("mark-to-market tax"). § 877A(a)(1).

   a. Nexus to Gross Estate. The covered expatriate is deemed to have sold any interest in property that would be included in his gross estate (with modifications) for the fair market value, determined as of the expatriate date. Notice 2009-85, Sec. 3, 2009-45 I.R.B. 598 (the IRS issued guidance in Notice 2009-85, 2009-45 I.R.B. 598, which taxpayers can apply in their entirety and which will be incorporated in regulations that would be effective for individuals whose expatriation date is after October 14, 2009).

   b. Gain. Gain from the deemed sale is taken into account at the time of the expatriation date, notwithstanding any other Code provisions. §877A(a)(2)(A). Any loss from the deemed sale generally is taken into account to the extent otherwise provided in the Code, except that the wash sale rules of section 1091 do not apply. § 877A(a)(2)(B).

   c. Exclusion Amount: $600,000 Threshold. The amount that would otherwise be includible in gross income under the mark-to-market rule is reduced by (but not below zero) by $600,000. § 877A(a)(3). The $600,000 is adjusted for post 2007 inflation, with the adjusted amount rounded to the nearest multiple of $1,000 ($626,000 in 2009, $627,000 in 2010, $636,000 in 2011, and $651,000 in 2012, and $668,000 in 2013) IRC §877A(a)(3)(B); Rev. Proc. 2010-40, 3.18, 2010-46 I.R.B.; Rev. Proc. 2009-50, 3.27, 2009-45 I.R.B. 617; Rev. Proc. 2008-66, 3.27, 2008-45 I.R.B. 1107. Thus, any net gain on the deemed sale is recognized only to the extent it exceeds $668,000 for 2013. Joint Committee Staff, Technical Explanation of the Heroes Earnings Assistance and Relief Tax Act Of 2008 (JCX-44-08), 5/20/2008, p. 39.

      (i) Allocation of exclusion amount. The exclusion amount is allocated among all built-in gain property that is subject to the mark-to-market regime, pro-rata, based on the amount of gain for each built-in gain asset. Notice 2009-85, Sec. 3, 2009-45 I.R.B. 598.

      (ii) Single lifetime exclusion. Each individual is allowed only onelifetime exclusion amount, with the result that an exclusion amount is no longer available upon a later expatriation to the extent that it has been used up in an earlier expatriation. Notice 2009-85, Sec. 3, 2009-45 I.R.B. 598.

d. Adjustments. Any gains or losses subsequently realized are to be adjusted for gains and losses taken into account under the deemed sale rules, without regard to the $600,000 exclusion exemption discussed above. IRC §877A(a)(2). Thus, Notice 2009-85 provides that after allocating the appropriate portion of the exclusion amount among the gain assets, the covered expatriate must report gains and losses on the appropriate schedules and forms depending upon the character of each asset. Notice 2009-85, Sec. 3, 2009-45 I.R.B. 598.

e. Allocation. The exclusion amount is allocated among all built-in gain property that is subject to the mark-to-market regime, prorata, based on the amount of gain for each built-in gain asset.

2. Step-Up in Basis. For purposes of determining the tax under the mark-to-market rules, property that was held by an individual on the date the individual first becomes a U.S. resident (§7701(b)) is treated as having a basis on that date of not less than the fair market value of the property on that date. § 877A(h)(2). A taxpayer may make an irrevocable election for this basis rule not to apply. § 877A(h)(2). The election is made on Form 8854.

a. United States Real Property Interests ("USRPI's"). The IRS and Treasury Department intend to exercise their regulatory authority to exclude from this step-up-in-basis rule United States real property interests within the meaning of section 897(c) ("USRPIs") and property used or held for use in connection with the conduct of a trade or business within the United States. Notice 2009-85, Sec. 3, 2009-45 I.R.B. 598.

b. USRPI Step-Up in Basis Still Permitted In Limited Instances. However, if before becoming a U.S. resident, the nonresident alien was a resident of a country with which the U.S. had an income tax treaty, and the nonresident alien held property used or held for use in connection with the conduct of a U.S. trade or business that was not carried on through a permanent establishment in the U.S. under the income tax treaty, the property is eligible for a step up basis to fair market value. Notice 2009-85, Sec. 3, 2009-45 I.R.B. 598.

c. Priority of Section 684. If the expatriation of an individual would result in the recognition of gain under section 684 (referring to transfers to foreign estates and trusts), the above rules on "termination of deferrals" and "step-up in basis" are applied after the application of code section 684. §877A(h)(3). More specifically, where a U.S. person transfers property to a nongrantor, foreign trust, §684 treats the transfer as a sale or exchange of the property for a price equal to its fair market value. Because a nonresident alien generally may not be considered owner of a trust under the grantor trust rules, an individual's expatriation can terminate his or her ownership of a grantor trust, thereby causing §684 to apply.

d. Simplification Effort. The exit tax simplifies the expatriation taxation picture significantly by no longer requiring every covered expatriate to file (and the IRS to track) her income for ten years after expatriation.

e. Withholding Requirement of Non-Grantor Trusts. The HEART Act imposes a tax withholding requirement on all nongrantor trusts, foreign or domestic, that make taxable distributions to a covered expatriate. §877A(f)(1)(A). The mark-to-market tax does not apply with respect to any portion of a trust that is not treated as owned (under the grantor trust rules) by the covered expatriate immediately before the expatriation date. See §877A(f)(3). Special rules apply to any nongrantor trust with respect to which the covered expatriate is a beneficiary on the day before the expatriation date. Where there is a direct or indirect distribution of any property from a nongrantor trust to a covered expatriate, the trustee must deduct and withhold from the distribution an amount equal to 30% of the portion of the distribution which would be includible in the gross income of the covered expatriate if the covered expatriate continued to be subject to tax as a citizen or resident of the United States. Such portion of such distribution that is subject to the 30% withholding requirement is subject to tax under section 871. It may be argued, however, that any distribution from a "nongrantor trust for purposes of § 877A(f)(3) but is in fact a grantor trust as to someone other than the covered expatriate, should not be taxable to the covered expatriate on account of the fact that it would not be includable in gross income if the covered expatriate continued to be subject to tax as a citizen or resident of the United States. The covered expatriate is treated as having waived any right to claim any reduction in withholding under any treaty with the United States on any distribution to which §877A(f)(1)(A) applies, unless the covered expatriate agrees to "such other treatment as the Secretary determines appropriate." If the nongrantor trust distributes appreciated property to a covered expatriate, the trust must recognize gain as if the property were sold to the covered expatriate at its fair market value. § 877A(f)(1)(B). If a trust that is a nongrantor trust immediately before the expatriation date subsequently becomes a grantor trust of which a covered expatriate is treated as the owner, directly or indirectly, such conversion is treated under the provision as a distribution to such covered expatriate to the extent of the portion of the trust of which the covered expatriate is treated as the own.

f. Succession Tax: New Section 2801. Pertains to gifts or bequests from covered expatriate donors to U.S. donees. The new "succession tax" cover any "direct or indirect gift or bequest," and imposes a tax rate that is equivalent to "the highest applicable gift or estate tax rates."

g. Succession Tax Imposed on Donee. The succession tax is imposed on the donee rather than the expatriate donor.

3. Election to Defer. Under section 877A(b)(1), an expatriate individual may elect to defer payment of the mark-to-market tax imposed on the deemed sale of property. This election may be made to delay payment of exit tax on one or more assets until the tax due-date in the year after those assets are actually sold. § 877A(b)(1). To take advantage of those deferrals, she must provide "adequate security" and "irrevocably waive the benefit of any U.S. tax treaty that would preclude assessment of the tax."

a. Deferred Payment of Mark-to-Market Tax.

(i) Interest Rate. Interest is charged for the period the tax is deferred at the rate normally applicable to individual underpayments. §877A(b)(7).

(ii) Property-by-Property Selection. The election is irrevocable and is made on a property-by-property basis. §877A(b)(6). Under the election, the deferred tax attributable to a particular property is due when the return is due for the taxable year in which the property is disposed (or, if the property is disposed of in a transaction in which gain is not recognized in whole or in part, at such other time as the Secretary may prescribe). §877A(b)(1).

(iii) Fractional Slice Permitted. The deferred tax attributable to a particular property is an amount which bears the same ratio to the total mark-to-market tax as the gain taken into account with respect to such property bears to the total gain taken into account for the mark-to-market tax. §877A(b)(2).

(iv) Mark-to-market tax. The deferral of the mark-to-market tax may not be extended beyond the due date of the return for the taxable year which includes the individual's death. §877A(b)(1).

(v) Election to Defer. The election is made by entering into a deferral agreement with the IRS and appointing a limited agent in the U.S. in the form described in the Appendices to Notice 2009-85, 2009-45 I.R.B. 598, and regarding how the deferral may be terminated. Notice 2009-85, Sec. 3, 2009-45 I.R.B. 598.

(vi) Impact of Section 1411 Tax. Since the deemed mark-to-market tax occurs on the day prior to the expatriation event, it would seem that the exception under section 1411 for non-residents would not be available and therefore section 1411 would apply. This result needs to be confirmed in the final regulations to be issued under section 1411.

b. Posting of Bond Requirement.

(i) In order to elect deferral of the mark-to-market tax, the individual is required to furnish a bond to the Secretary. §877A(b)(4)(A).

