THE UNITED STATES EXIT TAX

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Individuals who renounce United States citizenship and certain permanent residents who cease being such may be subject to an "alternative tax regime" known colloquially as the "exit tax" or "expatriation tax." An alternative regime of taxation for these individuals was first established in 1966. In 2008, the initial regime was replaced by a new one. This outline will briefly review the old regime and then provide a detailed analysis of the new.

I. BACKGROUND ON THE "OLD" ALTERNATIVE TAX REGIME FOR EXPATRIATING CITIZENS AND CERTAIN LONG-TERM RESIDENTS

A. In 1966, the United States Congress adopted an "alternative tax regime" for former citizens who had relinquished citizenship with the principal purpose of avoiding U.S. taxes (Foreign Investors Tax Act of 1966, P.L. 89-809).

1. For a period of 10 years after relinquishment, the expatriate faced income, estate, and gift tax exposure beyond what would have been typically the case for a nonresident, noncitizen of the U.S.

    a. The typical (non-expatriate) who is a nonresident, noncitizen faced:

        i. Income tax on dividends paid by U.S. domestic corporations, rents from U.S. real property, and certain other items (such as income from a U.S. trade of business). IRC §§ 871. In 1980, gains from the sale of U.S. real property was added to the tax base by the enactment of IRC § 897 (Foreign Investors in Real Property Tax Act of 1980 ["FIRPTA"], P.L. 96-499). The tax base does not include interest on marketable debt obligations (such as corporate or government bonds) or deposits, or gains on the sale of stock in domestic corporations. See IRC § 871 (h) & (i) (relating to interest and deposits).

        ii. Gift tax on the gratuitous transfer of real property and tangible personal property situated in the U.S. IRC §§ 2501, 2511.

        iii. Estate tax on real property and tangible personal property situated in the U.S.; stock in domestic corporations; debt instruments held by income- tax residents of the U.S. and, in the case of nonresidents for income tax purposes, on non-publicly traded debt obligations; and deposits held in U.S. banks and the domestic branch of a foreign bank, but only if in each case the deposits are effectively connected with a U.S. trade or business. IRC §§ 2101 et seq.

    b. Expatriating citizens faced enhanced taxes for a 10-year period after expatriation:

i. The income tax base was expanded to include capital gains on the sale of stock in domestic corporations and on the sale of debt obligations of domestic corporations and of the U.S., a state or a political subdivision of a state. IRC § 877.

ii. The gift tax further applied to transfers of certain intangibles: stock in domestic corporations and debt obligations of domestic corporations and of the U.S., a state or a political subdivision of a state. IRC §§ 2501(a)(3), 2511(b).

iii. The estate tax was expanded to include taxation of the decedent's interest in certain foreign corporations with U.S.-situated assets, according to a ratio that compares the value of the U.S. assets in the corporation to all of the corporation's assets. For this proportion of assets to be includible, however, the decedent must have held a certain threshold interest in the corporation, whether actually or constructively. IRC § 2107(b).

B. In 1996, Congress acted to extend expatriate treatment to former long-term U.S. residents and adopted certain anti-abuse rules designed to prevent circumvention of the alternative tax regime (Health Insurance Portability and Accountability Act of 1996, P.L. 104-191). Long-term residents who ceased to be such for tax avoidance purposes became subject to the same alternative tax regime as in place for former citizens: the enhanced nonresident income tax for ten years and the same estate and gift taxation for such ten-year period. IRC § 877(e)(1), referring to IRC §§ 2107, 2501.

C. In 2004, Congress made several refinements to the alternative tax regime (American Jobs Creation Act of 2004, P.L. 108-357). This legislation adopted a purely objective test of a deemed tax-avoidance motive. Under the new standard, an individual who relinquishes citizenship or ceases to be a long-term resident was subjected to the alternative tax regime if the person meets any one of three tests. IRC § 877(a)(2). These tests remain under the new alternative tax regime adopted in 2008 and will be discussed below.

This "old" alternative tax regime continued to be effective for expatriating citizens and former long-term residents whose citizenship terminated or residency ceased before June 17, 2008, for a period of 10 years thereafter. As of now, it is no longer relevant to any taxpayer, but several of its definitions are adopted as part of the new regime.

II. THE "NEW" ALTERNATIVE TAX REGIME: INTRODUCING THE "COVERED EXPATRIATE"

The new regime is effective for renunciations of U.S. citizenship and for cessations of long- term residency which occur on or after June 17, 2008. The regime involves income taxes (IRC § 877A) and wealth transfer taxes (IRC § 2801). They apply to citizens and long-term residents who fall under the definition of a "covered expatriate." A covered expatriate is a citizen who renounces citizenship (with two exceptions) or a "long-term resident" who ceases to be such and, in either case, the person meets one of three tests: the net worth test, the taxable income test, or the failure to certify compliance test. IRC § 877A(g)(1)(A) (Heroes Earnings Assistance and Relief Tax Act of 2008, P.L. 110-245).

A. U.S. Citizens Covered by the New Regime

A citizen of the United States who renounces citizenship is a potential covered expatriate, with two limited exceptions.

1. Dual Citizen Exception (IRC § 877A(g)(1)(B)(ii))

This exception is met if the person:

a. Became at birth a citizen of the U.S. and another country and, as of the expatriation date, continues to be a citizen of such other country and taxed as a resident of such country; and

b. Would not have been considered a resident of the U.S. under the substantial presence test of IRC §7701(b)(3) during 10 of the previous 15 years (see also IRC §7701(b)(1)(A)(ii)).

2. Exception for Minors (IRC §877A(g)(1)(B)(ii)).

This exception is met if:

a. The person relinquishes U.S. citizenship prior to age 18½; and

b. The individual has met the substantial presence test for only 10 or fewer years during his or her lifetime.

B. Long-Term Residents Covered by the New Regime

A "long-term resident" under the Internal Revenue Code is a person who has been a "lawful permanent resident" of the U.S. and, as of the time the person ceases to be a lawful permanent resident, he or she has been such a resident in at least eight of the 15 taxable years ending with the year in which the expatriating event occurs (which is sometimes referred to as the "8 of 15 Rule"). IRC § 877(e).

1. A "lawful permanent resident" is a person who has been "accorded the privilege of residing permanently in the United States as an immigrant," i.e. a "Green Card" holder, and such status has not been revoked or administratively or judicially determined to be abandoned. IRC § 7701(b)(6); Treas. Reg. § 301.7701(b)-1(b)(3).

