

**A New Context For Expatriation**  
**Plus: Newman's Own Estate**

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Expatriation to save estate tax in another country wouldn't make sense if estate tax was on the verge of being repealed here in another year, i.e., by 2010, especially under the burdensome expatriation rules that previously applied.

Both of those premises have changed—reversed in fact. The United States appears certain to retain its estate tax and now has a new approach to expatriation.

***Thinking The Unthinkable***

For those Americans with business or personal ties to another nation, any tax or financial benefits from moving out of the United States has to be factored into any long-term residency or citizenship plans. By and large, most Americans love the United States too much to move abroad or even consider expatriation seriously. Not even for a second.

But maybe for a nano-second, while signing a check to the IRS perhaps, or when calculating estate tax consequences, a thought steals into one's mind: "Would my family be better off if I were to become a citizen elsewhere?"

Clearly, most people will not benefit from expatriation for tax purposes. But surely this warrants at least some academic inquiry because the rare person who might benefit needs to know, and the rest of us need to satisfy our curiosity.

Let us therefore take a fresh look at what rules and requirements apply to a change in citizenship? What nations have favorable tax rates? And specifically, given the location, lifestyle and language factors, how would expatriation to our northern neighbor Canada work out?

***The Surreal Repeal***

When Congress repealed the estate tax in 2001, the estate tax was not actually repealed immediately. It was going to phase out over time.

First of all, "repeal" is such a strong term. What they really meant to say was, "have a period of increasing exemption levels over 8 to 10 years, keep everybody guessing, and then retain the estate tax at the last minute during 2009."

Secondly, Congress doesn't do simple repeals. That is so state legislature. Creative draftsmen at the federal level produced a repeal that arrives after 8 years in 2010, but then reverts back to 2001 estate tax levels in 2011. Like a ten-year experiment with a reset button in case things didn't work out.

Although the estate tax repeal was immediately declared dead on arrival by many leading estate planning professionals, considerable time has passed since 2001 and still we remain on course, marching toward the estate tax repeal. However, Congress has lacked sufficient votes to make the repeal permanent and that possibility has now encountered another shift in the political balance of power. This shift is definitely not in the direction of estate tax repeal.

### ***Obama and Estate Tax***

The estate tax exemption is currently scheduled to rise from \$2 million to \$3.5 million in 2009. This appears to be the last significant increase in the estate tax exemption for the foreseeable future with Democrats taking a larger majority in Congress and with the election of Barack Obama as president.

As a presidential candidate, Mr. Obama indicated a preference for a top estate tax rate of 45% and an exemption of \$3.5 million, i.e., exactly where we will be at the start of 2009, just a few weeks from when this is written.

There will presumably be some clarifications such as the future use of cost of living adjustments to the exemption, the retention of the stepped up basis for assets owned at death.

Other changes associated with estate tax repeal such as the separate gift tax and the end of the state death tax credit remain open questions. If the estate tax isn't going to be repealed, then a unified estate and gift tax system and a state death tax credit are both possibilities in the future.

Additional changes favored by Mr. Obama include an increase in the maximum tax rate on capital gains and dividends to 20% for persons making over \$200,000 (\$250,000 for families). He would also favor broker information reporting for basis of gains. The 20% rate represents an increase from the current 15% rate but coincides with the lowest rates applied during the 1990s and other past periods.

### ***New Expatriation Rules***

The United States is one of the only nations to tax its citizens on income earned anywhere on earth, regardless of where they have moved. Congress has repeatedly tried to close tax loopholes on expatriates. In 1995, Congress used IRC Section 877.

Under the old expatriation rules, an American taxpayer who renounced citizenship for the principal purpose of tax avoidance would still be subject to a ten-year regime of income taxation and the estate of an individual who so renounced would

similarly fall under a ten-year estate tax regime. “Look through” rules applied to estates with assets located in the United States which were owned by foreign corporations controlled by the expatriate.

The ten years would commence running upon providing notice to the IRS using Form 8854 and the rules were generally applicable to taxpayers with net worth in excess of \$2 million or a five-year average income tax liability of \$136,000 (in 2007 and as adjusted for inflation thereafter). And taxes would apply if the expatriate spent more than 30 days on U.S. soil in the same calendar year.

Under the new Heroes Earnings Assistance and Relief Act, there is a new approach to taxation of expatriates. Effective for citizens who expatriate after June 16, 2008, Section 877A now imposes an “exit tax” on “covered expatriates” who have a net worth in excess of \$2 million or an average annual income tax liability in excess of \$139,000 over the five years preceding expatriation.

Such expatriates will be deemed to have sold all their assets, with an exemption of \$600,000. Covered expatriates with an interest in non-grantor trusts will be subject to special 30% withholding and any direct or indirect gift or bequest to a U.S. person by an expatriate will be taxed at the highest applicable rate under new section 1208.

Applying the new rules to various circumstances may affect the ultimate conclusions. Instead of a ten-year process of expatriation, there is, essentially, a one-time exit fee. The timing of that exit fee may be especially relevant to someone who anticipates future wealth either through inheritance, business, career, etc. There are also exceptions in the new law for under age minors and taxpayers with dual citizenships.

### ***Where In The World?***

Taxpayers may wonder if the grass is greener, the sky bluer, and the taxes less burdensome in a more accommodating locale. Where can an American taxpayer find a viable place to expatriate? What would the savings be?

