

Tax Planning for U.S. persons
in Europe –
Residency in Europe, Disclosure,
Expatriation

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Agenda

- Issues U.S. Persons Encounter in Europe
- Disclosure Procedures
- Expatriation

Case Study

- Mr. A was born in the U.S. 40 years ago
- His parents moved with him to France when he was two years old
- He was not aware of U.S. filing and reporting requirements until his European bank contacted him with respect to F.A.T.C.A. reporting requirements
- He has bank accounts and portfolio investments in Europe
- 3 years ago he sold some of the portfolio investments and bought an apartment with these funds which he uses for himself and his family (no rental income)
- He is also deriving rental income from a holiday property he owns in France
- He is 100% shareholder of a UK HoldCo which in turn has a 25% ownership in two Mexican entities
- In 2012 he received U.S. \$500,000 as a gift from his non-U.S. and foreign resident grandfather

Alternative

- He moved back to the United States 10 years ago.

Issues U.S. Persons Encounter in Europe

- Double or multiple compliance & costs
- Refusal of banking services (discrimination)
- Wealth taxes
- Donation and succession taxes
- Tax complications around Trusts

Issues U.S. Persons Encounter in Europe

Expatriated US persons can look at alternative tax regimes, such as :

- UK resident non-dom status
- Swiss lump sum tax system (forfait)
- Portuguese non-habitual resident regime

Disclosure Procedures

Disclosure – Overview

- 2014 Offshore Voluntary Disclosure Program (O.V.D.P.)
- Streamlined Domestic Offshore Procedure
- Streamlined Foreign Offshore Procedure
- Transitional Streamlined Procedure

Mr A.'s Filing and Reporting Requirements as well as Penalties Outside Disclosure Procedures

- Annual income tax return (Form 1040NR for non-residents/Form 1040 for residents (Alternative)) – Penalty: Failure to file up to 25% of tax due (reduced to 22.5% if combined with failure to pay penalty); failure to pay penalty of up to 25% of tax due; accuracy related penalty of 20% or 40% of tax due – penalties may be levied accumulatively in addition to interest on tax due, accuracy related and late filing penalty
- From 2012 onwards including Form 8938, *Statement of Specified Foreign Financial Assets* – Penalty: \$10,000, with an additional \$10,000 for each month the failure continues beginning 90 days after the taxpayer is notified up to a maximum of \$50,000 per return
- Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*, for UK HoldCo (Alternative only) – Penalty: \$10,000 each, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return
- FBAR on foreign portfolio investments and bank accounts – Penalty: \$10,000 (non-willful); greater of \$100,000 or 50% of the total balance of the foreign account per violation (willful)
- Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, for the gift received in 2012 – Penalty: 5% of the gift per month up to a maximum of 25% of the gift; abatement possible in case of reasonable cause

Disclosure

O.V.D.P.	Streamlined Domestic Offshore Procedure	Streamlined Foreign Offshore Procedure
<ul style="list-style-type: none"> No criminal investigation or civil audit initiated N/A U.S. citizens or lawful permanent residents ("green card holders") Individuals who are not U.S. citizens or lawful permanent residents ("green card holders") meeting the substantial presence test in any one or more of the last 3 years N/A Income tax returns for past 8 years FBARs for past 8 years 27.5% offshore penalty (or 50% in case of accounts held at certain Financial Institutions or Facilitators identified by the I.R.S. (see next slide)) Highest balance in the bank account throughout past 8 years Interest on back taxes, accuracy related and late filing penalty, if any Accuracy related penalty (20%); late payment penalty (25%); late filing penalty (22.5%) Closing Agreement (Form 906) 	<ul style="list-style-type: none"> No criminal investigation or civil audit initiated Non-willfulness required U.S. citizens or lawful permanent residents ("green card holders") living outside the United States and 35 days or more spent in the United States in any of the 3 past years covered Individuals who are not U.S. citizens or lawful permanent residents ("green card holders") meeting the substantial presence test in any one or more of the last 3 years Previously filed tax returns (if required) for previous 3 years Income tax returns for past 3 years FBARs for past 6 years 5% penalty Highest aggregate year-end balance and asset values during the past 6 years Interest on back taxes N/A (unless original return was fraudulent or FBAR violation was willful) No formal closing 	<ul style="list-style-type: none"> No criminal investigation or civil audit initiated Non-willfulness required U.S. citizens or lawful permanent residents ("green card holders") living outside the United States and < 35 days spent in the United States in any of the 3 past years covered Individuals who are not U.S. citizens or lawful permanent residents ("green card holders") <u>not</u> meeting the substantial presence test in any one or more of the last 3 years N/A Income tax returns for past 3 years FBARs for past 6 years 0% penalty N/A Interest on back taxes N/A (unless original return was fraudulent or FBAR violation was willful) No formal closing
Transitional Streamlined Procedure		