2. For purposes of the 8 of 15 Rule, any part of a tax year in which the person is a Green Card holder counts as a year. Treas. Reg. § 301.7701(b)-1(b)(1). A year of lawful permanent residence does not include any year in which the person is treated as a resident of another country pursuant to an income tax treaty with that other country, and the person has not waived the benefits of the treaty that apply to residents of that country. IRC § 877(e)(2). Therefore, if the Green Card holder has taken up residence in a treaty country and files his U.S. tax return as a nonresident alien, then that year and other like years are not counted as years of permanent residence. The U.S. has income tax treaties with over sixty countries.

C. The Three Tests of Covered Expatriate Status

A citizen who has renounced citizenship or a long-term resident who has ceased to be so will be accorded the status of a covered expatriate if he meets any one of three tests:

1. The person's average annual net income tax for the preceding five tax years exceeds $124,000 (as adjusted for inflation since 2004). "Net income tax" is defined in IRC § 38(c)(1) to mean "regular tax liability" (itself defined in IRC § 26(b)(1) as the normal income tax before numerous additional taxes) plus the alternative minimum tax, reduced by certain credits. Recent inflation adjustments to the net income tax threshold are as follows:

YEAR	EXCLUSION
2008	$ 139,000
2009	$ 145,000
2010	$ 145,000

YEAR	EXCLUSION
2011	$ 147,000
2012	$ 151,000
2013	$ 155,000

YEAR	EXCLUSION
2014	$ 157,000
2015	$ 160,000
2016	$ 161,000
2017	$ 162,000

YEAR	EXCLUSION
2018	$ 165,000
2019	$ 168,000
2020	$ 171,000
2021	$ 172,000

In the case of a joint income tax return, the IRS takes the position that each spouse must calculate average annual net income on the full amount of tax as reflected on the return. Notice 97-19, 1997-1 CB 394, 2/24/1997, Sec. III. So, if a couple has a long-term plan for expatriation and each is a high earner, they may choose to file separate returns for the five years preceding the act of expatriation.

2. The person's net worth on worldwide assets is $2 million or more. This threshold is not indexed for inflation. The IRS advised on the calculation of "net worth" in a notice issued under the old regime as Notice 97-19. The calculation of net worth will be considered further below.

3. The person "fails to certify under penalty of perjury that he has met the requirements of this title for the five preceding taxable years or fails to submit such evidence of such compliance as the Secretary may require." This refers to all obligations imposed under Title 26 of the United States Code and, therefore, would include compliance under the income, gift, excise and other taxes and under all informational reporting sections, including FATCA compliance.

III. THE TAXES IMPOSED UNDER THE NEW REGIME

A covered expatriate faces four distinct income taxes, and his heirs (or a trust for their benefit) may face a wealth transfer tax that is in the nature of an inheritance tax.

A. Income Taxes — IRC Section 877A

The income taxes come in four varieties and are collectively referred to as the "Exit Tax."

1. The "Mark-To-Market Tax"

The "mark-to-market tax" is an income tax on the deemed gain on the worldwide assets of the person, with the value of each asset "marked to the market," as if the asset had been sold by the taxpayer on the day before the expatriation date at fair market value. IRC § 877A(a). If the covered expatriate's asset class is subject to one of the other three exit taxes, however, it is excluded from the mark-to-market regime.

a. In general, gains and losses are recognized and taxed according to the normal rules of Subtitle A (Income Taxes) of the Internal Revenue Code.

b. For former long-term residents, the gain or loss on assets which the person held on becoming a U.S. resident is calculated against a basis equal to at least the fair market value of the asset on the date of residency. The taxpayer can irrevocably elect out of such treatment. IRC § 877A(h)(2).

c. Deemed "wash sales" under IRC § 1091 will be taken into account for purposes of calculating losses. IRC § 877A(a).

d. If other Code provisions would create a tax on subsequent gains or give allowance for subsequent losses, then an adjustment is made for gain or loss recognized as part of the mark-to-market tax. IRC § 877A(a).

e. The expatriation or cessation of residency of a person could cause a trust to become a "foreign trust", as defined in IRC § 7701(a)(31). This would occur if the person were the donee of a power of appointment over the trust estate. Because the donee of the power would no longer be a "United States Person" (as defined in IRC § 7701(a)(30)) upon expatriation, a non-U.S. Person would hold substantial decision-making authority over the trust, thus rendering it a foreign trust. Under IRC § 684, when a trust becomes a foreign trust, it is subject to a tax on deemed mark-to-market gain on its assets (without an offset for deemed losses). To the extent that this tax under IRC § 684 applies, the exit tax under IRC § 877A would not apply.

f. Exclusion

The amount of gain calculated according to the above rules is reduced by a $600,000 exclusion, as adjusted for inflation since 2008. IRC § 877A(a)(3).

i. Since gain is taxable at different rates under Subtitle A (for example, long-term capital gain on marketable securities and ordinary income on the gain inherent in a life insurance contract or annuity), it is important how the exclusion is allocated among the various items of gain. The form for the calculation of the taxable gain is IRS Form 8854 — Expatriation Information Statement, which serves as an attachment to the taxpayer's income tax return. The Instructions to Form 8854 provide for a proportional allocation of exemption among the items of gain (at p. 6, under the instructions for Part II, Section C, Line 2, Column (e) (2019 form)).

ii. The exclusion figures, as adjusted for inflation since 2008, are as follows:

YEAR	EXCLUSION
2008	$ 600,000
2009	$ 626,000
2010	$ 627,000
2011	$ 627,000
2012	$ 651,000
2013	$ 668,000
2014	$ 680,000

YEAR	EXCLUSION
2015	$ 690,000
2016	$ 693,000
2017	$ 699,000
2018	$ 711,000
2019	$ 725,000
2020	$ 737,000
2021	$ 744,000

g. Election to defer the mark-to-market tax. Payment of the mark-to-market tax can be deferred until such time as the property is disposed of, but the terms are difficult.

i. The deferral may be elected on an asset-by-asset basis. If fewer than all assets are elected, then the deferred tax is a portion of the total tax, based on the value of the deferred assets in relation to the value of all assets. IRC § 877A(b)(2).

ii. The election may not be made unless adequate security is posted in favor of the U.S. Treasury Secretary. IRC § 877A(b)(4).

iii. Interest is charged on the deferred tax under Section 6601 at the rate normally applicable to individual underpayments. IRC § 877A(b)(7).

iv. The election is irrevocable. Furthermore, as part of the election, the taxpayer must irrevocably waive any right under a tax treaty which may preclude the later collection of the tax. IRC § 877A(b)(5) and (6).

v. The deferred tax on the asset to which it relates is due as of the due date of the return for the year in which the taxpayer disposes of the asset. If the taxpayer dies before disposing of the asset, the deferral as to the tax on all of the assets cannot be longer than the due date of the return for that year. IRC § 877A(b)(1) & (3).