(ii) The bond must be conditioned upon payment of the amount of tax due, plus interest thereon, and must be in accordance with such requirements relating to terms, conditions, form of the bond, and sureties, as may be specified by regulations § 877A(b)(4)(B).

(iii) The bond must be accepted by the Secretary. §877A(b)(4)(B)(i).

(iv) Other security mechanisms, including letters of credit, are permitted provided that they meet such requirements as the Secretary may prescribe. §877A(b)(4)(B)(ii).

(v) In the event that the security provided with respect to a particular property subsequently fails to meet the requirements of these rules and the individual fails to correct such failure, the deferred tax and the interest with respect to such property will become due. §877A(b)(3).

(vi) As a further condition to making the election, the individual is required to consent to the waiver of any treaty rights that would preclude the assessment or collection of the tax. §877A(b)(5)).

4. Termination of Deferrals. Any time period for acquiring property which results in the reduction in the amount of gain recognized on the property disposed of by the taxpayer terminates on the day before the expatriation date, § 877A(h)(1)(1)(A), and any extension of time for paying of tax ceases to apply on the day before the expatriation date and the unpaid portion of that tax is due and payable at the time in the manner determined by the IRS. § 877A(h)(1)(B). Accordingly, Notice 2009-85 provides that the tax is due and payable on the earlier of the date the tax would become due and payable without regard to the mark-to-market rule, and the due date of the covered expatriate's return for the tax year that includes the day before the expatriation date. Notice 2009-85, Sec. 3, 2009-45 I.R.B. 598.

5. Exceptions to Mark-to-Market. The mark-to-market tax described above applies to most types of property interests held by the individual on the date of relinquishment of citizenship or termination of residency, with certain exceptions. Deferred compensation items, interests in nongrantor trusts, and specified tax deferred accounts are accepted from the mark-to-market tax but are subject to the special rules described below. §877A(c).

a. Deferred Compensation in General. The provision contains special rules for interests in deferred compensation items. §877A(d). For purposes of the provision, a "deferred compensation item" means any interest in a plan or arrangement described in section 219(g)(5), any interest in a foreign pension plan or similar retirement arrangement or program, any item of deferred compensation, and any property, or right to property, which the individual is entitled to receive in connection with the performance of services to the extent not previously taken into account under section 83 or in accordance with section 83. § 877A(d).

b. Covered Plans. The plans and arrangements described in section 219(g)(5) are (i) a plan described in section 401(a), which includes a trust exempt from tax under section 501(a); (ii) an annuity plan described in section 403(a); (iii) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, but excluding an eligible deferred compensation plan (within the meaning of section 457(b)); (iv) an annuity contract described in section 403(b); (v) a simplified employee pension (within the meaning of section 408(k)); (vi) a simplified retirement account (within the meaning of section 408(p)); and (vii) a trust described in section 501(c)(18). §877A(d).

c. Eligible Item. If a deferred compensation item is an eligible deferred compensation item, the payor must deduct and withhold from a "taxable payment" to the covered expatriate a tax equal to 30 percent of such taxable payment. This withholding requirement is in lieu of any withholding requirement under present law. A taxable payment is subject to withholding to the extent it would be included in gross income of the covered expatriate if such person were subject to tax as a citizen or resident of the United States. A deferred compensation item is taken into account as a payment when such item would be so includible. A deferred compensation item that is subject to the 30 percent withholding requirement is subject to tax under section 871. §877A(d).

(i) "Eligible Deferred Item defined. An "eligible deferred compensation item" means any deferred compensation item with respect to which (i) the payor is either a U.S. person or a non-U.S. person who elects to be treated as a U.S. person for purposes of withholding and who meet the requirements prescribed by the Secretary to ensure compliance with the withholding requirements, and (ii) the covered expatriate notifies the payor of his status as a covered expatriate and irrevocably waives any claim of withholding reduction under any treaty with the United States. §877A(d).

(ii) Exception. The foregoing taxing rules regarding eligible deferred compensation items and items that are not eligible deferred compensation items do not apply to deferred compensation items to the extent attributable to services performed outside the United States while the covered expatriate was not a citizen or resident of the United States. §877A(d).

(iii) Specified tax deferred accounts. There are special rules for interests in specified tax deferred accounts. If a covered expatriate holds any interest in a specified tax deferred account on the day before the expatriation date, such covered expatriate is treated as receiving a distribution of his entire interest in such account on the day before the expatriation date. Appropriate adjustments are made for subsequent distributions to take into account this treatment. As with deferred compensation items, these deemed distributions are not subject to early distribution tax. §877A(e).

(a) The term "specified tax deferred account" means an individual retirement plan (as defined in section 7701(a)(37)), a qualified tuition plan (as defined in section 529), a Coverdell education savings account (as defined in section 530), a health savings account (as defined in section 223), and an Archer MSA (as defined in section 220). However, simplified employee pensions (within the meaning of section 408(k)) and simplified retirement accounts (within the meaning of section 408(p)) of a covered expatriate are treated as deferred compensation items and not as specified tax deferred accounts. §877A(e).

(iv) Non-Eligible Item. If a deferred compensation item is not an eligible deferred compensation item (and is not subject to section 83), an amount equal to the present value of the covered expatriate's deferred compensation item is treated as having been received on the day before the expatriation date. In the case of a deferred compensation item that is subject to section 83, the item is treated as becoming transferable and no longer subject to a substantial risk of forfeiture on the day before the expatriation date. Appropriate adjustments shall be made to subsequent distributions to take into account the foregoing treatment. In addition, these deemed distributions are not subject to early distribution tax. For this purpose, "early distribution tax" means any increase in tax imposed under §§72(t), 220(e)(4), 223(f)(4), 409A(a)(1)(B), 529(c)(6), or 530(d)(4). §877A(d).

6. Interests in Trusts.

a. Grantor trusts. In the case of the portion of any trust for which the covered expatriate is treated as the owner under the grantor trust provisions of the Code, as determined immediately before the expatriation date, the assets held by that portion of the trust are subject to a deemed disposition the mark-to-market tax. If a trust that is a grantor trust immediately before the expatriation date subsequently becomes a nongrantor trust, such trust remains a grantor trust for purposes of the provision.

b. Nongrantor trusts: 30% Withholding on Distributions to Expatriate. Special rules apply to trusts with respect to which the covered expatriate is a beneficiary on the day before the expatriation date. The mark-to-market tax does not apply with respect to the portion of any such trust not treated (under the grantor trust provisions of the Code) as owned by a covered expatriate immediately before the expatriation date. Instead, in the case of any direct or indirect distribution from such a portion of a trust ("nongrantor trust") to a covered expatriate, the trustee must deduct and withhold from the distribution an amount equal to 30 percent of the portion of the distribution which would be includible in the gross income of the covered expatriate if the covered expatriate continued to be subject to tax as a citizen or resident of the United States. Such portion of such distribution (that is subject to the 30 percent withholding requirement) is subject to tax under §871.

(i) Waiver of Treaty Reduction. The covered expatriate is treated as having waived any right to claim any reduction in withholding under any treaty with the United States. §877A(f).

(ii) Distributions to Covered Expatriates. In addition, if the nongrantor trust distributes appreciated property to a covered expatriate, the trust must recognize gain as if the property were sold to the covered expatriate at its fair market value. §877A(f).

(iii) Grantor Trust Conversion. If a trust that is a nongrantor trust immediately before the expatriation date subsequently becomes a grantor trust of which a covered expatriate is treated as the owner, directly or indirectly, such conversion is treated under the provision as a distribution to such covered expatriate to the extent of the portion of the trust of which the covered expatriate is treated as the owner. §877A(f). In other words, domestic donee trusts would have to file and pay the succession tax as if it were the ultimate donee. §2801(e)(4)(A). Foreign donee trusts would either have to "elect to be treated as a domestic trust solely for purposes of" section 2801 and pay the succession tax, section 2801(e)(4)-(B)(iii). or pass the succession tax burden to the U.S. donee of "any distribution attributable to such gift or bequest from such trust (whether from income or corpus) . . . as if such distribution were a covered gift or bequest." IRC §2801(e)(4)(B)(i). The donee can deduct, under section 164, the amount of tax imposed under section 2801 that is attributable to gross income of the recipient but not to the capital portion of the distribution.

(iv) Limited Exemption. The succession tax under section 2801 is not imposed on the first $12,000 (as of 2008) given to each U.S. donee annually. §2801(c). Similarly, any amount given by a covered expatriate to a U.S. donee, directly or indirectly, can benefit from applicable marital or charitable deductions. §2801(e)(3). Finally, if the covered expatriate, or her estate, had earlier filed a timely gift or estate tax return showing the taxable transfer, then the succession tax would not apply. §2801(e)(2)-(A).

B. Individuals Covered.

1. Covered Expatriate. The AJCA test for determining when a long-term resident has abandoned her residency remains in. IRC §877A: The section 877A test is met when an individual "ceases to be a lawful permanent resident of the United States (i.e., loses his or her green card status through revocation or has been administratively or judicially determined to have abandoned such status). The HEART Act amended, section 7701(b)(6) to provide that an ex-green card holder will no longer be treated as a permanent resident for tax purposes if: (i) he begins to be treated as a taxable resident of another country "under a tax treaty between the United States and such foreign country"'; (ii) chooses not to waive the benefits for which he would otherwise qualify as resident of the foreign country under the treaty; and (iii) notifies the Secretary of the Internal Revenue Service "of the commencement of such treatment."

