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Income and Gains of
**Individuals Who
Change Residence**
A Multinational Survey

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We Will Be Landing Soon

**How do various countries handle
the transition from nonresident to resident
status in the context of a variety of assets
and potential sources of income and gains?**

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A Multinational Survey of the
Treatment of Income and Gains of
Individuals Who
Change Residence

Today, more than ever, individual taxpayers change residence. In many cases, the change is long-term or permanent; in others, short-term or temporary. In decades and centuries past, most migrants who moved from one country to another brought little wealth with them and left little behind. A relative handful of wealthier migrants monetized wealth before moving so that what they brought with them apart from personal possessions consisted mostly of money; they too left little behind. Moves tended to be permanent or at least long-term.

In the modern age, air travel, inexpensive instant communication across the globe, the globalization of business, even the multiplication of countries,¹ as well as many other developments, have made it much more likely that migrants will have acquired and retained property and connections in the country from which they departed, or in third countries. Moreover, moves are less likely to be permanent. Itinerant and the temporary migrants are encountered far more commonly.



This article presents a survey of the treatment of individual taxpayers who change their residence to various countries. The law and practice in each country are described by a distinguished commentator based on a uniform structure proposed by the editor. The questions to the commentators were:

1. Does your country impose tax on resident individuals on their worldwide income? Does the tax base for residents include capital gains (whether as part of the income tax or as a separate tax)?
2. Please describe the basic tax treatment of new and temporary residents.
 - a. Do they benefit from any special treatment on gains, e.g., tax exemption or limited taxation (e.g., remittance basis) of foreign income or gains?
 - b. Do they receive a fair market value adjustment to tax basis or comparable adjustment, e.g., pro rata allocation of gain to pre- and post-residence periods?
3. Are there any special rules under which tax is imposed or tax cost is adjusted where no actual sale occurs?
 - a. Capital gains tax imposed on gifts.
 - b. Rollover of gains on corporate organization, contribution, or reorganization transactions.
 - c. Other tax-free exchanges of property or rollover of gains.
 - d. Basis (tax cost) adjustments on death or other non-sale transactions.
 - e. Is a distribution by a company in liquidation taxed as a dividend, capital gain, or any combination?
4. How does your country tax a pre-residence sale of property when part of the proceeds of sale are received before and part after an individual becomes a resident?
5. How does your country treat a distribution from a foreign trust to a resident beneficiary of property that has increased in value while the property was held by the trust?
 - a. Is the beneficiary treated as having income or gain from the distribution?
 - b. How is the beneficiary taxed when he later sells the distributed property and, specifically, how would gain be calculated?

6. If an individual moves to your country and later receives a distribution from a company that is attributable to pre-residence profits, how is that distribution taxed? Any special rules because the profits of the distributing corporation were accumulated before the shareholder became a resident in your country?

The authors were also invited to comment on any issues peculiar to their jurisdiction that they considered relevant.

The purpose of this article, therefore, is twofold. The first is to make it possible to compare broadly how various countries, particularly those that receive many immigrants and others who become resident for tax purposes, handle the transition from nonresident to resident status in the context of a variety of assets and potential sources of income and gains. The second is to allow tax professionals to have a sense of what to expect in countries other than their own. The authors are seeking to provide introductory information to the tax advisor of an outbound client and to help the inbound country advisor become aware of the approaches and concepts with which advisors in the outbound country will be familiar and that may have influenced outbound planning.

This is, therefore, a general survey of the relevant laws of many countries, not a treatise. In all too many cases, the general rules described in this article will be just that—general. The tax laws of most countries usually consist of legislation, judicial precedent, and administrative policies and practices, with exceptions piled on exceptions. Moreover, the authors do not discuss information reporting requirements, whether under FATCA, CRS, other multilateral treaties, or the individual requirements of the various countries.

In short, this is not a comprehensive description of every particular nuance. Caveat accordingly. Tax advisors around the world are standing by!

Part 1 of this article, below, covers Canada, France, and Germany. Parts 2 and 3, in forthcoming issues, will cover Israel, Japan, Luxembourg, Mexico, and the Netherlands (Part 2), and Switzerland, the United Kingdom, and the United States (Part 3).

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Dedication

This article is dedicated to the memory of the late **Sakura Shiga**, lawyer and friend, who passed away all too young in December 2015. He will be remembered for his many contributions to international tax law both in private practice and as a public servant, most notably as head of the international tax department of the Ministry of Finance of Japan. He will also be remembered for his delightful sense of humor, his generosity, his love of opera, American sports, and all things English. Foxhunter, we miss you!



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Does Canada impose tax on resident individuals on their worldwide income? Does the tax base for residents include capital gains (whether as part of the income tax or as a separate tax)?

The Income Tax Act (Canada) (ITA) is the statutory basis for federal income taxation in Canada. Every person who is tax resident in Canada at any time in the year must pay an income tax on their taxable income for that tax year (or portion thereof), as required by the ITA.² Taxable income includes income from all worldwide sources both inside and outside Canada.³

Currently, under the ITA, capital gains are included in income at a 50% rate. A taxpayer⁴ must include in computing the taxpayer's income the amount by which the taxpayer's "taxable capital gains" for the year exceed the taxpayer's "allowable capital losses" for the year.⁵ A "taxable capital gain" is one-half of the taxpayer's capital gain for the year from the disposition of capital property, and an "allowable capital loss" is one-half of the taxpayer's capital loss for the year from the disposition of capital property.⁶ Accordingly, the taxpayer pays an effective tax rate equal to one-half of the taxpayer's marginal tax rate in respect of net capital gains realized in the year.

Canada also imposes income tax on a nonresident of Canada who has income from Canadian source employment, from a business carried on in Canada or from the disposition of "taxable Canadian property."⁷ If the nonresident is a tax resident of another country with which Canada has a tax treaty, that person's income tax owing under the ITA may be reduced or eliminated pursuant to the terms of the treaty.

Please describe the basic tax treatment of new and temporary residents. Do new or temporary residents benefit from any special treatment on gains, e. g., tax exemption or limited taxation (e.g., remittance basis) of foreign income and/or gains? New and temporary residents of Canada are taxed on their worldwide income pursuant to ITA subsection 2(1) from the moment that they become resident in Canada for Canadian income tax purposes, subject to reduction by tax treaty. Except as explained below in relation to a step-up in the taxpayer's cost of certain assets, no particular exemptions or limitations on taxation are available to new or temporary tax residents of Canada.

Do new or temporary residents receive a fair market value adjustment to tax basis or comparable adjustment, e. g., pro rata allocation of gain to pre- and post-residence periods? A person who becomes a resident of Canada for tax purposes under the ITA receives a step-up in the tax cost of their property to the fair market value of each such property at the time that the person becomes a Canadian tax resident. In particular, immediately prior to becoming a tax resident of Canada, the person is deemed to have disposed of most property that the person owned for fair market value proceeds and to have reacquired such property at a tax cost, for Canadian purposes, equal to those proceeds.⁸ As such, any Canadian capital gains tax liability arising on a subsequent disposition of such property will be limited to the increase in the value of the property from the time that he became a tax resident of Canada. Certain properties are excluded from the deemed disposition and reacquisition rules, including inventory of a business that the person carries on in Canada and "taxable Canadian property"⁹ of the person (which includes Canadian real property).

Are there any special rules where tax is imposed or tax cost is adjusted where no actual sale occurs? Capital gains imposed on gifts. Section 69 contains deeming rules in respect of certain non-arm's-length transfers and gifts. When a taxpayer disposes of property to a person with whom the taxpayer does not deal at arm's length for proceeds that are less than the fair market value of the property, or disposes of property by way of a gift to any other person, the taxpayer is deemed to have disposed of such property for fair market value proceeds of disposition.¹⁰ Generally, any accrued gains in respect of the transferred property will be realized at the time of the disposition.

To the contrary, when a taxpayer acquires property from anyone (other than by way of gift, bequest, or inheritance) for less than the fair market value of the property, the taxpayer's tax cost of the property is equal to that amount, if any.¹¹ In other words, in that case, the taxpayer's tax cost is whatever the taxpayer paid for the property.

A transferor of property to a non-arm's-length transferee for value may suffer a fair market value disposition while the transferee who pays less than fair market value consideration will receive only the tax cost of such fair market value consideration. This could lead to double taxation on a subsequent disposition of the property by the non-arm's-length transferee to the extent that the purchase price was less than the fair market value of the property.

When a taxpayer acquires property from a person with whom the taxpayer does not deal at arm's length at an amount that exceeds the fair market value of the property, the taxpayer is deemed to have acquired the property at its fair market value.¹² When a taxpayer acquires property by way of gift, bequest, or inheritance (i.e., for no consideration), ITA subsection 69(1)(c) deems the taxpayer to have acquired the property at a tax cost equal to its fair market value at that time.

Rollover of gains on corporate organization, contribution, or reorganization transactions. (1) *Contribution of property to corporations and partnerships.* Individuals, corporations, and trusts are permitted to transfer "eligible property" to a Canadian corporation on a tax-deferred basis.¹³ "Eligible property" is defined to include capital property, resource property, eligible capital property (generally goodwill and other intangible property), and inventory (other than real property inventory).¹⁴ For this rollover to apply, the transferor must receive share consideration of the transferee corporation (and may also receive non-share consideration) as consideration for the transferred property, and the transferor and transferee must file a joint election with the Canada Revenue Agency (CRA) within the prescribed period setting the "agreed amount" for the transferred property.

The "agreed amount" is deemed to be the transferor's proceeds of disposition in respect of the transferred property and the corporation's tax cost of the transferred property. Subject to various limitations, the agreed amount generally can be set at



an amount between the transferor's tax cost of the transferred property and the transferred property's fair market value at that time. In general, and among other things, the transferor will realize a gain to the extent that any non-share consideration that the transferor receives from the corporation exceeds the tax cost to the transferor of the transferred property.

The ITA contains similar provisions permitting the tax-deferred transfer of certain property to a "Canadian partnership."¹⁵ Unlike the rollover for transfers of property to a corporation, the property eligible for the rollover to a Canadian partnership includes real property inventory.

(2) *Convertible property.* A tax-deferred rollover applies when a taxpayer acquires a share of a corporation in

¹ The U.N. began with 51 member states. Forty years ago, there were 147 members. As of today, there are 193 members. See www.un.org/en/sections/member-states/growth-united-nations-membership-1945-present/index.html.

² ITA subsection 2(1). All statutory reference in the Canada section of this article are to the ITA unless otherwise stated.

³ See paragraph 3(a).

⁴ "Taxpayer" is a term used frequently in the ITA and is defined broadly in section 248(1) as "any person whether or not liable to pay tax."

⁵ Subsection 3(b).

⁶ Subsection 38(1).

⁷ As defined in subsection 248(1), "taxable Canadian property" includes real property situated in Canada, Canadian resource properties, timber resource properties, and interests in corporations, trusts, or partnerships if, at any time during the 60-month period ending at the time of disposition, more than 50% of the fair market value of the interest was derived from one or any combination of real property situated in Canada, Canadian resource properties, timber resource properties, and options in respect thereof.

⁸ Paragraphs 128.1(1)(b) and (c).

⁹ See note 7, .

¹⁰ Pursuant to subparagraphs 69(1)(b)(i) and (ii).

¹¹ Pursuant to subparagraph 69(1)(b)(i).



exchange for capital property that is (a) another share of the corporation; or (b) a bond, debenture, or note of the corporation the terms of which confer on the holder the right to make the exchange (both (a) and (b) are referred to herein as the “convertible property”) and the taxpayer receives no consideration other than the shares of the corporation (i.e., no non-share consideration).¹⁶

When this deferred rollover applies, the exchange is deemed not to be a disposition of the convertible property and the tax cost of the new shares received on the exchange is deemed to equal the tax cost of the convertible property to the taxpayer. When multiple classes of shares are received on the exchange, the tax cost is allocated pro rata among the

shares received on the exchange based on the relative fair market values of each class of shares received. The tax-deferred rollover is automatic if the conditions are met and does not require an election to be filed.

(3) *Exchange of shares in the course of a reorganization of capital.* Pursuant to ITA section 86, a tax-deferred rollover occurs when, in the course of a reorganization of a corporation's capital, a taxpayer disposes of all of the shares of a particular class of shares of the corporation (“old shares”) in consideration for property that includes other shares of the corporation.¹⁷ Unlike section 51, this type of rollover permits non-share consideration to be received by the taxpayer.

When section 86 applies, the taxpayer acquires any non-share consideration at a tax cost equal to its fair market value at the time of the disposition, and acquires the new shares at a tax cost equal to the taxpayer's tax cost in the old shares less the fair market value of any non-share consideration received. If the taxpayer receives more than one class of new shares, the tax cost is allocated among the new shares based on the relative fair market values of such classes of shares. The taxpayer is deemed to have disposed of the old shares for proceeds of disposition equal to the aggregate of the tax cost to the taxpayer of all of the new shares and the non-share consideration received. A capital gain may result when a taxpayer receives non-share consideration the fair market value of which exceeds the taxpayer's tax cost of the old shares.¹⁸

The rollover in section 86 applies only when the transfer of property described above occurs in the course of a reorganization of the corporation's capital. The CRA considers that a “reorganization of capital” requires an amendment to the articles of a corporation, such as the creation of a new class of shares or the alteration of the rights of the existing shares.¹⁹ Simply exchanging one class of shares for another authorized class of shares of the corporation generally will not be regarded as a “reorganization” for section 86 purposes. However, such an exchange generally will fall automatically under section 51 if the conditions are met.²⁰

(4) *Amalgamation.* Canadian corporations may amalgamate on a tax-deferred basis.²¹ This applies when two or more “taxable Canadian corporations”²² merge to form one corporate entity and all of the following apply:

(A) All of the property (except amounts receivable from any predecessor corporation or shares of any predecessor corporation) of the predecessor corporations becomes property of the new corporation by virtue of the merger.

(B) All of the liabilities (except amounts payable to any predecessor corporation) of the predecessor corporations become liabilities of the new corporation by virtue of the merger.

(C) All of the shareholders (except any predecessor corporation) who owned shares of any predecessor corporation receive shares of the new corporation because of the merger.

¹² Pursuant to paragraph 69(1)(a).

¹³ Subsection 85(1).

¹⁴ Subsection 85(1.1).

¹⁵ Subsection 97(2).

¹⁶ Section 51.

¹⁷ Section 86. The shares must be held as capital property of the transferor.

¹⁸ A taxable dividend may also result when the taxpayer receives non-share consideration in excess of the paid-up capital of the old shares.

¹⁹ See CRA Document 2010-0373271C6.

²⁰ Subsection 51(4) says that section 51 does not apply if subsection 85(1) or section 86 applies.

²¹ Section 87.

²² Generally defined in subsection 89(1) as a corporation that is resident or incorporated in Canada and not tax exempt.

²³ Paragraph 87(2)(a).

²⁴ Section 87.

²⁵ A “common-law partner” is defined in subsection 248(1) as a person who has cohabited with the person in a conjugal relationship for a 12-month period or would be the parent of a child of whom the person is a parent. The definition applies to both opposite- and same-sex couples.

²⁶ Section 73.

An amalgamation creates a deemed year-end for each of the predecessor corporations immediately before the amalgamation.²³ Various tax attributes of the predecessor corporations flow through to the new amalgamated corporation.²⁴

In respect of the shareholders of the predecessor corporations, ITA subsection 87(4) provides for rollover treatment on the disposition of the predecessor corporation shares and acquisition of the amalgamated corporation shares. In general, if the shareholder receives no consideration other than the shares of the amalgamated corporation pursuant to an amalgamation of the predecessor corporations, the shareholder will be deemed to dispose of the predecessor corporation shares at their tax cost to the shareholder and to acquire the amalgamated corporation shares at that same tax cost.

Although the foregoing tax-deferred transactions are typical in Canadian tax planning, there are various technical issues that must be considered that are beyond the scope of this article.

Other tax-free exchanges of property or rollover of gains.

(1) *Transfers to spouses or common-law partners.* Transfers of capital property between Canadian tax resident spouses and common-law partners²⁵ or certain Canadian-resident trusts generally occur on a tax-deferred basis.²⁶ When this rule applies, the transferor is deemed to have disposed of the property for proceeds equal to the transferor's adjusted cost base of the property and the transferee is deemed to have acquired the property for an amount equal to such deemed proceeds.

However, tax-deferred transfers of property pursuant to this rule may trigger the application of various "attribution rules." These rules operate to attribute income or loss subsequently arising from the transferred property,²⁷ and capital gains or capital losses from a subsequent disposition of the capital property, to the transferor spouse.²⁸ These attribution rules generally do not apply when the transfer of the property occurs for fair market value consideration that meets the specified requirements.²⁹

(2) *Transfers to life-interest trusts.* The transfer of property to a trust normally results in a taxable disposition. However, automatic rollover treatment applies in respect of certain transfers of capital property by individuals to certain "life-interest trusts."³⁰ Life-interest trusts include spousal and common-law partner trusts ("spousal trusts"), "alter ego trusts" and "joint spousal and common-law partner trusts."

Certain property can generally be transferred on a tax-deferred basis to such life-interest trusts. In each case, the transferor and the transferee trust must each be tax residents of Canada at the time of the transfer.

In the case of spousal trusts, an individual may transfer certain property to such a trust at any time when the spouse beneficiary is, by the terms of the trust, entitled to all of the income of the trust while he or she is alive and no one other than the spouse beneficiary may receive or otherwise



obtain the use of any of the capital of the trust while he or she is alive. An individual may also transfer certain property on a tax-deferred basis to an alter-ego trust or a joint spousal trust, created after 1999, if the individual has attained 65 years of age at the time that the trust is created. These trusts have similar requirements with respect to the lifetime beneficiary's entitlement to income and the prohibition against anyone other than the lifetime beneficiary (or beneficiaries) benefiting from the trust while the lifetime beneficiary (or beneficiaries) is alive; however, such trusts can also benefit the individual transferor. These trusts are often used by Canadian taxpayers who have reached the age of 65 as a will substitute.

Various attribution rules may apply to these trusts. Generally, these trusts are not intended to be used to income-split with one's spouse or common-law partner, and often the tax results are unaffected by the establishment of such trusts. For example, in many cases, ITA subsection 75(2) may

²⁷ See section 74.1.

²⁸ See section 74.2.

²⁹ See section 74.5.

³⁰ Section 73.

³¹ See subsection 104(4).

³² In British Columbia in particular, the "Variation of Wills" provisions of the Wills, Estates and Succession Act.

³³ Such a testamentary spousal trust has requirements similar to those of the "spousal trust" discussed above.

³⁴ Subsection 128.1(4).

³⁵ Subparagraph 128.1(4)(b)(iv).

³⁶ "Paid-up capital" is a concept unique to the ITA and is used to measure a shareholder's equity contribution to the corporation. Paid-up capital is calculated class by class, starting with the stated capital for corporate



apply to a settlor who has contributed property to an alter ego trust or a joint spousal trust such that any income (or capital gains) and any loss (or capital losses) are attributed back to the settlor and taxed in his or her hands.

On the date of the settlor's death, in the case of an alter ego trust, death of the settlor's spouse, a spousal trust, or death of the survivor of the settlor and settlor's spouse (in the case of a joint spousal trust), the trust will be deemed to dispose of, and to reacquire, the trust's property at its then fair market value. The deemed disposition will trigger the realization of any accrued capital gains that will be taxable to the trust at that time.³¹ Accordingly, these trusts do not avoid the capital gains tax that otherwise would arise on the death of the settlor or settlor's spouse under the ITA (see "Death of a taxpayer" section below). These trusts are used for various nontax reasons, including asset protection, avoiding compulsory succession schemes,³² avoiding provincial probate, and probate tax regimes.

law purposes and adjusted based on the paid-up capital adjustment rules in the ITA.

³⁷ Subsection 84(2).

³⁸ The CRA's administrative position is to treat a distribution of 90% or more of a corporation's property as all or substantially all of its property.

³⁹ As discussed above, one-half of a capital gain is included in a person's income in a year. If the person is a corporation, the nontaxable portion of the capital gain is added to a notional corporate tax account, the capital dividend account, and may be paid by the corporation as a tax-free dividend to a Canadian resident shareholder.

⁴⁰ Subsection 69(5). The shareholder who receives the property is deemed to acquire it at a tax cost equal to its fair market value.

⁴¹ Subsection 88(1).

⁴² The time that the purchaser has a legally enforceable claim of ownership in respect of the property.

Basis (tax cost) adjustments on death or other non-sale transactions. (1) *Death of a taxpayer.* In general, when a taxpayer dies, the ITA deems the taxpayer to have disposed of most of his property for fair market value proceeds of disposition, thereby triggering any accrued gains or losses at the time of death. In particular, ITA subsection 70(5) deems the taxpayer to have disposed of each capital property that he held for fair market value proceeds immediately before death; thus, any accrued capital gains or losses are realized at that time. The taxpayer's estate is deemed to acquire the property at a tax cost equal to such fair market value proceeds and the estate can generally be distributed on a tax-deferred basis to Canadian resident beneficiaries without further tax.

In general, the deemed disposition on death is generally deferred to the date of death of the survivor of the individual's spouse or common-law partner in respect of property of the deceased that is transferred on death to the spouse or common-law partner, or to a testamentary spousal trust established under the last will and testament of the deceased.³³ In such cases, the deemed disposition will generally be deferred until the death of the individual's spouse or common-law partner.

(2) *Emigration from Canada.* Similar to the deemed disposition and reacquisition rules that apply to an individual who becomes a Canadian tax resident, an individual who ceases to be a tax resident of Canada is, immediately prior to that time, deemed to dispose of, and to reacquire, most of his property for fair market value proceeds of disposition.³⁴ Accordingly, any accrued gains (or losses) are realized at that time, and taxable in Canada in the hands of the emigrating individual.

A person who is not a resident of Canada for more than 60 months during the 120-month period that ends at the emigration time is exempt from the deemed disposition in respect of property owned on the date that the person became a resident of Canada for income tax purposes.³⁵ Accordingly, property that such an individual owned continuously throughout this period will not be subject to the deemed disposition rule on the individual's emigration from Canada. Certain property is not subject to the deemed disposition rules, including real or immovable property situated in Canada, Canadian resource property and timber resource property, that the individual owns on the date of emigration from Canada.