2. The Tax on Specified Tax Deferred Accounts.

The second income tax is on "specified tax deferred accounts." IRC § 877A(e).

a. Under this tax, the taxpayer is treated as receiving a distribution of his entire interest in the account on the day before the expatriation date. IRC § 877A(e)(1)(A). Thus, income tax will be due at ordinary income rates on the entire taxable amount.

b. "Specified tax deferred accounts" include (IRC § 877A(e)(2)):

i. Individual retirement plans (as defined in IRC § 7701(a)(37)), meaning an individual retirement account or an individual retirement annuity, other than simplified employee pensions (IRC § 408(k)) and simple retirement accounts (IRC § 408(p)). These two excepted items, however, are the subject of the tax on certain "deferred compensation items" (as discussed below).

ii. Qualified tuition programs (as defined in IRC § 529).

iii. Coverdell education savings accounts (as defined in IRC § 530).

iv. Health savings accounts (as defined in IRC § 223).

v. Archer medical savings accounts (as defined in IRC § 220).

c. There is no exemption applicable to this tax and no election to defer payment of the tax, as there are with the mark-to-market tax.

d. The treatment of these accounts as fully distributed on the day before the expatriation date will itself not trigger an early distribution penalty. The Code provides, "no early distribution tax shall apply by reason of such treatment." IRC § 877A(e)(1)(B).

i. Query: if the taxpayer must actually take an early distribution to pay the exit tax on this item, would the early distribution penalty apply? In other words, is there a distinction between "treatment" as distributed and actual distribution in terms of the early distribution penalty?

e. The Code further provides that "appropriate adjustments shall be made to subsequent distributions from the account to reflect such treatment." IRC § 877A(e)(1)(C). This provision gives comfort that subsequent distributions will not be subject to the full income tax (with the exception of future growth of the account).

i. The provision, however, does not answer the above question as to the application of the early distribution penalty in the case where the taxpayer actually takes a distribution in order to pay the exit tax.

f. IRS Form 8854 — Expatriation Information Statement — inquires into the existence of specified tax deferred accounts and instructs the taxpayer that "you must include in income the entire account balance on the day before your expatriation date." (at p. 3, Part II, Section C, Line 1c (2019 form)).

3. Deferred Compensation Items

The third income tax is on certain "deferred compensation items."

a. Deferred compensation items include (IRC § 877A(d)(4))

i. A qualified pension, profit-sharing, or stock bonus plan under IRC § 401(a).

ii. A qualified annuity plan under IRC § 403(a).

iii. A government-sponsored plan for its employees (federal, state or local).

iv. A Section 403(b) annuity (a "tax-sheltered annuity" or TSA) offered through nonprofits, governments (state and local), and educational organizations.

v. Simplified employee pensions under IRC § 408(k).

vi. Simple retirement accounts under IRC § 408(p).

vii. A foreign retirement plan (but in this case and in the case of any other deferred compensation item, the tax will not apply to the extent that the services were performed outside the U.S. while the person was not a citizen or resident of the U.S. IRC § 877A(d)(5));

viii. Any item of deferred compensation;

ix. Any property, or right to property, which the person is entitled to receive in connection with services described in IRC § 83 and not previously taken into account under such section.

b. "Eligible" and "Other"

There are two categories of deferred compensation items: "eligible" and "other." The categorization determines whether the tax can be deferred.

i. Eligible Deferred Compensation Items

The classification as "eligible" allows the tax to be deferred and for the tax to be capped at 30 percent.

(1) An eligible deferred compensation item is one where:

(a) The payor is a "United States person" (or a person who elects to be treated as a U.S. person and meets the requirements of the U.S. Treasury Secretary); and

(b) The covered expatriate notifies the payor of his or her status as such and makes an irrevocable waiver of any treaty right to claim a reduction in withholding on such item.

(2) In this case:

(a) The fiduciary or other payor withholds 30 percent of a distribution from the plan to the covered expatriate, to the extent that the distribution would be taxable to the person if such person were a citizen or resident of the U.S. (often the entire amount of the distribution). IRC § 877A(d)(1); and

(b) The covered expatiate pays tax on the distribution under IRC § 871, which is the section that taxes nonresident-noncitizens on U.S.-source dividends, rents and other items at a rate of 30 percent. IRC § 877A(d)(6)(B).

(3) IRS Form 8854 — Expatriation Information Statement — inquires into the existence of eligible deferred compensation items and advises the taxpayer that, by checking "yes", he is making an "irrevocable waiver of any right to claim any reduction in withholding for such eligible deferred compensation under any treaty with the United States" (at p. 3, Part II, Section C, Line 1a (2019 form)).

(4) IRS Form W-8CE is used to advise the plan administrator that the payee is a covered expatriate and is waiving the benefits of any treaty that would provide for a lower withholding rate.

ii. Other Deferred Compensation Items

(1) The categorization as "other" generally produces a tax due currently. These are referred to by the IRS as "ineligible deferred compensation items."

(2) All but one of these items is taxed such that the taxpayer is treated as having received a distribution on the day before expatriation equal to the present value of the accrued benefit. IRC § 877A(d)(2)(A)(i).

(3) The one item treated differently is property that the taxpayer is entitled to receive in connection with the performance of services when such property has not been previously taken into account under IRC § 83. Such an item is treated as becoming fully transferable and not subject to substantial risk of forfeiture on the day before expatriation. IRC § 877A(d)(2)(A)(ii).

(4) No early distribution tax applies by virtue of such treatment. IRC § 877A(d)(2)(B).

(5) Appropriate adjustments are made to subject distributions to reflect such treatment. IRC § 877A(d)(2)(C).

(6) IRS Form 8854 — Expatriation Information Statement — inquires into the existence of ineligible deferred compensation items and instructs the taxpayer to "include in income the present value of your account on the day before your expatriation date" (at p. 3, Part II, Section C, Line 1b (2019 form)).