2. Loss of Long-Term Residency in the U.S. The provision applies to any U.S. citizen who relinquishes citizenship and any long-term resident who terminates U.S. residency. The provisions are:

a. Income Requirement. The subject covered expatriate must have an average annual net income tax liability for the five preceding years ending before the date of the loss of U.S. citizenship or residency termination that exceeds $145,000. §§877(a)(2), 877A(g)(1)(A). For inflation adjustments to the $124,000 amount, see Rev. Proc. 2009-50, 2009-45 IRB 617, §3.26 ($145,000 for 2010); Rev. Proc. 2008-66, 2008-45 IRB 1107, §3.14 ($145,000 for 2009);

b. Net Worth Requirement. The covered expatriate has a net worth of $2 million or more on such date. §§ 877(a)(2), 877A(g)(1)(B); or

c. Certification Requirement. The covered expatriate must certify under penalties of perjury that he or she has complied with all U.S. Federal tax obligations for the preceding five years or fails to submit such evidence of compliance as the Secretary may require. §§877(a)(2), 877A(g)(1)(C). These "requirements" include filing all required income tax, employment tax, gift tax, and information returns and paying all tax liabilities, interest, and penalties. A taxpayer must make this certification on Form 8854, which must be filed by the due date of the taxpayer's income tax return for the taxable year that includes the day before the expatriation date. Notice 2009-85, 2009-45 IRB 598, §§2.A, 8.C.

d. Reporting Under Section 6039G Still Required. On the reporting front, post-HEART Act expatriates are still governed under the same.

3. Exception to Covered Expatriate Classification. Exceptions to an individual's classification as a covered expatriate due to (i) or (ii) above (but not (iii)) are provided in two situations.

a. Dual Citizen Returning Home Rule. The first exception applies to an individual who was born with citizenship both in the United States and in another country; provided that (1) as of the expatriation date the individual continues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual has been a resident of the United States (under the substantial presence test of section 7701(b)(1)(A)(ii)) for not more than 10 taxable years during the 15-year taxable year period ending with the taxable year of expatriation. §877A(g)(1)(B)(i)(II).

b. Minor Person Relinquishing U.S. Citizenship. The second exception applies to a U.S. citizen who relinquishes U.S. citizenship before reaching age 18 1/2, provided that the individual was a resident of the United States (under the substantial presence test of section 7701(b)(1)(A)(ii)) for no more than 10 taxable years before such relinquishment. §877A(g)(1)(B)(ii).

C. Long Term Resident.

The term "long-term resident" means any 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 tax year of expatriation. §§877A(g)(5), 877(e)(2).

1. Cessation of Long-Term Residence in the U.S. A long-term resident ceases to be a lawful permanent resident if:

a. the individual's status of having been lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with immigration laws has been revoked or has been administratively or judicially determined to have been abandoned, or if

b. the individual commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country,

c. does not waive the benefits of the treaty applicable to residents of the foreign country, and

d. notifies the IRS of such treatment on Forms 8833 and 8854. Notice 2009-85, 2009-45 IRB.

2. Loss of Residence. Any long-term resident who ceases to be a lawful permanent U.S. resident under the rules described above is treated for the purposes of section 877 as if the resident were a U.S. citizen who lost his U.S. citizenship on the date of the cessation or commencement. §877(e)(1). This includes a long-term resident who loses his green card status or gains benefits of a tax treaty as a foreign resident. Joint Comm Staff, Tech Expln of the Heroes Earnings Assistance and Relief Tax Act Of 2008 (JCX-44-08), 5/20/2008, p. 40.

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

4. Expatriation Date. In the case of a long-term resident, the date that long-term residency is terminated is the "expatriation date." §877A(g)(3)(B). In the case of a citizen, the date that the individual relinquishes citizenship is the "expatriation date." §877A(g)(3)(A). The deemed sale date is the day prior to the expatriation date.

D. Relinquishing U.S. Citizenship. The Heroes Act provides that, for all tax purposes, a U.S. citizen continues to be treated as a U.S. citizen for tax purposes until that individual's citizenship is treated as relinquished under the following rules. §7701(a)(50)(A), as amended by the 2008 Heroes Act §301(c)(1).

1. Possible Dates. An individual is treated as having relinquished U.S. citizenship on the earliest of four possible dates:

a. the date that the individual renounces his or her U.S. nationality before a diplomatic or consular officer of the United States (provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality). §877A(g)(4)(A);

b. the date that the individual furnishes to the State Department a signed statement of voluntary relinquishment of U.S. nationality confirming the performance of an expatriating act (again, provided that the voluntary relinquishment is later confirmed by the issuance of a certificate of loss of nationality). §877A(g)(4)(B);

c. the date that the State Department issues a certificate of loss of nationality. §877A(g)(4)(C); or

d. the date that a U.S. court cancels a naturalized citizen's certificate of naturalization. §877A(g)(4)(D).

2. Notice. The foregoing rules replace the pre-2008 Heroes Act rules that provide that an individual continues to be treated as a U.S. citizen or long-term resident for U.S. Federal tax purposes until the individual gives notice of an expatriating act or termination of residency. Section 7701(n) repealed by 2008 Heroes Act § 301(c)(2)(C).

3. Early Relinquishment. While an individual continues to be treated as a U.S. citizen until his citizenship is treated as relinquished under the above rules (1-4), notwithstanding, relinquishment may occur earlier under Treasury regulations with respect to an individual who became at birth a citizen of the United States and of another country. §7701(a)(50)(B); Joint Committee on Taxation Report -- JCX-44-08 Committee Reports for the Heroes Earnings Assistance and Relief Tax Act of 2008.

a. If an individual who is a covered expatriate becomes subject to tax as a citizen or resident of the United States for any period beginning after the expatriation date, the individual is not treated as a covered expatriate during that period for purposes of applying the withholding rules relating to deferred compensation items, the rules relating to interests in nongrantor trusts, and the rules relating to gifts and bequests from covered expatriates.

b. If the individual again relinquishes citizenship or terminates long-term residency (after meeting anew the requirements to become a long-term resident), the mark-to-market tax and other provisions are re-triggered with the new expatriation date.

VI. Treatment of Gifts and Bequests From a Former Citizen or Former Long-Term Resident.

A. Transfer Tax Provisions to U.S. Citizens and Domiciliaries (non-U.S. Citizens).

1. In General. U.S. citizens and resident aliens, the latter being "domiciled" in the U.S., are subject to U.S. transfer tax, including gift, estate and generation skipping transfer taxes (assuming such laws are in effect), on transfers of property wherever such property is situated. For non-domiciled, non-citizen, individuals, U.S. transfer taxes apply only with respect to transfers of property which are actually or treated by statute or case law as located within the United States.

   a. Estate Tax on Domiciliary Estates or Estates of U.S. Citizens. The U.S. estate tax is imposed on the taxable estate of a decedent. This tax is imposed on worldwide assets owned at death or rights with respect to certain interests in property as set forth in sections 2033 through 2044. All such property interests, wherever situated, must be included in the gross estate of a U.S. citizen or domiciled resident, even if he or she lived and died abroad. See Treas. Regs. §§20.0-1(b)(1), 20.2033-1.

   b. Transfers by Gift by U.S. Citizens or Domiciled Residents. The U.S. gift tax applies with respect to transfers by gift of interests in property, regardless of where the property is located or the individual making the gift may "temporarily" reside, or in all cases as to a U.S. citizen (including naturalized U.S. citizen). §2501; Treas. Reg. §25.2501-1.

   c. Generation Skipping Transfers by U.S. Citizens or Domiciled Residents. Section 2663 provides that the Treasury shall issue regulations that are necessary and appropriate with respect to the imposition of the GST on non-residents which regulations will be consistent with the rules governing the gift and estate tax provisions on non-residents. Under Treas. Reg. §26.2663-2, the GST tax is imposed on a non-resident's transfer of property situs in the U.S. provided that the property transferred would be subject to estate and gift tax provision. For example, a non-resident (non-U.S. citizen) would not be taxable on a direct skip by lifetime gift if the gift itself was not subject to gift tax in the U.S. under the various situs rules and exemptions. See Whitaker, "The U.S. May Be a Good Trust Jurisdiction for Foreign Persons," 33 Estate Planning 36 (Feb. 2006); Rothschild & Zlotnik, "Coming To America," STEP USA J. (Aug. 2008); Smith, "Careful Pre-Immigration Planning Can Save Significant Taxes," 34 Estate Planning 30 (Feb. 2007).

      (i) Non-issuance of regulations not a bar to the IRS. In <u>Neumann Est. v. Comm'r</u>, 106 T.C. 216 (1998), the Tax Court held that the failure to issue regulations under section 2663 did not bar the IRS from imposing the GST on a non-resident. Therefore, when U.S. property passed to an NRA's grandchildren at her death in 1990, a direct skip tax was due even though no regulations had yet been issued.

      (ii) Inclusion ratio. In many instances for a NRA will be zero. In many instances, where there is no gift tax applicable to a transfer of U.S. situs property to a non-skip person, the inclusion ratio will be zero.