From Dirty Dozen to Dirty Fifteen

Foreign Financial Institutions or Facilitators as of May 18, 2015

1. UBS AG
2. Credit Suisse AG, Credit Suisse Fides, and Clariden Leu Ltd.
3. Wegelin & Co.
4. Liechtensteinische Landesbank AG
5. Zurcher Kantonalbank
6. swisspartners Investment Network AG, swisspartners Wealth Management AG, swisspartners Insurance Company SPC Ltd., and swisspartners Versicherung AG
7. CIBC FirstCaribbean International Bank Limited, its predecessors, subsidiaries, and affiliates
8. Stanford International Bank, Ltd., Stanford Group Company, and Stanford Trust Company, Ltd.
9. The Hong Kong and Shanghai Banking Corporation Limited in India (HSBC India)
10. The Bank of N.T. Butterfield & Son Limited (also known as Butterfield Bank and Bank of Butterfield), its predecessors, subsidiaries, and affiliates
11. Sovereign Management & Legal, Ltd., its predecessors, subsidiaries, and affiliates (effective 12/19/14)
12. Bank Leumi le-Israel B.M., The Bank Leumi le-Israel Trust Company Ltd, Bank Leumi (Luxembourg) S.A., Leumi Private Bank S.A., and Bank Leumi USA (effective 12/22/14)
13. BSI SA (effective 3/30/15)
14. Vadian Bank AG (effective 5/8/15)
15. Finter Bank Zurich AG (effective 5/15/15)

O.V.D.P. Assets – Offshore Penalty Basis

- Financial accounts holding cash, securities or other custodial assets
- Real estate
- Patents or stock or other interests in U.S. or foreign business
- “Tax noncompliance” includes failure to report gross income from the assets (*e.g.*, “even one dollar” of unreported rental income pulls the rental property into the penalty calculation), as well as failure to pay U.S. tax that was due with respect to the funds used to acquire the asset (*e.g.*, art work or real estate acquired with untaxed U.S. income)

Streamlined Assets – 5% Penalty Basis (Domestic)

- Assets that should have been, but were not, reported on
 - An FBAR
 - A Form 8938
 - If the asset was properly reported for that year, but gross income in respect of the asset was not reported in that year

O.V.D.P. vs Streamlined

- Consider non-willfulness – non-compliance due to negligence, inadvertence, or mistake or conduct that is the result of good faith misunderstanding or the requirements of law – certification under the penalties of perjury
- O.V.D.P. process (Pre-clearance request; I.R.S. notification; Preliminary Acceptance; submission due within 90 days (extension possible for another 90 days))
- Formal closing under O.V.D.P. only
- Protection from criminal prosecution once closed under O.V.D.P. only as long as

Delinquent Filings

- Delinquent International Information Return Submission (including Reasonable Cause Statement)
 - Taxpayers who do not need to use the O.V.D.P. or Streamlined Filing Compliance Procedures to file delinquent or amended tax returns to report and pay additional tax, but who:
 1. Have not filed one or more required international information returns,
 2. Have reasonable cause for not timely filing the information returns,
 3. Are not under civil examination or criminal investigation by the I.R.S. and
 4. Have not already been contacted by the I.R.S. about the delinquent information returns.

Delinquent Filings (cont.)

- Delinquent FBAR Submission (including explanation for late filing)
 - Taxpayers who do not need to use the O.V.D.P. or Streamlined Filing Compliance Procedures to file delinquent or amended tax returns to report and pay additional tax, but who:
 1. Have not filed a required FBAR,
 2. Are not under a civil examination or criminal investigation by the I.R.S. and
 3. Have not already been contacted by the I.R.S. about the delinquent FBARs.
 - No penalty for failure to file if income from foreign financial accounts reported on his U.S. tax returns and paid all taxes on the income, and the taxpayer has not previously been contacted regarding an income tax examination or request for delinquent returns for the years for which the delinquent FBARs are submitted.