4. Interests in Nongrantor Trusts

The fourth income tax concerns distributions from a trust which (i) is a nongrantor trust as to the covered expatriate and (ii) includes the covered expatriate as a beneficiary on the day before the expatriation date. IRC § 877A(f). Distributions to the covered expatriate may be direct or indirect.

a. To the extent of the "taxable portion" of the distribution, the expatriate pays tax as a typical nonresident-noncitizen under § 871 (e.g., on dividends, rents), and the trustee is required to withhold 30 percent of the taxable portion of the distribution. IRC § 877A(f)(1)(A) and (4)(A).

i. The "taxable portion" is the part of the distribution that would be includable in the gross income of the covered expatriate if he or she were a citizen or resident of the U.S. IRC § 877A(f)(2)(b). Normal tax accounting rules applicable to trusts should apply in determining the taxable portion (Subchapter J of IRC Subtitle A, Chapter 1).

ii. The expatriate is treated as having waived any right to claim a treaty- based reduction in withholding unless the expatriate agrees to such other treatment as the Secretary determines to be appropriate. IRC § 877A(f)(4).

iii. In the case of a distribution in kind, if the fair market value of the property at the time of distribution exceeds its basis in the hands of the trust, the trust must recognize gain as if the property were sold to the beneficiary at FMV. The taxpayer in this case is the trust. IRC § 877A(f)(1)(B). This is the only component of the exit tax where the taxpayer is not the covered expatriate.

b. A nongrantor trust is a trust or a portion of a trust over which the covered expatriate is not considered the owner under the normal grantor trust rules. IRC § 877(f)(3).

c. IRS Form W-8CE is used to advise the trustee that the beneficiary is a covered expatriate.

d. IRS Form 8854 — Expatriation Information Statement — asks whether the taxpayer has an interest in a nongrantor trust. The taxpayer is advised that checking "yes" operates as "a waiver of any right to claim any reduction in withholding on any distribution from such trust under any treaty with the United States…" (at p. 3, Part II, Section C, Line 1d (2019 form)).

B. Wealth Transfer Taxes — IRC Section 2801

Under the new alternative tax regime, a tax will be imposed on the receipt by a U.S. citizen or resident of testamentary bequests and inter vivos gifts which are made by a covered expatriate, and such tax is imposed regardless of the situs of the transferred assets or when such bequest or gift is made. Such a transfer is referred to in the Internal Revenue Code as a "covered gift or bequest."

With respect to such covered gifts and bequests, a distinction must be made between transfers to individual recipients and transfer in trust.

1. Taxes Imposed on Transfers to Individuals.

a. A testamentary or inter vivos transfer by a covered expatriate to a U.S. citizen or resident is taxed at the highest rate of estate or gift tax imposed under IRC §2001(c) (on estates) or IRC §2502(a) (on gifts), which in either case was 45% for the years 2008 and 2009; 35% for the years 2010 - 2012; and is 40% for 2013 to present. IRC §2801(a).

b. The individual who receives the bequest or gift pays the tax. IRC §2801(b). As such, the U.S. tax code now includes an inheritance tax. To date, such a tax was only known in a few U.S. states, such as Iowa, Kentucky, Maryland, and New Jersey.

2. Taxes Imposed on Transfers in Trust

a. Domestic Trusts

i. If a U.S. "domestic trust" receives a bequest or gift from a covered expatriate, the trust pays the tax. The highest rate of U.S. estate or gift tax applies, as in the case of the tax on individual recipients. IRC § 2801(e)(4)(A).

ii. A "domestic trust" is a trust to which both of the following apply: a U.S. federal or state court is able to exercise primary jurisdiction over the administration of the trust and a U.S. person (generally a U.S. citizen or resident or a U.S. domestic corporation) has the authority to control all substantial trust decisions (presumably as a trustee and without substantial decisions being made by a non-U.S. trust protector or other party). IRC §7701(a)(30)(E).

iii. The transfer tax is imposed on the domestic trust without regard to the citizenship or residency of its beneficiaries.

b. Foreign Trusts

i. If a covered expatriate makes a bequest or gift to a "foreign trust," the tax is imposed on any subsequent trust distribution that is attributable to such bequest or gift and that is made to a U.S. citizen or resident. The tax is payable by the individual recipient. The highest rate of U.S. estate or gift tax applies. If all or a portion of the distribution from the foreign trust is includable in the income of the individual under the principles associated with U.S. income taxation of distributions from foreign trusts, then the individual receives an income tax deduction under IRC § 164 for the transfer tax imposed by §2801 on such part of the distribution that is so includable in income. IRC §§2801(e)(4)(B). (As to income taxability of such distributions, see generally IRC § 6048(c)(2).)

ii. A "foreign trust" is any trust that is outside the jurisdiction of a U.S. court or does not have a U.S. person controlling all substantial decisions. IRC §7701(a)(31)(B).

iii. For purposes of §2801, a foreign trust can elect to be treated as a domestic trust and thus avoid the attribution and informational issues. If such election is made, the trust would then pay the tax as of the time of the receipt of the bequest or gift. Such an election is revocable with the consent of the Treasury Secretary.

3. Deductions and Credits

a. Annual Exclusion Deduction

A deduction equal to the amount of the annual exclusion is available to the recipient, whether the recipient is an individual or presumably a domestic trust or the individual distributee of a foreign trust. IRC §§ 2801(c),(e)(4), 2503(b).

b. Marital Deduction

The value of the gift or bequest does not include any part for which a gift or estate tax marital deduction would be available if the covered expatriate were a U.S. citizen. IRC §2801(e)(3). For the availability of the marital deduction, reference must be made to IRC §2523 as to gifts and §2056 as to bequests.

i. Note that if the individual recipient of the gift or bequest is not a U.S. citizen, the availability of the marital deduction is limited. For gifts, the deduction is limited to a type of super-sized annual exclusion equaling approximately ten times the typical IRC §2503(b) exclusion. IRC §2523(i). For 2021, this jumbo exclusion is $159,000. Rev. Proc. 2020-45. For testamentary bequests, the deduction would not be available unless made through a Qualified Domestic Trust (QDOT), or the recipient irrevocably transfers the gift or bequest to a QDOT trust before the due date of the inheritance tax return on IRS Form 708. IRC §2056(d). In such instance, the tax would merely be delayed until distribution of principal from the QDOT Trust or upon termination of the trust. IRC §2056A.