See Treas. Reg. §26.2663-2(a). The regulations provide that every nonresident noncitizen is allowed a GST exemption based on the amount available under current law. The regulations provide that an individual is a resident or citizen of the United States for GST tax purposes if the individual is a resident or citizen of the United States under the rules for chapter 11 or 12, as the case may be. The regulations initially provided, per Treas. Reg. §26.2663-2(a) that every non-resident transferor is allowed a $1,000,000 GST exemption. It is reasonable to assume that the regulations are intended to be applied to provide the non-resident with the amount of the GST exemption allowable to a transferor who is a U.S. citizen or resident. See §2631(c).

(iii) Amount of the GST exemption currently. The 2010 Tax Relief Act, §303(b)(2), equates the amount of the GST tax exemption to the "basic exclusion amount" (i.e., $5,120,000, indexed for inflation after 2012, without regard to the "deceased spousal unused exclusion amount") instead of the "applicable exclusion amount." Thus, up to $5 million in GST exemption may be allocated by a nonresident to a trust created or funded during 2010, depending on the amount of the exemption used by the taxpayer before 2010. The $5 million GST exemption is available in 2010 regardless of whether the executor of the estate of a decedent dying in 2010 makes the election to be subject to the estate tax and the carryover basis rules.

d. General Rules. U.S. Estate Taxation of Foreign Estates. See §§2101-2108.

(i) Computing Gross Estate. Under §2103, the gross estate of a non-resident (non-citizen) consists of the value of property sitused within the U.S. See rules set forth below. See <u>Johnston Estate v. Comm'r</u>, 19 T.C. 44 (1952), acq., 1953-1 C.B. (estate inclusion of U.S. real property limited to value of net equity); <u>Nienhuys Estate v. Comm'r</u>, 17 T.C. 1149 (1952), acq. 1952-1 C.B. 3 (domestic corporation stock included in gross estate despite certificates being held in Netherlands). See also §2104(b)(inclusion of string provision transfers where funded with U.S. situs property or holding U.S. situs property at death). See CCA 210102009 (payment of gift tax by non-resident within 3 years of death is not a transfer within sections 2035-2038 and is therefore not property situated in the U.S. under section 2104(b). See § 2105 (life insurance on the life of a non-resident (non-citizen) bank accounts in U.S. banks if the interest would be treated as foreign source income under section 871(i)(3), deposits with the foreign branch of a U.S. bank, certain debt obligations, and works of art on loan for exhibition in the United States, are excluded from the gross estate of a foreign decedent. See also Rev. Rul. 82-193, 1982-2 C.B. 219 (reversionary interest in trust under facts not U.S. property).

(ii) Allocable Deductions. Section 2106, a foreign estate may deduct a ratable share of its worldwide expenses, losses, debts, and taxes that would otherwise be deductible under sections 2053 and 2054, in the proportion that the U.S. gross estate bears to the entire gross estate. IRC § 2016(a)(1). Treas. Reg. IRC § 20.2106-2. Certain qualifying transfers to certain charities are permitted as deductions. §§ 2106(a)(2)(A), 2106(b). See McAllister Estate v. Comm’r, 54 T.C. 1407 (1970), acq., 1971-2 C.B. 3 (deduction allowed for bequest in trust by nonresident non-citizen to Canadian foundation since funds were used exclusively for assisting needy students at U.S. colleges). The section 2106(b) disclosure rules apply.

(iii) Marital deduction. Before 1988, all persons subject to the federal estate or gift tax were allowed a full marital deduction for qualifying transfers to their spouses regardless of citizenship. This rule was eliminated in 1988 as applied with respect to transfers to any non-citizen spouses (specifically, effective for transfers made after November 10, 1988).

e. Estate Tax Purposes. Under the 1988 amendments contained in “TAMRA”, For FET purposes, a marital deduction for federal estate tax purposes is permitted for property that is passed to a qualified domestic trust (QDOT) established for the benefit of the surviving non-citizen spouse. Once funded, distributions of principal from the QDOT to the non-citizen spouse are subject to federal estate tax and a withholding type regime. There are certain requirements for a QDOT that must be adhered to. See IRC § 2056(d).Treas. Reg. §20.2056A-1(a). There are also guidelines for who may qualify as QDOT trustees, and there are security requirements imposed by the rules that are intended to ensure that the federal estate tax will be paid on distributions of principal from a QDOT. Treas. Reg. § 20.2056A-2. There are exceptions to the security requirements for certain small QDOTs, and for QDOTs holding the personal residence of the non-citizen spouse. A marital deduction is allowed under section 2106(a)(3) for U.S. property passing to a spouse who is a U.S. citizen, even if the decedent was not a U.S. citizen. The marital deduction is also allowed if the surviving spouse becomes a U.S. citizen before the estate tax return is filed and the spouse was a U.S. resident at all times after the decedent’s death and before becoming a U.S. citizen. § 2056(d)(4).

f. Gift Tax Purposes. For taxable gifts made on or after July 14, 1988, TAMRA also eliminated the federal gift tax marital deduction where the donee spouse is a non-citizen. See §2523(i). However, the annual exclusion under section 2503(b) is available and, as to gifts to a non-citizen spouse, the exclusion amount is increased to $100,000 annually (as indexed for inflation). For gifts made during 2012, the annual exclusion amount is $139,000. Rev. Proc. 2010-40, 2010-46 I.R.B. 663. For gifts made during 2010, the annual exclusion amount was $134,000. Rev. Proc. 2009-50, 2009-45 I.R.B. 617. TAMRA also revived former sections 2515 and 2515A in determining whether creating a joint tenancy between a husband and wife constituted a taxable gift, where the donee spouse is a non-citizen. § 2523(i).

g. Gift tax exclusion. The gift tax on nonresident alien donors is imposed under the unified rate schedule of section 2001(c), which also applies to citizens and residents. However, the unified credit is not allowed to a nonresident alien, and thus relatively small taxable gifts can therefore generate surprisingly high taxes.

However, for nonresident aliens, the gift tax is qualified by two exceptions: (1) section 2501(a)(2), stating that the tax shall not apply to transfers of intangible property by a nonresident alien and (2) section 2511(a), stating that the tax applies to transfers by nonresident aliens only if the property is "situated within the United States." Nonresident aliens thus are subject to gift tax only on transfers of real or tangible personal property situated in the United States at the time of the transfer

2. Rate of Tax on Non-resident (non-citizen) Estates. Section 2010(b) states that the estate of a non-U.S. person is subject to the same tax rates imposed on domestic estates as provided under section 2001(c). The tax base is determined by combining the decedent's "adjusted taxable gifts" (post 1976 taxable gifts for U.S. situs property) but not including gifts includible in the gross estate, to the value of assets includible in the gross estate at death under section 2033 and sections 2035 through 2042. This yields a tax on the combined base less a credit for gift taxes paid. §§2101(b), 2101(c)(1), 2101(c)(2), 20001(c), 2001(d).

3. No Unified Credit or Applicable Exclusion Amount under Section 2010. Foreign estates are entitled to only a $13,000 credit against U.S. estate tax liability, which shelters from tax only the first $60,000 of the estate. The estates of domiciliaries of U.S. possessions receive a credit of the greater of $13,000, or $46,800 multiplied by the percentage of the decedent's gross estate located within the United States. See §2012(b)(2)(for estates of decedents dying after 2004). A foreign estate is allowed credits for gift taxes on pre-1977 transfers (§2012) and for estate taxes on prior transfers (§2013).

4. Certain Treaty Provisions Allow the Section 2010 Unified Credit to a Foreign Estate. Burghardt Estate v. Comm'r, 80 T.C. 705 (1983), aff'd, 734 F.2d 3 (3rd Cir. 1984)(Italy); Mudry v. U.S., 11 Cl. Ct. 207 (1986)(Switzerland). Cf. Arnaud Estate v. Comm'r, 90 T.C. 649 (1988), aff'd 895 F.2d 624 (9th Cir. 1990)(unified credit not allowable under U.S. France estate tax treaty). See also IRC § 2102(c)(3)(effective for decedents dying after 2004) to the effect that if foreign

estate is entitled to full unified credit under U.S. law by treaty provision or interpretation, estate will receive portion of credit equal to the percentage of property located in the United States only.

a. U.S. Estate and Gift Tax Treaties. Designed to reduce or remove double estate taxation, i.e., where an individual dies “resident” in two countries or owns property in each jurisdiction. Special rules are provided for determining tax situs. Property not located in the U.S. is generally exempt from U.S. estate tax under a tax treaty. §2102(b)(3).