Is a distribution by a company in liquidation taxed as a dividend, a capital gain, or any combination? The default scheme in the ITA treats the liquidation (winding up) of a corporation as a taxable event. At the shareholder level, when a shareholder receives property in respect of the wind-up of a corporation resident in Canada, the shareholder is deemed to receive a dividend from the corporation equal to the excess of the value of the property distributed to the shareholder over the "paid-up capital"³⁶ of his shares.³⁷

If all or substantially all of the corporation's property³⁸ is distributed to its shareholders on a winding-up of the corporation, ITA subsection 88(2) can apply to allow the corporation to designate the deemed dividend to be paid out of various tax accounts of the corporation, if any, such as the corporation's "capital dividend account"³⁹ thereby reducing the tax consequences for the shareholder who is deemed to receive the dividend. At the corporate level, the property distributed to the shareholder is deemed to be disposed of by the corporation at its fair market value, triggering any accrued capital gains or losses.⁴⁰

The ITA provides relief from the default scheme when a subsidiary corporation is wound up into a parent corporation.⁴¹ To qualify for the relief, both the parent and the subsidiary must be "taxable Canadian corporations" (discussed above) and the parent must own at least 90% of the issued shares of the subsidiary immediately before the winding up. When the relief applies, the winding up of the subsidiary corporation generally occurs on a tax-deferred basis, and among other things, the parent will not be deemed to receive a dividend in respect of the disposition of the shares of the subsidiary; the subsidiary will generally be deemed to dispose of its assets to the parent at the tax cost to the subsidiary of its assets; and the parent generally will be deemed to have acquired the subsidiary's assets at that tax cost.

How does Canada tax a pre-residence sale of property when part of the proceeds of sale are received before and part after an individual becomes a resident? Canadian domestic income tax rules generally treat a disposition of property as occurring at the time that the beneficial interest in such property is conveyed from the vendor to the purchaser.⁴² Therefore, when a person bona fide disposes of his beneficial interest in property at a time when he was not resident in Canada for tax purposes, the disposition is treated as having occurred by a nonresident, regardless of whether the person actually receives the proceeds of disposition at a time when he or she is a tax resident of Canada. As noted above, nonresidents of Canada generally would not be subject to tax in Canada in respect of dispositions of property unless the property so disposed of was "taxable Canadian property." Accordingly, if the property disposed of is not "taxable Canadian property" of the nonresident vendor, the disposition should not be subject to Canadian tax. Although the portion of the proceeds receivable by the taxpayer after he becomes a Canadian tax resident should not be subject to Canadian tax, the new taxpayer may have a foreign reporting obligation to report the existence of the foreign receivable while the receivable remains outstanding.

How does Canada treat a distribution from a foreign trust to a resident beneficiary of property that has increased in value



while the property was held by the trust? Is the beneficiary treated as having income or gain from the distribution?

In general, distributions of trust "income" from a "personal trust"⁴³ that is a nonresident of Canada (and not deemed a resident trust under ITA section 94)⁴⁴ paid or made payable to a Canadian-resident beneficiary will be included in the income of the Canadian-resident beneficiary and taxed in the beneficiary's hands. Accordingly, such distributions of income to Canadian-resident beneficiaries are generally avoided by nonresident trustees.

In general, distributions of trust "capital" from a "personal trust" that is a nonresident of Canada to a Canadian-resident beneficiary are receivable by the Canadian-resident beneficiary as a tax-free capital distribution. Moreover, when a "personal trust" that is a nonresident of Canada makes a distribution of capital property *in specie* to a Canadian-resident beneficiary in satisfaction of a portion or all of the beneficiary's capital interest in the trust, such distribution generally occurs on an automatic tax-deferred basis pursuant to ITA subsection 107(2); the nonresident trust would be deemed to dispose of the property at the trust's tax cost (for Canadian purposes) of the property and the ben-

⁴³ A personal trust is generally a trust in which the beneficiaries did not acquire their interests in the trust for consideration. See definition of a "personal trust" in subsection 248(1).

⁴⁴ Nonresident trusts may be deemed resident in Canada for Canadian tax purposes pursuant to section 94. Such a discussion is beyond the scope of this article.

⁴⁵ Recall that a nonresident taxpayer is generally liable to capital gains taxation in Canada only in respect of dispositions of "taxable Canadian property" (discussed above).



eficiary would be deemed to acquire the property at the trust's tax cost.

However, if the trust's tax cost of the capital property so distributed is low, the Canadian-resident beneficiary will inherit the trust's low tax cost and any subsequent gains will be subject to tax in Canada on a subsequent disposition by the Canadian-resident beneficiary. Thus, it may be beneficial for the Canadian-resident beneficiary to elect out of the automatic rollover in ITA subsection 107(2) pursuant to subsection 107(2.002) so that the beneficiary receives a "step-up" in the tax cost of the distributed property to fair market value. When the beneficiary elects under subsection 107(2.002), the rules in subsection 107(2.1) will apply and the distribution from the trust to the beneficiary will result in a deemed fair market value disposition of the property by the trust and acquisition of the property by the Canadian-resident beneficiary at fair market value tax cost. Provided that the capital property is not "taxable Canadian property,"⁴⁶ the nonresident trust generally will not be subject to tax in Canada on the fair market value distribution, and the Canadian-resident beneficiary will receive the property at its stepped-up tax cost.

⁴⁶ Or certain other properties, such as property used in or in respect of a business that the nonresident trust carries on through a permanent establishment situated in Canada immediately before the distribution.

⁴⁷ A discussion of the various reporting requirements is beyond the scope of this article.

⁴⁸ Section 233.6.

⁴⁹ Section 233.2.

⁵⁰ Section 233.7.

Where the nonresident trust is distributing "taxable Canadian property,"⁴⁶ the taxable Canadian property may be distributed to a Canadian-resident beneficiary on an automatic tax-deferred basis (as noted above) pursuant to subsection 107(2), such that the trust disposes of the property at its tax cost and the Canadian-resident beneficiary inherits the trust's tax cost of the property. Alternatively, the nonresident trust may elect out of the automatic rollover in subsection 107(2) pursuant to subsection 107(2.001) to trigger a fair market value disposition of the taxable Canadian property. As a nonresident of Canada, the trust would be subject to Canadian tax on any gains accrued in respect to the disposition of the property, and the Canadian-resident beneficiary would acquire the taxable Canadian property at a tax cost equal to those fair market value proceeds. In either case, there are various Canadian reporting requirements under the section 116 withholding tax regime with respect to the disposition by a nonresident of taxable Canadian property that would apply to both the nonresident trust and the Canadian-resident beneficiary.⁴⁷

The ITA contains extensive reporting requirements for beneficiaries of nonresident trusts. The rules are intended to provide the CRA with information regarding property owned by or for the benefit of Canadian residents to assist them in the assessment of Canadian tax on income and capital gains arising from such assets.

Canadian resident beneficiaries of a nonresident trust are generally required to report the details of any distributions received from, or indebtedness owed to, the nonresident trust in the tax year in which the distribution was received, and in any tax year in which the indebtedness is outstanding.⁴⁸ Similar reporting requirements apply to transfers or loans by a Canadian resident to a nonresident trust.⁴⁹ Although the reporting requirements themselves do not create a tax liability, significant penalties apply for failure to file the required information returns. However, an individual is exempted from these foreign reporting requirements in the first year that the individual becomes a resident of Canada for Canadian income tax purposes.⁵⁰

If an individual moves to Canada and later receives a distribution from a company that is attributable to pre-residence profits, how is that distribution taxed? Any special rules because the profits of the distributing corporation were accumulated before the shareholder became a resident in Canada? Canada has a very complex set of rules regarding foreign corporations beneficially owned by Canadian tax residents. Although these rules are beyond the scope of this article, with proper planning, a new immigrant to Canada generally should be able to take steps to permit the distribution of pre-residence corporate profits to Canada in a tax-efficient manner with little or no Canadian tax cost.



Julia Novak and Laurent Gabaud, Cabinet Franklin, Paris

Overview of French taxation of gains. Introduction. France imposes an income tax (*impôt sur le revenu*).¹ Capital gains of private individuals from selling shares and other securities are among the types of income subject to income tax. The rules described below concern only this type of income.

The other types of capital gains are subject to different tax rules such as:

- Capital gains on movable assets.
- Capital gains on sales of securities issued by companies investing predominantly in real estate and not subject to corporate tax, or shares issued by real estate investment funds (*fonds de placement immobilier*). These are regarded as real estate capital gains for tax purposes.
- Business capital gains realized from sales of fixed assets used in industrial, commercial, artisanal, farming, or non-commercial operations by businesses that are not subject to corporate tax.

France uses a territorial tax system in which French tax residents are liable to French income tax on their worldwide income. The tax base is the sum of various types of income including capital gains from sales of shares and other securities.

Non-French tax residents are exempt from French tax on capital gains from the sale of French shares and other securities unless:

- The seller owns (with his spouse, descendants, ascendants), directly or indirectly, more than 25% of the rights to the company's earnings at any time during a five-year period preceding the sale, in which case the capital gain will be taxed at a 45% rate.

- The seller resides in a tax haven, in which case the capital gain will be taxed at a 75% rate.

France has entered into several double tax treaties regarding income tax, pursuant to which it has the right to tax capital gains from the sale of shares, rights, or interests (other than shares listed on an approved stock exchange in a contracting state) forming part of a substantial interest (generally more than 25%) in a company that is French tax resident.

Computation of capital gains tax. The taxable portion of the capital gain is the difference between the sale price (minus sale costs) and the acquisition price (plus any acquisition costs). Before being included in the tax base, the gross capital gain may be eligible for a general tax allowance based on duration of ownership of the asset sold (50% if the shares were held for at least two years, 65% if held for at least eight years).

However, specific capital gains may be eligible for a higher tax allowance, such as:

- Capital gains from sales of shares or other securities issued by small and medium-sized enterprises (SMEs) and subscribed or acquired within ten years of the SME's creation.
- Capital gains from the sale of more than 25% of the shares or other securities held by the seller's family group.
- Capital gains from the sale by retiring managers of shares or other securities issued by SMEs. In that case, an additional €500,000 tax allowance applies to the gross capital gain, before the increased tax allowance described hereafter.

The increased tax allowance varies depending on duration of ownership of the shares:

- 50% if held between one year and less than four years.
- 65% if held between four years and less than eight years.

- 85% if held for over eight years.

The tax base will then be subject to a progressive rate (up to 45%).

Capital gains from sales of founders' warrants (*bons de souscription de parts de createur d'entreprise*) (BSPCE) that SMEs issue to their employees are taxed at a flat rate of 19% (or 30% if the employee has been with the SME for less than three years). In addition, gross capital gains realized by French tax residents are subject to social contributions at a flat rate of 15.5%.

A special high-income tax may be due if the seller's worldwide revenue exceeds the limits in Exhibit 1.

Tax treatment of new and temporary residents. France applies a special income tax treatment: a tax exemption on 50% of foreign passive income received by temporary residents (employees or executive officers) who qualify as "inpatriates" for income tax purposes. This tax treatment is as follows:

1. Tax exemption for "inpatriate allowances" and for a part of their salary based on foreign workdays.
2. A 50% tax exemption for foreign passive income such as dividends, interests, capital gains, royalties, income from life insurance, income from copyright, if this income is paid by a foreign company established in a country that has a double tax treaty with France providing for administrative assistance against tax evasion and fraud. This exemption is not applicable for social contributions, due at a flat tax rate of 15.5% on the entire foreign passive income.

To qualify for this 50% exemption, the employee must actually receive an "inpatriate allowance."

These exemptions apply only if the employee (or corporate officer) has not been a French tax resident for the five calendar years preceding the date that he took up his duties in France, and are limited to a period of five years following the year that the employee took up his duties. New or temporary residents do not receive a fair market value adjustment to tax basis or comparable adjustment, e.g., pro rata allocation of gain to pre- and post-residence periods.

Special rules when tax is imposed or tax cost is adjusted and no actual sale occurs. Capital gains imposed on gifts. Under French tax law, capital gains on free transfers (by gift or inheritance) of shares or other securities are not considered as taxable income, except for gifts to public interest organizations and consisting of the full ownership of securities listed on a regulated market and eligible for a reduction in wealth tax.² When gifts or inherited assets are sold, the taxable capital gain is the difference between the sale price (minus sale fees) and the acquisition price (value of the asset on the date of the gift or inheritance) plus any acquisition fees (such as any gift or inheritance tax that the beneficiary paid). Consequently, the main advantage of transferring assets by gift or inheritance before selling them is that it serves to cancel the taxable capital gain recorded between acquisition by the donor/deceased and transfer by gift or inheritance. In the case of shares or other securities, such a transfer and subse-

quent sale could limit capital gains tax liability and should be analyzed in detail.

The application of the progressive gift/inheritance tax rates (up to 45% between parents and children, after a €100,000 allowance per parent and per child, renewable every 15 years) could be preferable to the progressive income tax rate (marginal tax rate of 45% + social contributions of 15.5% + special high-income tax). The French tax authorities are very careful to determine whether the gift really results in an irrevocable and permanent relinquishment by the donor. If the gift is returned to the donor, the donor will be taxed on the capital gain calculated as the difference between the sale price and the donor's acquisition price, and the additional taxes due will be subject to an 80% penalty for abuse of rights (*abus de droit*).

Rollover of gains on corporate organization, contribution, reorganization transactions. The following transactions are considered neutral for tax purposes and, therefore, eligible for a suspension of taxation:

- Contribution of securities by an individual shareholder to a company that is subject to French corporate tax or the equivalent in another jurisdiction and not controlled by the contributing shareholder.
- Share exchange offer, merger, spin-off.
- Redemption, split, or pooling of shares.

The resulting capital gain is neither determined nor taxed at the time of the above transactions. No capital gain tax liability arises until the securities are sold. The capital gain will be the difference between the sale price of the securities and their historical price. The non-realized capital gain is permanently exempt from tax when the securities are transferred by gift or inheritance.

Deferral of taxation. Tax deferral applies to contributions of shares by an individual shareholder to a holding company subject to French corporate tax or the equivalent in another jurisdiction, if the contributing shareholder controls the holding company. The capital gain from the contribution will be taxable when the shares of the holding company are sold. When the holding company sells the contributed shares, the resulting capital gain (corresponding to the difference between the sale price and the contribution value) will be subject to corporate tax.

If the holding company sells the contributed shares less than three years after the contribution, it must reinvest 50% of the sale price in a business activity within two years of the sale. If it fails to do so, the contributing shareholder will become immediately taxable on the capital gain from the contribution. The CGI defines strictly the nature of qualified business activity.

The main advantage of such a contribution to a holding company is that it defers taxation of the resulting capital gain and the need for cash to pay income tax. The contribution and subsequent sale of contributed shares is interesting for a shareholder who wants to reinvest the sale price of the contributed shares in new business operations.

Basis (tax cost) adjustments on death or other non-sale transactions. The term "sale" covers any transaction that involves a transfer of ownership for valuable consideration, such as:

- Loans of securities.

- Direct sales of securities.
- Contributions or exchanges of securities (but most of these transactions are eligible for suspended or deferred tax).

A transfer by gift or inheritance is a non-sale transaction, and the capital gain that the beneficiary realizes is taxable if and when the property is sold. The taxable capital gain will be the difference between the sale price and the value of the asset transferred at the time of the gift or inheritance.

The transfer of residence from France may lead to the application of an exit tax based on unrealized capital gains. Individuals who transfer their tax residence from France after having been French tax residents for at least six of the last ten years and who own, directly or indirectly, shares or other securities or rights that entitle them to 50% or more of the issuing company's profits, or who own more than €800,000 in shares or other securities, are liable to a French exit tax (French income tax at a progressive tax rate, social contributions at the rate of 15.5%, and special high-income tax) on the related unrealized capital gains (including any earn-out payments).

Is a distribution by a company in liquidation taxed as a dividend, capital gain, or any combination? A distribution by a company in liquidation, after the shareholders have decided on dissolution, is taxed as follows:

- The amount of capital contributions is distributed tax free.
- The *boni de liquidation*, corresponding to the difference between the net profit of liquidation and the amount of capital contributions, is taxed as a dividend. The dividend will be subject to income tax at a progressive tax rate up to 45% after applying an allowance of 40%. In addition, social contributions of 15.5% will be due on the gross dividend, and special high-income tax may be due.

Further, in case of share capital's reduction for reasons other than for losses, the sums that the shareholders or partners receive are taxed as a capital gain in accordance with CGI Article 150-0 A. The taxable capital gain is the difference between the redemption price and the acquisition price or capital subscription cost. As mentioned above, this gain may be eligible for a tax allowance based on length of ownership.

Pre-residence sales when proceeds are received post-residence.

Under French individual income tax rules, income tax applies to any available income that the taxpayer earns. Available income is different from received income, i.e., the income actually paid to the taxpayer.

This general principle has exceptions. Certain types of income are taxed at the time of payment even if paid after they become due, such as wages, pensions, investment income, and rental income. Consequently, whether the capital gains from a sale are taxable depends on whether the proceeds of the sale qualify as available income.

If the proceeds are determined but their payment is deferred, the related capital gain will be taxable on the date of the sale, regardless of the date of payment of the sale price. In this context, if an individual receives part of the proceeds of a sale before becoming a resident and the remainder after becoming a resident, he will not be taxable on the latter.

EXHIBIT 1 France—Special High-Income Tax

A special high-income tax may be due if seller's worldwide revenue exceeds the following limits:

| | 3% | 4% |
|-------------------|---|--|
| Single individual | Worldwide revenue between €250,000 and €500,000 | Worldwide revenue exceeding €500,000 |
| Couple | Worldwide revenue between €500,000 and €1,000,000 | Worldwide revenue exceeding €1,000,000 |

If a portion of the sale price is not determined but paid under an earn-out clause as defined by the CGI, the proceeds will not be considered available income until they are paid. Consequently, if part of the proceeds of sale received after the individual becomes a resident is an earn-out payment, the individual will be taxable in France.

Specific tax rules apply to capital gains from the sale of qualified stock-options or qualified free shares awarded to employees. The spread (difference between fair market value at the exercise date and the option cost) and the gain of acquisition (fair market value of the shares on the transfer date of the shares), respectively, are taxable at the time of the sale.

If the award recipient transfers his tax residence to or from France before the sale, the spread or the gain of acquisition will be taxable in France according to its source. The portion of the spread or of the gain of acquisition that will be taxable in France corresponds to the recipient's length of residency or length of exercise of professional activity in France between the date of the award and date of vesting.

Regarding capital gains, if the award recipient left France after March 3, 2011, and had been a French tax resident for more than six of the ten years preceding his departure, the shares definitively acquired fall under the exit tax described

¹ The income tax is governed by the *Code General des impôts* (CGI), www.legifrance.gouv.fr/initRechCodeArticle.do, and most updated version (text as of October 22, 2016) at www.legifrance.gouv.fr/affichCode.do?cidTexte=LEGITEXT000006069577&dateTexte=20161022.

² CGI Article 885-0 V bis A.

³ CGI Article 120, 9°.



above. Consequently, the unrealized capital gain (including earn-out payments) corresponding to the difference between the value of the shares the day before the departure and their value at the time of definitive acquisition will be taxable in France at the time of departure.

Treatment of distributions by trusts. The following describes the rules that come into play in France with regard to a distribution from a foreign trust to a resident beneficiary of property that has increased in value while the property was held by the trust.

Treatment of the beneficiary on distributions. The law says that “income” (*produits*) distributed by a trust is considered investment income “regardless of the nature of the assets held by the trust” subject to French income tax.³ Therefore, when the beneficiary is a French tax resident, the trust income distributed to him is subject to progressive income tax, social contributions and, in some cases, special high-income contributions.

So, the increase in value distributed to a French beneficiary by a trust is subject to French income tax when the beneficiary is the settlor. However, when the beneficiary is not the settlor, a distribution of assets or accumulated income is not considered a distribution of income but a transfer of assets subject to gift/inheritance tax. Consequently, in practice, it may be difficult to determine whether the distribution is considered as income subject to income tax or as assets/accumulated income subject to gift/inheritance tax.

When a distribution is made to a French tax resident beneficiary, the trustee must file a special tax return in the follow-

ing month, failing which the trustee, settlor, or beneficiaries will be liable to a penalty of €20,000. If the trust is established in a tax haven, there may be French income tax consequences even if the trust makes no distributions. Individuals are liable to tax on investment income based on 125% of the amount of the income or positive income of the foreign trust, in proportion to the shares, units, or financial rights that they hold directly or indirectly in this trust. The total French tax cost (income tax, social contributions, and special high-income tax) is around 80% of the income generated by the assets that the trust holds.

Only a few of France’s income tax treaties specifically refer to trusts. These are its tax treaties with Canada, the United Kingdom, and the United States.

Tax treatment of beneficiary when he later sells distributed property/calculation of gain. The resulting capital gain from the sale of a distributed asset is determined according to generally applicable capital gains tax rules, as follows:

- When the beneficiary is also the settlor, by calculating the difference between the sale price of the asset and its value at the time of the distribution. The increase in value distributed by the trust to a French beneficiary is treated as investment income subject to French income tax.
- When the beneficiary is not the settlor and sells the distributed asset received during the lifetime of the settlor or on settlor’s death, the resulting capital gain will be the difference between the sale price of the asset and its value at the time of the distribution. The increase in value distributed by the trust to a French beneficiary has been subject to gift tax/inheritance tax.
- When the beneficiary is not the settlor and sells the distributed asset received after the settlor’s death, the resulting capital gain is determined by the difference between the sale price of the asset and the price of acquisition corresponding to the asset’s value at the time of settlor’s death. French inheritance tax is due at the time of settlor’s death whatever the time of distribution of the asset. Consequently, French tax administration considers that if the distributed asset corresponds to the asset that has been subject to inheritance tax, the distribution is realized tax free.

Post-residence distributions by companies of pre-residence profits. Under French individual income tax rules, income tax applies to available income that the taxpayer earns. Available income is different from received income, i.e., the income actually paid to the taxpayer. This general principle has exceptions. Certain types of income are taxed at the time of payment even if paid after they become due, such as dividends received from a company.