ii. If the recipient of the gift or bequest is the taxpayer—domestic trust, then the availability of the deduction would presumably turn on the identity of the beneficiaries. If the sole beneficiary or at least the life beneficiary were the transferor's spouse and a U.S. citizen, then one of the marital deductions may be available to the trust (IRC §2523 as to gifts or §2056 as to

bequests). If the sole or sole life beneficiary were the transferor's spouse but not a U.S. citizen, then there would be no gift tax marital deduction (for lack of a present interest under the super-sized annual exclusion under IRC §2503(b) and §2523(i)) and the availability of the estate-tax marital deduction would be limited to QDOT trusts under IRC §2056(d).

iii. If the recipient of the gift or bequest is a foreign trust, then the wealth transfer tax is imposed on a distribution to a U.S. citizen or resident, and the tax is paid by the recipient. If the recipient were the spouse of the covered expatriate, then a U.S. citizen spouse should enjoy the marital deduction. If the recipient spouse is not a U.S. citizen, then it is not clear what type of marital deduction would be available, whether a gift tax deduction (limited to the jumbo annual exclusion) or the marital deduction (available only if the distribution were made or assigned to further trust meeting the requirements of QDOT).

c. Charitable Deduction

The statute also provides for a charitable deduction under IRC §2522 (as to gifts) or §2055 (as to bequests), but presumably this deduction would only be available to a recipient domestic trust that qualifies as a charitable trust under normal rules. IRC §2801(e)(3).

d. Credit for Foreign Gift or Estate Tax

To the extent that a foreign country imposes a gift or estate tax on the transfer, the foreign tax serves as a credit against the U.S. transfer tax. IRC §2801(d).

4. Exceptions for Transfers Otherwise Subject to U.S. Estate or Gift Tax

A gift or bequest from a covered expatriate will not be subject to the transfer tax if the transfer is otherwise subject to U.S. gift or estate tax and is reported to the IRS on a timely-filed gift or estate tax return. IRC §2801(e)(2). Two possible scenarios could give rise to this exception:

a. As a nonresident-noncitizen of the U.S., the covered expatriate makes a gift of U.S.-sited real or tangible personal property or dies owning any of such property or any other property subject to the nonresident-noncitizen estate tax (such as shares of U.S. corporations or a U.S. receivable).

b. The covered expatriate later becomes a resident of the U.S. for estate and gift tax purposes and, as a result, is subject to full estate and gift taxation as a resident. IRC §§ 2001(a), 2501(a)(2). Residency for U.S. transfer tax purposes is defined in Treas. Reg. §§ 20.0-1(b), 25.2501-1(b), and 26.2663- 2(a). For these purposes, residency is defined in a manner that equates to domicile under the Anglo-American common law concept. Thus, a person becomes a domiciliary in a place by living there, even if for a brief period, with no present intention of leaving there, and a later intention to change domicile will not be effective unless the person actually leaves. The definition differs substantially from the income tax tests of residency under IRC §7701(b).

5. The transfer taxes imposed by IRC § 2801 will be reported on IRS Form 708

U.S. Return of Tax for Gifts and Bequests Received From Expatriates. The covered gift or bequest may also need to be reported on IRS Form 3520 — Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts.

C. Expatriation Date

The "expatriation date" is crucial because it serves as a means of establishing the valuation date under which most of the income taxes are addressed. For example, the mark-to-market gains tax, the tax on

specified tax deferred accounts, and the tax on ineligible deferred compensation items are based on values as of the day before the expatriation date. The expatriation date further serves as the date after which any gift or bequest to a U.S. citizen or resident or to certain trusts triggers the transfer tax under IRC § 2801.

1. Relinquishment of U.S. Citizenship

The expatriation date of a citizen is the earliest of (IRC §877A(g)(4)):

a. The date the individual renounces U.S. nationality before a diplomatic or consular officer, and the U.S. Department of State subsequently confirms the renunciation by using a certificate of loss of nationality.

b. The date the individual files a signed statement of voluntary relinquishment of U.S. nationality with the U.S. Department of State, and the Department subsequently confirms the relinquishment by issuing a certificate of loss of nationality.

c. If the Department of State issues a certificate of loss of nationality without the process having been voluntarily initiated by the individual pursuant to a. or b. above, then on the date of issuance of the certificate.

d. The date a U.S. court cancels the certificate of naturalization of a naturalized citizen.

2. Cessation of Long-Term Residency

A long-term resident ceases to be such upon the happening of any of the following events (IRC §§877A(g)(3)(B), 7701(b)(6)):

a. The filing with U.S. Citizenship and Immigration Services (USCIS) (formerly the Immigration and Naturalization Service) or a U.S. consular officer of an application for abandonment of lawful permanent residence status (USCIS Form I-407) or of a letter stating intent to abandon with the individual's Permanent Resident Card ("Green Card") enclosed. The filing date is the expatriation date. Treas. Reg. §301.7701(b)-1(b)(3). Accord, Gerd Topsnik v. Commissioner, 146 T.C. No. 1 (1/20/2016). The issuance of a final administrative order of abandonment, if the USCIS or a consular officer initiates a determination of abandonment. If a U.S. federal court grants an appeal of the final administrative order, then upon a final judicial order of abandonment. The date of the final administrative or final judicial order is the expatriation date. Treas. Reg. §301.7701(b)-1(b)(3).

b. The issuance of a final administrative order or final judicial order of exclusion or deportation. Treas. Reg. §301.7701(b)-1(b)(2).

c. 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, does not waive the benefits of such treaty applicable to residents of the foreign country, and notifies the [U.S. Treasury] Secretary of the commencement of such treatment." IRC §7701(b)(6) — flush language. See also Notice 2009-85, Section 2.A. This will be referred to as the Tax Treaty Event.

   i. The Tax Treaty Event is an attempt to sync the expatriation rules with existing bilateral income tax treaties. The U.S. has income tax treaties with over sixty countries. *See* IRS Publication 901. The Regulations under IRC §7701(b)(6) refer to a "dual resident taxpayer," i.e., an individual who is considered to be a U.S. resident for income tax purposes under federal tax law and is considered to be a resident of the treaty country pursuant to that country's internal law. These long- standing Regulations were issued for purely income tax reasons to solve the problem

of the individual who is a resident of two countries for income tax purposes and seeks relief from taxation by the U.S. under a treaty. The Regulations provide a mechanism for electing into treaty benefits when the individual can validly claim that, under the tie- breaking scheme for settling residency under the treaty, he or she is a treaty resident of the other country for any tax year or portion of a tax year. For that year or portion of that year, the person is free to calculate U.S. income tax liability as a nonresident alien (which generally limits U.S. taxation to U.S.-source income) and as permitted under the treaty (which typically provides for a reduced rate of taxation on U.S.-source income). Treas. Reg. § 301.7701(b)-7(a).

