Coming and going II: focus on going – exit strategies for the private client. Is getting up and going a good solution?

A joint session of the Family Law Committee and the Individual Tax and Private Client Committee

Tuesday 5 October 2010
10:00 – 13:00

INTERNATIONAL BAR ASSOCIATION
the global voice of the legal profession

Tax Law

If the client were to sell all of his assets prior to moving, would he pay income/capital gains tax on their appreciation in value? What about losses?

Canada	Generally, yes. Losses (except personal losses) could be deducted, provided the sales were to unaffiliated persons. Certain gains would be exempt (e.g. principal residence).
USA	Generally, yes. U.S. Citizens and Residents taxable on worldwide basis, subject to foreign tax credits. Some exclusions and rate preferences apply. Personal losses not deductible.
India	Yes, Indian residents are subject to tax on gains regarding capital assets. Rate depends upon type of asset and period of holding. Capital losses are deductible against capital gains only.
UK	UK resident domiciliary: subject to income tax and CGT on worldwide income and gains, but exemption from CGT on main residential property and entrepreneur's relief (10% CGT) for the first GBP 5m of gains realised.
Germany	Business assets: yes, losses deductible; private assets: yes, depending on duration of ownership, losses deductible only against similar capital gains; sale of residential home: no.

How do you get out of your jurisdiction's tax net ("exit"), by moving residency or by surrendering citizenship? How do you actually do this?

Canada	Liability to Canadian income tax is based on residence. Citizenship is generally not relevant. Residence is a question of fact, to be determined having regard to all relevant factors.
USA	Depends. Citizens must give up citizenship. Residents must cease to be residents. File appropriate forms.
India	Citizenship is not a consideration; an individual can move out of India's tax net by moving residency, i.e. spending less than 182 days in India.
UK	Become non-UK resident (to avoid income tax and CGT), i.e. move and sever ties to UK or work full time abroad; lose UK domicile status (to avoid IHT)
Germany	Income tax: residency decisive; personal and economic ties must essentially be severed; inheritance tax: 5 years' tax liability for German citizens after termination of residency.

If the client were to exit to France, would your jurisdiction lose its taxing right (income / capital gains / inheritance tax) regarding certain assets?

Canada	Yes. Canada imposes tax on the income and gains of a non-resident only to the extent the income or gains are from Canadian sources (e.g. real property or a business in Canada).
USA	No, because client is a citizen. U.S. – France DTA could become applicable to give France certain preferences. Savings clause.
India	India would impose tax on capital gains where situs of the asset is in India and on Indian sourced income (no dividend WHT on shareholder). This right may have been given up in a DTA.
UK	Neither UK resident, domiciled nor deemed domiciled in the UK: income tax: UK source income only; CGT: not chargeable at all even on UK situated assets including land; IHT: only chargeable on UK situs assets; UK domiciled but not resident: income tax and CGT as above but chargeable on worldwide assets for IHT.
Germany	Yes. Loss of taxing right for essentially all assets (except residential home and German p.e.) and all types of taxes (inheritance tax: only after 5 years from exit).

Do you have an exit tax regime in respect of income / capital gains / inheritance tax? What assets would be encompassed by the exit tax?

Canada	Most assets are deemed to be disposed of for proceeds equal to their fair market value immediately before departure, and any resulting income or gains will be taxable in Canada. E.g. real or immovable property situated in Canada, and certain assets used in a p.e. in Canada, would be exempt from this regime.
USA	Yes to all; IRC Sections 877A and 2801. All worldwide assets marked to market upon departure, other than some qualified deferred compensation and certain interests in trusts.
India	No. See however, Indian exchange control restrictions.
UK	In broad terms no, but: possible CGT charge on export of trust, deemed disposal of trust assets.
Germany	Genuine exit tax only for capital gains from shares representing $\geq$ 1% shareholding if taxpayer was – prior to exit – for at least 10 years subject to unlimited taxation in Germany.