Consequently, if an individual moves to France and later receives a distribution from a company that is attributable to pre-residence profits, the distribution will be taxable in France, subject to the provisions of any applicable income tax treaty. There are no special rules because the profits of the distributing corporation were accumulated before the shareholder became a resident in France. (*Continued on page 61*)



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Does your country tax resident individuals on their worldwide income? Does the tax base for residents include capital gains (whether as part of the income tax or as a separate tax)? Germany imposes an income tax (*Einkommensteuer*) on resident individuals on their worldwide income.¹ An individual will be subject to worldwide taxation if his residence or habitual abode is located in the Federal Republic of Germany.² An individual is deemed to be resident at the place where he maintains a dwelling under circumstances indicating that he will maintain and use that dwelling. Persons who spend more than six consecutive months in Germany are generally assumed to have their habitual abode in Germany. An individual may also elect to be treated as a German resident in limited circumstances. Unlike the United States, Germany does not impose income tax on the worldwide income of its non-resident German citizens. They may, however, be subject to tax on German-source income like any other nonresident.

An individual may nevertheless be found to be nonresident for treaty purposes on the basis of the tiebreaker rule (usually Article 4) in any relevant double taxation agreement to which Germany is party. In this case, the individual will continue to be treated as a German resident under internal law, but the scope of taxable income will be limited to those items of income in respect of which Germany as the source country (i.e., the country that loses the tie breaker) retains taxing rights pursuant to the relevant tax treaty.

The income tax is a national tax³ at progressive rates of up to 45% (plus 5.5% thereof as a solidarity surcharge) at the time of writing. In addition, municipalities impose a trade tax, which is, in effect, an income tax on business income derived by a German permanent establishment and not generally relevant to the present discussion.

Income tax is imposed on some but not all capital gains. If the shares were held as nonbusiness (private) assets, gain from a sale of shares is generally taxed as investment income to which a flat rate of 25% applies plus 5.5% thereof in solidarity surcharge. The tax rate is uniform, regardless of the holding period. This tax is generally collected by withholding when the issuer is in Germany or the security was held by a German disbursing agent such as a German branch of a German or foreign bank or broker. However, when the seller owned at least 1% of the corporation at any time during the preceding five years, the gain is treated as business income but the tax is imposed only on 60% of the gain⁴ (and, therefore, only 60% of losses from such assets are allowable⁵).

Subject to certain rollover provisions described below, gains derived in the course of business are taxed at ordinary income tax rates, including gains from shares held as business property. The same 60% rules described above apply to gain from shares held as business assets, regardless of the 1% threshold.⁶

Private capital gains include gains derived from private assets (other than shares and securities) and are taxable only

in the case of real property held for ten years or less⁷ and of personal property held for one year or less. For personal property, the holding period is extended to ten years if the relevant asset has produced taxable income at any time during this period.⁸ Otherwise, such gains are not taxable. In general, private capital losses may be set off only against private capital gains arising in the same year, with any excess carried back one year or carried over indefinitely.

Please describe the basic tax treatment of new and temporary residents. Do new or temporary residents benefit from any special treatment on gains, e. g., tax exemption or limited taxation (e.g., remittance basis) of foreign income or gains? The EStG did not use to provide general rules for special treatment of new or temporary residents. However, the jurisprudence and case history from the fiscal courts did fill some of the gaps that arose as a consequence—for instance, relative to taxation on departure. This has changed under new EStG provisions that define as taxable withdrawals of assets from, and contributions of private assets to, a business to include, under certain circumstances, events whereby Germany's right to tax such assets is limited or excluded (departures), or established (immigration).⁹ Germany does not exempt income derived by tax residents, but not remitted to, Germany.

Do new or temporary residents receive a fair market value adjustment to tax basis or comparable adjustment, e. g., pro rata allocation of gain to pre- and post-residence periods? As a matter of principle, once an individual has become a resident of Germany, he is taxed on income and capital gains realized during the period of residence in the same manner as an individual who has always been a resident of Germany. There is no general principle whereby all “incoming” assets are stepped up at the border.

However, there is a patchwork of rules that are complex and do not follow a consistent policy approach. At issue here is the avoidance of international double taxation that can arise if both the former country of residence (“departure country”) and Germany as the new country of residence (“receiving country”) attempt to tax the same gain that has accrued inside the incoming assets and that the incoming individual causes to come under the German taxing jurisdiction.

Example 1: Business property—deemed contribution of assets to a German business. G is a U.S. citizen and successful gallerist living in Los Angeles. He deals in paintings and sculptures. In 2013, G decides to open a new sculpture gallery in Frankfurt and to move to Germany. He physically moves the sculptures to Frankfurt to equip the new gallery. The sculptures were originally bought for 1,000 in 2010 and had a value of 1,500 when G made them part of the inventory of the new gallery in 2013. G becomes a German resident under internal law and the tie-breaker rules of the treaty. He continues to maintain the gallery in Los Angeles buying and selling paintings. In 2015, G sells the sculptures for 2,000.

For purposes of determining the German taxable gain from the sale of the sculptures, G is entitled to a step-up in basis to 1,500. When G made the sculptures part of the inventory of the Frankfurt permanent establishment as a



German tax resident, this created a German taxing right in respect of a future disposal of these assets. The law deems this a contribution of assets to a German business¹⁰ and such a contribution is accounted for at fair value.¹¹ The fair value of the sculptures is treated as their relevant acquisition cost for purposes of calculating gain from dispositions, regardless of how the United States taxes the gain. This step-up does not apply to private property that comes under the German tax jurisdiction by reason of the taxpayer moving to Germany.

Example 2. G also owns private residential property in Ibiza, Spain, that he originally bought for 2,000 in 2010. He sells it in 2015 for 4,000.

There is a gain of 2,000 taxable in Germany under internal law (capital gain inside the applicable ten-year holding period for real estate) regardless of any appreciated value at the time of G's immigration in 2013. The deemed contribution rule explained in Example 1 does not apply because the house in Ibiza does not constitute business property. The treaty with Spain does not provide for an exemption from German tax of gain from privately held real property located in Spain.

As noted above, German law provides for a special tax regime in respect of gain from 1%-or-greater shareholdings that do not constitute business property. Gain from the disposition of shares forming part of such a stake is generally

¹ The principal source of law is the *Einkommensteuergesetz* (EStG) (Income Tax Law). See www.gesetze-im-internet.de/estg/. Procedural law relating to most German taxes is in the *Abgabenordnung* (AO), www.gesetze-im-internet.de/ao_1977/index.html, with a translation at www.gesetze-im-internet.de/englisch_ao/index.html. In many cases, a law will be supplemented or interpreted by detailed legislative and administrative regulations (*Rechtsverordnungen* und *Verwaltungsrichtlinien*).

² AO sections 8 and 9.

³ While the legislation is passed on the national level, the income tax revenue is shared under complicated rules of fiscal federalism by the federal, state, and municipal governments.



computed as the excess of net sales proceeds over acquisition costs. The gain does not constitute investment income (which, as also noted above, is taxed at a flat rate of 25% plus solidarity surcharge) but income from a trade or business, although the securities are not business property.

If the individual can show that he was the beneficial owner of the stake at the time of establishing tax residency in Germany, he is entitled to a special step-up, but only if the departure country assesses him to tax under a departure tax regime comparable to Germany's. In that case, the value of the stake on which the departure country's tax assessment was based—but not in excess of fair value—is used instead of the shares' acquisition costs.¹²

Double taxation is not avoided under this rule if the following apply:

- Departure country A operates a departure tax regime.
- The individual owns a 1%-or-greater stake in a German company.
- He does not take residency in Germany but in third country X.
- He later sells the German shares at a profit.

Because the shares are German shares, the gain is taxable in Germany in the hands of the nonresident shareholder now living in X.¹³ However, the step-up to the value on which the departure country A based its assessment under its depart-

ture tax regime is not available as the German rules require the individual to take residency in Germany.

If an individual ceases to be a U.S. resident, he is treated under U.S. tax law as having sold property and is, therefore, taxed by the United States. The individual may then elect to be treated for purposes of taxation in Germany as if he had, immediately before ceasing to be a U.S. resident, sold and reacquired the property for its fair market value at that time.¹⁴

The United States imposes a tax on "covered expatriates" under Section 877A of the Internal Revenue Code. Under this section, for purposes of U.S. law, the individual who gives up U.S. citizenship or terminates long-term residence is treated as having sold all his assets worldwide. This may be covered by Article 13(6) of the Germany-U.S. income tax treaty, although it is not clear if it would apply to U.S. citizens since the tax in their case applies as a result of relinquishing citizenship rather than ceasing to be a U.S. resident. (Indeed, even if the covered expatriate were treated from the expatriation date as a U.S. resident under the definition of "resident alien" in IRC Section 7701(b), he would still be treated as selling his worldwide assets.) But Article 13(6) might apply to a long-term resident who ceased to be treated as a resident and thereby triggered the tax under Section 877A.

When the incoming assets constitute neither business property nor a 1%-or-greater stake in a company, German law does not provide for a step-up in basis. Any resulting double taxation would have to be addressed in a mutual agreement procedure under applicable treaties (see, for instance, Article 25 of the Germany-U.S. treaty).

Are there any special rules where tax is imposed or tax cost is adjusted when no actual sale occurs? When a long-term German resident holds a 1%-or-greater stake in a German or foreign corporation as a nonbusiness asset and departs to a low-taxing jurisdiction, the German departure tax rules treat this as a deemed sale of the stake.¹⁵

Capital gains tax imposed on gifts. Germany does not treat a gift as giving rise to a capital gain taxable to the donor. A German resident donee would pay gift tax on a scale that depends on the family or other relationship between donor and donee. For income tax purposes, the donee would generally inherit the donor's tax cost in the donated property.

Rollover of gains on corporate organization, contribution or reorganization transactions. Germany has extensive and complex provisions regarding mergers of corporations, contributions to corporations, and demergers. These provisions address the taxability of the transactions to the various parties and the effect on the tax base, losses, and other tax attributes. A detailed discussion of these provisions is beyond the scope of this article.

Other tax-free exchanges of property or rollover of gains. *Rollover of gains on sales of shares held as business property by a noncorporate holder.* Individual taxpayers may roll over up to €500,000 of gains realized on the disposition of shares in corporations.¹⁶ The rollover reduces the tax basis of the relevant replacement assets. These may include shares in corporations, depreciable personal property, or

⁴ EStG sections 17 and 3 no. 40(c).

⁵ EStG section 3c(2).

⁶ See EStG section 3 no. 40(a).

⁷ There is an exception for gain from the sale of a private home in which the taxpayer lived in the year of sale and the two preceding years. See EStG section 23(1), third sentence.

⁸ EStG section 23.

⁹ EStG section 4(1).

¹⁰ EStG section 4(1), eighth sentence.



buildings (but not land). Other limitations may apply such as the time period for acquiring a replacement asset. If the reinvestment does not take place in the same fiscal year, the taxpayer may establish a tax-deductible reserve that must later be released to the acquisition costs of the replacement asset or, if no replacement is made within the applicable statutory period, to taxable income. If the reserve is not rolled over, interest at 6% of the taxable amount of the release will come due for each full year in which the reserve was maintained.

Basis (tax cost) adjustments on death or other non-sale transactions. Section 6 of the AStG treats several events other than expatriation as also giving rise to a deemed sale of a 1%-or-greater stake in a corporation. These include:

- Conveyance of the stake *inter vivos* or at death to a non-resident recipient.

¹¹ EStG section 6(1) no. 5a.

¹² EStG section 17(2). This rule applies in parallel to the treaty rules described below.

¹³ EStG section 49(1) no. 2(e). If X has a tax treaty with Germany, the treaty may prevent Germany from taxing the capital gain.

¹⁴ See Art. 13(6) of the Germany-U.S. income tax treaty. Practically all German treaties that provide for a departure clause require the receiving state to grant a step-up to FMV as per the time of immigration. At least a dozen German treaties provide for a step-up to the asset value on which the departure country based its departure tax.

¹⁵ See German Foreign Tax Act (*Aussensteuergesetz*) (AStG), section 6.

¹⁶ EStG section 6b(10).

¹⁷ EStG section 17(4).

¹⁸ See Haag and Richter, "German Gift Tax on Trust Distributions," 70 Tax Notes Int'l 1307 (Tax Analysts, 2013), available at the authors' law firm's website, www.pplaw.com/sites/default/files/publications/2013/06/ari-mh-2013-german-gift-tax-trust-distributions.pdf.

¹⁹ Haag and Richter, *id.* at 1308, referring to EStG section 20, para. 1, no. 9, sentence 2 and section 32d, para. 1.

²⁰ EStG section 17(2), fifth sentence.

- Establishment by the stakeholder of a foreign residence that causes him to lose German treaty residency under the relevant treaty tie-breaker rule.
- Contribution of the stake to a non-German business or permanent establishment.
- Any other event that results in the loss or limitation of Germany's right to tax capital gains from the stake.

Is a distribution by a company in liquidation taxed as a dividend, capital gain, or any combination?

A liquidating distribution is treated as a dividend to the extent that the company has current or accumulated profits and as a repayment of capital for the non-dividend portion of the distribution.¹⁷

How does Germany tax a pre-residence sale of property when parts of the proceeds of sale are received before and parts after the individual becomes a resident? If the sale occurred while the individual was a nonresident and the sale did not generate German-source income, the receipt of proceeds after the immigration of the recipient is not taxable.

How does Germany treat a distribution from a foreign trust to a resident beneficiary of property that has increased in value while the property was held by the trust? Is the beneficiary treated as having income or gain from the distribution? As often in civil law countries, German law did not recognize the concept of trusts. However, as in other civil law countries, Germany has encountered trusts with German beneficiaries and has had to consider the tax consequence. In a 2012 decision of the Bundesfinanzhof (German Supreme Tax Court), it was made clear that German gift tax will apply to trust distributions to a German beneficiary.¹⁸ The decision did not, however, make clear if income tax also applies to the distribution. Two commentators on the decision nevertheless expressed concern that income tax might—indeed was even likely to—apply to distributions.¹⁹ Presumably, the amount of any distribution *in specie* would be the fair market value of the distributed property.

How is the beneficiary taxed when he later sells the distributed property and how would gain be calculated? As regards a trust distribution involving corporate shares, this is treated as a gratuitous conveyance, not an acquisition for consideration. Consequently, the beneficiary's tax basis in the shares would be that of the trust (typically, the trust's acquisition costs, assuming that the trust acquired the shares for consideration).²⁰ This is true even if the distribution of the property occurred prior to the beneficiary establishing German tax residency.

If an individual moves to Germany and later receives a distribution from a company that is attributable to pre-residence profits, how is that distribution taxed? Any special rules because the profits of the distributing corporation were accumulated before the shareholder became a resident in Germany? The distribution would be treated under generally applicable rules, i.e., taxed regardless of whether the distribution was funded out of pre- or post-immigration proceeds. ●



We Will Be Landing Soon

In the transition from nonresident to resident status, and in the context of a variety of assets and potential sources of income and gains, what can tax professionals expect in countries other than their own?

EDITED BY
MICHAEL J. A. KARLIN
(UNITED STATES)



A Multinational Survey of the
Treatment of Income and Gains of
Individuals Who
Change Residence

PART 2 This article continues the survey, begun in Part 1, of the treatment of individual taxpayers who change their residence to various countries. The law and practice in each country are described by a distinguished commentator based on a uniform structure proposed by the editor. The authors were also invited to comment on any issues peculiar to their jurisdiction that they considered relevant.

Part 1 of the article (28 JOIT 28 (April 2017)) covered Canada, France, and Germany. Part 2 below discusses Israel, Japan, Luxembourg, Mexico, and the Netherlands. Part 3, in a forthcoming issue, will look at Switzerland, the United Kingdom, and the United States.



Israel

Jeremy M. Cohn, Jerusalem

Does Israel tax resident individuals on their worldwide income? Does the tax base for residents include capital gains (whether as part of the income tax or as a separate tax)? Israel taxes resident individuals on their worldwide income.¹ Capital gains are assessed separately.² The tax rate on capital gains is generally 25% (but this is higher for assets acquired prior to the end of 2002). An inflationary allowance, equal to the rise in the consumer price index, is deductible from the gain, and (on sale of assets acquired after 1993) this amount is thus not taxed. Capital gains must be declared, and tax paid on account, within 30 days of the transaction being executed (normally, the date of signing the agreement).

Income Tax Ordinance (ITO) s.88 contains the definitions pertinent to the imposition and calculation of capital gains, and s.89 says that “[t]he law applicable to income shall apply to consideration. . . and the law applicable to taxable income shall apply to capital gains.” In this way, all operative sections of the Ordinance apply equally to capital gains as they do to income.

Subject to bilateral tax treaties, residents are subject to capital gains tax on their worldwide gains. Foreign residents are subject to Israeli tax on gains from Israeli situated assets (but subject to certain exemptions discussed below).

Gains from the disposal of Israeli real estate—including, for this purpose, sale of shares in a corporate entity in which the sole or main asset is Israeli real estate—are subject to a

different tax, the land appreciation tax (Taxation of Real Estate Law). The tax is calculated and assessed in a manner essentially identical to capital gains tax.

Please describe the basic tax treatment of new and temporary residents. Do new or temporary residents benefit from any special treatment on gains, e.g., tax exemption or limited taxation (e.g., remittance basis) of foreign income and/or gains? Although there are rebuttable presumptions of residence, based on day-counts, the only substantive test of residence is the “center-of-life” test.³ This is defined in the ITO but the definition is substantially the same as in treaty tie-breakers worldwide (including availability of a home, habitual residence, place of business or employment, and economic, social, and cultural ties). This test is thus more akin to the test of domicile in other jurisdictions, which means that it is perfectly possible to spend an entire year in Israel without being considered resident, or an entire year outside Israel without being considered nonresident. Someone moving to Israel will, regardless of visa status, usually be considered a resident (at least with hindsight) from the date of arrival.

A person becoming resident for the first time, or becoming resident again after ten full tax years of nonresidence, is exempt, for ten years from the date of becoming resident, from tax on any gains on sale of assets held outside Israel.⁴ When such an asset

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Editor's Note From Michael J.A. Karlin

Part 1 dedicated this series of articles to the late **Sakura Shiga** (志賀櫻) and I would like to recount a little of Shiga-sensei's distinguished career. After graduating with an LL.B. from the University of Tokyo in 1971, Shiga-sensei served in the Ministry of Finance of Japan for over 30 years, from 1971 to 2002. During that time, he occupied many important roles in finance and taxation. In 1988, he began a three-year posting as the fiscal counsellor to the Japanese Embassy to the United Kingdom becoming, in the process, an enthusiastic anglophile. He then undertook a series of increasingly prominent appointments, including Deputy Director General of the Ministry's International Finance Bureau, Commissioner for International Affairs at the Financial Services Agency, and Director of International Tax Affairs. In 2002, he began his own very busy private practice as a tax litigator and advisor but also continued to serve the public both in Japan and internationally, including on the Executive Committee of the International Fiscal Association, the Japan Federation of Bar Associations, the editorial board of BNA International's Tax Treaties Analysis, and as Visiting Professor at Kokugakuin University. He was a prolific writer and speaker, his books, articles, and lectures far too numerous to list here. He was a lover of opera and American sports teams. But above all, he was a warm and welcoming colleague, with a mischievous sense of humor who loved life and left us too soon.

Although he was already gravely ill, Shiga-sensei was one of the first to offer to contribute to this article and provided an outline shortly before he passed away in December 2015. I am grateful to Eiichiro Nakatani and Kohei Kajiwara for agreeing to undertake the work that Shiga-sensei was unable to fulfill.



is sold after more than ten years of residence, a pro rata exemption will still apply (on a linear basis) to the amount of the gain attributable to the period that includes both any holding prior to becoming resident and the first ten years of residence.

A similar exemption applies to all foreign-sourced income.⁵ Once the exemption has been triggered, which happens automatically with the assumption of residence, it will continue to run notwithstanding periods of absence from Israel. Further, foreign-sourced income and gains that are exempt from tax are also exempt from any reporting requirement.⁶

Persons who would normally qualify for the exemption can elect to be treated as a foreign resident for the first year of their residence. In this way, if they then leave Israel before that "probationary" year has expired, they will not have triggered application of the exemption and will be entitled to use it at some stage in the future.

Under income tax regulations of 2006, certain categories of people (who may, for this purpose, be considered "temporary residents") who have become resident under the normal center-of-life test, can, as long as they are not "new immigrants" to Israel, elect to be treated as foreign residents. This includes diplomats and their immediate family members, soldiers of foreign armies or U.N. forces, journalists (for up to five years), and, for up to three years, students, teachers, and ministers of religion. As nonresidents, they will be subject to Israeli tax only on Israeli-sourced income and gains.

Israel will not issue a certificate of fiscal residence, for treaty purposes, to a person who has made the election for a probationary period or under the 2006 Regulations.

Do new or temporary residents receive a fair market value adjustment to tax basis or comparable adjustment, e.g., pro rata allocation of gain to pre- and post-residence periods? Addressed above.

Are there any special rules where tax is imposed or tax cost is adjusted when no actual sale occurs? Capital gains imposed on gifts. Any "disposal" is a sale for tax purposes, and this includes a disposal without consideration—a gift.⁷ There is an exemption for gifts to close relatives, and for other gifts when the tax office is persuaded of the bona fides of the gift.⁸ This does not apply to gifts to foreign residents. When the exemption applies, the recipient will take the asset without a stepped-up basis, such that, on eventual sale, the recipient will be taxed on the gain that arose during the period that the donor held the asset.

Rollover of gains on corporate organization, contribution, or reorganization transactions. Gains can be rolled over in all

of these circumstances, subject to stringent and specific anti-avoidance rules, and, in many cases, to either receipt of a ruling from, or filing notice with, the tax authority.⁹

Other tax-free exchanges of property or rollover of gains. Donations to recognized charities are exempt from capital gains tax,¹⁰ and sale by the charity will also, usually, be exempt.¹¹ Foreign residents are, subject to certain limitations (notably when the holder is a permanent establishment of the foreign resident in Israel or the underlying asset is Israeli real estate) exempt from tax on sales of shares registered on an Israeli stock exchange,¹² and also shares in certain private companies.¹³ Gains can be deferred both on issue and vesting and on certain exercises of options held within employee option plans, but only after receipt of a ruling on the plan and subject to certain elections and conditions (including that the options be held in trust).¹⁴

Basis (tax cost) adjustments on death or other nonsale transactions. There is no estate or inheritance tax in Israel, and death is not a capital gains event. However, as with gifts (see above), the heir does not take the asset with a stepped-up basis.