(1) For example, under the internal law of France, an individual will be deemed to be a tax resident of France if one of three criteria is met (Article 4.B of the French Tax Code):

(a) The person maintains his or her home (understood as the place where the person, spouse, and children normally live) or the person maintains his or her principal place of residence in France.

(b) The person has his or her professional activity in France.

(c) The person has the center of his or her economic interests in France.

Any one of these suffices. No definite number of days of presence in France is required under any of them.

(2) In order to determine residency for treaty purposes, the U.S.- France Income Tax Treaty uses a tie-breaking scheme to determine residency for treaty purposes. When, under the internal law of each country the individual is considered a resident of each, the treaty looks first to where the person has a permanent home available. If the person has a permanent home available in each country or in neither, he or she is deemed to be a resident in the country "with which his or her personal and economic relations are closer (center of vital interest)." U.S.-France Income Tax Treaty, Article 4, Paragraph 3.a. This is a typical tie-breaking mechanism under treaties. See, e.g., U.S.-Austria Income Tax Treaty, Article 4, Paragraph 2. U.S.-Germany Income Tax Treaty, Article 4, Paragraph 2.a.

ii. This mechanism for electing into treaty benefits was picked up by the former alternative tax regime as establishing the expatriation date, which is important for purposes of marking the ten-year period of enhanced U.S. income taxation under the old regime.

iii. Similarly, the new alternative tax regime uses this same mechanism for determining the expatriation date for all purposes under the Expatriation Tax. For example, the day before the expatriation date is used as the date for valuing assets under the mark-to-market tax scheme.

iv. For purposes of the Expatriation Tax, the election by a dual-resident, U.S. permanent resident taxpayer into treaty benefits serves as an act of expatriation (the Tax Treaty Event) if the person meets the definition of a covered expatriate. Determining the exact date of the Tax Treaty Event, however, is difficult, and the IRS has not issued any definitive guidance.

v. The Regulations under IRC § 7701(b)(6) further provide the mechanism for telling the IRS that the dual-resident taxpayer has elected treaty benefits. The taxpayer is instructed to file a U.S. Nonresident Alien Income Tax Return (Form 1040NR) and attach a Treaty-Based Return Position Disclosure Under Section 6114 or 7702(b) (Form 8833). Treas. Reg. § 301.7701(b)-7(b) & (c).

vi. The Regulations under IRC § 7701(b)(6), however, do not help the taxpayer zero in on the exact date of "expatriation," which is not surprising since they were not originally issued in that context.

vii. On IRS Form 8854 — Initial and Annual Expatriation Statement (2019), there is a blank space where the "long-term resident with dual residency in a treaty country" enters his or her expatriation date. The form reads as follows: "Date commencing to be treated, for tax purposes, as a resident of the treaty country ." (At p. 1, General Information, Line 5) In discussing the proper date to be provided, the Instructions refer the preparer to the "Date of termination of long-term residency" at pages 1-2. At numbered paragraph 4 on page 2, the Instructions provide as follows:

"If you were a dual resident of the United States and a country with which the United States has an income tax treaty, the date you commenced to be treated as a resident of that country and you determined that, for purposes of the treaty, you are a resident of the treaty country and gave notice to the Secretary of such treatment on a Form 8833 attached to a timely filed income tax return. See Regulations section 301.7701(b)-7 for information on other filing requirements if you are such an individual."

Form 8833 — Treaty-Based Return Position Disclosure — is required to be attached to any IRS form on which the taxpayer is claiming treaty relief.

viii. These instructions are picking up on the statutory definition of cessation of long-term residency, which provides that "An individual shall cease to be treated as a lawful permanent resident [Green Card holder] of the United States if such 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." IRC § 7701(b)(6). This commencement date under the treaty will mark the expatriation date. In general, it seems that if there is a date on which the taxpayer, having affirmatively left the U.S., with spouse and children or other significant persons, arrived in a treaty country and began making a home there, such date will likely be the relevant date for Expatriation Tax purposes. Perhaps the IRS will provide guidance in this area.

ix. It is possible and indeed likely that some long-term Green Card holders will land in a treaty country and, without knowledge of Expatriation Tax, simply file a U.S. nonresident income tax return (Form 1040NR) and claim treaty benefits so as to avoid double taxation. This will result in an inadvertent act of expatriation. In addition to the exit tax, the taxpayer's failure to file Form 8854, even if inadvertent, would trigger a penalty of $10,000. IRC § 6039G(c). Beginning with the version of Form 8833 issued in December 2012, the Service provides this warning in the form:

> **Note.** If the taxpayer is a dual-resident taxpayer and a long-term resident, by electing to be treated as a resident of a foreign country for purposes of claiming benefits under an applicable income tax treaty, the taxpayer will be deemed to have expatriated pursuant to section 877A.

x. If the Green Card holder is aware of the consequences of filing Form 1040NR and claiming treaty benefits, he or she may opt to file the normal income tax return for a U.S. resident, the Form 1040, and not claim treaty benefits. By not claiming treaty benefits, he or she will likely be subject to double taxation on various items of income. As partial relief, the foreign tax credit would be available. IRC §§27, 901- 908. The credit provisions, however, are designed to preserve full taxation of U.S.-source income. IRC §904. As a result, if the Green Card holder

resides in a country that taxes the worldwide income of its residents, he or she will incur double taxation on U.S.-source income, unless the domestic law of that country gives relief.

xi. The problem faced by the Green Card holder who takes up residence in a treaty country applies only if the individual meets the definition of "long-term resident" under the 8 of 15 Rule of IRC §877(e)(2) (See I.B.1. above). If the Green Card holder has not been a lawful permanent resident during eight out of the previous 15 years, then the individual's election of treaty benefits serves merely to toll the number of years counting toward the eight required years for long-term resident status. As a result, a Green Card holder who has held his card during seven or fewer years can take up residence in a treaty country and not fear the exit tax.

