B. Alternative Tax Regime for Individuals Who Relinquish U.S. Citizenship or Terminate U.S. Residency With a Principal Purpose of Tax Avoidance

1. Income taxation

(a) In general

An individual who relinquishes his or her U.S. citizenship or terminates his or her U.S. residency with a principal purpose of avoiding U.S. taxes is subject to an alternative tax regime for income tax purposes for the 10 taxable years ending after citizenship relinquishment or residency termination.[106] The alternative tax regime applies to such individuals only if it results in a higher U.S. tax liability than would otherwise be determined if the individual were taxed as a nonresident noncitizen.

The alternative tax regime for an individual who relinquishes U.S. citizenship or terminates U.S. residency with a principal purpose of avoiding U.S. taxes modifies the rules generally applicable to the taxation of nonresident noncitizens in several ways. First, the individual is subject to tax on U.S.-source income at the rates applicable to U.S. citizens rather than the rates applicable to other nonresident noncitizens.[107] Second, the scope of items treated as U.S.-source income for section 877 purposes is broader than under the general sourcing rules.[108] Third, the individual is taxed on exchanges of certain types of property that give rise to U.S.-source income for property that gives rise to foreign-source income.[109] Fourth, the individual is taxed on certain income or gain derived from stock in a closely-held foreign corporation.[110] Fifth, the individual is taxed on income or gain from certain property contributed to a controlled foreign corporation.[111]

The determination of whether an individual relinquishes his or her U.S. citizenship for purposes of section 877 is governed by the provisions of the Immigration and Nationality Act.[112]

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[106] Sec. 877.

[107] Sec. 877(b).

[108] Sec. 877(d). For example, gains on the sale or exchange of personal property located in the United States, and gains on the sale or exchange of stocks and securities issued by U.S. persons, generally are not considered to be U.S.-source income under the Code. Thus, such gains normally would not be taxable to a nonresident noncitizen. If an individual is subject to the alternative tax regime, however, such gains are treated as U.S.-source income with respect to that individual.

[109] Sec. 877(d)(2).

[110] Sec. 877(d)(1)(C).

[111] Sec. 877(d)(4).

[112] 8 U.S.C. sec. 1481. *See* Treas. Reg. sec. 1.1-1(c).

Under these provisions, a U.S. citizen may voluntarily give up his or her U.S. citizenship at any time by performing one of a number of "expatriating acts" with the intention of relinquishing U.S. nationality.[113] The most common of these acts are (1) to formally renounce one's nationality before a U.S. diplomatic or consular officer in a foreign country (by executing an Oath of Renunciation), or (2) to become naturalized in a foreign country.[114] An individual generally is considered to have lost his or her citizenship on the date that an expatriating act is committed, even though the loss may not be documented until a later date. When an individual acknowledges to a consular officer that an expatriating act was taken with the requisite intent, the consular officer prepares a certificate of loss of nationality ("CLN").[115] Once the CLN has been approved by the Department of State, a copy of the CLN is issued to the affected individual.

Section 877 also applies to long-term residents of the United States whose U.S. residency is terminated.[116] For this purpose, a long-term resident is any individual who was a lawful permanent resident of the United States for at least eight out of the 15 taxable years ending with the year in which such termination occurs.[117] An individual's U.S. residency is considered to be terminated when the individual either (1) ceases to be a lawful permanent resident pursuant to section 7701(b)(6) (i.e., the individual loses green-card status), or (2) is treated as a resident of another country under a tax treaty (and the individual does not also elect to waive the benefits of such treaty).

An individual who either relinquishes U.S. citizenship or terminates U.S. residency is subject to tax for a taxable year as though such year were comprised of two separate periods -- the time during which he or she is a U.S. citizen or U.S. resident and the time during which he or she is not a U.S. citizen or U.S. resident.[118] The individual is considered to be a noncitizen or a nonresident on the day he or she relinquishes U.S. citizenship or terminates U.S. residency.[119] Thus, for the tax year in which an individual's status as either a U.S. citizen or U.S. resident changes, such individual would be required to file one tax return as a U.S. citizen or U.S.

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[113] 8 U.S.C. sec. 1481.

[114] *See* Part V.B, below, for a more comprehensive description of these provisions.

[115] A sample of a CLN is at A-209.

[116] For purposes of determining any tax imposed under the alternative tax regime, any property held by a long-term resident on the date he or she becomes a U.S. resident is treated as having a tax basis of no less than its fair market value on such date. However, the individual may irrevocably elect not to have this provision apply.

[117] In applying the eight-year test, an individual is not considered to be a lawful permanent resident for any year in which the individual is treated as a resident of another country under a tax treaty (and the individual does not also elect to waive the benefits of such treaty).

[118] Treas. Reg. sec. 1.871-13(a)(1).