Is a distribution by a company in liquidation taxed as a dividend, capital gain, or any combination? Distribution of liquidation proceeds is considered capital gain.¹⁵ As the tax rate that applies to capital gains is the same as the rate that applies to dividends, there is very little practical difference.

How does Israel tax a pre-residence sale of property when part of the proceeds are received before, and part after, an individual becomes a resident? For capital gains purposes in Israel, the effective date of the transaction is the date that it is executed. The date of payment of the proceeds is thus not relevant.

How does Israel treat a distribution from a foreign trust to a resident beneficiary of property that has increased in value while the trust held the property? The taxation of trusts in Israel is very new and was revised drastically with effect from January 2014. Although the tax authority very recently finally issued guidelines covering some of the (many) *lacunae* in the legislation, there are still very many unanswered questions, and this must be considered a work in progress.

The general rule is that trust income is always taxed at the level of the trust, and that distributions are not then tax events. This applies also to capital gains. In general, any trust that has an Israeli resident beneficiary is treated as subject to tax in Israel. When the settlor is and has remained a foreign resident, the settlor or the settlor's spouse who was the spouse at the date of settlement is still alive, and the Israeli resident beneficiary is a close relative, the trust is classified as a "family trust" and the

beneficiary pays a tax of 30% on any distributions except of demonstrable original capital. The trustees can elect to earmark a certain percentage of income or gains for the Israeli resident beneficiary and pay 25% tax on an accrual basis, regardless of whether they are then distributed. After the deaths of the settlor and spouse, these routes no longer apply, and the trust will be taxed as an Israeli residents trust. When a settlor or beneficiary become resident in Israel, there may be limited exemptions available to the trustees, equivalent to the ten-year exemption for new residents, but in many cases this is more restricted than if there were no trust.

Is the beneficiary treated as having income or gain from the distribution? Except in the case of the “distribution tax” route applicable to family trusts, a distribution from a trust is not treated as a tax event.

How is the beneficiary taxed when he later sells the distributed property and, specifically, how would gain be calculated? If the settlor contributed the asset *in specie*, the basis will be the settlor’s basis, subject to a concessionary step-up to the date of contribution in certain family trusts (see above). If the trustees bought the asset, the basis is the purchase price. In other words, there is no step-up to the date of distribution.

If an individual moves to Israel and later receives a distribution from a company that is attributable to pre-residence profits, how is that distribution taxed? Any special rules because the profits of the distributing corporation were accumulated before the shareholder became a resident in Israel? In view of the ten-year tax exemption for someone becoming resident for the first time, this is an unlikely scenario. However, in the case of a dividend paid after expiration of the exemption period, no relief is offered for accumulation of those profits during the exemption period. In a closely held company, this would make payment of the dividend before the end of the exemption period attractive. When the company is a CFC, there is a deemed dividend of all passive income annually.¹⁶

¹ Income Tax Ordinance (ITO) s.2. An unofficial English translation is available from the Ministry of Finance at [www.financeisrael.mof.gov.il/Financelsrael/Docs/En/legislation/Fiscallssues/5721-1961_Income_Tax_Ordinance_\(New_Version\).pdf](http://www.financeisrael.mof.gov.il/Financelsrael/Docs/En/legislation/Fiscallssues/5721-1961_Income_Tax_Ordinance_(New_Version).pdf).

² ITO s.91.

³ ITO s.1.

⁴ ITO s.97(b).

⁵ ITO s.14.

⁶ ITO s.134B.

⁷ ITO s.88.

⁸ ITO s.97(a)(5).

⁹ ITO ss.102-105.

¹⁰ ITO s.97(a)(4).

¹¹ ITO s.9(2).

¹² ITO s.97(b2).

¹³ ITO s.97(b3).

¹⁴ ITO s.102.

¹⁵ ITO s.93A.

¹⁶ See ITO s.75B.



Eiichiro Nakatani and Kohei Kajiwara, Anderson Mori & Tomotsune, Tokyo

Taxpayers. Individual taxpayers under the Income Tax Act are classified into three categories:

1. *Permanent resident.* An individual who satisfies both of the following requirements:¹ (a) has a “residence” (*jusho*) in Japan, or has continuously stayed in Japan for one year or more;² and (b) does not fall within the category of a non-permanent resident as below.
2. *Non-permanent resident.* An individual who satisfies all of the following requirements:³ (a) has a “residence” (*jusho*) in Japan, or has continuously stayed in Japan for one year or more; (b) does not have Japanese nationality; and (c) has not had “residence” (*jusho*) in Japan or stayed in Japan, in aggregate, for more than five years within the most recent ten years.
3. *Nonresident.* An individual who has no “residence” (*jusho*) in Japan or who has not stayed in Japan continuously for one year or more.⁴

Taxable income. Individual taxpayers are subject to income tax on the following income depending on their residency status:

- *Permanent resident*—worldwide income (including capital gains: same hereinafter).⁵
- *Non-permanent resident*—all non-foreign sourced income, and any portion of foreign sourced income (see below) that is paid in or remitted into Japan.⁶
- *Nonresident*—domestic sourced income (see below).⁷

There are no fair market value adjustments or comparable adjustments for new or temporary residents when they become a resident of Japan.



Domestic-sourced income. Domestic-sourced income includes, in particular, the following items:⁸

- Income of an enterprise attributable to a permanent establishment in Japan.
- Income from utilization or holding of assets located in Japan.
- Income from transfer of certain kinds of assets in Japan, such as real estate located in Japan or controlling shares in a Japanese corporation.
- Consideration for personal services provided in Japan.
- Consideration for lending of real estate located in Japan.
- Dividend received from a domestic corporation.
- Royalty for IP received from a person who performs operations in Japan.

Foreign-sourced income. Foreign-sourced income includes, in particular, the following items:⁹

- Income of an enterprise attributable to a permanent establishment outside of Japan.

- Income from use or holding of assets located outside Japan.
- Income from transfer of certain kinds of assets outside Japan, such as real estate located outside Japan or controlling shares in a foreign corporation.
- Consideration for personal services provided outside Japan.
- Consideration for lending of real estate located outside Japan.
- Dividend from a foreign corporation.
- Royalty for IP from a person who performs operations outside Japan.

Special treatment for capital gains. Capital gains on gifts. When an individual transfers property to a corporation without charge or at a price less than half of the fair market value, the taxpayer is deemed to have transferred the property at the fair market value and the income tax is accordingly imposed on the capital gains.¹⁰

On the other hand, in principle, when an individual transfers property to another individual without charge, no gains are recognized. In addition, when an individual transfers a property to another individual at a price less than half of the fair market value, and the price is lower than the acquisition cost and transfer cost, such loss is not recognized.

Other than above, when an individual transfers property to another individual, the income tax is imposed on the capital gains based on the actual transfer price. In addition to income tax on an individual transferor, an individual transferee is subject to gift tax (see “Other issues—Gift tax” below).

Rollover of gains on corporate organization, contribution, or reorganization transactions. There are some gain rollover rules for corporations, not for individuals. In principle, corporations are subject to corporate tax on the capital gains from the transfer of the property in corporate reorganizations, such as a corporate merger or split. However, if the requirements (such as 100% holding of shares of a corporation by another corporation) are satisfied, the corporation is not subject to corporate tax on the capital gains arising in a corporate reorganization (qualified corporate reorganization). In such a case, the successor corporation succeeds to the tax base of the properties.

Other tax free exchanges of property or rollover of gains. There are further special rules, above all, as follows:

¹ Article 2(1), item 3 of the Income Tax Act; all reference to Article numbers in this section are to the Income Tax Act unless otherwise stated. The Japanese government publishes the original Japanese text of Acts and abridged translations: Original Japanese text: law.e-gov.go.jp/htmldata/S40/S40HO033.html; English translation: www.japaneselawtranslation.go.jp/law/detail/?id=52&vm=04&re=02. However, the translations do not necessarily reflect the most recent amendments to Acts and the translation date at the headnote on each link should be checked. In addition, the National Tax Agency publishes guidance for aliens to file the tax return: www.nta.go.jp/tetsuzuki/shinkoku/shotoku/tebiki2015/pdf/43.pdf#search=income+tax+aliens.

² “Residence” (*jusho*) is a specific concept peculiar to Japanese law. Though it is often translated as “domicile,” it is not precisely comparable. *Editor’s note:* One American author has defined it as where one lives for the purpose of pursuing a livelihood. See www.yoshabunko.com/citizenship/Citizenship_Japan_and_US_article.html. This evokes parallels to the U.S. concept of a tax home, meaning the taxpayer’s regular (or if more than one, principal) place of business that is used for determining if the taxpayer is “away from home” for purposes of deducting expenses and also for application of certain aspects of the definition of residence in IRC Section 7701(b).

³ Article 2(1), item 4.

⁴ *Id.* item 5.

⁵ Article 7(1), item 1.

⁶ *Id.* item 2.

⁷ *Id.* item 3.

⁸ Article 161(1).

⁹ Article 95(1) and (4).

¹⁰ Article 59(1), item 1.

- When a resident exchanges a certain kind of a fixed asset that he has had for more than one year for the same kind of fixed asset, and their fair market values are similar, and the resident will use the newly obtained fixed asset for the same purpose, it is deemed that there will have been no transfer of the fixed asset and income tax will not be imposed on any capital gain attributable to the fixed asset.¹¹
- When a resident transfers a certain kind of asset, and acquires and starts to use the similar kind of asset shortly afterwards, it is deemed that there will have been no transfer of the asset and income tax will not be imposed on any capital gain attributable to the asset.¹²

Tax base adjustment for inheritance/gift. In principle, on the death of the owner of a property and transfer to an heir by inheritance, the heir will succeed to the tax base. When the owner (that is not a corporation) of a property gives the property to a recipient, the recipient will also succeed to the tax base.¹³ Apart from the above, as mentioned previously, the transferee is subject to gift tax. In addition, the heir is subject to inheritance tax. With regard to gift tax, see “Other issues—Gift tax” below.

Liquidation of corporation. The proceeds that a shareholder receives on liquidation of the corporation are divided into a capital gains portion and a constructive dividends portion.¹⁴ Details of the calculation are technical and complicated.

Taxable at the time of sale. Taxable income is deemed to be accrued at time that the property is transferred. Therefore, as long as the taxable property in Japan is sold and transferred when the seller is a nonresident, such pre-residence sale is taxed as domestic-sourced income of the nonresident, even if part of the sale proceeds are received after the seller has become a resident. The nonresident must submit a tax return and pay income tax.

If a nonresident sells real estate located in Japan, the purchaser is obligated to withhold income tax at a rate of 10.21% of the amount of the consideration and pay it to the tax authority.¹⁵ Notwithstanding the above, the purchaser is not obliged to withhold tax if (1) the purchaser is an individual;



(2) the consideration is paid for the purpose of using it as his own or his relative's residence; and (3) the consideration of the real estate is not more than 100 million yen.¹⁶

Trusts are treated as transparent. In principle, trusts are treated transparently from a tax perspective. Therefore, the beneficiary is deemed to have the income or gains arising in the settled property.¹⁷ As the beneficiary has already been taxed at the time that the settled property receives income or gains, he will not be taxed when he later receives the settled property.

Dividend income attributable to pre-residence period. When a nonresident receives dividends from a corporation in Japan, the corporation is obligated to withhold income tax at a rate of 20.42% (or 15.315% in the case of dividends from listed shares, excluding those for major shareholders) and pay it to the authority.¹⁸ Likewise, when a resident receives a dividend from a corporation in Japan, the corporation is also obliged to withhold income tax at the same rate.¹⁹

¹¹ Article 58(1) and (2).

¹² E.g., Articles 36-2(1) and 37-5(1) of the Act on Special Measures Concerning Taxation. Original Japanese text: law.e-gov.go.jp/htmldata/S32/S32HO026.html; English translation: www.japaneselawtranslation.go.jp/law/detail/?id=1847&vm=&re=02.

¹³ Article 60(1), item 1.

¹⁴ Article 25(1), item 3; Article 37-10(3), item 3, of the Act on Special Measures Concerning Taxation.

¹⁵ Article 212(1), Article 213(1), item 2, Article 161(1), item 5; Article 28(1) and (2) of the Act on Special Measures Concerning Securing Financial Resources Necessary for Reconstruction From the Great East Japan Earthquake. Original Japanese text: law.e-gov.go.jp/htmldata/H23/H23HO117.html.

¹⁶ Article 281-3 of the Order for Enforcement of the Income Tax Act.

¹⁷ Article 13(1).

¹⁸ Article 212(1), Article 213(1), Article 161(1), item 9; Article 9-3, item 1 of the Act on Special Measures Concerning Taxation; Article 28(1) and (2) of the Act on Special Measures Concerning Securing Financial Resources Necessary for Reconstruction From the Great East Japan Earthquake.

¹⁹ Article 181(1), Article 182, item 2; Article 9-3, item 1 of the Act on Special Measures Concerning Taxation; Article 28(1) and (2) of the Act on Special Measures Concerning Securing Financial Resources Necessary for Reconstruction From the Great East Japan Earthquake. There is no rule providing for the division of the amount between the periods before and after the residency status has changed.

²⁰ E.g., Japan-U.S. tax treaty, Article 13(7).

²¹ E.g., Japan-Canada tax treaty, Article 13(4).

²² Article 95(1).

²³ Article 60-2.

²⁴ Article 170(3), item 1 of Order for Enforcement of the Income Tax Act, and Appendix 1 of the Immigration Control and Refugee Recognition



Other issues. Tax treaties. Some tax treaties amend the rules under Japanese law and stipulate that transfer of property in Japan by nonresident do not need to be taxed in Japan, except for special cases, e.g., real estate.²⁰ On the other hand, some other tax treaties stipulate that transfer of property in Japan by a nonresident can be taxed in Japan.²¹

Foreign tax credit. The amount of tax paid to foreign authorities is credited from the Japanese income tax, under certain requirements.²²

Standard planning scheme. No standard planning schemes seem to exist under Japanese tax laws.

Exit tax. A resident who exits Japan, meaning that the resident no longer has a “residence” (*jusho*) or ceases to stay continuously in Japan, is deemed to have transferred his securities at fair market value and will be taxed on any capital gain if he satisfies, above all, all of the following requirements.²³

- The amount of securities held is 100 million yen or more.
- He had a “residence” (*jusho*) in Japan or has stayed in Japan, in aggregate, for more than five years within the most recent ten years.

As an exception, an alien who resides in Japan under the following residence statuses does not include the period of residence under such statuses in a period when he has had “residence” (*jusho*) in Japan or has stayed in Japan:²⁴

- Diplomat, official, professor, artist, religious activities, and journalist.
- Highly skilled professional, business manager, legal/accounting services, medical services, researcher, instructor, engineer/specialist in humanities/international services, intracompany transferee, entertainer, skilled labor, and technical intern training.
- Cultural activities and temporary visitor.
- Student, trainee, and dependent.
- Other activities that the Minister of Justice designates.

Gift tax. When an individual transfers any property to another individual without charge, the transferee is subject to gift tax on condition that (1) the transferee has a “residence” (*jusho*) in Japan; (2) the transferee has Japanese nationality and he or the transferor has a “residence” (*jusho*) in Japan within the most recent five years;²⁵ or (3) the transferor has a “residence” (*jusho*) in Japan.²⁶

Even if the conditions above are not satisfied, the transferee is subject to gift tax as long as a transferred property is located in Japan.²⁷ In addition, even if a transfer is conducted with charge, the transferee is subject to gift tax as long as it is a remarkable low price.²⁸

Act. Original Japanese text: law.e-gov.go.jp/htmldata/S26/S26SE319.html; English translation: www.japaneselawtranslation.go.jp/law/detail/?id=2647&vm=04&re=02. For the list of statuses, see also www.immi-moj.go.jp/english/tetuduki/kanri/qaq5.html.

²⁵ The 2017 Tax Reform Proposal, which the Japanese cabinet approved on December 22, 2016, says that the period will be extended from five to ten years. It will apply to transfers after April 1, 2017.

²⁶ Article 1-4, items 1 and 2, and Article 2(1) of the Inheritance Tax Act. Original Japanese text: law.e-gov.go.jp/htmldata/S25/S25HO073.html. The 2017 Tax Reform Proposal says that if only a transferor has a “residence” (*jusho*) in Japan within the most recent ten years, the condition will be satisfied and a transferee will be subject to gift tax on any property transfer. It will apply to transfers after April 1, 2017.

²⁷ Article 1-4, item 3, and Article 2(2) of the Inheritance Tax Act.

²⁸ Article 7 of the Inheritance Tax Act.



James T. O'Neal, AMMC Law, Luxembourg

Overview of taxation of gains. Short answer: Luxembourg taxes capital gains at the same rates as ordinary income though subject to reductions or even exemptions depending generally on whether the capital gains are related to immovable (e.g., real estate) vs. movable property (e.g., shares, stocks, goods) and the holding period of the asset: speculative (short term) vs. long term. For individuals, this is a gradual rate from 0% up to 43.6%, taking into account the unemployment fund surcharge as well. Luxembourg includes worldwide income and capital gains in the tax base.

Speculative (short-term) capital gains. A capital gain is speculative if an immovable asset is sold within two years from its acquisition. For moveable property, the period is six months from acquisition. Speculative capital gains are generally taxed at the full individual tax rate to the extent that they exceed 500 € per annum. Speculative gains and losses can be offset to result in a net speculative gain or loss.

Long-term capital gains. Long-term capital gains are generally subject to the following reduced rates:

- The default rule is half the applicable rate (e.g., the maximum rate of 43.6% would be reduced to 21.8%) if the moveable property is held more than six months or the immovable property is held more than two years.
- Exemption from capital gains if it is the taxpayer's main residence.
- Exemption from capital gains if the shareholding is less than 10% of the issued shares of the company.

A deduction of up to 50,000€ (double for married couples) is available once every ten years.

Luxembourg generally has no "controlled foreign corporation" (CFC) regime. Therefore, it may be possible with appropriate planning to hold investment portfolios via an offshore company or other investment vehicle and thus defer the investment portfolio income until dividends are paid or capital gains occur on the sale of the investment vehicle's shares.

Further, a special tax regime applies to carried interest payments received by employees of (1) alternative investment funds' managers, and (2) management companies of alternative investment funds, as defined. Eligible employees can benefit from a reduced rate on capital gains of approximately 10% if certain conditions are met (primarily that the employee transferred his residence to Luxembourg in 2013 or during one of the five following years and has neither been tax resident nor subject to taxation on his professional income in Luxembourg during the five-year period preceding 2013). This special regime is available for ten years after the year in which the employee started his relevant professional activity in Luxembourg.

Treatment of new and temporary residents. An individual qualifies as a tax resident in Luxembourg if his domicile or usual abode is in Luxembourg:

- A domicile is defined as a permanent home that the individual actually uses and intends to maintain.

- A usual abode is deemed to exist if the individual remains in Luxembourg for more than six consecutive months (short periods of absence are disregarded).

Tax residence applies from the first day of the individual's presence in Luxembourg. There is no specific tax regime for temporary residents.

A specific tax regime that applies to certain inbound employees ("inpatriates") aims at attracting foreign workers and encouraging them to settle in Luxembourg. If the conditions are met, it is possible to obtain a tax relief for certain expenses that fall under certain categories (e.g., relocation, school fees, home leave, tax equalization). Other than the benefits when certain expenses can be offset against taxable income, there is no "expat regime" as in other EU countries such as the Netherlands or Ireland.

The principle of step-up in value was enacted in Luxembourg as of December 2015 (applicable to tax years starting in 2015). Under this principle, any non-Luxembourg resident individual who becomes a Luxembourg tax resident may revalue the purchase price of securities to their market value on the day that the person becomes a Luxembourg tax resident. This beneficial regime would apply only to substantial shareholdings (i.e., holdings of more than 10% of the share capital of a company) and to convertible loans when the taxpayer also holds a substantial shareholding in the issuer of the loan.

Are there any special rules where tax is imposed or tax cost is adjusted when no actual sale occurs? Capital gains imposed on gifts. A gift tax is levied on gifts made during the individual's lifetime (inter vivos gifts). A notarial deed is, in principle, required to evidence gifts under Luxembourg law. Gifts that are not required to be made in writing (e.g., gifts on certain non-real estate assets) are generally accepted without notarial deed and thus without registration. In this case, no tax is due unless the donor dies within the civil year (the value of the gift is then reintegrated in the transferred estate for the computation of inheritance tax).

Gift taxes are based on a percentage of the value of the property. The percentage duty depends on the degree of relationship between donor and donee. For gift tax purposes, the fiscal domicile of donee and donor are irrelevant. Moreover, gifts of immovable property may be subject to an additional transfer duty of 1% (*droit de transcription*). Inter vivos gifts to direct-line heirs, which qualify as ancestors' partition (*partage d'ascendants*), are exempt from transfer duty.

Rollover of gains on corporate organization, contribution or reorganization transactions. Taxation of gains of resident individuals on realization of shares representing the assets of a business may be deferred by reinvesting the sale proceeds into other fixed assets under certain conditions (Article 54 of Luxembourg income tax law (*Loi concernant l'impôt sur le revenu*) (LIR)). The deferral can also take place in a share-for-share exchange in application of Article 22bis LIR, providing for tax neutrality of an exchange of shares if certain conditions are met.

Other tax-free exchanges of property or rollover of gains.

None.

Basis (tax cost) adjustments on death or other non-sale transactions. For the determination of the tax basis subject to inheritance/transfer tax, it is possible to deduct liabilities guaranteed by the assets transferred as well as liabilities related to the purchase, improvement, and keeping of the assets, as they exist on the day of the death. No inheritance/transfer tax is due on transfers of property in the direct line of descent. The same applies to the transfer of assets in favor of the spouse or declared domestic partner in presence of common children or descendants. Inheritance/transfer taxes are progressive and vary from 0% to 48% (including a surcharge) according to the degree of relationship between the beneficiary and the deceased and the value of the property inherited.