IV. SPECIAL ISSUES WITH RESPECT TO THE EXIT TAX

A. Determining Net Worth when Trusts are Involved

One of the three tests that a taxpayer must meet before considered a covered expatriate is that the taxpayer must have a net worth of $2,000,000 or more. Special issues arise where the taxpayer has transferred assets to a trust or where he is the beneficiary of a trust. In either case, IRS Notice 97-19 provides guidance. This Notice was issued under the old alternative tax regime, but its analysis for determining net worth was picked up in the Notice issued under the new regime, which is Notice 2009-85 (see Section 2.B.).

1. Taxpayer as Transferor/Donor/Settlor

Where the taxpayer has transferred assets to a trust and that transfer was a completed gift for U.S. Gift Tax purposes, those assets will not be included in the taxpayer's net worth. Notice 97-19 provides:

> DETERMINATION OF NET WORTH. For purposes of the net worth test, an individual is considered to own any interest in property that would be taxable as a gift under Chapter 12 of Subtitle B of the Code if the individual were a citizen or resident of the United States who transferred the interest immediately prior to expatriation. For this purpose, the determination of whether a transfer by gift would be taxable under Chapter 12 of Subtitle B of the Code must be determined without regard to sections 2503(b) through (g), 2513, 2522, 2523, and 2524.

Assets which a taxpayer has previously transferred away as a completed gift would not be eligible for transfer immediately prior to expatriation.

On Form 8854 — Initial and Annual Expatriation Statement (2019), net worth is computed at Part II, Section B (Balance Sheet). Line 9 requires a stated value "Assets held in trust. See Instructions." The Instructions in turn quote the same language from Notice 97-19 set forth above.

2. Taxpayer as a Beneficiary of a Trust

Although property held in an irrevocable trust is not titled in the name of any beneficiary, the IRS attempts to include a beneficiary's interest in the trust itself as property for net worth purposes. Notice 97-19 takes a two-step approach to valuing a beneficial trust interest.

The first step attempts to allocate the value of the trust estate to beneficiaries "based on all relevant facts and circumstances." These include "…the terms of the trust instrument, letter of wishes (and any similar document), historical patterns of trust distributions, and any functions performed by a trust protector or similar advisor."

Under this approach, the IRS would look first to the terms of the trust. For example, if the potential covered expatriate has a traditional lifetime income interest, the interest could be valued under established principles, and such value would be added to net worth. In the absence of an interest that is ascertainable from the trust's terms, the facts and circumstances approach gives the IRS the opportunity to look back over the life of a trust to determine how the potential covered expatriate has already benefited from it.

The second step is objective. If the facts and circumstances do not indicate how the trust estate is to be allocated among the various beneficiaries, the IRS looks to an allocation based on the Uniform Probate Code (UPC). The UPC provides a mechanism for dividing a decedent's property among his heirs where he dies without leaving a Will (known in law as an "intestacy"). In applying UPC principles to a trust, the IRS assumes that the settlor of the trust had died intestate and that the terms of the trust do not govern disposition. As an example, if the settlor's estate under the UPC would be divided evenly between two children, and if one of the children is the potential covered expatriate, such child's one-half intestate interest is transposed as his ultimate interest in the assets of the trust in question. As such, one-half of the value of the trust estate would be includible in net worth.

On Form 8854 — Initial and Annual Expatriation Statement (2019), Section B (Balance Sheet), Line 10 requires a stated value for "Beneficial interests in trusts not included in Line 9. See Instructions." The Instructions in turn direct the preparer to "the two-step process described in Section III of Notice 97-19."

It is unlikely that the Service's attempt to value beneficial interests in purely discretionary trusts will hold up if tested. Under such a trust arrangement, a beneficiary holds nothing more than a mere expectancy under property law, which is neither a present nor a future interest. It is very difficult if not impossible to value such an interest. The Service's arbitrary substitution of a UPC intestacy method for assigning a value is untenable. This approach assumes a property division that will likely never happen under the terms of the trust.

Furthermore, if the taxpayer has established a self-settled asset protection trust under foreign or domestic law and has remained as a purely discretionary beneficiary, the guidance produces an odd but favorable result. Following the logic of the guidance, if the taxpayer as settlor is deemed to have passed away, then he would receive nothing under the UPC's intestacy rules. Thus, his beneficial interest in the trust would be zero, assuming that the facts and circumstances case would not indicate value (such as if there were a pattern of distributions back to the settlor). See M. J. Stegman and J. L. Campbell, "Confronting the New Expatriation Tax: Advice for the U.S. Green Card Holder" (Journal of the American College of Trust & Estate Counsel, Vol. 35, No. 3, Winter 2009).

B. Determining Assets includible in the Mark-to-Market Tax Base when a Trust is Involved

A distinct issue from whether trust assets are includible in the taxpayer's net worth is whether they are includible in a covered expatriate's tax base for purposes of the mark-to-market exit tax.

1. Covered Expatriate as Transferor/Donor/Settlor

According to IRS guidance, if the covered expatriate has settled a trust, then the assets of the trust will be includible in the mark-to-market tax base under IRC Section 877A(a)(1) if the assets of the trust would otherwise be includible in the taxpayer's gross estate for federal estate tax purposes as if the covered expatriate had died on the day before the expiration date and, if so, at values that would be applicable under Chapter 11 of the Code. Notice 2009-85 provides this guidance (at Section 3A.):

For purposes of the mark-to-market regime, the covered expatriate is deemed to have sold any interest in property that he or she is considered to own under the rules of this paragraph other than property described in section 877A(c) [dealing primarily with assets such as qualified and nonqualified retirement assets]. For purposes of computing the tax liability under the mark-to-market regime, a covered expatriate is considered to own any interest in property that would be taxable as part of his or her gross estate for Federal estate tax purposes under Chapter 11 of Subtitle B of the Code as if he or she had died on the day before the expatriation date as a citizen or resident of the United States. Whether property would constitute part of the gross estate will be determined without regard to sections 2010 through 2016 [dealing, for example, with the applicable exclusion amount].

2. Covered Expatriate as a Beneficiary of a Trust

Subject to the exception for nongrantor trusts explained next below, if the covered expatriate is a beneficiary of a trust which would not otherwise includible in his gross estate, then his beneficial interest in the trust must be determined. Once determined, it seems that a proportional part of the assets associated with that interest would have to be included in the mark-to-market tax base (although the guidance does not explicitly so state). In order to determine the taxable beneficial interest, Notice 2009-85 directs us to the same scheme (with the same faults) for making such determinations as is contained in Notice 97-19.