In Rev. Rul. 90-101, 1990-2 C.B. 315, the Service held that the estate tax conventions between the U.S. and Australia, Finland, Greece, Italy, Norway, Japan and Switzerland permit residents of such countries to the unified credit per section 2102(b)(3). Prior to an amendment in 1988 in P.L. 100-647 (TAMRA), Rev. Rul. 81-303, 1981-2 C.B. 255 held that residents of treaty countries were entitled to only the smaller exemption under section 2102(b)(1)(formerly § 2102(b)(1). Before a 1988 amendment of this provision by TAMRA, 1090 the IRS had ruled in Rev. Rul. 81-303 1091 that residents of those countries were entitled to only the smaller exemption allowed under section 2102(b)(1) (formerly § 2102(c)(1)). The IRS revoked Rev. Rul. 81-303 for the estates of decedents dying after November 10, 1988 (the effective date of the TAMRA amendment) and conceded that for the estates of decedents dying before that date, the IRS accepted the higher exemption allowed by certain court cases. Issues under particular tax conventions should be analyzed carefully and this material only provides a brief look at the subject. Readers are directed to carefully review the tax treaties and relevant case law where these issues are involved, including issues of permitted deductions and credits, residence tie breaker rules, rules on situs. Section 6114 provides that where the application of a tax treaty results in a reduction in tax a disclosure is required. Treas. Reg. §301.6114-1. See also § 6712 and Treas. Regs. §§ 301.6712-1, 301.6114-1(c)(waiver of certain return positions); Form 8833 (treaty based return position disclosure).

5. Dual Citizens. Treated as U.S. citizens for transfer tax purposes, subject to treaty override by application of a tie-breaker rule, and as may be subject to a particular savings clause provision. U.S. v. Matheson, 532 F.2d 809 (2d Cir.), cert. denied, 429 U.S. 823 (1976); Vriniotis Est. v. Comm’r, 79 T.C. 298 (1982). A foreigner who has filed his or her declaration of intention of becoming a U.S. citizen but who has not yet been admitted to U.S. citizenship by a final order of a naturalization court should presumably not be treated as a U.S. citizen. See Treas. Reg. § 1.1-1(c). See for further background, United States: Treasury Technical Explanation 11/20/1980 (1980 Estate & Gift tax treaty).

6. Determination of Domicile of a Non-U.S. Citizen.

a. Facts and Circumstances Test. Place where an individual intents to permanent reside or return to as his or her permanent residence. See Rev. Rul. 80-363, 1980-2 C.B. 249; Rev. Rul. 80-209, 1980-2 C.B. 248. See, e.g., Nienhuys Estate v. Comm'r, 17 T.C. 1149 (1952); Jack Estate ex rel Blair v. U.S., 54 Fed. Cl. 590 (2002); Carlson v. Reed, 249 F.3d 876 (9th Cir. 2001); Paquette Estate v. Comm'r, T.C. Memo. 1983-571; Bloch-Sulzberger Estate v. Comm'r, 6 T.C.M. 1201 (1947). Still, evidence goes to the subjective intent of the individual based on objective criteria.

(i) Statements, declarations, admissions of the decedent.

(ii) Immigration status including visa, work permit, passport.

(iii) Location of business and economic interests.

(iv) Comparison of residences as to size and cost.

(v) Family member domiciles and citizenships.

(vi) Period of time spent in the United States.

(vii) Centre of personal life, social and recreational affiliations, church affiliations, etc.

(viii) Voting registration.

b. Impact of Tax Treaty. The United States has estate tax conventions with Austria, Denmark, France, the Netherlands, the United Kingdom, and Germany, which have tie-breaker provisions on avoiding double domicile. Other treaties, such as Australia, Finland, Greece, Ireland, Japan, Norway, South Africa, or Switzerland, leave the domicile determination to be based on competent authorities where necessary to avoid double domicile status. See OECD Model Estate and Gift Tax Treaty, Article 4(1). See §7852(d)(1)(in construing a treaty and U.S. domestic law, neither is to have preferential status over the other). See discussion on tax treaties on estate tax above.

c. Change in Domicile by Non-Citizen. The taxpayer bears the burden of proving that his (subjective) intent to permanently remain resident in the United States has changed, and this also goes to the factors listed above as to the change in "presence" so to speak. See, e.g., Khan Estate v. Comm'r, T.C. Memo. 1998-22.

7. Situs of Property Rules for U.S. Transfer Taxation on Non-Residents.

a. Real Property Located In the United States. Included in the gross estate and subject to U.S. gift tax. Treas. Reg. §20.2104-1(a)(1). Although the regulations do not mention such items, real property will include the obvious categories of land, improvements made thereon and fixtures treated as interests in real property under local law. See Estate of Fung v. Comm'r, 117 T.C. 247 (2001), aff'd, 58 Fed. Appx. 328 (9th Cir. 2003). This presumably includes units in a condominium as well as time-share units again on the basis that such interests are treated under local law as interest in real property See Rev. Rul. 77-423, 1977-2 C.B. 352 (time share unit as "real property). On the other hand, a cooperative apartment would be treated as intangible personal property, i.e., an interest in a corporation and a proprietary interest in a proprietary lease. See §2104(a)(estate tax inclusion of co-op under the domestic stock situs rule for non-resident decedents). Mortgages may be treated as interests in real property even though the underlying note is an interest in intangible personal property. Some states treat mortgages as merely security for a debt obligation (lien theory) while others follow the rule that a mortgage is an interest in real property (title theory).

b. Personal Property Located in the United States. Treas. Reg. §20.2104-1(a)(2) is U.S situs except for certain works of art on loan for exhibition. de Perigny Est. v. Comm'r, 9 T.C. 782 (1947)(as to leased personal property), nonacq., 1948-2 C.B. 5. Domestic and foreign currency is treated as personal property and situsd where located at death. See Rev. Rul. 55-143, 1955-1 C.B. 465.

c. Intangible Personal Property. Except as may be otherwise provided in the regulations, i.e., Treas. Regs. Sections 20.2104-1, 20.2105-1, property is situated in the U.S. at death where: (i) it is intangible personal property; (ii) the written evidence of the property is not treated as being the property itself; and (iii) the interest, e.g., obligation, stock, is issued by or enforceable against a resident of the U.S. or a domestic corporation or governmental unit. See Treas. Reg. §20.2104-1(a)(4).

(i) Works of Art on Loan, Exhibition. Works of art owned by a non-resident decedent is not situated in the U.S. where on exhibition or loaned to a public gallery or non-for-profit museum or on route to or return from exhibition at the time of death. IRC § 2105(c); Treas. Regs. §§20.2105-1(b), 20.2104-1(a)(2).

(ii) Stock in U.S. Corporation. Shares of stock issued by a U.S. corporation are treated as situated within the United States, even if the shares are located outside of the country. §2104(a); Treas. Reg. §20.2104-1(a)(5). Charania Est. v. Comm'r, 133 T.C. 122 (2009), aff'd in part, rev'd in part, 603 F.3d 67 (1st Cir. 2010). See also §2105(d)(stock in a RIC; special provision enacted in AJCA, 108-357 (2004)). Another special consideration is the application of the corporate inversion rules under section 7874(b), also enacted by AJCA, that may cause shares of stock in a foreign holding company to be treated as shares of a U.S. corporation for all purposes of the Code, notwithstanding section 7701(a)(4). Section 7874(b) applies to a corporate inversion (i.e., the expatriation of a U.S. corporation) if: (i) the U.S. corporation (former parent corporation) becomes a subsidiary of a foreign corporation or transfers substantially all of its assets to a foreign corporation; (ii) the former shareholders of the U.S. parent corporation own at least 80% of the foreign corporation's stock (by vote or value) after the transaction; and (iii) the foreign corporation does not have substantial business activities (as compared with its "group's" worldwide business activities) in the foreign country in which it is incorporated.

(iii) Debt Obligations of U.S. Persons/Bank Deposits. Debt obligations of a "U.S. person" including a citizen or resident of the U.S., the U.S., any state or political subdivision or the District of Columbia constitute property within the U.S. IRC §§ 7701(b), 7701(a)(4), (30). Where there is more than one primary obligors, the debt is apportioned among the obligors in accordance with the regulations. Treas. Reg. §20.2104-1(a)(7). See §§2104(b), 2105(b). While deposits with domestic financial institutions will are subject to a special exception and are not includible in a non-resident's gross estate, for decedents dying after 1969, deposits with a domestic branch of a foreign commercial bank are debt obligations and are deemed property within the United States. See §§2104(c), 2105(b)(2).

(iv) Transfers in Trust with Retained Interests by Non-Resident. For transfers described within the "string" provisions of sections 2035-2038 made by a non-resident in trust is includible in the gross estate where the property transferred into the trust was sitused within the U.S. when transferred or at the time of death. § 2104(b). Treas. Reg. §20.2104-1(b).

(v) Interests in Domestic and Foreign Partnerships. No clear rules are contained in the Code or the regulations. See Sanna, "Calling for Clarity on NRA's Partnership Situs," Tr. & Est. (Nov. 2009); Martin, "Why Section 2104 Must Address When Partnership Interests Owned by Foreign Investors Are (And Are Not) Subject to United States Estate Tax," Tax Notes Today 94-127 (May 15, 2003); Cassell, Karlin, McCaffrey & Streng, "U.S. Estate Planning for Nonresident Aliens Who Own Partnership Interests," Tax Notes (June 16, 2003); and Hudson, "Current Techniques for Foreign

Investment in U.S. Real Estate -- Income and Estate Tax Considerations,” 22 Tax Notes Int’l 3027 (June 11, 2001).

(a) Related issue. Is a partnership interest an intangible for purposes of section 2501(a)(2) pertaining to transfers of intangibles by non-residents for gift tax purposes See Rev. Proc. 2001-17, 2011-1 I.R.B. 233, § 4.01(27)(no ruling).