Treatment of distribution by a company in liquidation (dividend, capital gain, or any combination). The sums received from liquidation of a company are generally characterized by the shareholder as capital gain (see above). Luxembourg, therefore, generally exempts all liquidation proceeds from withholding tax on dividends.

Pre-residence sales when proceeds received post-residence.

Luxembourg nonresidents are taxable only on their Luxembourg source income. If at the time of the transaction generating the gain the individual is not a Luxembourg tax resident, the gain should not cause any Luxembourg taxes (no matter when the seller effectively receives the sale proceeds) except if the gain is considered Luxembourg-source income.

Capital gains that a nonresident shareholder realizes on disposal of shares in a Luxembourg company are, in principle, not subject to tax in Luxembourg unless the shareholding exceeds 10% and the shares are sold less than six months after their acquisition. Several Luxembourg double tax treaties eliminate this nonresident short-term capital gains tax on the disposal of Luxembourg company shares.

Treatment of distributions by trusts. Luxembourg law recognizes foreign trusts (an agreement under which a fiduciant (principal) agrees with a fiduciary (trustee) that, subject to the obligations determined by the parties, the fiduciary becomes the legal owner of assets), but it does not provide for the possibility to set up Luxembourg trusts. The Luxembourg tax treatment on trust and fiduciary operations is based on general tax principles (i.e., there are no specific trust tax provisions under Luxembourg tax law) and depends on the terms and conditions of the trust agreement to be analyzed case by case.

Is the beneficiary treated as having income or gain from the distribution? Generally, under Luxembourg tax principles, there are the following outcomes:

- If the settlor (grantor) retains powers such that it could be considered a "revocable" trust and the settlor is also



Mexico

resident in Luxembourg, any income or gains that the trust earns could be subject to tax in Luxembourg.

- If the settlor (grantor) sets up an “irrevocable” trust such that no powers of revocation remain, the trust should become the taxable person. However, beneficiaries may be taxed on trust income and gains that are actually distributed or made available.
- If the trustee manages a foreign trust from Luxembourg, there could be a risk of a permanent establishment and Luxembourg taxation on the ongoing trust income and gains.

How is the beneficiary taxed when he later sells the distributed property and how would gain be calculated? If the beneficiary is Luxembourg resident, he normally would have already been taxed on the distributed property at its fair market value at the time of distribution. Thus, in any subsequent disposition by the beneficiary, the tax basis of the property would be its FMV

Post-residence distributions by companies of pre-residence profits. Luxembourg resident individuals are taxable on their worldwide income. Thus, any distribution received from a company (even attributable to pre-residence profits) should still be subject to standard progressive Luxembourg corporate income tax rates.

Planning and noteworthy rules. A frequently used planning device is the Luxembourg private wealth management company (*societe de gestion de patrimoine familial*) (SPF), which allows for tax exemption of income and capital gains on securities and other similar investments, as well as exemption from withholding taxes on distributions.

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Does Mexico tax resident individuals on their worldwide income? Mexico imposes income tax¹ on resident individuals based on their worldwide income.² If applicable, domestic legislation provides a foreign tax credit that can be applied for taxes paid abroad and thereby reduce the tax burden.³ This is available for taxes paid directly by the Mexican resident and, if certain conditions are met, by a foreign entity owned by the Mexican resident (indirect credit). The credit applies against taxable income received in Mexico from abroad.

Mexican legislation provides very straightforward rules when a nonresident individual becomes a tax resident in Mexico.⁴ Once an individual becomes a resident and sells or otherwise disposes of pre-residence acquired property, he must compute gains comparing the original acquisition cost, according to general rules applicable to Mexican residents.⁵ This might be construed as applying even if the property was acquired years before having residence status in Mexico, since there is no specific rule for “tax in-migration” established in Mexican domestic legislation. The income tax base for resident individuals (and nonresident aliens) does include capital gains as part of the income tax.

Please describe the basic tax treatment of new and temporary residents. Do new or temporary residents benefit from any special treatment on gains, e. g., tax exemption or limited taxation (e.g., remittance basis) of foreign income or gains? The straightforward answer would be no. The Mexican worldwide income rule is very clear as to accrual of taxable income regardless of where it is generated or when the property was acquired. Notwithstanding the above, the domestic rules

applicable for Mexican residents (either permanent, new, or temporary) consider some “benefits” when calculating gains compared with other jurisdictions. Some examples are as follows:

1. The tax basis of assets acquired before the Mexican residence is acquired is adjusted for (Mexican) inflation during the whole period of ownership,⁶ so a new resident that sells assets acquired before he was a resident in Mexico benefits from this adjustment.
2. The Mexican rules for calculating gains on the sale of Mexican shares also apply for the sale of foreign shares by new residents (these rules allow for adjustments to tax basis for inflation as well); if such a new Mexican resident sells Mexican shares acquired before he became a Mexican resident, an adjustment for profits that were already subject to tax during the whole ownership period is available.⁷
3. Possible “relief” might arise by construing the domestic provisions for disposition of real estate by Mexican resident individuals.⁸ These rules provide for an option to calculate the applicable *tax rate* based on an average of the previous five years’ rates, which may lead to a reduction of the rate since the new resident in Mexico will not have “previous” tax years in Mexico. Even though the approach is different (tax basis vs. tax rate), the practical outcome may be similar.

Do new or temporary residents receive a fair market value adjustment to tax basis or comparable adjustment, e.g., pro rata allocation of gain to pre- and post-residence periods? Neither domestic legislation nor the treaty network provides for a tax result different from those discussed above (e.g., no basis step-up if the taxpayer had to pay a mark-to-market-style exit tax on leaving his former country); nevertheless, in practice, if an exit tax is paid when migrating from a different jurisdiction, it might be possible to sustain a step-up in Mexico if proper documentation is exhibited to Mexican authorities, supporting that the exit tax is imposed on a “deemed sale” according to foreign rules.⁹

Are there any special rules where tax is imposed or tax cost is adjusted when no actual sale occurs? There is no such a rule in Mexico.

Capital gains imposed on gifts. No special rules.

Rollover of gains on corporate organization, contribution, or reorganization transactions. Mexican domestic legislation has special rules for domestic corporate reorganizations by which an option is available where disposition/alienation of shares might be done considering a carryover basis¹⁰ (no gain computable at the moment of the reorganization). Also, according to some double taxation treaties, corporate reorganizations where nonresidents dispose of shares issued by Mexican residents might defer gain recognition until the shares are sold out of the corporate group.¹¹

Other tax-free exchanges of property or rollover of gains. Donations between relatives (descendants and ascendants) are tax exempt if documentary and tax information requirements are met.¹² If the exemption applies, the acquiror (donee) should recognize a carryover basis.¹³

Basis (tax cost) adjustments on death or other non-sale transactions. Same rules as for donations between relatives.

Is a distribution by a company in liquidation taxed as a dividend, capital gain, or any combination? According to Article 78 of the income tax law, a distribution by a company in liquidation may be taxable as a “distributed profit” if certain thresholds are passed, which resembles more a dividend than a capital gain. If the threshold is not surpassed, the liquidation may be treated as a tax-free capital redemption. This also applies when a company migrates its residence from Mexico to another jurisdiction, since a “deemed liquidation” should be computed following the same rules.

How does Mexico tax a pre-residence sale of property when part of the sale proceeds are received before and part after the individual becomes a resident? According to domestic provisions (a recent amendment to the law), sales of property trigger tax consequences at the moment of the consensual agreement, regardless of the deferral of the payments (installment sales are now computing gain at the moment of the actual sale).¹⁴ In this sense, an initial starting point is whether the sale is Mexican sourced. If it is, and parts of the proceeds are received before an individual becomes Mexican resident, domestic legislation says that taxable income should be computed and higher tax rates are provided.¹⁵ As mentioned above, foreign tax credits may be available to reduce the tax

¹ The Mexican income tax law is *Ley del Impuesto Sobre la Renta* (LISR), supplemented by regulations, *Reglamento de la Ley del Impuesto Sobre la Renta* (RLISR). Spanish-language text is at www.diputados.gob.mx/LeyesBiblio/ref/cff.htm, from which one can navigate to the latest version of the law and the regulations. Links to the LISR can also be found directly at www.diputados.gob.mx/LeyesBiblio/ref/lisr.htm and the regulations at www.diputados.gob.mx/LeyesBiblio/actual/ultima.htm.

² LISR Article 1, section I.

³ LISR Article 5.

⁴ The Mexican Federal Fiscal Code, *Código Fiscal de la Federación* (CFF), is on the *diputados* webpage, *supra* note 40. For further reference on the residence rules, see CFF Article 9, sections I and II.

⁵ LISR Articles 121 and 124.

⁶ LISR Article 121, section I.

⁷ LISR Articles 22 and 124.

⁸ LISR Article 120, section III(b) and RLISR Article 202.

⁹ A ruling request could be filed with the tax authorities according to CFF Article 34.

¹⁰ LISR Article 24. There is a similar rule for nonresidents that do a corporate reorganization under Article 161.

¹¹ Mexico has a wide treaty network for the avoidance of double taxation. Spanish-language text of the whole network is at www.sat.gob.mx/informacion_fiscal/normatividad/Paginas/tratados_fiscales.aspx, from which one can navigate to the latest version of every treaty that Mexico has signed.

¹² LISR Article 93, section XXIII(a), (b), and (c). In the case of upstream donations (descendants to ascendants), the exemption applies to the extent that the donee does not donate or sell the goods to any other descendants (e.g., sons, daughters, grandsons).

¹³ LISR Article 124, sixth paragraph.

¹⁴ LISR Article 17, second paragraph.

¹⁵ LISR Article 153 *et seq.*

¹⁶ CFF Article 14, section V(a) and (b).

¹⁷ LISR Article 140.

burden. In this case, double taxation conventions are also available to provide relief (either tax exemption or reduced tax rates). If the sale is not Mexican sourced, none of the proceeds, whether received before or after an individual becomes Mexican resident, trigger tax consequences in Mexico.

How does Mexico treat a distribution from a foreign trust to a resident beneficiary of property that has increased in value while the property was held by the trust? Is the beneficiary treated as having income or gain from the distribution? Mexican domestic rules treat trusts (including foreign ones) as pass-through vehicles if formal requirements are met. Regarding disposition of property by the Mexican-resident grantor, the rules say that “reversion clauses” should be taken into consideration, since such clauses determine whether there is a sale of the property to the trust for Mexican tax purposes.¹⁶

If reversion clauses are included in the trust agreement, no tax consequences arise for the grantor or the trust at that moment (in this case, the trust acts as a pass-through vehicle for the grantor). Also, no tax consequences arise in a later distribution of the property from the trust to a Mexican resident (the Mexican resident grantor preserves pre-incorporation-of-the-trust tax basis in the property, regardless of the appreciation in value).

If a reversion clause is not included when setting up the trust by the Mexican resident grantor, a sale for tax purposes arises at that moment and there may be a taxable gain for the grantor, and the acquiror is the beneficiary of the trust, who receives the property at the same value as the contribution and accrues income for that amount.

How is the beneficiary taxed when he later sells the distributed property and, specifically, how would gain be calculated? In the scenario where reversion clauses were not included in the trust, and the Mexican resident beneficiary later sells the distributed property, a second taxable event arises and taxable gain should be computed by the beneficiary (comparing the amount for which the property was contributed to the trust and the sales price).

If an individual moves to Mexico and later receives a distribution from a company that is attributable to pre-residence profits, how is that distribution taxed? Any special rules because the profits of the distributing corporation were accumulated before the shareholder became a resident in Mexico? The taxable event, according to Mexican domestic legislation, would be the distribution by a foreign company to a Mexican resident,¹⁷ regardless that the distribution is attributable to pre-residence profits. The Mexican resident individual will compute taxable income and, if requirements are met, a foreign tax credit might be available (a two-tier credit is available to the extent that the second-tier company is resident in a country that has a broad exchange-of-information treaty in force with Mexico, as well as a direct tax credit for withheld taxes to the Mexican resident).

No special rules are available. See the foreign tax credit option discussed above.

Notwithstanding the above, counterarguments could be raised to request a tax ruling before the tax authority. Such arguments would try to sustain that no taxable event arises on this type of distribution since there was no Mexican source, and the profits were generated before there was Mexican residence.



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Does the Netherlands¹ tax resident individuals on their worldwide income? Does the tax base for residents include capital gains (whether as part of the income tax or as a separate tax)? Dutch residents are taxed on a worldwide basis.² Whether an individual is a tax resident of the Netherlands is determined based on the actual facts and circumstances.³ The relevant factors have been developed in case law. Any individual who left the Netherlands and returns without having lived in any other jurisdiction or the BES Islands⁴ for more than a year is also considered tax resident of the Netherlands for the period that they did not live in the Netherlands.⁵ For Dutch nationals employed by the government, a fiction exists under which they are always considered a tax resident of the Netherlands if they are detached abroad⁶ (1) as a member of a diplomatic, permanent or consular representation of the Netherlands, or (2) for purposes of working in another jurisdiction in the context of a treaty to which the Netherlands is a party.

Individuals residing outside the Netherlands but in the EU, EEA, Switzerland, Bonaire, Saba, or St. Eustatius may opt to be treated as a Dutch tax resident if at least 90% of their employment income is subject to Dutch income tax. This is based on EU case law and there are more specific cases in which this option applies. Opting to be treated as a tax resident of the Netherlands would allow these individuals to deduct personal costs (e.g., alimony, special health costs) and mortgage interest in relation to the individual's home from the income that is taxable in the Netherlands.

Income is allocated in three income categories, or “boxes”:⁷

Box 1: income from employment, own home, and private enterprise (business income). In this box, all income from employ-



ment, own home, and private enterprises is added together. A progressive tax rate will apply in 2017⁸: 36.55% for income up to EUR 19,982; 40.8% for income up to EUR 67,072; and 52% for any income in excess of EUR 67,072.⁹ These brackets include social security contributions and are updated annually. The tax rates for pensioners and individuals that are not part of the Dutch social security system are lower in the first two brackets.

Home. The income from own home is determined by computing fictitious income based on the value of the home, and deducting mortgage interest from that fictitious income.¹⁰ In general, this leads to a negative sum that can be deducted from employment or business income when computing the total box 1 tax liability. A capital gain on the sale of an individual's own home is tax exempt, but limits future possibilities to deduct mortgage interest on any new home.¹¹

Business. Business income from private enterprises and transparent partnerships held by individuals is computed based on Dutch GAAP, modified slightly for Dutch tax purposes.¹² An exemption of 14% of business income applies before including it in the box 1 income computation.¹³ Capital gains may be part of this business income but are not treated differently from any other business income.

Supply to businesses and companies. A fourth important category of box 1 income is the income from supplies to businesses of family members¹⁴ and companies in which the taxpayer holds a substantial interest (see below, box 2).¹⁵ To avoid arbitration between what is in the family member's business or taxpayer's company and what is private property, income from supplying goods and services to a company in which the taxpayer holds a substantial interest is also taxable in box 1. Usu-

ally this is with regard to rental income from real estate that is held privately but rented out to a company in which the taxpayer or his spouse holds a substantial interest. Another example is if a taxpayer grants a loan to a company in which he or his spouse holds a substantial interest. The income is also computed based on Dutch GAAP.¹⁶ Twelve percent of this income is exempt first, then the result of that computation is included in the consolidated box 1 income computation.¹⁷

Lucrative interest. A fifth category of box 1 income is "lucrative interest," which exists if a taxpayer holds shares or a loan or similar rights in a company and, in brief, the return is deemed to be remuneration for employment.¹⁸ Lucrative interest is an anti-abuse rule aimed at managers participating in the equity of leveraged buy-outs.¹⁹ It may be avoided if structured properly as a box 2 investment.²⁰ Capital gains may be part of this category of income but are not treated differently from regular income.

Other: pensions and benefits. All other employment-like income such as pension, benefits for disability, and unemployment are also taxed in box 1.²¹

Box 2: income from substantial interests. A substantial interest exists (roughly) when an individual holds (solely or together with qualified family members) at least 5% of the share capital in a company.²² The income consists of any benefit derived from the shares in whichever form it arises.²³ Therefore, benefits in the form of dividends, liquidation payments, buy-back of shares, sale of shares, payment of bonus shares, and all other transactions that are deemed to be a benefit derived from the substantial interest are taxable. Although the legal transaction (e.g., sale, dividend) is decisive on whether and when a taxable moment happens, deemed distributions are also taxable. Related costs such as financing and costs related to receiving the income are deductible.²⁴ A flat tax rate of 25% applies on the net income.²⁵

An important deemed taxable transaction is "emigration from the Netherlands."²⁶ In that event, a fictitious capital gain is assessed on the substantial interest in a "conservatory assessment."²⁷ The assessment is not payable immediately but rather on receiving actual income from the shares, e.g., as dividends or proceeds from disposal of the shares. If the individual emigrates to a country outside the EU, the Dutch tax authorities may require the individual to post security for this assessment. This may be a pledge on the shares, mortgage, bank guarantee, or a different mean of collateral.²⁸

The deemed taxable transaction of "emigration from the Netherlands" does not apply to individuals that lived in the Netherlands temporarily.²⁹ For this exception to apply, the following conditions should be met:

- The company in which the individual holds a substantial interest is not a tax resident of the Netherlands.
- The individual has lived less than eight years in the Netherlands prior to emigration.
- In total, the individual has lived less than ten years in the Netherlands during the past 25 years prior to the individual's last emigration from the Netherlands.

Box 3: income from investments. This income is computed by assessing the value of all investment assets and liabilities as per January 1 of each year that are not already included



when assessing the income for box 1 and box 2. Up to 2016, 1.2% effective income tax was due on the net asset value.³⁰ From 2017, the effective rates become progressive:

- 0.861% on a net asset value up to EUR 75,000.
- 1.38% on a net asset value between EUR 75,000 and 975,000.
- 1.617% on a net asset value above EUR 975,000.³¹

The actual net income from the assets, whether regular or capital income, is irrelevant. An exemption of EUR 25,000 will apply for each resident.³² As the income is computed based on the net asset value each year, it is deemed to include some sort of taxation on capital gains. The new method of computing the income from 2017 was introduced to accommodate taxpayers with small savings accounts and the current low interest rates. Taxpayers with substantial investments and savings accounts are deemed to be able to achieve a higher return through diversification of investments. The MSCI (Morgan Stanley Capital International) indices are used to benchmark these percentages. There is substantial criticism of this new method as it still may cause more than 100% effective taxation of actual income from savings accounts and bonds given the current low interest rates. More technical criticism is that this method still uses fictions instead of actual income to compute taxable income.

The Netherlands has concluded over 100 tax treaties. A tax treaty always has preference over national law. The Netherlands does not have a treaty override provision. This also applies to the qualification of income. If an item of income is regarded as a certain type of income under Dutch tax law, a new assessment needs to be made under the tax treaty. That assessment will be decisive in the further application of the tax treaty from a Dutch perspective.

Netherlands tax treaties largely follow the OECD model but there are some exceptions. One notable deviation is that the Netherlands has a policy to claim taxation on capital gains on substantial interests for ten years after an individual has left the Netherlands to a contracting state. The Netherlands usually does not grant tax relief for income that is not actually taxed under a remittance base system.

Gift and inheritance tax is levied on anyone receiving a gift or an inheritance from individuals living in the Netherlands at the time that they make the gift or die.³³ There is a legal fiction that individuals who have Dutch nationality are deemed to live in the Netherlands for gift and inheritance

tax purposes for ten years after they have left the Netherlands.³⁴ Individuals who do not have the Dutch nationality are deemed to reside in Netherlands for gift and inheritance tax purposes for one year after they leave the Netherlands.³⁵

The tax is levied on the donees or heirs regardless of where they live or where the assets that are donated or inherited are located. The tax rate is progressive. Gifts and inheritances between parents and children are subject to 10% tax for amounts up to EUR 121,903 and 20% for amounts exceeding EUR 121,903. The tax is computed per donee or heir based on what amount they actually are donated or inherit, with a few exceptions. Grandchildren are subject to tax rates of 18%-36% for the same brackets and third parties (e.g., trusts, more distant family members, and non-family members) are subject to 30%-40%. There are exemptions for receiving a gift of or inheriting business assets. The Netherlands has concluded six treaties on inheritance tax and provides for unilateral tax relief in the event of double taxation, albeit that is not always effective.

Please describe the basic tax treatment of new and temporary residents. Do new or temporary residents benefit from any special treatment on gains, e. g., tax exemption or limited taxation (e.g., remittance basis) of foreign income or gains? Individuals moving to the Netherlands for purposes of accepting employment may apply for a 30% ruling³⁶ under which 30% of the employment income is deemed to be compensation for extra-territorial costs, and hence not taxable in the Netherlands. Individuals moving to the Netherlands who receive a 30% ruling may choose to be taxed on either their worldwide income or only on their employment income.³⁷

A benefit of choosing to be taxable on the worldwide income in the Netherlands is that it allows the individual to invoke full access to the Dutch tax treaty network. For example, under Article 4(1) of the Netherlands-U.S. tax treaty, U.S. citizens are always considered tax resident of the United States and so cannot choose to be treated as tax resident of the Netherlands under the 30% ruling. To qualify for a 30% ruling, the individual must bring certain knowledge or skills to the Dutch economy that are not available easily or readily. The 30% ruling can apply for a maximum of eight years, reduced by the time that the individual has stayed in the Netherlands in the past 25 years prior to moving to the Netherlands. This “reference period” rule is intended to make sure that it is indeed individuals who have not worked before in the Netherlands who benefit from the 30% ruling. Most recently, some political parties in the far left and far right have taken the stance that the 30% ruling benefits should be abolished.

