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COVERED EXPATRIATE SUBJECT TO U.S. TAX

***133** The Tax Court in *Topsnik*,¹⁴⁶ TC No. 1 (2016), held that a taxpayer who was a German citizen was not a German resident, and therefore, was subject to U.S. tax as a nonresident. Also, he was subject to the [Section 877A](#) tax on covered expatriates.

The taxpayer was a lawful permanent resident (LPR) of the U.S. In 2004, the taxpayer agreed to an installment sale of stock he owned in a U.S. corporation. He received the down payment and monthly installment payments on time. The final monthly installment payment was made in September 2013.

In 2010, the taxpayer formally abandoned his green card and LPR status. After this time, he failed to file the required Form 8854, Initial and Annual Expatriation Statement, and failed to certify, under penalties of perjury, that he had complied with all of his U.S. federal tax obligations for the five tax years preceding the tax year that includes the expatriation date, including his obligation to file income returns and pay all relevant tax liabilities. Also, the taxpayer did not file a return for 2010. In 2011, he filed a Form 1040NR, U.S. Nonresident Alien Income Tax Return. On this return, he reported his installment income as being exempt under the U.S.-Germany Tax Treaty because he claimed that he was a German resident during 2010.

In 2013, the IRS issued the taxpayer a deficiency notice because it said that he was not a German resident in 2010. It learned from the German Competent Authority that for the 2010 tax year the taxpayer was registered in Germany as a person subject to taxation as a nonresident; did not file a German tax return; and did not have a registered residence or habitual abode in Germany.

The court first determined that the taxpayer's installment payments were taxable by the U.S. The taxpayer argued that he had several German contacts, including a German driver's license and

passport, and that he owned an inn in Germany. However, based on the treaty definitions, the court found that the taxpayer was not a German resident in 2010. The court said that the taxpayer's German contacts were not relevant to his status as a German resident during that year except insofar as they served to subject him to German taxation on his worldwide income. The taxpayer did not allege that he was subject to German tax on his worldwide income, and the record was to the contrary.

The court next held that the taxpayer was an LPR for at least 10 out of the 15 years before he formally abandoned his LPR status. Therefore, he was treated as a long-term resident of the U.S. for [Section 877A](#) purposes. Under [Section 877\(e\)\(2\)](#), a long-term resident of the U.S. is any person who is an LPR of the U.S. in at least eight tax years during the period of 15 tax years ending with the tax year of expatriation. A person is not treated as an LPR for any tax year if he or she is treated as a resident of a foreign country under the provisions of a tax treaty with the U.S.

****2** If the taxpayer expatriated in 2010, to be a long-term resident he would have to be an LPR for 8 of the 15 years beginning with tax year 1996. In an earlier case, the court concluded that the taxpayer was an LPR during 2004-2009, and that the taxpayer was not a German resident during these years. Tax years 2004-2010 constituted seven of the eight years necessary for the taxpayer to qualify as a long-term resident. Even if the court accepted as true the taxpayer's claim that he was a German resident from 1999-2003, there was still not evidence that he was not an LPR from 1996-1998. Thus, the taxpayer was an LPR for at least 10 out of the 15 years before formally abandoning his LPR status in 2010, and he was treated as a long-term resident for [Section 877A](#) purposes.

[Section 877A\(g\)\(1\)](#) provides that a covered expatriate is an expatriate who meets at least one of the requirements of [Sections 877\(a\)\(2\)\(A\)-\(C\)](#). [Section 877\(a\)\(2\)\(C\)](#) says that a person ***134** is a covered expatriate if he or she fails to certify under penalty of perjury that he or she has met the requirements of the Code for the five preceding tax years or fails to submit evidence of such compliance. In determining whether the taxpayer was a covered expatriate, the court considered Notice 2009-85, [2009-45 IRB 598](#), even though it was not bound by its contents.

For the year of the taxpayer's expatriation, he failed to complete a Form 8854 certifying under penalties of perjury that he complied with all U.S. federal tax obligations for the five tax years preceding the tax year that included his expatriation date. Also, there was evidence that the taxpayer did not file all of his U.S. income tax returns before expatriating and was not in payment compliance for taxes owed for the five years before 2010. Consequently, because the taxpayer failed to certify tax compliance for five years before expatriation, he was a covered expatriate for [Section 877A\(g\)\(1\)\(A\)](#) purposes. A covered expatriate is treated as having sold all of his property on the day before his expatriation and is subject to income tax on the net unrealized gain arising

from property deemed sold while he was still a U.S. LPR. The court held that the taxpayer's expatriation date was 11/20/10, the date on which he initiated abandonment of his LPR status.

Finally, the court considered whether the taxpayer's right to the monthly installment payments was property subject to [Section 877A](#), and if so, the income that he had to recognize on the deemed sale. To determine which property is subject to the Section 877A mark-to-market regime, [Notice 2009-85](#) advises consideration of whether property is of a type whose value would be includable in the value of a decedent's gross estate for federal estate tax purposes if the covered expatriate died on the day before his expatriation date. The value of an installment obligation held at death is included in the value of a decedent's gross estate for federal estate tax purposes.

****3** In computing a tax liability under the mark-to-market regime, a covered expatriate must use the FMV of each interest in property as of the day before the expatriation date in accordance with the valuation principles applicable for federal estate tax. Reg. 20.2013-4 provides that a note's FMV, for estate tax purposes, is presumed to be the amount of unpaid principal, plus accrued interest to the date of death, unless the executor establishes the value is lower or that the notes are worthless. Thus, on 11/19/10, the day before the taxpayer expatriated, his right to receive monthly installment payments was presumed to have had a FMV of approximately \$1.4 million on the basis of the amount of unpaid principal and interest.

[Section 453\(b\)](#) provides that a taxpayer's basis in an installment obligation is the excess of the face value of the obligation (the remaining principal amount) over an amount equal to the income that would be returnable were the obligation satisfied in full (the portion of the payments that would be included in the taxpayer's income). The court said that the taxpayer's basis in his right to receive monthly installment payments was \$189,388, the excess of the face amount of the right, \$1,373,374 over an amount equal to the income that would be returnable were the right satisfied in full, \$1,183,986.