A few places on earth can be ruled out right away. Intemperate climates, hot-headed dictators, wars and/or terrorists, places where the natives a) don't speak English and/or b) don't have much use for Americans (other than as an entrée). There are places with too many bugs and not enough to do. Many otherwise suitable locations are simply too far away and subject to too many unknowns.

### ***Oh, Canada!***

What about Canada? It's closer to portions of the United States than some far away tax havens making visits feasible. Most Canadians appear to speak English, albeit with amusing accent. There does not appear to be much prospect of war, diseases or bugs in Canada. And Canada produces several fine beers and ales: Molson, Labatt, and Moosehead.

With this positive foundation, let us then consider the financial impacts of a Canadian estate. Would an estate grow more in Canada? Would one's dollar go farther? Would assets be conserved or grow faster? And then the ultimate estate planning question: Would an estate escape more transfer taxes for an American becoming a citizen of Canada?

### ***Canadian Income Taxation***

At first blush, Canada's top income tax rate of 29% and lack of an inheritance or estate tax is rather encouraging. However, upon closer inspection, there are hidden costs of Canadian citizenship.

Canada has both federal and provincial (regional) income taxes. The top federal income tax rate in Canada presently is 29% and applies to taxable income over \$123,184 (Canadian). But Canada has 13 provinces with various taxes. The highest provincial tax rate is in New Brunswick with a 17.95% rate on income over \$113,273. When combined with the federal rate, the effective top rate is 46.95%.

### ***Canadian Estates***

Although there is no estate or inheritance tax per se, that is very deceptive. Inheritances are treated as disposals of property that trigger capital gains...which in turn are included in taxable income after a 50% deduction. So if half of an inheritance were taxed at an effective top rate of 46.95%, that would be comparable to an inheritance tax of 23.48%. Note, however, that recipients can choose to roll over the cost basis and defer the capital gain on the inheritance of farm machinery, farm land, or spousal transfers.

There are other taxes as well. Capital gains are provided a 50% deduction with the balance included in taxable income. And local governments utilize property taxes to generate revenues.

### ***Canadian Currency***

Another concern: The currency exchange rate has fluctuated over the past nine months, with the Canadian dollar being worth \$.95 to the American dollar in November, 2007, rising to about \$1.05 by September 2008, spiking upward to \$1.30 during the financial meltdowns of October, 2008 before heading downward to \$1.18 at the time this newsletter is prepared.

That can be a significant consideration if funds converted could lose so much of their value in such a short time. A conversion at the wrong time could have the same effect as an extra tax event.

## CELEBRITY ESTATES

### *The Legacy of Paul Newman*

The recent passing of Paul Newman provides an opportunity to observe a life well lived. He was so much more than a great actor. He was a businessman who made great philanthropic gestures. But it was his acting career that established his celebrity status that made his company, Newman's Own, possible.

Newman was nominated for ten Oscars and won in 1987 for *The Color of Money* (1986). He was also awarded honorary Oscars in 1986 for the body of his acting work and again in 1994 for his charity work. He was best known for *Cool Hand Luke*, *Hud*, *The Hustler*, *Butch Cassidy and the Sundance Kid*, *The Sting*, and *The Verdict*.

After losing his son in 1978, Newman turned to a variety of pursuits. He loved auto racing and co-owned a racing company since 1982.

But by far the most impressive accomplishment was the company he founded along with writer A.E. Hotchner. It began as something of a joke. Newman's Own was built from the ground up and became a great success...and all profits have gone to charities.

Newman's Own has produced a few quality products such as tomato sauce, popcorn, or salad dressing and indicated that all profits would go to charity. The products caught on, the product line gradually expanded to include a half dozen items, then more. And the revenues poured in. There were sufficient revenues to do something extraordinary, and Newman did. He started The Hole in the Wall Gang Camps, an organization for terminally ill children.

“Paul occasionally referred to Newman's Own as the “joke that got out of control” and would express astonishment at its success. Despite this humorous approach, Paul was committed to the company's business and to providing top-notch quality – he brought all-natural food products to a wide audience long before it was fashionable. And he was one of the greatest recyclers, giving back to charity all the money he earned from the sale of Newman's Own products.” –*From Newman's Own website's tribute to its founder.*

“What many may not know is that he donated 100% of post-tax profits and royalties from the Newman's Own company to charities world-wide — more than \$250 million to date. He was also passionate about the Hole in the Wall Camps he helped found for children with life-threatening illnesses, and he was deeply involved with a variety of other innovative nonprofit organizations including his most recent undertaking, the Safe Water Network.” —*Wall Street Journal “What CEOs can learn from Paul Newman, by John Whitehead and Peter Malkin, October 2, 2008.*

Paul Newman used his celebrity and skills to generate vast revenues for public benefit. He wanted his charitable work to continue after his death. So far, Hollywood

turned out in force to support a fundraiser for the Hole In The Wall camps which serve 13,000 children annually.

Interestingly enough, Newman's Own was not set up as a not-for-profit organization under 501(c)(3). Rather, it is a for-profit corporation that chooses to make charitable donations of all of its profits. An educated guess as to why: A for-profit entity can be more flexible in its corporate pay, how it decides what to reinvest in the company and what gets donated, and perhaps retains a more competitive edge.

Paul Newman's children and grandchildren will be taking over the business. Although the image of Paul Newman is a key to the current product line, it will be up to his family to keep his philanthropic efforts alive.