Do new or temporary residents receive a fair market value adjustment to tax basis or comparable adjustment, e. g., pro rata allocation of gain to pre- and post-residence periods? Individuals moving to the Netherlands who start a business in the Netherlands (and, therefore, are taxable in box 1) using assets that they already owned before moving to the Netherlands, are allowed a basis step-up on their Dutch tax opening balance sheet. A basis step-up can be applied up to the market value as of the time that the business is started in the Netherlands. Depreciation and amortization are based on the stepped-up basis.³⁸

Individuals moving to the Netherlands and holding a substantial interest that is taxable in box 2 are also entitled to a basis step-up, to the market value of their shareholdings at the time of their entry.³⁹ The following individuals will not be granted a basis step-up on entry into the Netherlands:

- Individuals that have emigrated from the Netherlands earlier and return to the Netherlands.⁴⁰
- Individuals who have a substantial interest for which they were already taxable in the Netherlands as a nonresident.⁴¹

A basis step-up can be obtained in these excepted situations if the individual can demonstrate that an increase in value was subject to tax prior to entry into the Netherlands (e.g., an exit tax in the country of departure).

Individuals moving to the Netherlands that are subject to box 3 taxation will be taxed on a pro rata parte basis in the year of their entry into the Netherlands.⁴² Their net asset position for box 3 is computed based on the values as per January 1 of the year of entry. The tax due is then relative to the number of full months that the individual lives in the Netherlands in the year of entry.

Example: An individual moves to the Netherlands on October 6, 2016. The box 3 taxation for 2016 is assessed by computing the net asset value of the box 3 investments on a worldwide basis as of January 1, 2016. As the individual lives in the Netherlands for two full months in 2016, 2/12 of the tax that is computed on a full-year basis is due.

Are there any special rules where tax is imposed or tax cost is adjusted when no actual sale occurs? Capital gains imposed on gifts. A gift of an asset or a complex of assets and liabilities usually triggers taxation of capital gains for those instances where capital gains are taxed. This is the case for:

1. Gift of a business (box 1).

2. Gift assets that are supplied to a company in which the taxpayer has a substantial interest (box 1).
3. Gift of shares that form part of a lucrative interest (box 1).
4. Gift of shares in a company in which the donor owns a substantial interest (box 2)

In box 3, capital gains are irrelevant. The result is that from January 1 of the next year, the asset must be included in the overall tax basis of the gift recipient. The donor does not have to report the donated assets in box 3 in the year after the gift.

A gift tax exemption is available if income tax needs to be paid.⁴³ However, taxpayer and taxable object must coincide to apply that rule, so it does not apply if a capital gain is being taxed. The capital gain is taxable to the donor and the gift tax to the beneficiary.

In some cases, levy of income tax on the capital gain or gift tax can be avoided:

Gift of a business. A gift of a business is in principle a taxable event in which all hidden reserves are deemed to be realized; therefore, a capital gain is also recognized. This is based on the general concept of alienation of assets, which includes gifts. If a business is transferred to an individual who has worked in the business for at least 36 months, or who is a co-entrepreneur in the same business for at least 36 months at the time of the gift, taxation of capital gains can be avoided on request.⁴⁴ The individual continuing the business must continue the book value of the business for tax purposes. The consideration for this advantageous tax treatment is irrelevant and so does not necessarily need to be a gift. The conditions for obtaining this rollover relief coincide roughly with the conditions for a gift tax exemption for the same.⁴⁵ Hence, this facility is often used for the transfer of family businesses to the next generation. The gift tax exemption is conditional on the beneficiary maintaining the business for at least five years.

¹ The discussion in this article applies only to the Kingdom of the Netherlands in Europe. The Caribbean parts of the Netherlands have their own legislation, which are not covered herein.

² Article 2.1(1)(a) *Wet op de inkomstenbelasting* (Dutch Personal Income Tax Act 2001) ("IB"), wetten.overheid.nl/BWBR0011353/2016-07-01.

³ Article 4(1) *Algemene Wet inzake rijksbelastingen* (Dutch General Tax Act) ("AWR"), wetten.overheid.nl/BWBR0002320/2016-05-01.

⁴ The BES Islands consist of Bonaire, St Eustatius, and Saba. Since 2010, they are municipalities within the Kingdom of the Netherlands but have their own tax legislation. The laws described in this discussion do not apply to the BES Islands or any other Caribbean part of the Kingdom of the Netherlands.

⁵ IB Article 2.2(1).

⁶ IB Article 2.2(2).

⁷ IB Article 2.7.

⁸ According to the Tax Bill for 2017 (*Belastingplan* 2017).

⁹ IB Article 2.10.

¹⁰ IB Articles 3.110 and 3.120.

¹¹ IB Article 3.119a(3)(a).

¹² IB Articles 3.2, 3.8, and 3.25.

¹³ IB Article 3.79a.

¹⁴ IB Article 3.91.

¹⁵ IB Article 3.92.

¹⁶ IB Article 3.95.

¹⁷ IB Article 3.99b.

¹⁸ IB Article 3.92b.

¹⁹ Also commonly known as "carried interest."

²⁰ IB Article 3.95b(5).

²¹ IB Article 3.100.

²² IB Article 4.6.

²³ IB Article 4.12.

²⁴ IB Articles 4.15 and 4.20.

²⁵ IB Article 2.12.

²⁶ IB Article 4.16(1)(h). It is actually worded "ceasing to be a domestic taxpayer including the situation in which a taxpayer becomes a tax resident of a different jurisdiction through application of a tax treaty or the Tax Arrangement of the Kingdom of the Netherlands." The latter Arrangement functions as a tax treaty between the Netherlands in Europe and the Caribbean parts of the Kingdom of the Netherlands.

²⁷ IB Article 2.8(2).

²⁸ Article 25(8) *Invorderingswet* (Tax Collection Act) ("Inv").

²⁹ IB Article 4.18.

³⁰ IB Articles 5.4 and 2.13.

³¹ These percentages are based on the Tax Bill for 2017.

³² IB Article 5.5.

³³ Article 1(1) Gift and Inheritance Tax Act (*Successiewet*) ("SW").

³⁴ SW Article 3(1).

³⁵ SW Article 3(2).

³⁶ Article 31a(2)(e) *Wet op de Loonbelasting* (Wage Tax Act) ("LB").

³⁷ IB Article 2.6.

³⁸ IB Article 3.8.

³⁹ IB Article 4.25.



Gift of assets to a company in which the taxpayer has a substantial interest. Donating assets to a company in which the taxpayer has a substantial interest is a taxable event under the general concept of a gift being an alienation under Dutch law. The gain is taxable in box 1. For real estate, there is a gift tax exemption if, along with the real estate, shares in the company to which the real estate is supplied are also donated to the same beneficiary.⁴⁶ The gift tax exemption is conditional on the beneficiary maintaining the real estate for at least five years.

Gift of shares that form part of a lucrative interest. This transaction is always considered a taxable event under the concept of a gift being an alienation under Dutch law. No relief is available for income tax or gift tax.

Gift of shares in which the taxpayer holds a substantial interest. This transaction is always considered a taxable event under the concept of a gift being an alienation under Dutch law. Income tax on the capital gain can be avoided if the shares are held in a company that operates an active business.⁴⁷ To qualify, the beneficiary must have been employed by the company in which the shares are donated for at least 36 months. The cost basis of the shares for substantial interest taxation purposes is transferred to the beneficiary. There is also a gift tax exemption under similar conditions. The gift tax exemption is conditional on the beneficiary maintaining the business for at least five years. Exemptions for the gift of shares in active business companies are some of the most used tax planning tools for transferring a business to the next generation.

Rollover of gains as a result of corporate reorganizations. Dutch tax law recognizes the following forms of corporate reorganizations:

1. Legal merger (two or more companies located in the EU amalgamating into one company by virtue of a legal act; shareholders of the disappearing company receive shares in the acquiring company).
2. Spin-off (legal act by which one or more EU companies are created receiving assets and liabilities from the company that initiates the spin-off; shareholders may receive shares in a newly created company in the EU).
3. Share-for-share merger (legal act by which one company located in the EU acquires at least 51% of the shares in another company located in the EU and offers virtually

(cash compensation up to 10% is allowed) only shares in the acquiring company as compensation to the shareholders of the acquired company).

4. Contribution (transfer of assets and liabilities to a company in return for shares).

Each of these forms of reorganizations is in principle ruled by the EU Merger Directive,⁴⁸ with the exception of the contribution of an enterprise by an individual into a corporate entity ((4) above).

Explanation of corporate reorganizations under the EU Merger Directive deserves several books in itself. For purposes of this discussion, only the highlights are described, i.e., the tax consequences for individuals involved in the corporate reorganization. (Companies located in Iceland, Liechtenstein, and Norway also qualify for these EU rules, although they are not EEA but not EU member states.)

In each of situations (1)-(3) above (legal merger, spin-off, share-for-share merger), the rules are similar. The corporate reorganization itself triggers a taxable event and, therefore, leads to taxation of the capital gain. If shares are held in the context of a personal business or lucrative interest, taxation occurs in box 1. If the shares involved in a corporate reorganization form part of a substantial interest, taxation occurs in box 2.

Under the EU Merger Directive, tax law provides a rollover facility for qualifying corporate reorganizations.

Legal merger⁴⁹ and spin-off.⁵⁰ If an individual shareholder holds shares in a company that forms part of this personal enterprise and that disappears in the context of a legal merger, he is entitled to a rollover of the capital gain under the condition that the legal merger is not aimed at tax evasion or tax avoidance. Tax avoidance or tax evasion is deemed to be present if the legal merger has no business rationale.

Share-for-share merger.⁵¹ If an individual shareholder holds shares in a company that form part of this personal enterprise and has to transfer his shares in the context of a share for share merger, he is entitled to a rollover of the capital gain.

Contribution.⁵² If an individual transfers his personal enterprise to a company in return for shares ("conversion"), he may elect to do so tax free. This facility is often used by small business owners that want to continue their business in a corporate entity. The conditions for this exemption are as follows:

- All individuals for whom the enterprise is carried on need to participate in the conversion.
- Each individual participating in the conversion should be entitled to the same ration as he was entitled in the personal enterprise.
- The equity of the personal enterprise for tax purposes needs to be converted into nominal share capital. A rounding of 10% is allowed.
- The individual needs to maintain the shares that he received for at least three years. In the event of a prior alienation, the transfer of the enterprise is considered taxable unless the taxpayer can demonstrate that the alienation within the three-year period was not part of the plan.
- The company needs to continue the book value of the assets transferred.

- The shares received as a compensation for the conversion usually form part of a substantial interest. The cost basis for this equals the tax equity of the enterprise with some minor adjustments.

For individuals owning a lucrative interest in box 1, a corporate reorganization is in principle a taxable event in which the capital gain is taxable. However, they can apply the same exemptions as individual entrepreneurs do, as described above.⁵³

For individuals owning a substantial interest in box 2, a corporate reorganization is in principle a taxable event in which the capital gain is taxable. They may apply an exemption similar to the exemptions for an individual entrepreneur if their shareholding is part of a corporate reorganization.⁵⁴ The exemption never applies to any cash payment in connection with the corporate reorganization. The cost basis of the shares that have been transferred in the context of a corporate reorganization continues to apply to any newly received shares.

Other tax-free exchanges of property or rollover of gains. Individual entrepreneurs who alienate business assets with a profit may reserve that profit in a tax-free “reinvestment reserve.”⁵⁵ The entrepreneur must have the intention to reacquire other assets within three years. If other assets are purchased, the profit of the old asset is used as a first depreciation on the newly acquired assets. Hence, the depreciation in future years is lower, thus taxing gradually the profit from the old asset. For real estate, the criteria are stricter—the real estate must have a similar function in the business of the entrepreneur.

Basis (tax cost) adjustments on death or other non-sale transactions. The main rule is that no tax base adjustment takes place unless tax has been paid. Dutch law recognizes several non-sale or deemed transactions that trigger taxation of capital gains. For individuals with a business, this may occur if they transfer their business (taxable in box 1) outside the Netherlands. This transfer is a deemed sales and all hidden reserves in the enterprises will be taxed. For individuals that hold a substantial interest, there is list of non-sale transactions that trigger capital gain taxation, of which the most important are:⁵⁶

- Legal merger where the shareholder ceases to be shareholder in the disappearing company and becomes a shareholder in the absorbing company.
- Transfer of shares under universal legal title or special legal title in the event of death of a shareholder.
- The individual's shareholding drops below the 5% threshold.
- Ceasing to be a tax a resident of the Netherlands other than through death.
- Granting options on shares that the individual owns.
- If the company in which the shares are held earns predominantly passive income and ceases to be taxed at a (from a Dutch tax perspective) reasonable tax rate of at least 10%.⁵⁷
- If shares held in a trust or similar entity are no longer attributed to the individual to which these shares should be attributed under the attribution rules.⁵⁸

In all of these situations, a capital gain is recognized. Tax is payable in some cases immediately but in others, payment can be deferred on request until an actual sale occurs.

Is a distribution by a company in liquidation treated as a dividend, capital, or a combination? For individuals holding shares as part of their business, any income from shares is taxable as business income in box 1. Distributions from a liquidation are hence treated as business income and the qualification of dividend or capital gain is not relevant. Any withholding tax due on the liquidation payment can be offset against Dutch income tax due.

Technically, liquidation payments to individuals who hold shares that are taxed in box 2 are regarded as a capital gain.⁵⁹ This may have effect under tax treaties in which there is no specific definition of liquidation payments. The liquidation payment is taxed in box 2 at the flat rate of 25%. Withholding tax due on the liquidation payment can be credited against Dutch income tax.

For individuals holding their shares in box 3, the qualification of a liquidation payment is irrelevant. In the year of receiving the liquidation payment, they recognize the value of their shares as per January 1 of that year. Any withholding

⁴⁰ IB Article 4.25(2).

⁴¹ IB Article 4.25(3).

⁴² IB Article 5.2(3).

⁴³ SW Article 33, 9°.

⁴⁴ IB Article 3.63.

⁴⁵ SW Article 35b.

⁴⁶ SW Article 35c(1)(c).

⁴⁷ IB Article 4.17c.

⁴⁸ Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States.

⁴⁹ IB Article 3.57.

⁵⁰ IB Article 3.56.

⁵¹ IB Article 3.55.

⁵² IB Article 3.65.

⁵³ IB Article 3.95 extends the application of IB Articles 3.55, 3.56, and 3.57 to a lucrative interest.

⁵⁴ IB Article 4.41 grants the rollover facility, referring to IB Articles 3.55, 3.56, and 3.57.

⁵⁵ IB Article 3.54.

⁵⁶ This list is not exhaustive. IB Article 4.16 IB contains all deemed transactions.

⁵⁷ Introduced in IB Article 4.16(1)(k) in the Tax Bill for 2017.

⁵⁸ IB Article 2.14a.

⁵⁹ IB Article 4.16(1)(c).

⁶⁰ See the discussion in the text above on the changes in the Box 3 taxation as from 2017.

⁶¹ Concluded on July 1, 1985, applicable in relation to the Netherlands as from February 1, 1996, wetten.overheid.nl/BWVBV0002005/1996-02-01 (English).

⁶² IB Article 2.14a.

⁶³ Proposed Article 2.14a, Par. 7 IB Tax Bill for 2017.

⁶⁴ Article 3(1)(c) *Wet op de vennootschapsbelasting* (Dutch Corporate Income Tax Act 1969) (“CITA”).

⁶⁵ CITA Article 17(3)(b).

⁶⁶ IB Article 4.25(2).

⁶⁷ IB Article 4.25(3).

⁶⁸ IB Article 4.12.

⁶⁹ IB Article 4.13(1)(b).

⁷⁰ IB Article 4.33.



tax may be credited against Dutch tax due. After receiving the liquidation payment, instead of the shares, the cash or other assets that may have been purchased with the liquidation proceeds need to be recognized as an asset in the box 3 computation. If the liquidation proceeds have been used to invest in the individual's own home or business, the cash is no longer taxed in box 3, but may generate taxable income in box 1. If the liquidation proceeds have been used to invest in a company in which the individual holds a substantial interest, income from these shares is taxed in box 2.

How does the Netherlands tax a pre-residence sale of property when part of the sale proceeds are received before and part after the individual becomes a resident? The sale of property is not a taxable event in the Netherlands, hence the moment of payment is not relevant. Nonresident taxpayers may be subject to box 3 taxation in relation to real estate located in the Netherlands. They pay 1.2% income tax on the net asset value of the property.⁶⁰ If the property is sold before becoming a resident of the Netherlands, but in the same year in which the individual becomes a tax resident of the Netherlands, it will form part of the box 3 basis for the first year of tax residency.

How does the Netherlands treat a distribution from a foreign trust to a resident beneficiary of property that has increased in value while the property was held by the trust? The Dutch legal system does not include a trust or a trust-like entity. The Netherlands recognize trusts for civil and corporate legal purposes as a consequence of the Hague Trust Convention.⁶¹ The Dutch tax system is designed to tax either individuals or corporate entities. Trusts are neither, so certain measures have been taken in both the income tax act and corporate income tax act.

Assets and liabilities of a trust are attributed to an individual who is the settlor of a trust.⁶² This means that for Dutch income tax purposes, all assets and liabilities and income are taxable to the settlor as if they were his own. If the settlor deceases, all assets, liabilities, and income are attributed to his heirs in relation to their respective entitlement to the estate of the settlor. There is an exception if an heir can demonstrate that he is not and can never be a beneficiary to the trust.

The concept of attributing trust assets, liabilities, and income to the settlor for tax purposes has far-reaching consequences. For example, related-party provisions in the corporate income tax act may also apply as a consequence of this fiction.

Assets, liabilities, and income from fixed trusts, when there is no discretionary role of a trustee, are attributed to the beneficiary. From 2017, income, assets, and liabilities from a trust are not attributed to the settlor if the trust is engaged in an active business and is subject to tax.⁶³

A trust is defined as a taxable entity in the corporate income tax act.⁶⁴ This is especially relevant if the trust holds at least 5% of the shares in a Dutch company since it is then subject to corporate tax for income and capital gains against the corporate income tax rate.⁶⁵ If assets of a trust are attributed to an individual under the Dutch income tax act, the situation could arise that the trust itself is also subject to corporate income tax. This will lead to double taxation for which there is no mitigation provision yet.

Any transaction between a trust with a beneficiary is regarded for Dutch tax purposes as a transaction between the settlor and the beneficiary as if the trust did not exist. Depending on the nature of the transaction, it could be a regular sale, gift, or bequest from the settlor, and taxed accordingly.


The Dutch tax authorities actively combat the use of trusts as they are seen as abusive. Trusts are used incidentally in privacy structures. In those instances, active cooperation with the Dutch tax authorities is strongly recommended. Also, individuals who enter the Netherlands from an Anglo-Saxon jurisdiction and are connected to a trust should seek active cooperation with the Dutch tax authorities on the way that their connection with the trust is treated for Dutch tax purposes.

If an individual moves to the Netherlands and later receives a distribution from a company that is attributable to pre-residence profits, how is that distribution taxed? Any special rules because of the fact that the profits of the distributing corporation were accumulated before the shareholder became a resident in the Netherlands?

As explained above, anyone moving to the Netherlands holding a substantial interest is entitled to a step-up in basis, with the exception of two situations:

- Individuals who have emigrated from the Netherlands earlier and return to the Netherlands.⁶⁶
- Individuals who have a substantial interest for which they were already taxable in the Netherlands as a nonresident.⁶⁷

The basis step-up, however, is relevant only in the event of a(n) (deemed) alienation of the shares. For dividends, the cost basis is not relevant; they are always taxable.⁶⁸ The only exception is if there is a repayment of capital. In that situation, any repayment within the cost basis is tax free.⁶⁹ The cost basis is reduced by the amount of the capital repayment.⁷⁰ A proven solution in these situations is to structure a conversion of profit reserves into nominal share capital for the amount to be received tax free. Depending on the country of departure and the country where the company resides, this should be done either before or after immigrating into the Netherlands ●



As in Parts 1 and 2 of this article, the authors seek to provide introductory information to the tax advisor of an outbound client and to help the inbound country advisor become aware of the approaches and concepts with which advisors in the outbound country will be familiar and that may have influenced outbound planning.

We Will Be Landing Soon

EDITED BY
MICHAEL J. A. KARLIN
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A Multinational Survey of the
Treatment of Income and Gains of
Individuals Who
Change Residence

PART 3 This article concludes the survey, begun in Part 1, of the treatment of individual taxpayers who change their residence to various countries. The law and practice in each country are described by a distinguished commentator based on a uniform structure proposed by the editor. The authors were also invited to comment on any issues peculiar to their jurisdiction that they considered relevant.

The prior installments of this article covered Canada, France, and Germany (Part 1),¹ and Israel, Japan, Luxembourg, Mexico, and the Netherlands (Part 2).² Part 3 below concludes the series with Switzerland, the United Kingdom, and the United States.