How would the exit tax be calculated? What is the tax basis and what is the tax rate?

Canada	Tax is applied to income and gains resulting from the deemed sales at the same graduated rates applicable to other income. These rates begin at about 20% and rise to about 45% (depending on the province or territory of residence) for income over about CAD 130,000. Only half of capital gains are included in income for this purpose.
USA	Gain/loss computed asset-by-asset, FMV less tax basis. Aggregate net gain taxed to extent > USD 627,000 in 2010. Normal tax rates apply, based on character and period.
India	–
UK	Trustee deemed to have disposed of trust assets; charge at a maximum rate of 28%; may be taxed on the settlor.
Germany	Tax base: 60% of fair market value of shares minus acquisition cost; normal (progressive) tax rate.

Is a deferral of payment of the exit tax possible? Is interest payable? Must security be provided?

Canada	The exit tax may be deferred until the subject property is actually sold. Security must be posted for the tax that is deferred on any taxable income over CAD 50,000, calculated at the highest marginal rate (about 45%). Interest does not accrue on balances deferred under these rules.
USA	Yes, in theory. Bond, LOC, or “other“ adequate security required. Interest payable at usual tax underpayment rate. Asset-by-asset deferral. Annual Form 8854 filing required.
India	–
UK	No.
Germany	Exit to EEA-country: deferral mandatory (until realization), interest-free, no security; otherwise: payment in installments for max. of 5 years, regularly subject to interest and security.

the global voice of the legal profession

What happens when the assets subject to the exit tax are later on sold at a price higher or lower than the fair market value at exit?

Canada	A subsequent change in the value of a property will not generally affect the liability for departure tax. However, certain relief is available for “taxable Canadian property“ that is subsequently disposed of for proceeds less than the value at the time of emigration.
USA	Only matters for US real property and US business assets. US loses right to tax other assets. Basis adjustment at departure from US perspective, so same asset not taxed twice.
India	–
UK	Trustee (or the settlor) should consider negotiating with HMRC.
Germany	Exit to EEA-country: adjustment of exit tax possible under restrictive conditions if sales price is lower than FMV at exit; other cases: no influence on amount of exit tax.

Does your jurisdiction provide for a kind of extended tax liability after exit?

Canada	No.
USA	No. Used to, pre-June 17, 2008. Replaced with mark-to-market system. Continuing annual filing obligation if defer tax or have DC or NGT items under new regime.
India	No. An individual becomes a non-resident in the year he/she spends less than 182 days in India.
UK	CGT 5 year claw back if UK residence re-acquired; IHT hang-over period – a person actually domiciled in the UK (e.g. the client) will be deemed domiciled in the UK for 3 years after they have actually left and lost their domicile.
Germany	Yes. Extended income tax liability (10 years) of German citizens having been subject to unlimited taxation in Germany for $\geq$ 5 years and moving to a low-tax jurisdiction; 5 years' extended inheritance tax liability; covering essentially all (income generating) assets except German p.e. and foundation.

the global voice of the legal profession

What planning opportunities exist?

Canada	Use of a Canadian resident trust to hold residence after emigration; planning for minimum tax in relation to private company (capital gains exemption, tax integration, etc.); review relevant DTA for reduced taxation on amounts paid to non-residents (e.g. amounts paid out of retirement arrangements).
USA	Best planning is to avoid application of the new regime and accompanying succession tax provision where possible.
India	Setting up trust: contribution to trust in not taxable in India; distribution of capital by a trust to its offshore beneficiaries may also not be taxed in India. Accumulated income, added back to the corpus may be regarded as capital and not be subjected to tax at the time of distribution.
UK	Sell assets after ceasing to be UK resident; establish tax efficient trust to benefit from the excluded property regime (when ceased to be domiciled and deemed domiciled); tax efficient will(s) (100% spouse exemption available?); Family Limited Partnership
Germany	Pre-exit restructuring of assets; exit to (EEA-) country without inheritance tax.