[119] Treas. Reg. sec. 1.871-13(a)(2).

resident (i.e., Form 1040) and another tax return as a noncitizen or nonresident (i.e., Form 1040NR).[120]

(b) Former citizens and former long-term residents deemed to have a principal purpose of tax avoidance

U.S. citizens who relinquish their citizenship and long-term residents who terminate their U.S. residency generally are treated (i.e., deemed) as having relinquished such citizenship or terminated such residency with a principal purpose of the avoidance of taxes if either: (1) the individual's average annual U.S. Federal income tax liability for the five taxable years ending before the date of such citizenship relinquishment or residency termination is greater than $100,000 (the "tax liability test"), or (2) the individual's net worth as of the date of such citizenship relinquishment or residency termination is $500,000 or more (the "net worth test").[121] These two tests are collectively referred to as the "monetary thresholds." The monetary thresholds are indexed for inflation in the case of a relinquishment of citizenship or termination of residency occurring in any calendar year after 1996. For 2003, the monetary thresholds for the tax liability test and the net worth test are $122,000 and $608,000, respectively.[122] Notwithstanding that an individual exceeds one of the monetary thresholds, as discussed in Part IV.B.1.c. below, certain exceptions may apply.

Although no regulations have been issued under section 877, Notice 97-19,[123] as modified by Notice 98-34,[124] provides guidance regarding the alternative tax regime, including rules applicable to the tax liability test and the net worth test. For purposes of the tax liability test, an individual's net U.S. income tax is determined under section 38(c)(1) (which provides a definition of net income tax for purposes of a limitation on general business credits). For purposes of the net worth test, a former citizen or former long-term resident is considered to own any interest in property that would be subject to gift tax if the individual were a U.S. citizen or resident who transferred the interest immediately prior to citizenship relinquishment or residency termination. A former citizen's or former long-term resident's beneficial interest in a trust also is included in the net worth calculation.

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[120] Each of these tax returns should reflect the income that is attributable to the respective number of days that fall within each of the two periods. Special rules apply for these purposes with respect to foreign-source income which is not effectively connected with a U.S. trade or business. Treas. Reg. sec. 1.871-13(c).

[121] Sec. 877(a)(2).

[122] Rev. Proc. 2002-70, 2002-46 I.R.B. 845.

[123] 1997-1 C.B. 394. *See* A-166.

[124] 1998-2 C.B. 29. *See* A-193.

(c) Former citizens and former long-term residents not deemed to have a principal purpose of tax avoidance

Former citizens and former long-term residents falling below the monetary thresholds

A former citizen or former long-term resident who falls below the monetary thresholds is not automatically treated as having a principal purpose of tax avoidance, but nevertheless is subject to section 877 if the individual's relinquishment of citizenship or termination of residency had as one of its principal purposes the avoidance of tax. Factors taken into account in making a determination as to the existence of a principal purpose of tax avoidance include the substantiality of a former citizen's ties to the United States (including ownership of U.S. assets) prior to citizenship relinquishment, the retention of U.S. citizenship by the former citizen's spouse, and whether a former citizen resides in a country that imposes little or no tax.[125] If the Secretary of the Treasury establishes a reasonable belief that a relinquishment of U.S. citizenship or termination of U.S. residency would likely result in a substantial tax reduction for the year of citizenship relinquishment, the former citizen or former long-term resident bears the burden of proof that his or her relinquishment of citizenship or termination of residency did not have a principal purpose of tax avoidance.[126]

Former citizens who exceed the monetary thresholds

A U.S. citizen who loses his or her citizenship and who exceeds one of the monetary thresholds (described above) is nevertheless not treated (i.e., not deemed) as having a principal purpose of tax avoidance if the individual: (1) within one year from the date of loss of citizenship submits a ruling request for a determination by the Secretary of the Treasury as to whether such loss had as one of its principal purposes the avoidance of taxes; and (2) falls within one of certain categories of individuals eligible to submit such a ruling request.[127] The categories of individuals who are eligible to request a ruling are: (1) individuals born with dual citizenship who retain only their non-U.S. citizenship; (2) individuals who become, within a reasonable period after citizenship relinquishment, a citizen of the country in which the individual, the individual's spouse, or one of the individual's parents, was born; (3) individuals present in the United States for no more than 30 days during each year in the 10-year period immediately preceding the date of his or her loss of citizenship; (4) individuals who relinquish their citizenship before reaching age 18 ½; and (5) any other category of individuals prescribed by

[125] H.R. Conf. Rep. No. 104-736, at 325 (1996).

[126] Sec. 877(f).

[127] Sec. 877(c)(1).