(b) BNA Portfolio 837-3rd. Provides excellent background in this entire area. It provides: “In summary, there would seem to be four possible approaches regarding the situs of a partnership interest owned by an NRNC: (1) that situs is based on the location of the partnership’s “trade or business”; (2) that situs is based on domicile of the holder of the partnership interest; (3) that situs is based on location of the partnership assets; or (4) that the situs of a partnership interest, like corporate stock, depends on whether the issuing partnership simply is or is not formed under domestic law. The ultimate issue being, can an NRNC invest in U.S. assets through a domestic or foreign partnership and, nevertheless, avoid U.S. estate tax, as the inclusion would look only to the partnership interests, which could or should be given situs offshore? The reason for this debate is simple: Advisors and commentators have really been given no choice, as Congress is silent on the issue, the rules in the regulations are incomplete or poorly written (and perhaps, as some commentators have surmised, are invalid), and the guidance from the IRS is flawed. One might guess that a partnership interest is best categorized as a species of general intangible personal property; however, some commentators suggest that it should not and that it really is a chose in action that lies against the other partners and thus would be best categorized specifically as a debt obligation.”

(c) Rev. Rul. 55-701, 1966-2 C.B. 836. Involved the application of the U.S.-U.K. Estate Tax Treaty. The ruling involved a partner’s share in a co-partnership is situated where the partnership business is carried on, in this case the U.S. At the time of death, the decedent was domiciled in the UK and a partner in a co-partnership organized in and doing business in the State of New York. The Service noted three potential outcomes: (i) the interest is a “debt” and under Article III(2)(c) of the U.S.-U.K. tax treaty is situated at the place of decedent’s domicile; (ii) that the situs of his interest is where the individual items of the partnership assets are located; or

(3) that the situs of a partner’s interest is where the business is carried on.

After reviewing the potential arguments, certain cases in the U.S. for state inheritance tax purposes, and a review of pertinent sections of the tax treaty, the Service ruled that it is held that in the application of the United States-United Kingdom Estate Tax Convention the situs of a partnership interest is where the business is carried on. See Glod, “Estate and Gift Taxation of Nonresident Aliens: Troublesome Situs Issues,” 51 Tax Law. 109 (1997). See Cassell, Karlin, McCaffrey & Streng, “U.S. Estate Planning for Nonresident Aliens Who Own Partnership Interests,” Vol. 99, No. 11, Tax Notes 1683 (June 16, 2003); Martin, “Why Section 2104 Must Address When Partnership Interests Owned by Foreign Investors Are (and Are Not) Subject to United States Estate Tax,” Electronic citations: 2003 TNT 94-127 (May 13, 2003).

(d) Treas. Reg. Section 301.7701-5(c)(1). A business entity (including an entity that is disregarded as separate from its owner under section 301.7701-2(c)) is domestic if it is created or organized as any type of entity (including, but not limited to, a corporation, unincorporated association, general partnership, limited partnership, and limited liability company) in the United States, or under the law of the United States or of any State. If not domestic, the entity is “foreign”. A suggestion in the above BNA Portfolio is that for planning purposes where a non-resident invests in a foreign partnership that is a partner in a domestic partnership and the foreign partnership owns other foreign assets and carries on business offshore, there can be no inclusion in the U.S. gross estate of the non-resident (non-citizen).

(e) Where partnership terminates at death, there is authority that the decedent (non-resident’s) estate should include the value of his share of the partnership’s assets which have a U.S. situs. See Sanchez v. Bowers, 70 F.2d 715 (2d Cir. 1934). See also OECD Model Estate and Gift Tax Treaty, Article 8.

(f) Interests in Limited Liability Companies. The nonresident alien may hold an interest in an LLC organized under the LLC laws of a U.S. state. Should be analyzed based on its U.S. income tax classification although other models are available to apply as well. So, where the LLC is treated as a partnership for U.S. tax purposes, the same estate tax risks apply as apply to partnership interests. As for treaty overlap, the association versus partnership versus disregarded entity status for U.S. federal tax purposes should control. There is no U.S. estate tax treaty that addresses the estate taxation of LLC interest transferred or held at death by a non-resident (non-U.S. citizen).

8. Beneficial Interests in Trusts and Estates.

a. Participating Units in U.S. Trust Rev. Rul. 55-163, 1955-1 C.B. 674. Where trust funds held by a New York trust company under a revocable deed of trust executed by a resident and national of Great Britain are invested by the trustee in participating units of a common trust fund, the situs of the participating units is in the United States for Federal estate tax purposes. Generally, the situs of an equitable interest in a conventional private trust is determined by reference to the underlying assets. <u>Comm'r v. David Barclay Nevius</u>, 76 Fed. (2d) 109, Ct. D. 1049, C. B. XIV-2, 350 (1935). The Service noted that in this situation, the participating units in the U.S. trust constitute the underlying assets of the trust. Such units are also evidence of the rights of the trust against the trustee of the common trust fund. While the participating units are not a "debt" per Article II (2)(c) of the U.S.-U.K. estate tax convention, the units are still in the nature of proprietary units...therefore the situs of the participating units is in the U.S. for U.S. estate tax purposes.

b. Beneficial interest in U.S. Trust not evidenced by a participation unit. Situs of beneficial interest in a trust is based on a look through approach by examining the value of the underlying assets. The courts have tended to regard trusts as look-through entities with the settler in a revocable trust as the owner of all of the trust's assets. Then the situs of such assets as either U.S. or non-U.S. would be determined, subject to the "string" rule being applied. See <u>Swan Est. v. Comm'r</u>, 247 F.2d 144 (2d Cir. 1957); Rev. Rul. 82-193, 1982-2 C.B. 219; Rev. Rul. 55-163, 1955-1 C.B. 674. The same look through approach would apply with respect to the decedent (non-resident's) holding of a general power of appointment of a trust created by another person. <u>Comm'r v. Nevius</u>, 76 F.2d 109 (2nd Cir. 1935), cert.den. See also <u>Estate of Swan v. Comm'r</u>, 247 F.2d 144 (2d Cir. 1957). IRC §§ 2103, 2104(a).

c. Decedent's interest in an estate. Perhaps as to a decedent's interest in a specific legacy or devise, situs should be where the property being bequeathed is situated. Still, it may be argued that as to a general bequest, the situs of the personal representative of the estate should be a key factor. Perhaps the domicile of the decedent should control. As to a residuary bequest perhaps a pure look through approach to the assets being transferred pursuant to such clause should be the controlling factor. Still the domicile of the decedent should control. See, e.g., Blodgett v. Silberman, 105 Conn. 192, 134 A. 778 (1926), aff'd in part, rev'd in part, 277 U.S. 1 (1928). See Treas. Regs. §§20.2104-1(a)(4), (7); Rev. Rul. 55-143, 1955-1 C.B. 465; PLR 7737063.

9. Other Assets. The foregoing categories of assets that must be analyzed under the situs rules is not exhaustive. For a thorough and thoughtful evaluation of such additional categories of assets, as well as discussion on the preceding categories, see. Heimos, BNA Tax Mgmt. Portfolio #837-3rd: Non-Citizens -- Estate, Gift and Generation-Skipping Taxation.

VII. Transfer Tax and Succession Tax Implications of Expatriation.

A. Prior Law.

Americans who give up U.S. citizenship and establish foreign domiciles become nonresident aliens for purposes of the U.S. gift and estate taxes, as do alien individuals who abandon their U.S. domiciles. Because the estate and gift taxes apply to the worldwide estates and gifts of U.S. citizens and residents, while nonresident (non-domiciled) aliens and their estates are only taxed on transfers of property located in the United States under specific statutory provision or controlling case law authority, provisions of the Code have, in certain instances, limited the estate and gift tax savings flowing from a loss of U.S. citizenship or residence. For individuals expatriating before June 17, 2008, these provisions expand the taxable estates and gifts of expatriated donors and decedents to include some, but far from all, transfers that are normally not taxable when made by nonresident donors and decedents. The expansion generally applies for taxable years ending within 10 years after the loss of citizenship or residence.

1. Expatriation Prior to June 17, 2008. The usual rules for nonresident alien donors and decedents are modified for many former citizens and residents who lost U.S. citizenship or residence before June 17, 2008. §§2107, 2501(a)(3). See Notice 97-19, 1997-10 IRB 40 (guidance on 1996 amendments to §§2107 and 2501(a)(3). The modifications are most significant under the gift tax. For a period of 10 years, an affected expatriate loses the benefit of the usual exemption of gifts of intangible property. The principal estate tax modification is that the gross estate includes all or part of the value of stock of a foreign corporation that owns U.S. property.

2. Alien donors and Decedents Affected by Modifications. The modifications apply to the estate of a nonresident alien decedent who lost U.S. citizenship or relinquished U.S. residence after June 3, 2004, and before June 17, 2008, if the decedent was "subject to the tax under section 877(b)" for the taxable year during which he or she died. § 2107(a). Section 877 only applies to former citizens and residents who expatriated before June 17, 2008. IRC § 877(h).