Quiet Disclosure

- Filing original or amended returns and delinquent FBARs with the appropriate I.R.S. Service Center to correct deficiencies in original returns
- May be selected for I.R.S. audit or referred to the I.R.S. Criminal Investigation Division
- Pros:
 - If successful, avoiding all penalties with respect to undisclosed foreign accounts
 - May shorten the look back period
- Cons:
 - Disfavored by I.R.S.
 - Exposure to I.R.S. audit or referral to the I.R.S. Criminal Investigation Division
 - Streamlined procedure still possible, however, penalties assessed previously with respect to quiet disclosures will not be abated

Expatriation

Expatriation – Definition

- A U.S. citizen who surrenders U.S. citizenship or
- A Green Card holder who is a long – term resident (holds card 8 out of 15 years) who
 - Officially ceases to be a lawful permanent resident or
 - Elects to be treated as a resident of a treaty partner of the U.S. under a tiebreaker test for residence

Expatriation – Taxable Event for Covered Individuals

- Expatriation is a taxable event, and gifts and bequests are subject to special inheritance tax, only if an individual is a “Covered Individual”
- Three triggers for being covered:
 - Average net income tax liability over most recent 5 years exceeds \$160,000 if expatriation occurs in 2015, or
 - Net worth exceeds \$2.0 million, or
 - Failure to certify that the individual is compliant with all US Federal tax obligations under the Code (including income tax, employment tax, gift tax and information returns) for the five taxable years preceding expatriation

Expatriation – Exceptions to Covered Individual Status

- Dual Citizen at birth
 - Remains both a citizen and income tax resident of the other country as of the expatriation date
 - Not a U.S. resident for more than 10 of most recent 15 years using substantial presence test
- Minor children
 - Expatriation occurs before the age of 18½ years
 - Not a U.S. resident for more than 10 years

Expatriation – Income Tax for Covered Individuals

- Mark-to-Market Tax
 - All property in the tax base is treated as sold on the day before the expatriation date for fair market value
 - All property that would be included in a taxable estate if owned at death or to the extent transferred during life for less than adequate compensation in money or money's worth or because of retained power or interest is included
 - Both gain and loss are recognized
 - Nonrecognition provisions of the Code do not apply
 - The amount of gain included in gross income as a result of this deemed sale is
 - The first \$690,000 of gain benefits from an exclusion for expatriation in 2015

Expatriation – Special Income Tax Rules

- A Covered Expatriate may defer payment of the exit tax but must provide security to the I.R.S.
- Deferred compensation is included at current value of future payment other than eligible deferred compensation, which is taxed upon receipt at a 30% flat rate
- Individual retirement accounts and annuities (self-directed retirement accounts) are taxed as if distributed on the day prior to expatriation
- Non-grantor trust distributions taxed at time of distribution; subject to an acceleration option

Expatriation – Special Inheritance Tax for U.S. Heirs and Gift Recipients

- A US citizen or resident who receives a “covered gift” or “covered bequest” from a Covered Expatriate is subject to an inheritance tax imposed at the highest gift or estate tax rate in effect on the date of the receipt, now 40%
- Primary liability is on the recipient
- Tax applies to direct or indirect gifts or bequests, inclusive of gifts to non-U.S. trust followed by distribution to U.S. beneficiary
- Inheritance tax not applicable to
 - U.S. situs property subject to gift or estate tax
 - U.S. citizen spouse
 - U.S. Charity

Expatriation Planning

- Come into compliance – O.V.D.P. or Streamline Procedure so as to certify
- Consider re-filing past returns as married filing separately in order to reduce average tax
- Consider pre-expatriation gifts up to lifetime exemption of \$5.43 Million
- Consider filing amended or initial returns for past years to prevent a Green Card holder from being a long-term resident

Expatriation Planning

- Consider having a Green Card holder confirm domicile abroad as a prelude to giving gifts of non-U.S. situs property or intangible property
- Consider reducing value of net worth through special valuation rules applicable to minority ownership of entities owning property
- Consider renunciation of interests in trusts