Treasury regulations.[128] The ruling procedures to qualify for these exceptions are detailed in Notice 97-19, as revised by Notice 98-34.[129]

Under Notice 98-34, if a former U.S. citizen's tax liability or net worth exceeds the applicable thresholds, the individual will not be treated as having a principal purpose of tax avoidance if he or she: (1) is eligible to submit a ruling request that his or her citizenship relinquishment did not have for one of its principal purposes the avoidance of U.S. taxes (based on one of the categories set forth above); (2) submits such a request in a timely manner; and (3) provides the IRS with a complete and good faith ruling request.[130] The IRS determines whether a submission was complete and provided in good faith. If the ruling request constitutes a complete and good faith submission, the IRS may also, depending on the information submitted, provide a substantive ruling as to whether the individual's citizenship relinquishment had as one of its principal purposes the avoidance of U.S. taxes. Alternatively, the determination may express no opinion as to whether the individual's citizenship relinquishment had for one of its principal purposes the avoidance of U.S. taxes in cases in which, although there is a complete and good faith submission, the information submitted does not clearly establish the existence or lack of such a principal purpose. In sum, under Notice 98-34, an individual must receive a determination that he or she made a timely, complete, good-faith ruling request in order to avoid the deemed treatment of having a principal purpose of tax avoidance under section 877(a)(2). Such a determination may express a favorable opinion, an unfavorable opinion, or no opinion as to whether one of the individual's principal purposes is tax avoidance.

If the IRS determines only that a request was complete and submitted in good faith, such a determination means that the individual is not deemed to have a tax avoidance purpose. The determination, however, is not conclusive as to whether the individual ultimately can be found to have a principal purpose of tax avoidance based on the individual's facts and circumstances. Such a determination would be reserved for a subsequent time, such as on audit.

Before the IRS issued Notice 98-34, Notice 97-19 provided that a former citizen or former long-term resident who satisfied the tax liability test or net worth test would be subject to the alternative tax regime, unless such individual obtained a favorable ruling that the individual did not relinquish citizenship or terminate residency with a principal purpose to avoid tax. Thus, under Notice 97-19, the IRS would render either a favorable or unfavorable ruling as to the substantive question of the individual's purposes. The IRS stated in Notice 98-34 that making a

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[128] Sec. 877(c)(1)(A) and (2).

[129] 1997-1 C.B. 394 and 1998-2 C.B. 29, respectively. *See* A-166 and A-193, respectively.

[130] In addition, under the notices, former citizens who "narrowly" fail to satisfy one or more of the respective criteria may nevertheless submit a ruling request. The Secretary of the Treasury, in his or her sole discretion, may decline to rule on any such request if it is determined that the taxpayer more than "narrowly" failed to satisfy any of the requirements. In such a case, the former citizen would not be considered to have submitted a ruling request and, thus, would be subject to section 877.

determination regarding tax avoidance in an advance ruling presented difficulties due to the inherently factual and subjective nature of the inquiry and that in some cases the information submitted with the ruling request did not clearly establish the existence or lack of such a principal purpose.[131] As a result, the IRS modified its procedures to add a third type of ruling, a "fully submit" ruling, under which the deemed tax-avoidance purpose treatment under section 877(a)(2) does not apply when an individual meets all submission criteria and completes a good-faith ruling request. The modified procedures apply to ruling requests pending on and submitted after July 6, 1998.[132]

Former long-term residents who exceed the monetary thresholds

The Secretary of the Treasury is authorized to prescribe regulations to exempt categories of former long-term residents from section 877.[133] Under Notice 97-19, as modified by Notice 98-34, a former long-term resident may be excepted from being treated as having a principal purpose of tax avoidance (notwithstanding that such person exceeds one of the monetary thresholds), but only if he or she submits a ruling request within one year after residency termination, and the individual either: (1) becomes, within a reasonable period after residency termination, a resident fully liable for income tax in the country in which he or she was born, his or her spouse (if married) was born, or his or her parents were born; (2) was present in the United States for 30 days or less during each year of the 10-year period prior to residency termination; or (3) ceases to be taxed as a lawful permanent resident, or commences to be treated as a resident of another country under an income tax treaty and does not waive the benefits of such treaty applicable to residents of the foreign country, before the individual reaches age 18½ .[134]

(d) Income subject to section 877

Nonresident noncitizens (including former citizens and former long-term residents) are subject to U.S. income tax at graduated rates on certain types of U.S.-source income. Such

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[131] Notice 98-34, sec. III. *See* A-166.

[132] In addressing the ruling requests under Notice 97-19, the IRS also found that the information required to be submitted under that notice was insufficient in many instances. Notice 98-34 therefore modifies the information that must be submitted with the ruling request in order for the request to be considered a complete and good faith submission. For a detailed description of the required information, *see* Notice 98-34, sec III.

[133] Sec. 877(e)(4).

[134] As is the case with former citizens, Notice 97-19 and Notice 98-34 provide that former long-term residents who "narrowly" fail to satisfy one or more of the ruling criteria may nevertheless submit a ruling request.

income includes income effectively connected with a U.S. trade or business and gains from the disposition of interests in U.S. real property.[135]

The scope of items treated as U.S.-source income for section 877 purposes is broader than those items generally considered to be U.S.-source income under the Code. These special sourcing rules treat as U.S.-source income such items as gain on the sale or exchange of certain property located in the United States, gain on sale or exchange of stock of a U.S. corporation or debt of a U.S. person, income derived through controlled foreign corporations, gain on certain foreign property acquired in nonrecognition transactions, and gain on certain contributions of U.S. property to foreign corporations.