3. Special Rule for Nongrantor Trusts

If, however, the beneficial trust interest is in a trust that is nongrantor as to the covered expatriate, then the mark-to-market tax does not apply. Instead, the special taxation scheme for taxing distributions from this trust to the covered expatriate applies (IRC Sec. 877A(c)(3) and (f)).

It would seem that this exception swallows the rule (the rule set forth in paragraph 2 immediately preceding), but there is a scenario in which the mark-to-market scheme and not the exception would apply. If the covered expatriate created a self-settled asset protection trust that constituted a completed gift and would not be includible in his estate at death, and that trust were a grantor trust as to the covered expatriate, then the special rule for nongrantor trusts would not apply, because on the day before the expatriation date, the trust was a grantor trust. Furthermore, to determine what part of the trust estate would be includible in the mark-to-market tax base, Notice 2009-85 directs the covered expatriate to the analysis for determining the covered expatriate's beneficial interest in the trust under Notice 97-19. If this trust were purely discretionary as to the covered expatriate as a beneficiary, then there could be no value attributable to the beneficiary (as discussed above under the net worth analysis). In this regard, it is important to note that the determination of grantor trust status is made as of the day before expatriation (IRC Sec. 877A(f)(3)). So, if the trust becomes nongrantor on the day of expatriation (because a trust cannot generally have a foreign owner under IRC Sec. 671), then the change of status as of expatriation would have no effect for purposes of the applicability of the tax on distributions from nongrantor trusts.

V. EFFECT OF BILATERAL TREATIES

The U.S. internal revenue laws are generally subject to the bilateral treaties between the U.S. and various countries. The treaties affecting taxation are of two primary types, income tax treaties and estate/gift tax treaties.

A. Income Tax Treaties

The effect of the numerous income tax treaties is beyond the scope of this presentation. In general, however, it is thought that the treaties will not provide significant relief to the covered expatriate who takes up residency in a treaty-partner country, at least with respect to the immediate taxes imposed by IRC § 877A, i.e. the mark-to-market exit tax, the tax on specified tax-deferred accounts, and the tax on ineligible deferred compensation items. In these cases, the tax is calculated as if assets were sold or accounts distributed as of the day before the expatriation date. Because the expatriation date is likely to be the date of establishing residency in the foreign country for treaty purposes and the taxpayer must cut short his U.S. resident tax year at that point, the treaty would probably not provide relief.

B. Estate/Gift Tax Treaties

The various estate/gift tax treaties, which are currently in force with sixteen countries, concern taxes on gratuitous transfers. Many treaties deal with only testamentary transfers (bequests); one concerns only inter vivos transfers (gifts), and the more modern ones treat both estate and gift taxes. With respect to the treaties that cover testamentary gratuitous transfers, it is irrelevant whether the tax is denominated as estate or inheritance. Both are subject to the treaty.

The keystone of each treaty is a mechanism for determining which of the two countries has sole or primary taxing right with respect to the transfer. This determination turns on either the situs of the transferred property or the “fiscal domicile” of the transferor. Fiscal domicile under a treaty must be distinguished from domestic law definitions of domicile or residency. Although the treaties first look to the domicile or residency of the taxpayer under the internal law of each country, the treaties provide a tie-breaking mechanism in the event the laws of both counties would treat the person as domiciled there. The tie-breaking rules can differ by treaty, and they are beyond the scope of this presentation.

If the treaty assigns sole taxing rights to one country, the other loses its right to tax the transfer under its internal laws. In the case where one country has primary taxing rights and the other secondary rights, the treaty requires the other country to give a substantial credit against the taxes it would otherwise impose.

Under the transfer tax regime set forth in IRC § 2801, the U.S. always gives a credit for the tax imposed by a foreign country on a transfer from a covered expatriate, but a treaty might cause the U.S. to give a substantial credit against its own tax even when no foreign tax is actually due (owing, for example, to an exemption under the internal law of the treaty country).

When the various bilateral transfer tax treaties play into the analysis of the taxation of a gratuitous transfer, it is difficult to speak in generalities. The analysis is treaty- specific, and the particular treaty involved must be consulted. The following will serve as examples of the possible effect of certain treaties on fact situations where the U.S. would impose the tax under IRC § 2801 on a transfer from a covered expatriate to a U.S. citizen or resident.

1. **Example:** A covered expatriate dies as a fiscal domiciliary of the United Kingdom and leaves a cash bequest of 250,000 to his U.S.-resident daughter. The U.K. does not impose its transfer tax because the overall chargeable estate under its domestic law is within the nil rate band of 325,000. The U.S. would normally tax the transfer under IRC § 2801 and, because there is no foreign transfer tax applicable to the transaction, would not give a foreign tax credit under IRC § 2801(d). Under the U.S.-U.K Estate and Gift Tax Treaty, however, the U.K. has exclusive taxing jurisdiction (with exceptions that do not apply here), and the U.S. is precluded from taxing the bequest. Article 5, Paragraph 1.a.

2. **Example:** A covered expatriate becomes a fiscal domiciliary of Germany and, at a time which is more than ten years after her expatriation date, makes a gift to her U.S.-citizen son of various marketable securities comprised of shares in various German and U.S. corporations. The value of the securities is €300,000. Germany does not tax the transfer because its value, taking into account other gifts made to the son within the previous ten years, does not exceed the German inheritance tax exemption of €400,000 applicable to transfers to a child within such period. (The €400,000 exemption came into effect 1 January 2009. § 16 ErbStG) Under the U.S.-Germany Estate and Gift Tax Treaty, the U.S. is precluded from taxing a transfer of this property. Article 9.

    a. If the gift had occurred within ten years after the expatriation date, the U.S. would have been permitted to impose tax on the total value of the property. The U.S.-German Treaty, like some other treaties, contains a savings clause that preserves the right of the U.S. to tax former citizens and long-term residents whose loss of such status had tax avoidance as one of its principal purposes, but only for a period of ten years. Article 11, Paragraph 1.a.iii. In negotiating treaties of this type, the U.S. authorities had in mind the then- current alternative tax regime, which continued to impose a grossed-up nonresident-noncitizen estate and gift tax on such persons for a period of ten years only (See I.B & C above). The new alternative tax regime, with its new transfer tax under IRC § 2801, does not contain a time limit on such transfers. Nonetheless, certain existing treaties will only permit continued taxation for a period of 10 years.

In considering the foregoing examples, however, one must take into account whether the U.S. Congress intended to override the various treaties in enacting IRC § 2801. In this case, the tax would apply regardless of the treaties.