Section 877(b) applies only if the tax under that provision exceeds the U.S. tax that would be imposed on the individual for the year in the absence of section 877. §

877(a)(1). If the requirements described in the text are met, a decedent is probably "subject to the tax under section 877(b)," even if, for the taxable year ending with the decedent's death, the section 877(b) tax is less than the tax determined apart from section 877. Congress likely did not intend that the application of section 2107(a) should turn on the relative amounts, for a single year, of the section 877(b) tax and the tax without section 877(b). The modifications apply to gifts made by a nonresident alien donor who lost citizenship or relinquished residence during the period June 4, 2004, through June 16, 2008, if section 877(b) "applies for the taxable year which includes the date of the transfer." § 2501(a)(3)(A). It is not clear whether section 877(b) "applies" for a year for which tax under section 877(b) is less than the tax determined apart from section 877(b). A former citizen who lost citizenship during this period is subject to section 877(b) for taxable years ending within 10 years after the loss of citizenship if his or her average annual net income tax for the five taxable years ending most recently before the loss exceeded $124,000 (adjusted for inflation), his or her net worth was at least $2 million when citizenship was lost, or he or she "fails to certify under penalty of perjury" that he or she met "the requirements of" the Internal Revenue Code for the five preceding taxable years. § 877(a)(2). An alien individual who relinquished residence during this period is subject to section 877(b) for taxable years ending within 10 years after he or she ceased being a U.S. resident or became a resident of a country with which the United States has an income tax treaty if he or she satisfies one of the criteria described in the preceding sentence and was a lawful permanent resident of the United States for at least eight of the preceding fifteen taxable years. Section 877(b) also applies to a former alien resident if he or she was a resident during at least three consecutive calendar years and resumes residence before completing at least three calendar years of nonresidence.

3. Expatriation Prior to June 4, 2004. For a nonresident alien donor or decedent who lost U.S. citizenship before June 4, 2004, the modifications apply if the individual lost U.S. citizenship during the 10 years preceding the gift or the date of death and avoidance of federal income, gift, estate, or generation-skipping taxes was a principal purpose for the loss of citizenship. §§2107(a), 2501(a)(3)(A) (before amendment in 2004. If the IRS "establishes that it is reasonable to believe that an individual's loss of" citizenship would "result in a substantial reduction" in U.S. taxes, the individual has the burden of proving that tax avoidance was not a principal purpose for the loss of citizenship. §§2107(d), 2501(a)(4) (before amendment in 2004). A former citizen is also treated as having a principal purpose to avoid U.S. taxes, regardless of actual motivation for loss of citizenship, if (1) his or her average annual net income tax exceeded $100,000 (adjusted for inflation) over the five taxable years ending before the loss of citizenship or (2) the person's net worth was at least $500,000 when citizenship is lost. §§877(a)(2), 2107(a)(2), 2501(a)(3)(B) (applicable to persons losing citizenship after February 5, 1996, and before June 4, 2004). A person may be exempted from the rule described in the preceding sentence if he or she:

a. Was, at birth, a citizen of both the United States and another country,

b. Became, within a reasonable time after losing U.S. citizenship, a citizen of the country of birth of the taxpayer, the taxpayer's spouse, or either of the taxpayer's parents,

c. Was not present in the United States for more than 30 days during any year within the 10 years preceding the loss of citizenship, or

d. Lost citizenship before reaching the age of 18½. §877(c)(before amendment in 2004). Under a similar rule of prior law, a loss of citizenship before February 6, 1996, is irrefutably presumed not to be tax-motivated if it occurred under specified provisions of the Immigration and Nationality Act, including the provision relating to renunciation of U.S. citizenship by a person who acquired dual citizenship at birth. IRC §2107(d) (before amendment in 1996), §2501(a)(3)(A) (before amendment in 1996).

4. Obtaining benefit prior to June 4, 2004. To obtain the benefit of this exemption, an individual, not later than one year after the loss of citizenship, had to request a ruling that avoidance of federal taxes was not a principal purpose of the loss of citizenship and receive a favorable response from the IRS.

a. The modifying rules apply to a nonresident alien donor or decedent who relinquished U.S. residence before June 4, 2004, if (1) the rules would have applied had the donor or decedent lost citizenship when U.S. residence was relinquished and (2) the donor or decedent was a lawful permanent resident of the United States for at least eight of the fifteen years ending with the year in which residence was relinquished. §877(e) (applicable to aliens who, after February 5, 1996, cease being U.S. residents or acquire residence in a treaty country). An alien ceases being a lawful permanent resident of the United States only if the right of permanent residence is revoked or is administratively or judicially determined to be abandoned. §§877(e)(1), 7701(b)(6)(B). An individual who remains a lawful permanent resident is deemed for this purpose to relinquish residence on becoming a resident of a country having an income tax treaty with the United States if he or she does not waive treaty benefits allowable to residents of that country and was a lawful permanent resident for at least eight years during the 15-year period ending with the year during which residence in the treaty country begins. Whether avoiding U.S. taxes was a principal purpose of a relinquishment or constructive relinquishment of residence is determined by the same rules that apply to losses of citizenship. For example, if an alien giving up lawful permanent residence then had a net worth of at least $500,000, the relinquishment of residence is deemed tax motivated, regardless of actual purpose. §877(a)(2). A former citizen may be exempted from this irrefutable presumption if, for example, he or she was born a dual citizen. IRC §877(c), discussed supra and accompanying text. This exemption is not available to lawful permanent resident aliens or former lawful permanent residents. IRC §877(e)(3)(A).

B. Gift tax modifications.

A donor to whom the modifications apply is denied the benefit of the rule that normally exempts nonresident alien donors' gifts of intangible property from gift tax. §2501(a)(3)(A). However, whether the property is tangible or intangible, taxable gifts are, with one exception noted in the next paragraph, restricted to property situated in the United States. IRC §2511(a). The situs of property is determined under rules resembling those used in applying the estate tax to nonresident aliens. IRC §2511(b); Treas. Reg. §25.2511-3(b). Stock of a domestic corporation, as well as real and tangible personal property located in the United States, is considered situated in the United States and is therefore subject to gift tax if given during the tainted 10-year period. Also, debt instruments issued by U.S. obligors (including deposits in U.S. banks) have a U.S. situs for this purpose, even though they are not usually considered situated in the United States when held by other nonresident aliens. §2511(b)(2); Treas. Reg. §25.2511-3(b)(4).

1. Foreign Stock Transfer. Stock and obligations issued by foreign corporations are not situated in the United States. However, an otherwise includable transfer of stock in a foreign corporation is included in taxable gifts, even though the stock is considered situated outside the United States, if all of the following are true:

    a. Section 877(b) applies to the donor for the taxable year that includes the date of transfer,

    b. Immediately before the transfer, the donor owned stock of the foreign corporation carrying at least 10 percent of the total combined voting power of all classes of stock entitled to vote, and

    c. The donor then owned, directly, indirectly, or constructively, stock of the foreign corporation representing more than 50 percent of either the total combined voting power of all classes of stock entitled to vote or the total value of all of the corporation's stock. §2501(a)(5) (effective for donors who expatriated after June 3, 2004).

2. Foreign Stock Value. The gift tax value of such stock is its fair market value when transferred, multiplied by a fraction whose numerator is the fair market value at that time of the assets owned by the foreign corporation that are situated in the United States and whose denominator is the aggregate fair market value of all of the corporation's assets. Congress adopted this rule in 2004 because it was "concerned that [prior law did] not adequately address opportunities for the avoidance of tax on the value of assets held by a foreign corporation whose stock the individual transfers." HR Rep. No. 548, 108th Cong., 2d Sess. 254 (2004). The rule applies "regardless of how such stock was acquired (e.g., whether issued originally to the donor, purchased, or received as a gift or bequest)." HR Rep. No. 548, 108th Cong., 2d Sess. 256 (2004).

3. Property Situs. Because an expatriate is not taxed on gifts of property situated outside the United States, apart from the rule described in the preceding paragraph, an expatriate may avoid gift taxes, even on gifts made during the ensuing 10 years, so long as he or she takes care to shift the situs of property outside the United States before giving it away (e.g., by selling U.S. securities, depositing the proceeds in an account in a foreign bank, and writing a check to the donee from this account). However, a sale of U.S. property within 10 years of expatriation may subject an expatriate to U.S. income tax on gain realized in the sale. §877. Thus, a donor making a gift within the tainted 10-year period can easily avoid the gift tax or the income tax, but usually not both. With respect to tangible personal property located in the United States at the time of the expatriation, it is apparently possible to avoid both taxes by removing the property from the United States before making the gift. However, the Treasury may, by regulations, treat the removal as a taxable sale for income tax purposes. §877(d)(2)(E). The gift tax resulting from the expatriation rules may be offset by a credit for foreign gift taxes on the same gift. §2501(a)(3)(B) (effective for persons losing citizenship after June 3, 2004), §2501(a)(3)(D) (effective for persons losing citizenship after February 5, 1996, and before June 4, 2004).

C. Estate Tax Modifications.

When the modifications apply, estate tax is imposed only on property situated in the United States, just as for estates of other nonresident aliens, but with one modification. § 2107(a)(1) (before amendment in 2004): A decedent's shareholdings in a foreign corporation are included in the U.S. gross estate, in whole or in part, if the decedent (1) owned at least 10 percent of the voting corporation's stock, directly or indirectly through other foreign corporations, and (2) owned more than 50 percent (by vote or value) of the stock directly, indirectly, or constructively through family members and related entities. §2107(b). The amount included in the gross estate is the value of the stock owned directly or indirectly, multiplied by a fraction whose numerator is the value of the corporation's assets situated in the United States and whose denominator is the value of the corporation's worldwide assets. For purposes of this rule, a decedent is deemed to own at death any stock included in the gross estate under sections 2035 through 2038.