Gains from the sale or exchange of property located in the United States

Section 877 recharacterizes as U.S.-source income certain gains of former citizens or former long-term residents who are subject to the alternative tax regime, thereby imposing U.S. income tax on such gains (which otherwise would not be subject to U.S. tax in the hands of a nonresident noncitizen). Under this rule, gain on the sale or exchange of property (other than stock or debt obligations) located in the United States, as well as gains on the sale or exchange of stock issued by a U.S. corporation or debt obligations of a U.S. person, are treated as U.S.-source income.[136] In this regard, the substitution of a foreign obligor for a U.S. obligor generally is treated as a taxable exchange of the debt instrument and, therefore, any gain on such exchange is subject to tax under section 877. Such U.S.-source income and gains of the individual are taxable during the 10-year period after citizenship relinquishment or residency termination, without regard to whether the property giving rise to such income or gains was acquired before or after the date the individual became subject to section 877.

Income or gain derived from controlled foreign corporation stock

Section 877 treats as U.S.-source any income or gain derived from stock in a foreign corporation if the individual relinquishing citizenship or terminating residency owns, directly or indirectly, more than 50 percent of the vote or value of the stock of the corporation on the date of such relinquishment or termination or at any time during the 2-year period preceding such date.[137] Such income and gains are recharacterized as U.S.-source only (1) to the extent of the amount of earnings and profits attributable to such stock earned or accumulated prior to the date

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[135] For example, compensation (including deferred compensation) paid with respect to services performed in the United States is subject to such tax. Thus, a U.S. citizen who earns a stock option while employed in the United States and delays the exercise of such option until after such individual loses his or her citizenship is subject to U.S. tax on the compensation income recognized upon exercise of the stock option (even if the stock received upon the exercise is stock in a foreign corporation).

[136] Sec. 877(d)(1)(A) and (B).

[137] Sec. 877(d)(1)(C).

of loss of citizenship (or termination of residency, as applicable) and (2) while the ownership requirement is satisfied.[138]

Nonrecognition exchanges of U.S. property for foreign property

An individual subject to section 877 who exchanges property that would produce U.S.-source income for property that would produce foreign-source income is required to recognize immediately as U.S.-source income any gain on such exchange (determined as if the property had been sold for its fair market value on such date).[139] To the extent gain is recognized under this provision, the property would be accorded a step-up in basis. This rule requiring immediate gain recognition does not apply if the individual enters into an agreement with the Secretary of the Treasury specifying that any income or gains derived from the property received in the exchange during the 10-year period after the relinquishment of citizenship (or termination of residency, as applicable) will be treated as U.S.-source income. The gain recognition agreement terminates if the property transferred in the exchange is disposed of by the acquiror; any gain that had not been recognized by reason of the agreement is then recognized as U.S.-source. The Secretary of the Treasury is authorized to issue regulations providing similar treatment for nonrecognition transactions that occur within five years immediately prior to the date of relinquishment of citizenship (or termination of residency, as applicable). Under Notice 97-19, the above rules are applied by substituting the 15-year period beginning five years prior to the citizenship relinquishment or residency termination for the 10-year period described above.[140] In the case of any exchange occurring during the five years prior to the citizenship relinquishment or residency termination, any gain realized is to be recognized immediately after the loss of citizenship (or termination of residency).

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[138] The following example illustrates this rule: Mr. B lost his U.S. citizenship on July 1, 2002 and is subject to section 877. Mr. B has owned all of the stock of a foreign corporation, ("FCo"), since its incorporation in 1996. As of December 31, 2001, FCo has accumulated earnings and profits of $500,000. FCo has current earnings and profits of $100,000 for 2002 and does not have any subpart F income. FCo makes a $100,000 distribution to Mr. B in each of 2003 and 2004. On January 1, 2005, Mr. B disposes of all his stock of FCo and realizes $400,000 of gain. The distributions from FCo and the gain on the sale of the stock of FCo would be treated as U.S.-source income and would be taxed to Mr. B under section 877, subject to the earnings and profits limitation. For this purpose, FCo's earnings and profits for 2002 are pro-rated based on the number of days during 2002 that Mr. B is a U.S. citizen. Thus, the amount of FCo's earnings and profits earned or accumulated before Mr. B's loss of citizenship is $550,000. Accordingly, the $100,000 distributions from FCo in 2003 and 2004 would be treated as U.S.-source income taxable to Mr. B under section 877. In addition, $350,000 of the gain realized from the sale of the stock of FCo in 2005 would be treated as U.S.-source income taxable to Mr. B under section 877.

[139] Sec. 877(d)(2).

[140] Notice 97-19, sec. I. *See* A-166.