Daniel Bader and Ruth Bloch-Riemer, Bar & Karrer, Zurich

Overview of Swiss tax system

Tax residence in Switzerland. Individuals are residents for tax purposes in Switzerland when they have their tax domicile or tax residence in Switzerland.³ An individual has a tax domicile in Switzerland if he resides in Switzerland with the intention of settling or has a special statutory domicile pursuant to federal law.⁴ A tax residence in Switzerland is regarded as existing when an individual—regardless of temporary interruption—stays for at least 30 days while being employed or, without employment, at least 90 days in Switzerland.⁵

Basic taxation principles in Switzerland. Switzerland imposes tax on resident individuals on their worldwide income on federal, cantonal, and communal level.⁶ The tax base for residents only partially includes capital gains:

- Capital gains on the sale of movable assets held in the individual's private wealth are generally tax exempt at the federal and cantonal levels.⁷ Exceptions apply in indirect partial liquidation and transformation situations (see below).
- Capital gains on the sale of real estate, including participations in real estate through other classes of assets (e.g., shares in a real estate company), are subject to real estate capital gains tax at the cantonal level;⁸ however, at the federal level, they are tax exempt for individuals.⁹

Commercial investments. Nevertheless, when selling real estate, securities, works of art, and other investment options,

a private capital gain will, according to legislation and practice, be tax exempt only as long as the investment is not considered commercial and does not qualify as a self-employment activity. The mere management of private assets is not considered a self-employment activity. To assess whether an activity is considered commercial, the tax authorities and courts usually take into account, among others, the following criteria: nexus to taxpayer's professional activity; borrowing of capital; frequency of transactions; systematic approach to investing; and reinvestment of gains.¹⁰

According to Federal Supreme Court case law, the fulfillment of one criterion can lead to the conclusion that an activity is considered commercial.¹¹ If an activity is considered commercial, direct federal taxes, cantonal taxes, and social security contributions are due on the capital gain as well as on the income from the self-employment. If an activity is considered a business activity, VAT may be due.¹²

Indirect partial liquidation and transformation. The “indirect partial liquidation” (*indirekte teilliquidation*) and transformation (*transponierung*) are further (codified) exceptions to the general tax exemption of capital gains realized by individuals on privately held movable assets. The indirect partial liquidation concerns the sale of shares held privately by one or more Swiss resident individuals to a Swiss or foreign resident purchaser and, to the purchaser, the shares will be

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business property (i.e., a change from private assets to business assets), when the shares that such individuals are selling represent in the aggregate a participation of at least 20% in the share capital or nominal capital of the target company.¹³ If, within five years of the sale, the target company makes a distribution of “non-operating substance” (funded from cash or other non-operating assets of the target company) already existing at the moment of the sale of shares and available for distribution according to the last commercial balance sheet of the target company prior to the sale of shares, the private Swiss sellers may be taxed on a deemed dividend from the target company provided that the private sellers have “co-operated” with such distribution of substance to the purchaser of the shares. According to Swiss tax law, the “co-operation” of the sellers is assumed as a fact when the sellers knew or must have known that “substance” would be taken out of the target company (and would not be put back in) to refinance payment of the purchase price of the shares.¹⁴ In practice, however, tax authorities generally stipulate the seller’s knowledge in a distribution within the five-year period.

Similar to the indirect partial liquidation, transformation is a special rule according to which capital gains from the sale of shares might be recharacterized into taxable dividend income (for tax purposes). The transformation concerns certain sales of shares by private individuals to a “self-controlled” legal entity, which are not recognized as “genuine sales.” A transformation is assumed when one or more Swiss resident individuals sell a participation of, in the aggregate, at least 5% in a corporate legal entity into the business property of a partnership or corporate entity in which the sellers, after the transaction, hold (in the aggregate) a participation of at least 50%. Accordingly, the difference between the share sale proceeds and the sum of attributable nominal share value and distributable retained earnings and reserves (excluding recognized reserves from capital contributions) are taxed on the sale of the shares as dividend income.¹⁵ However, if the seller (individually) held a participation of at least 10% in the target enterprise, the deemed dividends are only taxed in the amount of 60%.¹⁶

Capital gains tax on real estate. The real estate capital gains tax is levied as a special capital gains tax at the cantonal level (*grundstückgewinnsteuer* (real estate capital gains tax or RECGT)). While some cantons levy this special tax only on capital gains realized on real estate held as private property (“dualistic” system, also known as St. Gallen system), other cantons levy RECGT on all capital gains on real estate situated in their territory (“monistic” system, also known as Zürcher system), irrespective of whether the real estate sold was held as business or private property. Under the “monistic” system, real estate capital gains are split into two parts:

- Any gain from the recapture of previous depreciation is exempt from RECGT and is included in taxable profit for regular income tax purposes.
- Any gain pertaining to realized value appreciation is subject to RECGT and is, thus, carved out from taxable profit for regular income tax purposes.

For RECGT purposes, the taxable capital gain broadly corresponds to the net proceeds from the sale or exchange of the property, minus the original acquisition cost base and any further, value-adding investments made into the property.

In the cantons applying the dualistic system, all realized capital gains on real estate assets belonging to the business property of individual or corporate taxpayers are exempt from RECGT. Such business gains are fully included in taxable net income for regular individual or corporate income tax purposes, as relevant.

In the context of corporate reorganizations, as e.g., mergers, demergers, and similar transactions, real estate transfers are generally exempt from RECGT or eligible for a tax deferral. The same applies to gratuitous transfers by death and transfers in settlement of a deceased person’s estate. Further, Swiss tax law provides for a tax deferral of real estate capital gains from a sale of owner-occupied residential property if the disposal proceeds are reinvested in another accommodation in Switzerland.¹⁷

Besides actual sales or exchanges of real estate, RECGT also applies to gains on “economic real estate transfers” (transfers of the economic power to dispose of real estate). Such economic transfers include in particular the sale of a majority interest in a “real estate company” that owns real estate in the respective *situs* canton. A company is regarded as a real estate company if the main focus of its activity is exploitation of the value of its real estate assets by means including leasing, selling, and developing.¹⁸ Besides RECGT, real estate transactions typically trigger registration fees, notary fees, and, in some cantons, real estate transfer tax.

Treatment of new and temporary residents

Taxation of expatriates. At both the federal and cantonal levels, special (i.e., additional) deductions are available for certain expatriates working in Switzerland on a temporary assignment.¹⁹ The special deductions as well as the concept of “expatriate” and key criteria to be treated as expatriate are in a federal ordinance (“Expatriate Ordinance”), which has been revised slightly as of tax year 2016. The deductions include housing, travelling, and private school tuition fees.²⁰

Under the Expatriate Ordinance, expatriates are defined as senior employees and specialists with special professional qualifications whom their foreign employer sends to Switzerland temporarily (up to five years).²¹ Absent a secondment by a foreign employer, foreign executives or specialists under a temporary employment contract with a Swiss employer for up to five years will be eligible for “expatriate” taxation if their temporary employment in Switzerland is based on a transfer by an international group, and the previous foreign employer guarantees contractually re-employment of the individual abroad after the Swiss assignment.²² As of January 1, 2016, to be deemed an expatriate according to the Expatriate Ordinance, the temporary posting is also decisive for specialists.²³ The definition of “expatriate” under the revised Ordinance is narrower than under the old Ordinance. Employees qualifying as expatriates as of January 9,

2015, will maintain expat status until the end of their assignment but with the new, more restrictive rules applied.²⁴

Further, expatriates and foreign specialist coming to work in Switzerland temporarily (generally up to five years) may be exempt from the Swiss social security system under certain conditions and if they have obtained a certificate of coverage or similar document from their home state. If so, they are typically also exempt from Swiss pension plan contribution liabilities.²⁵

Lump-sum taxation. Under certain preconditions, foreign citizens relocating to Switzerland may apply for the lump-sum (*forfait*) taxation regime, which provides for a simplified calculation base to determine taxable income and wealth. While the regime has been abolished in some cantons (Zurich, Basel-City, Basel-Landschaft, Appenzell-Ausserrhoden, and Schaffhausen), it remains available at the federal level²⁶ and in the majority of the cantons. Only individuals who (1) are not Swiss citizens; (2) are subject to unlimited taxation in Switzerland for the first time or after an absence of at least ten years; and (3) do not exercise any employment activity in Switzerland are eligible for the lump-sum taxation.²⁷

As of 2016, married couples must fulfill these requirements individually.²⁸ While legislation requires that no gainful activity be performed abroad or in Switzerland, cantonal practice varies. However, the administration of one's own assets is generally not considered gainful activity and permitted under the lump-sum regime.²⁹

Under the lump-sum taxation regime, an individual's taxable income is essentially calculated on the basis of the annual living costs that the taxpayer and his family incurred in Switzerland and abroad. The regime is a simple and transparent procedure for tax assessment that estimates living expenses pragmatically and does not require details on worldwide income and wealth.³⁰

Taxable income is computed on one of the following four categories. The category producing the highest amount will be used as the tax basis (according to a tax ruling):

- Worldwide living expenses, which include rent of an apartment in Switzerland or costs of privately owned real estate as well as expenses for furnishing, travel, housekeepers, insurance, and donations.



- Seven times rental costs/value, i.e., seven times the annual rent when property is rented and seven times the rental value when property is owned.
- Control calculation, which includes all income from sources in Switzerland (e.g., real estate or bank accounts in Switzerland) and treaty protected income.
- The minimum tax basis for federal tax purposes must be at least CHF 400,000, whereby the minimum tax basis for cantonal tax purposes varies between the cantons.

To determine the final tax burden, the regular federal, cantonal, and communal tax rates apply (to the special lump-sum tax basis).³¹ The different calculations of the taxable income must be made for each tax year.

Social security contributions in the amount of (currently) up to CHF 23,900 per person will be due each year in most cases. Besides the taxation of the income, it is advisable to discuss the taxation of wealth structures (as trusts, for example) with the competent tax authorities prior to relocating to Switzerland (and request a respective ruling).

¹ 28 JOIT 28 (March 2017)

² 28 JOIT 46 (April 2017).

³ Art. 3(1), Federal Direct Tax Act, *Bundesgesetz über die direkte Bundessteuer* (DBG), December 14, 1990, SR 642.11. The text is available at www.admin.ch/opc/de/classified-compilation/19900329/index.html.

⁴ Art. 3(2) DBG.

⁵ Arts. 3(3)(a) and (b) DBG and Art. 3(1) Federal Law on the Harmonization of Direct Cantonal and Communal Taxes, *Bundesgesetz über die Harmonisierung der Direkten Steuern der Kantone und Gemeinden* (StHG), December 14, 1990, SR 642.14.

⁶ Art. 6(1) DBG.

⁷ Art. 16(3) DBG.

⁸ Art. 2(1)(d) StHG.

⁹ Bader and Seiler, "Taxation of High-Net-Worth Individuals in Switzerland," 69 IBFD Bulletin for International Taxation No. 4/5 (2015), page 252.

¹⁰ See *Eidgenössische Steuerverwaltung* (ESTV), *Kreisschreiben* Nr. 36 "Gewerbsmassiger Wertschriftenhandel," July 27, 2012 (circular letter of

the Federal Tax Administration (SFTA) No. 36, Professional Security Dealer).

¹¹ BGer, June 9, 1999, StE 1999, para. B 23.1 no. 43.

¹² Note 9, *supra*.

¹³ Arts. 20a(1)(a) and (2) DBG; Arts. 7a(1)(a) and (2) StHG.

¹⁴ Art. 20a(2) DBG.

¹⁵ Art. 20a(1)b DBG; Art. 7a(1)(b) StHG.

¹⁶ Art. 20(1^{bis}) DBG.

¹⁷ Art. 12(3)(e) StHG.

¹⁸ See ESTV, *Steuerinformationen*, "Die Besteuerung der Grundstcksgewinne," July 1, 2015 (tax information of the SFTA, taxation of capital gains on real estate).

¹⁹ See Arts. 1(1) and 2 of the Ordinance governing the deduction of specific professional costs for federal direct tax purposes of key employees and specialists temporarily working in Switzerland (Expatriate Ordinance, *ExpaV*), *Verordnung über den Abzug besonderer Berufskosten bei der direkten Bundessteuer von vorübergehend in der Schweiz tätigen leitenden*



Do new or temporary residents receive a fair market value adjustment to tax basis or comparable adjustment, e.g., pro rata allocation of gain to pre- and post-residence periods?

An individual becomes subject to unlimited tax liability in Switzerland by moving to and taking up residence in Switzerland. Accordingly, he will be subject to worldwide income taxation in Switzerland at the federal level (Art. 6(1) DBG) and wealth taxes at the cantonal and communal levels (Art. 2(1)(a) StHG).³² Further, he will have the obligation to submit a tax return annually (Art. 124 DBG).

As capital gains on the sale of movable assets held in the individual's private wealth are generally tax exempt and, typically, no tax basis exists, the question of fair market value adjustments to tax basis or comparable adjustments usually does not arise from a Swiss perspective. Movable assets in private wealth will be declared at fair market value in the Swiss tax return. In respect of immovable property, step-ups/adjustments such as pro rata allocation of gain to pre- and post-residence periods are not granted on relocation to Switzerland. Accordingly, RECGT will be imposed on the entire gain from a sale of real estate on sale in Switzerland

(Switzerland imposes tax only on real estate located in Switzerland; gains from the sale of real estate located abroad are taken into account only for determination of the applicable tax rate).

However, self-employed individuals who will be subject to unlimited tax liability in Switzerland on relocation and hold assets as business property might receive a step-up/fair market value adjustment to tax basis or comparable adjustment. The availability and extent of such adjustments should be discussed and negotiated with the competent tax authorities prior to relocation to Switzerland.

When individuals are not subject to taxation for an entire tax period in Switzerland, Swiss tax law provides for pro rata allocation of gains and income. In principle, only the income effectively earned/received during the actual tax residency and liability in Switzerland will be taxed. Recurring income such as income from employment, however, will be annualized to determine the tax rate within the progressive rate system applied in Switzerland. On the contrary, non-recurring/extraordinary income, e.g., bonuses, will not be annualized in the context of the determination of the applicable tax rate. The same principles apply to deductions.

Are there any special rules where tax is imposed or tax cost is adjusted when no actual sale occurs?

Capital gains tax imposed on gifts. In general, the transfer of an asset as a gift is not regarded as a realization of profit in Switzerland. Accordingly, no capital gains tax is levied on a transfer of a movable asset as a gift. In the case of immovable property, a deferral of the real estate capital gains tax is usually granted.

However, most cantons levy a gift tax on the fair market value of the respective asset—the Confederation is not empowered to levy gift tax. Except for the cantons of Schwyz and (generally) Lucerne, all cantons levy gift taxes. Cantonal gift taxes are due if the donor resides in the respective canton and, for immovable property, if the property is located in the canton concerned.³³ Regarding transfer tax, there is no difference between an inter vivos gift and property that passes mortis causae. In general, gift tax liability arises when a gift is made and the donee is liable. Some cantons (e.g., Zurich³⁴) impose joint tax liability on the donee and the donor.

den Angestellten, Spezialisten und Spezialistinnen (Expatriates-Verordnung, ExpaV), December 12, 2000, SR 642.118.3.

²⁰ Art. 2 ExpaV.

²¹ Arts. 1(2) and (2) ExpaV.

²² See *Erlautender Bericht zur Revision der ExpaV*, page 3 (available under www.news.admin.ch/message/index.html?lang=en&msg-id=55929).

²³ *Id.* Art. 1(1).

²⁴ *Id.* Art. 4a.

²⁵ Whereby the concept of expatriates under Swiss social security law does not necessarily correspond to the definition of expatriates according to the ExpaV.

²⁶ Art. 14 DBG; Art. 6 StHG.

²⁷ See Art. 6(1) StHG; Art. 14(1) DBG. Same as individuals taxed ordinarily, individuals applying for the lump-sum taxation regime also need a residence permit. While the application for residence permits for EU/EFTA citizens is usually a mere formality, the granting of residence permits for non-EU/EFTA citizens normally depends on whether the application for the lump-sum taxation regime will be approved.

²⁸ Art. 14(2) DBG, Art. 6(2) StHG.

²⁹ Note 9, *supra*, page 254.

³⁰ *Id.*

³¹ *Id.*

³² Wealth taxes are not imposed at federal level.

³³ See e.g., section 2(1) Cantonal Gift and Inheritance Tax Law of the Canton of Zurich, *Erbschafts- und Schenkungssteuergesetz* (EschG), September 28, 1986, LS 632.1. As an exception, gift tax can also be due if the donor does not reside in Switzerland—the canton of Tessin imposes gift tax on donees residing in Tessin if the donor resides abroad.

³⁴ Section 57(3) EschG.

³⁵ See ESTV *Kreissschreiben* Nr. 5, "Umstrukturierungen," June 1, 2004, effective from July 1, 2004 (Circular Letter of the SFTA No. 5, Reorganizations); Arts. 19(1)(c) and 61(1)(c) DBG; Arts. 8(3)(c) and 24(3)(c) StHG; Art. 6(1)(abisi) StG.

³⁶ For the similar rule regarding corporations, see Art. 64 DBG.

³⁷ Art. 12(3)(e) StHG.

Rollover of gains on corporate organization, contribution, or reorganization transactions. Swiss tax law provides for certain exemptions or relief from income/corporate income tax and further taxes (e.g., withholding taxes and stamp duties) for corporate organization, contribution, or reorganization transactions.³⁵ Accordingly, transfers of participations and other business assets to other group companies held by a common direct or indirect Swiss parent company are possible on a tax-neutral basis. Depending on the type of transaction and the asset transferred, a restriction period may be imposed on a subsequent sale of specific shares or assets.

A corporate reorganization may include the following tax-neutral transactions:

- Legal mergers.
- Demergers.
- Quasi-merger/share-for-share exchanges.
- Hive-downs.

Other tax-free exchanges of property or rollover of gains. According to Art. 30 DBG, the capital gain (respectively the hidden reserves) on the replacement of noncurrent assets that are necessary for business purposes can be rolled over if the newly purchased asset is likewise necessary for business purposes, is located within Switzerland, and has the same or a similar function as the replaced assets.³⁶ Further, Swiss tax law provides, inter alia, for a tax deferral of real estate capital gains from a sale of owner-occupied residential property if the disposal proceeds are reinvested in another accommodation located in Switzerland.³⁷

Basis (tax cost) adjustments on death or other non-sale transactions. There is no inheritance tax imposed at the federal level. However, most of the cantons and some municipalities impose inheritance and gift taxes according to cantonal and (when applicable) communal laws. Generally, the fair market value of the respective good is used as tax basis for inheritance tax purposes and will define the tax value for ongoing taxation purposes of the successor. Transfers to the spouse, descendants, and recognized charities are tax exempt in most cantons.

Is a distribution by a company in liquidation taxed as a dividend, capital gain, or any combination? Liquidation surpluses are taxed as income from movable property unless the payment constitutes a repayment of existing capital contributions (nominal paid-up share capital and recognized capital contribution reserves).³⁸ As dividends, liquidation



surpluses may benefit from partial taxation relief. They are taxable at the federal level only in the amount of 60% if the respective participation rights constitute at least 10% of the share capital or nominal capital of a corporation or cooperative.³⁹ Cantonal tax laws provide for similar tax relief.⁴⁰

Liquidation surpluses that a Swiss entity pays to its shareholders are generally⁴¹ subject to the 35% withholding tax.⁴² Whereas Swiss recipients can claim a refund of the withholding tax, non-Swiss recipients may reclaim the withholding tax only based on a double tax treaty between Switzerland and the recipient's country of residence. As for income tax purposes, the taxable surplus for withholding tax purposes corresponds to the net proceeds, minus the nominal paid-up share capital and the recognized capital contribution reserves.⁴³

How does Switzerland tax a pre-residence sale of property when part of the proceeds of sale are received before and part after the individual becomes a resident? As the taxation of pre-residence sale of property when part of the proceeds of sale are received after the individual becomes a resident depends on the particular facts and circumstances of each case, it is recommended to discuss such situations and the respective tax consequences with the competent tax authority in advance. If an individual was entitled to the entire proceeds before he

³⁸ Art. 20(1)(a) DBG; see www.swisntaxnetwork.ch/corporate-taxationbesteuerung-jur-personen/Tax-Consequences-of-Liquidation.

³⁹ Art. 20(1^{bis}) DBG; see also Arts. 18b, 58, 69 DBG; Arts. 24(1), 28(1), (1^{bis}) StHG.

⁴⁰ Art. 7(1) StHG; see, e.g., section 35(4) Tax Act of the Canton of Zurich, *Steuergesetz des Kantons Zurich*, June 8, 1997, LS 631.1.

⁴¹ Except when the notification procedure (*Meldeverfahren*) applies.

⁴² Art. 20(1) of the Ordinance on the Federal Withholding Tax, *Verordnung über die Verrechnungssteuer (Verrechnungssteuerverordnung, VStV)*, December 19, 1966, SR 642.211.

⁴³ See ESTV, *Kreisschreiben Nr. 29a, "Kapitaleinlageprinzip neues Rechnungslegungsrecht"*, September 9, 2015, effective as per September 9, 2015 (Circular Letter of the SFTA No. 29a, capital contribution principle).

⁴⁴ *Schweizerische Steuerkonferenz Kreisschreiben Nr. 30, "Besteuerung von Trusts"*, August 22, 2007 (Circular Letter of the Swiss Tax Conference No. 30, Taxation of Trusts).

⁴⁵ In practice, the qualification (and thus the taxation) of a trust is agreed with the competent Swiss tax authorities based on a tax ruling.

⁴⁶ See Art. 16(3) DBG.

⁴⁷ *Id.*

⁴⁸ According to the *Reinvermögenszuflusstheorie*, only income that the taxpayer realized is taxable.

⁴⁹ Art. 20(1)(a) DBG; see www.swisntaxnetwork.ch/corporate-taxationbesteuerung-jur-personen/Tax-Consequences-of-Liquidation.

⁵⁰ Art. 20(1^{bis}) DBG; see also Arts. 18b, 58, 69 DBG; Arts. 24(1), 28(1), (1^{bis}) StHG; Art. 7(1) StHG; see e.g., section 35(4) Tax Act of the Canton of Zurich.



became a resident of Switzerland, it might be arguable that the part of the proceeds that he received as a resident of Switzerland will also be allocated to his previous residence state.

When immovable property is sold, Switzerland taxes only the gain from the sale of immovable property located in Switzerland; gains from the sale of real estate located abroad are tax exempt based on Swiss domestic law and most Swiss tax treaties and are taken into account only in determining the tax rate applicable.

How does Switzerland treat a distribution from a foreign trust to a resident beneficiary of property that has increased in value while the property was held by the trust?

Is the beneficiary treated as having income or gain from the distribution? Because Switzerland does not have its own trust legislation, it ratified the Hague Convention on the Law Applicable to Trusts and on Their Recognition in 2007. In addition, the Swiss Tax Conference and Federal Tax Administration issued a Circular Letter dealing with the taxation of trusts in Switzerland.⁴⁴ In practice, the qualification (and thus the taxation) of a trust is agreed with the competent Swiss tax authorities based on tax rulings. Hence, it is recommended to request the respective tax rulings regarding income, wealth, and inheritance and gift tax consequences, as well as with respect to the possibility of withholding tax refunds from the competent tax authorities in advance, i.e., before moving to Switzerland. The taxation of a trust depends on the qualification of the trust:⁴⁵

- If a foreign trust is qualified as revocable, it is typically treated as transparent for Swiss tax purposes and a distribution to a resident beneficiary is qualified as a gift from the settlor to the beneficiary and thus subject to gift tax (according to cantonal tax law).
- If the foreign trust is qualified as an irrevocable fixed interest trust, the beneficiary of the trust is treated as a usufructuary. Hence, the trust assets are allocated to the beneficiary for Swiss wealth tax purposes and the beneficiary will generally be subject to income tax on the trust's

income irrespective of whether that income is distributed to the beneficiary or accumulated by the trust. Accordingly, if the beneficiary holds the property as a “private” asset, distribution of the property will be tax free (if it is movable property).⁴⁶

- A foreign trust might be qualified as an irrevocable discretionary trust. Accordingly, distributions to the beneficiary are qualified as taxable income at the level of the beneficiary whereby distributions of trust capital are generally tax free.