1. For Example. Assume D, a nonresident alien decedent, was sole shareholder of X Corp., a foreign corporation whose only assets are a portfolio of publicly traded stocks of domestic corporations. Because stock issued by a foreign corporation is generally considered not situated in the United States, regardless of the location of the corporation's business or assets, the X stock is not included in the U.S. gross estate unless the rules for tax-motivated expatriations apply. However, if D is subject to section 877(b) for the taxable year ending with her death, the X stock is included in the gross estate because the decedent satisfied the 10 percent and 50 percent ownership tests and the corporation's assets consist solely of property situated in the United States (stock of domestic corporations). Assume, in contrast, that X's assets consist of stock and bonds of domestic corporations. Portfolio debt instruments of domestic corporations are deemed not situated in the United States.

Because only part of X's assets have a U.S. situs, only part of the X stock is included in D's gross estate under the rules for expatriates.

2. Estate Tax Computation. The tax computation for the estate of an expatriate is generally the same as for other nonresident aliens. Tax is determined under the unified rate schedule of section 2001(c). §2107(a). A unified credit of $13,000 is allowed, and other credits are allowed subject to the same restrictions that apply to nonresident aliens' estates generally. §2107(c). A credit is allowed for foreign death taxes on property that is included in the gross estate solely because of the rules for expatriates. §2107(c)(2). The credit for taxes paid to a particular foreign country may not exceed the lesser of (1) the foreign death tax ratably allocable to property included in the gross estate solely because of the expatriate rules or (2) that property's proportionate share of the increase in U.S. estate tax resulting from the expatriate rules.

D. Physical Presence in United States Causing Alien to be Treated as U.S. Citizen or Resident.

If a nonresident alien to whom section 877 would otherwise apply for a taxable year is physically present in the United States on more than 30 days during the year, he or she is treated as a U.S. citizen or resident for the year for all U.S. tax purposes. §877(g)(1) (applicable to persons expatriating after June 3, 2004). If an expatriate's taxable year is not the calendar year, this rule applies for a taxable year if he or she is present in the United States for more than 30 days during the calendar year ending within the taxable year. If the individual makes gifts or dies during a year to which this rule applies, the gift and estate taxes apply as though he or she were a U.S. citizen or resident. HR Rep. No. 548, 108th Cong., 2d Sess. 255 (2004).

1. Congressional Adoption. In recommending adoption of this provision in 2004, the House Ways and Means Committee said, Individuals who relinquish citizenship or terminate residency for tax reasons often do not want to fully sever their ties with the United States; they hope to retain some of the benefits of citizenship or residency without being subject to the U.S. tax system as a U.S. citizen or resident. These individuals generally [could, under prior law,] continue to spend significant amounts of time in the United States following citizenship relinquishment or residency termination--approximately four months every year--without being treated as a U.S. resident. The Committee believes that provisions in the bill that impose full U.S. taxation if the individual is present in the United States for more than 30 days in a calendar year will substantially reduce the incentives to relinquish citizenship or terminate residency for individuals who desire to maintain significant ties to the United States. HR Rep. No. 548, 108th Cong., 2d Sess. 253-54 (2004).

E. Presence.

Considered for purposes of this rule, a person is considered present for a day if he or she is physically within the United States at any time during the day. A day of physical presence may, however, be ignored if the person is "performing services in the United States on such day for an employer" that is not "related" to him or her. § 877(g)(2)(A). Relatedness is determined under section 267(b) and 707(b). The Treasury may, by regulations, prescribe additional conditions "to prevent the avoidance of the purposes of this paragraph." This exclusion applies only if at least one of the following is true:

1. Within "a reasonable period after loss of United States citizenship or termination of residency," he or she (1) became a citizen or resident of the country in which the individual, his or her spouse, or either of his or her parents were born and (2) became "fully liable for income tax in such country." § 877(g)(2)(B);

2. He or she was not present in the United States for as many as 30 days during any year within the 10-year period ending when the person lost U.S. citizenship or terminated U.S. residency. §877(g)(2)(C). A day of presence is disregarded for this purpose if the individual was "unable to leave the United States on such day because of a medical condition which arose while such individual was present in the United States." § 7701(b)(3)(D)(ii); or

3. Even if a person satisfies one of these tests, however, not more than 30 days may be disregarded for any calendar year. §877(g)(2)(A).

F. Heroes Act.

Under the new provision, a special transfer tax is imposed in any calendar year during which a U.S. citizen or resident receives a "covered gifts or bequests". §§2801(a), 2801(b). Congress, in 2008, adopted an entirely new approach to this issue. Under this approach, which applies to gifts by and the estates of persons who expatriate after June 16, 2008, the expatriate is taxed under the normal rules for nonresident alien decedents and donors, but a special tax, in the nature of an inheritance tax, applies to a U.S. citizen or resident who receives a gift or bequest from a "covered expatriate." §2801. This tax applies regardless of the length of time between the expatriation and the gift or bequest. Thus, if a U.S. citizen or resident emigrates together with all objects of his or her bounty, the U.S. estate and gift taxes have no application to subsequent transfers of his or her property, except as they are caught by the rules for nonresident alien donors and decedents, but if an emigrating citizen or resident later transfers property to donees or heirs who remain in the United States, the donees and heirs are subject to this special tax, which may exceed the gift or estate tax that the expatriate or his or her estate would have paid, absent expatriation. According to the House Ways and Means Committee, in recommending enactment of these rules, "where U.S. estate or gift taxes are avoided with respect to a transfer of property to a U.S. person by reason of the expatriation of the donor, it is appropriate for the recipient to be subject to a transfer tax similar to the avoided transfer taxes." HR Rep. No. 431, 110th Cong., 1st Sess. 114 (2008).

G. Covered gift or bequest.

A covered gift or bequest is any property acquired (i) by gift directly or indirectly from an individual who is a covered expatriate at the time of such acquisition, or (ii) directly or indirectly by reason of the death of an individual who was a covered expatriate immediately before death. § 2801(e)(1).

1. Exception. A covered gift or bequest, however, does not include (i) any property shown as a taxable gift on a timely filed gift tax return by the covered expatriate, (ii) any property included in the gross estate of the covered expatriate for estate tax purposes and shown on a timely filed estate tax return of the estate of the covered expatriate, and (iii) any property with respect to which a deduction would be allowed under section 2055, 2056, 2522 or 2523, whichever is appropriate (these sections allow deductions for transfers for charitable purposes or to spouses, for purposes of determining estate and gift taxes). §§2801(e)(2) and 2801(e)(3).

H. Rate of Tax Under Section 2801.

The amount of the section 2801 tax is determined by multiplying the value of the covered gift or bequest by the greater of (i) the highest estate tax rate listed in the IRC section 2001(c) rate table in effect on the date the transferee receives the covered gift or bequest, or (ii) the highest gift tax rate listed in the section 2502(a) rate table in effect on that date. §2801(a).

1. Net Gift. For gift tax purposes, the donor is the person primarily liable for paying the tax. The donor may make the gift conditional on the donee paying the tax out of the transferred property, i.e., a "net gift". The value of a net gift is the fair market value of the property passing from the donor, minus the amount of gift tax to be paid by the donee.

2. Covered Gift. A covered gift is similar to a net gift in that the recipient of a covered gift is liable for the section 2801 tax on the gift. However, neither section 2801 nor the legislative history contains any statement that the value of a covered gift is computed in the same way as the value of a net gift. In the absence of such a statement, it would appear that Congress intended that the full value of a covered gift, without reduction for the section 2801 tax payable by the donee, is subject to the section 2801 tax.

I. Exception for Certain Gifts.

The tax applies to a recipient of a covered gift or bequest only to the extent that the total value of covered gifts and bequests received by such recipient during a calendar year exceeds the amount in effect under IRC section 2503(b) for that calendar year (Rev. Proc. 2007-66, sec. 3.32(1), 2007-45 I.R.B. 970).§2801(c). The tax on covered gifts and bequests is reduced by the amount of any gift or estate tax paid to a foreign country with respect to such covered gift or bequest. §2801(d).

J. Transfers in Trust.

Special rules apply to the tax on covered gifts or bequests made to domestic or foreign trusts.

1. Domestic Trust. In the case of a covered gift or bequest made to a domestic trust, the tax applies as if the trust is a U.S. citizen, and the trust is required to pay the tax. In the case of a covered gift or bequest made to a foreign trust, the tax applies to any distribution from such trust (whether from income or corpus) attributable to such covered gift or bequest to a recipient that is a U.S. citizen or resident, in the same manner as if such distribution were a covered gift or bequest. Such a recipient is entitled to deduct the amount of such tax for income tax purposes to the extent such tax is imposed on the portion of such distribution that is included in the gross income of the recipient. §2801(e)(4)(A).

2. Foreign Trust. For purposes of these rules, a foreign trust may elect to be treated as a domestic trust. The election may not be revoked without the Secretary's consent. §2801(e)(4)(B).