The Secretary of the Treasury is authorized to issue regulations to treat removal of tangible personal property from the United States, and other circumstances that result in a conversion of U.S.-source income to foreign-source income without recognition of any unrealized gain, as exchanges for purposes of computing gain subject to section 877. The taxpayer may defer the recognition of the gain if he or she enters into a gain recognition agreement as described above. For example, a former citizen who is subject to the alternative tax regime and who removes appreciated artwork that he or she owns from the United States could be subject to immediate U.S. tax on the appreciation under this provision unless the individual enters into a gain recognition agreement. Under Notice 97-19, the removal from the United States of appreciated tangible personal property having an aggregate fair market value in excess of $250,000 within the 15-year period beginning five years prior to the citizenship relinquishment or residency termination will be treated as an "exchange" subject to these rules. Gain from the removal of tangible personal property worth $250,000 or less will not be subject to the section 877 alternative tax regime.

Contributions of U.S. property to controlled foreign corporations

Section 877 provides for recharacterization if an individual to whom section 877 applies contributes property that would produce U.S.-source income to a foreign corporation, and: (1) the property is contributed to the foreign corporation during the 10-year period after citizenship relinquishment or residency termination; (2) the foreign corporation would be a controlled foreign corporation if the individual were a U.S. citizen; and (3) the individual owns, directly or indirectly, 10 percent or more (by vote) of the stock of such corporation.[141] Under these recharacterization rules, the former citizen or former long-term resident who is subject to the alternative tax regime is treated as receiving or accruing directly the income or gains received or accrued by the foreign corporation with respect to the contributed property (or other property that has a basis determined by reference to the basis of such contributed property) during the 10-year period after citizenship relinquishment or residency termination.[142] Moreover, if the individual

[141] Sec. 877(d)(4). For purposes of determining indirect and constructive ownership, the rules of section 958 apply.

[142] The recharacterization rules under section 877 for transfers to a foreign corporation are illustrated by the following example: Ms. A lost her U.S. citizenship on January 1, 2002, and is subject to section 877. On June 30, 2003, Ms. A transfers the stock she owns in a U.S. corporation ("USCo"), to a foreign corporation, ("FCo"), in exchange for all the stock of FCo in a transaction that qualifies for tax-free treatment under section 351. At the time of such transfer, A's basis in the stock of USCo is $100,000 and the fair market value of the stock is $150,000. Any income or gain on the USCo stock would be treated as received or accrued by Ms. A and not by FCo. Accordingly, if the USCo stock pays a dividend of $10,000 in 2004, Ms. A would be treated as receiving the dividend and would be subject to U.S. tax under section 877 on such dividend. Moreover, if FCo sells the USCo stock in 2004, Ms. A would be treated as recognizing the gain on such sale and would be taxable thereon under section 877. Alternatively, if Ms. A disposes of the stock of FCo in 2004 while FCo holds the USCo stock, the USCo stock would be treated as if sold by FCo immediately before Ms. A's disposition of the FCo stock;

disposes of the stock of the foreign corporation, the individual is subject to U.S. tax on the gain that would have been recognized if the corporation had sold such contributed property immediately before the disposition. If the individual disposes of less than all of his or her stock in the foreign corporation, such disposition is treated as a disposition of a pro rata share (determined based on value) of such contributed property.[143] Authority is provided for the Department of Treasury to issue regulations to prevent the avoidance of this rule. Information reporting is required as necessary to carry out the purposes of this rule.

Under Notice 97-19, individuals are required to apply the above rules by substituting a 15-year period beginning five years prior to the citizenship relinquishment or residency termination for the 10-year period described above.[144] In addition, an individual who makes a contribution must attach certain information to his or her U.S. tax return for the year in which the contribution is made, including the date of the contribution, a description of the property contributed, and a description of the percentage interest in the foreign corporation to which the property was contributed.

Special rule for shift in risks of ownership

Section 877 applies to income and gains for the 10 taxable years ending after the loss of citizenship (or termination of residency, as applicable). For purposes of applying section 877, the 10-year period is suspended for gains derived from a particular property during any period in which the individual's risk of loss with respect to such property is substantially diminished.[145]

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accordingly, Ms. A would be subject to U.S. tax under section 877 on the gain on the USCo stock.

[143] For example, if the individual owns 100 shares of the foreign corporation's stock and disposes of 10 of such shares, such disposition is treated as a disposition of 10 percent of the property contributed to the foreign corporation.

[144] Notice 97-19, sec. I. *See* A-166.

[145] Sec. 877(d)(3). For example, Ms. C lost her citizenship on January 1, 2002, and is subject to section 877. On that date, Ms. C owns 10,000 shares of stock of a U.S. corporation ("USCo"), with a value of $1 million. On the same date, Ms. C enters into an equity swap with respect to such USCo stock with a five-year term. In the transaction, Ms. C will transfer to the counter-party an amount equal to the dividends on the USCo stock and any increase in the value of the USCo stock for the five-year period. The counterparty will transfer to Ms. C an amount equal to a market rate of interest on $1 million and any decrease in the value of the USCo stock for the same period. Ms. C's risk of loss with respect to the USCo stock is substantially diminished during the five-year period in which the equity swap is in effect and, therefore, the 10-year period under section 877 is suspended during such period. Accordingly, if Ms. C sells her USCo stock for a gain on January 1, 2014, such gain would be treated as U.S.-source income taxable to Ms. C under section 877.

2. Estate, gift, and generation skipping transfer taxation

(a) Estate tax

In general, estates of nonresident noncitizens are subject to U.S. estate tax on the transfer at death of certain U.S.-situated property.[146] Such property includes real estate and tangible property located within the United States. In addition, stock held by nonresident noncitizens is treated as U.S.-situated if issued by a U.S. corporation.[147]

A special estate tax rule applies to former citizens and former long-term residents who relinquish citizenship or terminate residency with a principal purpose of tax avoidance. Under this rule, if the former citizen or former long-term resident dies within 10 years of citizenship relinquishment or residency termination, the former citizen's or former long-term resident's U.S. gross estate includes the value of certain closely-held foreign stock to the extent the foreign corporation owns U.S.-situated property. This rule applies only if: (1) the decedent owned, directly, at death 10 percent or more of the combined voting power of all voting stock of the corporation; and (2) the decedent owned, directly or indirectly, at death more than 50 percent of the total voting stock of the corporation or more than 50 percent of the total value of all stock of the corporation.[148]

(b) Gift tax

Nonresident noncitizens are subject to gift tax with respect to certain transfers by gift of U.S.-situated property.[149] Such property includes real estate and tangible property located within the United States. Nonresident noncitizens generally are not subject to U.S. gift tax on the transfer of intangibles, such as stock or securities, regardless of where such property is situated.[150]

A special gift tax rule applies to former citizens and former long-term residents who relinquish citizenship or terminate residency with a principal purpose of tax avoidance.[151] Under

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[146] Secs. 2101, 2103.

[147] Sec. 2104.

[148] Sec. 2107(b).

[149] Secs. 2501, 2511(a).

[150] Sec. 2501(a)(2).

[151] A former citizen or former long-term resident is treated as having relinquished citizenship or terminated residency with a principal purpose of tax avoidance if he or she meets certain monetary thresholds relating to a five-year tax liability test or a net worth test. Sec. 2501(a)(3)(B). (These thresholds are discussed in more detail in Part IV.B.1.b. above). Certain categories of individuals can avoid being treated as having a principal purpose of tax avoidance if they submit a timely and complete ruling request with the IRS as to whether their citizenship

this rule, the former citizen or former long-term resident is subject to gift tax on gifts of U.S.-situated intangibles (e.g., U.S. stock), if made within 10 years of citizenship relinquishment or residency termination.[152]

(c) Generation skipping transfer tax

No special rules apply relating to the generation skipping transfer tax for former citizens or former long-term residents who relinquish citizenship or terminate residency with a principal purpose of tax avoidance.

3. Double tax relief

In order to mitigate the double taxation of individuals subject to the alternative tax regime, a credit is permitted against the U.S. tax imposed under such provisions for any foreign income, gift, estate or similar taxes paid with respect to the items subject to such taxation.[153] This credit is available only against the tax imposed solely as a result of the alternative tax regime and is not available to be used to offset any other U.S. tax liability.[154]

4. Interaction with tax treaties

In general, U.S. tax treaties contain a "saving clause" which provides that the treaty does not affect the taxation by a country of its citizens or residents. By reason of this saving clause, unless otherwise provided in the treaty, the United States may continue to tax its citizens or

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relinquishment or residency termination had a principal purpose of tax avoidance. Sec. 2501(a)(3)(C). (These exceptions are discussed in more detail in Part IV.B.1.c. above.).

[152] Sec. 2501(a)(3)(A).

[153] Secs. 877(b), 2107(c)(2), and 2501(a)(3)(D). Because section 877 alters the sourcing rules generally used to determine the country having primary taxing jurisdiction over certain items of income, there is an increased potential for such items to be subject to double taxation. For example, a former citizen subject to the section 877 rules may have capital gains derived from stock in a U.S. corporation. Under section 877, such gains are treated as U.S.-source income, and, therefore, are subject to U.S. tax. The internal laws of the former citizen's new country of residence, however, may provide that all capital gains realized by a resident of that country are subject to taxation in that country and, thus, the gain from the sale of U.S. stock also may be taxable in his country of residence.

[154] For example, Mr. D lost his citizenship on January 1, 2002, and is subject to section 877. Mr. D becomes a resident of Country X. During 2002, Mr. D recognizes a $100,000 gain upon the sale of stock of a U.S. corporation. Country X imposes $15,000 tax on this capital gain. But for the double tax relief provision, Mr. D would be subject to U.S. tax of $20,000 on this gain under section 877, for a total of $35,000 of aggregate tax liability between the United States and the foreign country. However, Mr. D 's U.S. tax under section 877 would be reduced by the $15,000 of foreign tax paid, and Mr. D 's resulting U.S. tax on this gain would be $5,000.

residents as if the treaty were not in force. Some U.S. tax treaties contain a provision under which the saving clause (and, therefore, the U.S. jurisdiction to tax) applies to a former citizen or former long-term resident whose loss of citizenship or resident status had as one of its principal purposes the avoidance of tax; such application is limited to the 10-year period following the loss of citizenship or resident status. This approach is consistent with the alternative tax regime under section 877 for former citizens and former long-term residents as described above. However, not all U.S. tax treaties in force contain this provision. Tax treaties that do not contain this provision could preclude the United States from subjecting former citizens to U.S. tax under the alternative tax regime.[155]

A conflict arises because section 877 does not explicitly deny treaty benefits to former citizens or long-term residents. If former citizens and long-term residents qualify for resident status under the tax treaty between the United States and the country where they relocate, they are generally entitled to treaty benefits. This allows former citizens and long-term residents to benefit from treaty provisions that reduce or exempt their U.S.-source income that would otherwise be subject to tax under section 877. When former citizens or long-term residents are not mentioned in the saving clause of such treaty, it prevents the United States from continuing to tax them as though the treaty never went into effect. Therefore, unless former citizens and long-term residents are included in the saving clause, treaty provisions could preclude the United States from applying the alternative tax regime.

The legislative history of the 1996 legislative changes to the alternative tax regime indicates that the purpose of these provisions, as amended in 1996, was not intended to be defeated by any treaty provision.[156] It was anticipated that the Department of Treasury would review all outstanding treaties to determine whether the alternative tax regime, as revised in 1996, potentially conflicts with treaty provisions (such as the saving clauses in the various treaties) and to eliminate any such potential conflicts through renegotiation of the affected tax treaties as necessary.[157] The legislative history of the 1996 changes to the alternative tax regime states that beginning on the tenth anniversary of the enactment of such changes, any conflicting treaty provisions that remain in force take precedence over the alternative tax regime as revised.[158] This coordination rule is effective until August 21, 2006.[159]

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[155] *See Crow v. Commisioner, 85 T.C. 376 (1985)* (holding that section 877 does not apply if its application is inconsistent with a treaty).

[156] H.R. Conf. Rep. No. 104-736, at 329 (1996).

[157] *Id.*

[158] *Id.*

[159] *See* A-2 through A-9 for a list of outstanding U.S. tax treaties with savings clause provisions that potentially conflict with the alternative tax regime.

Consistent with Congressional intent, the IRS published Notice 97-19, declaring that all provisions of section 877 will prevail over treaty provisions in effect on August 21, 1996.[160] Typically, U.S. courts apply the "later-in-time" rule to determine whether a U.S. statute or a treaty is controlling authority in the event of a conflict, because both Federal laws and treaties are supreme law of the land.[161] However, the 1996 legislative history, along with Notice 97-19, call for only temporary non-supremacy of the treaties.[162]

5. Required information reporting and sharing

In order to enhance compliance with the alternative tax regime and to assist the IRS in identifying former citizens and former long-term residents who are subject to the alternative tax regime, the Health Insurance Portability and Accountability Act of 1996 added an information reporting requirement to the Code.[163] This information reporting obligation is imposed on former citizens and former long-term residents at the time of citizenship relinquishment or residency termination. In addition, the Department of State and other governmental entities are required to share certain information with the IRS with respect to such individuals.

Information reporting

Under the Code, a U.S. citizen who loses his or her citizenship is required to provide an information statement to the Department of State (or other designated government entity).[164] This information statement includes the following information: (1) the individual's social security number; (2) the mailing address of the individual's principal foreign residence; (3) the new country of residence; (4) the new country of citizenship; (5) information concerning the individual's assets and liabilities if the tax liability threshold or the net worth threshold under section 877(a)(2) is met; and (6) such other information as the Secretary of the Treasury

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[160] Notice 97-19, Sec. VIII. *See* A-166.

[161] Section 7852(d), enacted by the Technical and Miscellaneous Tax Act of 1988 ("TAMRA"), provides that neither a treaty nor a statute have preferential status, so that the later-in-time of a statute or a treaty controls (commonly referred to as the "later-in-time" rule).

[162] In the event the IRS seeks assistance from a treaty partner to enforce the provisions under section 877 with respect to a former U.S. citizen or long-term resident who has moved overseas, the IRS may have difficulty convincing the treaty partner that the provisions of section 877 override the treaty language agreed upon by both parties at the time of negotiation. In addition, the IRS has indicated that it has not utilized treaty provisions to obtain information as to whether or not an individual is subject to the expatriation tax rules. *See* A-123 (August 14, 2002, letter from the IRS).

[163] Pub. L. No. 104-191, sec. 512.

[164] Sec. 6039G.

prescribes.[165] A similar information statement is required for long-term U.S. residents who terminate their residency.[166]

Since January 1999, individuals can provide this information on IRS Form 8854.[167] Form 8854 requires the individual to provide: (1) the individual's social security number; (2) forwarding foreign address; (3) new country of residence; (4) all foreign countries of citizenship and the method by which citizenship was acquired; (5) the number of days the individual was physically present in the United States during the year of citizenship relinquishment or residency termination and each of the two preceding taxable years; and (6) information concerning U.S. tax liability for the five years preceding the date of citizenship relinquishment or residency termination. In the case of individuals with gross assets having a collective fair market value of more than $500,000, the form also requires the completion of a balance sheet showing assets and liabilities immediately prior to citizenship relinquishment or residency termination. If the tax liability threshold or the net worth threshold of section 877(a)(2) is met, Form 8854 asks several questions concerning the eligibility for and submission of a ruling request regarding whether the citizenship relinquishment or residency termination had as a principal purpose the avoidance of U.S. tax. The form must be signed under penalty of perjury.

The information statement must be provided by former citizens no later than the earliest day on which the individual (1) renounces U.S. nationality before a diplomatic or consular officer of the United States, (2) furnishes to the Department of State a statement of voluntary relinquishment of U.S. nationality confirming an act of citizenship relinquishment, (3) is issued a certificate of loss of U.S. nationality by the Department of State, or (4) loses U.S. nationality because the individual's certificate of naturalization is canceled by a U.S. court (collectively, the "reporting date").[168] The office reviewing the statements is required to provide to the Secretary of the Treasury copies of all statements received and the names of individuals who refuse to provide such statements.[169] A long-term resident whose residency is terminated generally is

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[165] Section 6039G(b) specifically requires some of this information to be reported, while other items are specified by Notice 97-19, as modified by Notice 98-34, and IRS Form 8854.

[166] Sec. 6039(G)(f).

[167] There is, however, no statutory requirement that individuals provide the required information on the official IRS form. Some Department of State consular offices will accept the information in alternate formats. Prior to January 1999, no uniform information statement (e.g., on an IRS form) existed. However, section 6039G and Notice 97-19 provide a list of certain required information.

[168] Sec. 6039G(a) and (c).

[169] Under Notice 97-19, a former citizen whose reporting date is on or before March 10, 1997, must provide the information statement to the IRS by June 8, 1997. If the reporting date is after March 10, 1997, and on or before June 8, 1997, the former citizen must provide the information statement to the nearest consular office, the Department of State, or a Federal court (if the individual's CLN was canceled by a court) on or before June 8, 1997. If the reporting

required to attach the information statement to his or her U.S. income tax return for the year of such termination.[170]

In addition, a former citizen or former long-term resident who is liable for U.S. taxes under the alternative tax regime for a taxable year during the 10-year period (and accordingly must file IRS Form 1040NR) must attach to that return a statement setting forth (generally by category) all items of U.S.-source and foreign-source gross income.

The IRS may impose penalties if an individual fails to provide the required information unless such failure is due to reasonable cause and not to willful neglect.[171] An individual who fails to provide the required information statement is subject to a penalty for each year (of a 10-year period beginning on the date of loss of citizenship or termination of residency) during which the failure to provide the statement continues. The penalty is equal to the greater of five percent of the tax required to be paid under section 877 for that year or $1,000.[172]

Interagency information sharing

The Department of State is required to provide the Secretary of the Treasury with a copy of each CLN documenting a loss of citizenship, that is approved by the Department of State. Similarly, the INS is required to provide the Secretary of the Treasury with the name of each individual whose status as a lawful permanent resident has been revoked or has been determined to have been abandoned. Further, the Secretary of the Treasury is required to publish in the *Federal Register* the names of all former citizens with respect to whom it receives the required statements or whose names or CLNs it receives under the foregoing information-sharing provisions. Because of restrictions placed on the disclosure of returns and return information by section 6103, the Department of Treasury is unable to share confidential information with the Department of State and the INS for purposes of administering civil immigration laws.[173]

6. Certain resident noncitizens having a break in residency status

A special rule applies in the case of a noncitizen who has been treated as a resident of the United States for at least three consecutive years, if the individual becomes a nonresident but

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date is after June 8, 1997, the former citizen must provide the information statement to the nearest consular office or Federal court (as the case may be) on or before the reporting date.

[170] Under Notice 97-19, a former long-term resident who terminated residency after February 5, 1995, and before January 1, 1996, must attach the information statement to either a 1996 IRS Form 1040NR (whether or not the individual is required to file a tax return) or an amended 1995 U.S. income tax return.

[171] Sec. 6039G(d).

[172] *Id.* No similar penalties were required to be imposed under pre-1996 law.

[173] For a more detailed discussion of the effect of section 6103 and the immigration exclusion for certain former citizens, see Part V.D., below.

regains residency status within a three-year period.[174] In such cases, the individual is subject to U.S. tax for all intermediate years under the alternative tax regime described above (i.e., the individual is taxed in the same manner as a former citizen or former long-term resident who relinquished citizenship or terminated residency for tax avoidance purposes). The special rule for a break in residency status applies regardless of the subjective intent of the individual.

[174] Sec. 7701(b)(10).