How is the beneficiary taxed when he later sells the distributed property and how would gain be calculated? Depending on the treatment of the trust structure, it may be recommended to pre-discuss the later sale of the property with the competent tax authorities, especially if the distribution of the property was subject to tax. If the individual holds the property as a “private” asset and the asset is movable property, a subsequent sale of the property will be tax free.⁴⁷

Taxation of new resident on corporate distribution attributable to pre-residence profits. As Switzerland follows the *Reinvermögenszuflusstheorie*,⁴⁸ the moment when the shareholder is entitled to the distribution respectively receives the distribution is decisive and not when the profits of the distributing company were accumulated. Hence, when moving to Switzerland, no tax will be imposed on the accumulated, undistributed profits in Switzerland; the profits accumulated before the shareholder became a resident of Switzerland are taxable only on distribution in Switzerland. However, depending on the tax system of the former residence state, the profits accumulated at the corporation level might be taxed on emigration of the individual, as the former resident state might, e.g., levy an exit tax on these undistributed profits.

Accordingly, normally, no special rules apply from a Swiss perspective in these cases. However, it is advisable to pre-discuss specific situations with the competent tax authorities and request a respective ruling. The rules regarding distributions constituting a repayment of existing capital contributions (nominal paid-up share capital and recognized capital contribution reserves) generally also apply in these cases and are thus tax free.⁴⁹

If the participation rights giving entitlement to the distribution constitute at least 10% of the share capital or nominal capital of a corporation or cooperative, partial taxation relief on distribution or sale of the shares at the federal level (and similar cantonal tax relief) will be granted.⁵⁰ Depending on the tax law of the former residence state, a more favorable outcome may result from distribution of the accumulated profits either before or after the individual moves to Switzerland, as the taxation right regarding the distribution will be allocated according to the applicable tax treaty (if a tax treaty between Switzerland and the former residence state is in place). In light of the Swiss lump-sum taxation regime, for example, it might be favorable to distribute the profits after the individual relocated to Switzerland. Thus, unfavorable tax treatment could be addressed.



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Overview

Under U.K. tax law, the scope of income tax and capital gains tax is largely dependent on the taxpayer's residence in the U.K. The extent of the taxpayer's liability is tempered for certain non-U.K. domiciliaries by the remittance basis. Domicile is a complex common law concept. The government has proposed to curtail it for tax purposes with effect from April 6, 2017. There is no concept of temporary U.K. residence.

A statutory residence test (SRT)¹ was introduced in April 2013 to determine an individual's U.K. residence status. In many circumstances, the SRT involves looking at the amount of time that an individual spends in the U.K. as well as the number of "ties" that he has to the U.K. The analysis required to determine residence status can be complex and have a significant bearing on an individual's liability to U.K. taxation, especially if he has overseas income and gains.

When a non-U.K.-domiciled individual becomes U.K. resident, he has the option of being taxed on the arising basis or remittance basis. Under the arising basis, an individual is liable to U.K. tax on his worldwide income and gains as they arise.

Under the remittance basis, U.K. tax is payable on foreign income and gains only if they are remitted to the U.K. Remittance is a highly technical concept in respect of which bespoke advice should be sought. The remittance basis can be claimed free of charge during the first six years of U.K. residence. However, long-term U.K. residents must pay an annual remittance basis charge to receive this tax treatment. The current charges are £30,000 p.a. if an individual has been resident for seven of the last nine years, rising to £60,000 p.a. if

an individual has been resident for 12 of the last 14 years, and finally £90,000 p.a. if an individual been resident for 17 of the last 20 years.² The £90,000 charge will become academic from April 6, 2017, when non-U.K. domiciliaries who have been U.K. resident for 15 of the previous 20 years will start to be deemed U.K. domiciled for U.K. income, capital gains, and inheritance tax purposes.³ These residents will lose the ability to claim the remittance basis altogether and will be taxed on the arising basis going forward.

If an individual claims the remittance basis of taxation in a tax year, he will lose his entitlement to the tax-free personal allowances (£11,000 in 2016/17) and capital gains tax-free allowance (£11,100 in 2016/17) in that year. (The U.K. tax year runs from April 6 to April 5.)

Does the U.K. tax resident individuals on their worldwide income? Does the tax based on residence include capital gains (as part of the income tax or as a separate tax)?

Income tax. An individual who is U.K. resident and U.K. domiciled is subject to U.K. income tax on his worldwide income. The same applies, subject to possible availability of the remittance basis, to a U.K. resident and non-domiciled individual.⁴

Capital gains tax. In general, capital gains tax is charged on a disposal of assets, including gifts, by U.K.-resident individuals.⁵ Subject to exemptions and relief, tax is charged on the increase in the value of the asset during the individual's period of ownership. At present, a taxpayer who is entitled to the remittance basis in the year of a disposal will not incur tax on the disposal of an asset situated outside the U.K., except to the extent that the gain is remitted to the U.K. Until April 6, 2015, the only non-U.K.-resi-

dent individuals who could be liable to U.K. capital gains tax were those trading in the U.K. through a branch or agency or permanent establishment and persons temporarily nonresident. (Also, gains realized by non-U.K.-resident trustees or close companies could and still can be attributed to U.K.-resident settlors and beneficiaries and participators—see discussion below.) From April 6, 2015, non-U.K. resident persons, including individuals and trustees, are subject to capital gains tax on the disposal of interests in U.K. residential property⁶. Exemptions and reliefs, such as principal private residence relief, may apply. They must complete an online nonresident capital gains tax return within 30 days of the disposal, unless they already have a relationship with HMRC.

When a U.K.-resident individual leaves the U.K. and then becomes U.K. resident again, he may be treated as a temporary nonresident. Disposals by temporary nonresidents during their period of absence may become chargeable to capital gains tax on their return to the U.K.

There are several reliefs from U.K. capital gains tax including entrepreneurs' relief⁷ on the sale or gift of qualifying business assets, and rollover relief⁸ when the proceeds of a sale of business assets are invested in new business assets. (See discussion below on relief when a disposal is not a sale.)

Please describe the basic tax treatment of new and temporary residents

Do new or temporary residents benefit from any special treatment on gains, e.g., tax exemption or limited taxation (e.g., remittance basis) of foreign income or gains? There is no concept of temporary residence. Arrivers in the U.K. midway through a U.K. tax year may be regarded, in limited circumstances, as non-U.K. resident in the part of the tax year before arrival. Otherwise, if the SRT is passed in any year, the individual is taxed as a U.K. resident for the whole year of arrival.⁹

Aside from the remittance basis, new or temporary residents generally do not receive any special treatment regarding income or capital gains. However, when an individual intends to become resident in the U.K. as a remittance basis user, there are various pre-arrival planning steps that can be undertaken before U.K. residence begins—for example creating a segregated fund of “clean capital” (containing no foreign income or gains), which can be brought to the U.K. without tax being triggered on a remittance of foreign income and gains.

Special treatment is also potentially available when an individual moves to the U.K. for temporary employment. “Overseas workday relief” allows U.K.-resident non-domiciled individuals who are working partly in the U.K. and partly outside the U.K. to incur U.K. tax only on the proportion of their employment income from their U.K.-based duties.¹⁰ This relief can be claimed in the year of arrival and for two subsequent tax years.¹¹ In addition, when a person is seconded to the U.K. for up to 24 months, income tax relief can be claimed in relation to some of their expenses, such as accommodation and travel.¹²

Because the U.K. tax year is not aligned with the calendar tax year that the majority of other tax systems use, when arriving in the U.K., there is a greater risk of an individual being found to be tax resident in two jurisdictions at once. In

that case, the tie-breaker clause in the relevant double tax treaty will need to be considered carefully.

Do new or temporary residents receive a fair market value adjustment to tax basis or comparable adjustment, e.g., pro rata allocation of gain to pre- and post-residence periods? Unlike some other jurisdictions, there is no rule that “rebases” assets automatically when an individual becomes resident in the U.K. Therefore, before becoming U.K. resident, an individual should consider whether there is scope for his investments to be rebased—for example, by a sale and possible repurchase, or disposal into a trust. The purpose of rebasing assets is to ensure that gains on a later disposal are calculated by reference to the market value of the investments prior to the commencement of U.K. residence, rather than the original acquisition cost of the investments.

New U.K. residents who are beneficiaries of offshore trusts can be liable to capital gains tax on capital payments that they receive from the trust¹³ (see discussion below). The trustees can make an election to limit the exposure of such beneficiaries in respect of pre-April 6, 2008, asset growth, in limited circumstances.¹⁴

Are there any special rules where tax is imposed or tax cost is adjusted when no actual sale occurs?

Capital gains tax on gifts. The capital gains tax rules as explained above apply equally to gifts: tax is charged on any gain found on comparing the donor's acquisition cost with market value at the date of the gift, subject, on occasion, to rebasing the acquisition cost—for example in the case of assets owned since before 1982. Taxation may be deferred effectively in gifts of business or agricultural assets to U.K. residents (and non-U.K. residents who are subject to U.K. capital gains tax on U.K. residential property) or on a gift into settlement, if the settlor has no interest in the settlement and is U.K. resident. The deferral is achieved by a claim by the transferor and transferee, or the transferor alone in a gift into trust.

Disposals by trustees other than sales. U.K.-resident trustees are liable to U.K. capital gains tax on gains realized on their disposals. They are treated as making disposals in certain situations, including when they (1) distribute an asset to a beneficiary; (2) transfer assets to the trustees of another trust; (3) create new trusts that replace entirely the trusts of the original settlement; or (4) become non-U.K. resident. The deemed disposal takes place at the market value of the asset.

Rollover of gains on corporate reorganizations. Incorporations of businesses as going concerns by individuals and share exchanges may benefit from deferral relief on disposal of the business or shares. In the latter, an HMRC clearance should be obtained.

Other tax free exchanges or rollover of gains. Transfers between spouses who are living with each other are capital gains tax neutral, irrespective of the residence statuses of the spouses.

Basis (tax cost) adjustments on death. There is a deemed disposal for capital gains tax purposes on the owner's death, but without a capital gains tax charge. This results in a tax-free uplift in the capital gains tax base cost of the assets to the market value at the date of death.

Liquidations. A shareholder is deemed to dispose of his shares on the liquidation of a company in consideration of assets received in the liquidation. This is in addition to any taxable gain that the company realizes on disposal of its assets.

How does the U.K. tax a pre-residence sale of property when part of the proceeds of sale are received before and part after the individual becomes a resident? The residence status of the individual at the date of disposal of the property will determine the overall tax treatment of the proceeds. A sale is a “disposal.”¹⁵ The general rule is that a disposal of property is made on the date that the unconditional contract is made, not any later date when the property may be transferred or sale price paid.¹⁶ When the contract is conditional, the date of disposal is the date that all of the conditions are satisfied.¹⁷ Therefore, if any unconditional contract for sale is entered into before the vendor becomes U.K. resident, the gain is capital gains tax free, unless in respect of a U.K. residential property interest and occurring after April 5, 2015.¹⁸

How does the U.K. treat a distribution from a foreign trust to a U.K.-resident beneficiary of property that has increased in value? Trustees who transfer property to a beneficiary are deemed to dispose of it at market value so that when the market value is higher than the trustees’ acquisition cost, they realize a gain.¹⁹ As non-U.K. residents, they are not subject to U.K. tax on the gain (except in relation to U.K. residential property interests²⁰). If the settlor is U.K. resident and U.K. domiciled in the year in question, and has an interest in the settlement, he is taxable on the gain.²¹ Absent such a settlor, the gain is effectively attributed to any beneficiaries who receive a capital payment, though the interplay of income tax and capital gains tax where a capital payment is made to a

beneficiary may result in income tax being applied in respect of such a payment in priority to capital gains tax.²²

A distribution to a beneficiary of property with gain is both a capital payment and a disposal by the trustees. The capital payment will be “matched” against the gains realized by the trustees on the deemed disposal together with any other gains realized in the same year.²³ The U.K.-resident beneficiary will, therefore, be subject to U.K. capital gains tax (with the benefit of the remittance basis if a remittance-basis user²⁴) up to the value of the gains of the year and, if these are less in value than the capital payment, with gains of any earlier years in reverse order. There is a surcharge for delayed payments of up to six years. Any balance of the capital payment may be taxed later if further trustee gains are realized. The matching of benefits to realized gains is a highly complex area.²⁵ When the capital payment that the beneficiary receives is an asset *in specie*, he acquires it at its market value so that any gain or loss that he realizes on a subsequent disposal is measured by reference to that market value.

If an individual moves to the U.K. and later receives a distribution from a company that is attributable to pre-residence profits, how is that distribution taxed? Any special rules because the profits of the distributing corporation were accumulated before the shareholder became a resident in the U.K.? A dividend is taxable in the hands of a U.K. resident individual on receipt, irrespective of whether the dividend is attributable to pre-residence profits. Large dividends intended for shareholders on the move to the U.K. should be paid before they become U.K. resident. This is particularly important for non-domiciled individuals intending to use the remittance basis because, on becoming U.K. resident, such pre-residence income would be regarded as “clean capital” and could be brought into the U.K. free of U.K. tax.

¹ For the SRT, see Schedule 45, Finance Act 2013 (www.legislation.gov.uk/ukpga/2013/29/schedule/45/enacted).

² For the current remittance basis charges, see section 24, Finance Act 2015 (www.legislation.gov.uk/ukpga/2015/11/section/24).

³ For further details on the proposed changes, see Consultation paper on the proposed reforms to the taxation of non-domiciles, www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles/reforms-to-the-taxation-of-non-domiciles. A further Consultation paper was released on December 5, 2016, which gives further details on the changes—see www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles-further-consultation/reforms-to-the-taxation-of-non-domiciles-further-consultation.

⁴ Income Tax Act 2007 Pt. 14.

⁵ The main provisions governing the taxation of chargeable gains are in the Taxation of Chargeable Gains Act 1992 (TCGA 92).

⁶ Finance Act 2015, schedule 7, TCGA 92 ch. VI.

⁷ See TCGA 92 section 169H onward and Finance Act 2015 sections 41–44.

⁸ See section 152 TCGA 92.

⁹ See Finance Act 2013, schedule 45, para. 2(3) (www.legislation.gov.uk/ukpga/2013/29/schedule/45/paragraph/2).

¹⁰ See section 26 Income Tax (Earnings and Pensions) Act 2003 (www.legislation.gov.uk/ukpga/2003/1/section/26).

¹¹ *Id.* section 26A (www.legislation.gov.uk/ukpga/2013/29/schedule/46/paragraph/10).

¹² See HMRC, “490: Employee travel—a tax and National Insurance contributions guide” (www.gov.uk/government/publications/490-employee-travel-a-tax-and-nics-guide).

¹³ See section 87, Taxation of Chargeable Gains Act 1992 (TCGA 1992) (www.legislation.gov.uk/ukpga/1992/12/section/87/enacted).

¹⁴ See Finance Act 2008, schedule 7, para. 126 (www.legislation.gov.uk/ukpga/2008/9/schedule/7/paragraph/126).

¹⁵ There is no statutory definition of “disposal” so the word must be given its normal meaning.

¹⁶ See section 28(1) TCGA 1992 (www.legislation.gov.uk/ukpga/1992/12/section/28/enacted).

¹⁷ *Id.* section 28(2). (www.legislation.gov.uk/ukpga/1992/12/section/28/enacted).

¹⁸ See Finance Act 2015, section 37, leading to schedule 7 (www.legislation.gov.uk/ukpga/2015/11/schedule/7).

¹⁹ See section 71(1) TCGA 1992 (www.legislation.gov.uk/ukpga/1992/12/section/71/enacted).

²⁰ *Id.* sections 14B(1), 14B(2)(c), 14D(1).

²¹ *Id.* section 86(4) (www.legislation.gov.uk/ukpga/1992/12/section/86/enacted). The rules relating to the taxation of settlors and beneficiaries of certain non-U.K.-resident trusts are subject to proposals for reform with effect from April 6, 2017. See note 53, *supra*.

²² *Id.* section 87(2) (www.legislation.gov.uk/ukpga/1992/12/section/87/enacted).

²³ *Id.* sections 2(2), 87(3) (www.legislation.gov.uk/ukpga/1992/12/section/2/enacted and www.legislation.gov.uk/ukpga/1992/12/section/87/enacted).

²⁴ *Id.* section 87B.

²⁵ *Id.* section 87A.



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Overview of U.S. income taxation of gains. The United States imposes an income tax on individuals.¹ The scope of the tax depends on whether the individual is either (1) a citizen or a resident of the United States, as defined for income tax purposes; or (2) an alien (meaning a non-citizen) of the United States who is not a resident.² Citizens and residents are taxed on their income from all sources worldwide, whether or not remitted to the United States.³ Income includes gains from the sale or exchange of property, although several special rules apply to gains from the sale or exchange of a capital asset. Nonresident aliens are taxed on income and gains effectively connected with the conduct of a trade or business within the United States and on investment income (but not gains) received from U.S. sources.⁴ Gains from sale or exchange of U.S. real property interests are always treated as effectively connected with a trade or business.

The maximum federal income tax rate is 39.6%; however, for long-term capital gains recognized with respect to capital assets and certain property used in a trade or business, the maximum rate is currently 20%.⁵ In addition, U.S. individuals and non-grantor trusts also pay a tax of 3.8% on “net investment income,” to the extent that income exceeds \$200,000 or \$250,000, depending on taxpayer’s marital status; the tax does not apply to nonresident aliens.⁶

Virtually all individual taxpayers report their income on the cash method of accounting. The United States allows individuals to deduct a variety of losses against income and capital gains. In particular, if gains and losses from property used or held for use in a trade or business produce a net loss, it is

an ordinary loss; net losses from sales of capital assets enter into the computation of net short-term and long-term capital gain. Individuals are further allowed to deduct up to \$3,000 of net capital loss each year against ordinary income.

Gain or loss is the positive or negative difference between the amount realized from the sale or exchange of an asset and the asset’s adjusted basis. In most cases, the amount realized is the sale price of the asset; if that price is not paid in U.S. dollars, the amount realized will be the fair market value of the property (including the U.S. dollar equivalent of foreign currency) received in the sale or exchange. (Foreign currency is property and sale or exchange of foreign currency, including by using it to purchase property, can, in effect, be a transaction in which gain or loss is recognized, unless the transaction occurs within a “qualified business unit” with respect to which the foreign currency in question is the “functional currency.”⁷)

The basis of an asset will generally be the historical cost of the property sold or exchanged, subject to a variety of adjustments that depend on the type of property.⁸ For example, if a property was subject to the allowance for depreciation, the amount of the depreciation allowed or allowable must be deducted from the basis; the increased gain that results from the reduction in basis is said to be “recaptured.”⁹ Certain corporate distributions can result in adjustments to the shareholder’s basis in corporate stock.¹⁰ Distributions by partnerships, trusts, and estates generally result in the distributee receiving a basis in the distributed asset equal to that of the distributor. Special rules also apply to property acquired (including by exercise of an option) in exchange for

services.¹¹ As noted below, property acquired by reason of death receives a fair market value basis; the basis of property acquired by gift is the lesser of cost or fair market value.¹² Indeed, special rules abound.

The United States does not have a clear statutory rule concerning when gain arises. It is generally considered to arise when a sale occurs, that is, when the benefits and burdens of ownership pass from seller to buyer. Almost always, this means the date of closing or completion of the sale rather than the date that the parties enter into a contract for sale, unlike the rule in some other countries, where the exchange of binding contracts is the moment when gain arises for purposes of taxation.

Treatment of new and temporary residents. The United States adopts an all-or-nothing approach. An individual who is a citizen or resident alien is taxable on worldwide income from all sources. An individual who is a nonresident alien is taxed only on certain limited classes of income and gains. There is no intermediate stage, for either new or temporary residents. Therefore, when an individual becomes a resident, he will be taxed on any gain realized on or after the first day of residence, even if the entire increase in value occurred prior to him becoming a U.S. resident. Conversely, the new resident can incur a loss for tax purposes even if the entire decline in value occurred before residence began.

Adjusted basis of an asset of a new or temporary resident is determined under U.S. tax rules even if neither the resident nor the asset had any connection with the United States at the time of the acquisition or other transaction that affects basis.^{12.1} Not only is cost determined based on translating any foreign currency cost of purchasing the property at the rate prevailing on the date of purchase, but U.S. rules apply to adjusting the basis. For example, if the new resident sells depreciable property, the basis must be adjusted downward for depreciation that would have been allowed during the



period of ownership had the new resident been a U.S. resident for the whole of that period.^{12.2}

These rules are quite helpful for new residents who acquired property denominated in currencies that have declined over the years against the U.S. dollar, which may be the majority of currencies—less so for, say, holders of assets acquired in Swiss francs. Certainly, planning needs to take account of such matters.

Are there any special rules where tax is imposed or tax cost is adjusted when no actual sale occurs? Because U.S. basis rules

¹ The tax is imposed by the Internal Revenue Code (“Code”). Unless otherwise stated, “Section” in the U.S. discussion herein refers to the Code. Most but not all states and some cities also impose taxes on income, but these are beyond the scope of this article, although they should not be ignored by individuals moving to the United States.

² The definition of a resident is in Section 7701(b) and refers to an individual who is a lawful permanent resident under the immigration laws or who, in any calendar year, meets the substantial presence test, which is based on the number of days that the alien was physically present in the United States.

³ Sections 1 and 55.

⁴ Section 871.

⁵ Section 1(h). The rate for gain from the sale of a collectable (e.g., a work of art) is 28%; the rate for gain consisting of depreciation recapture is 25% (see note 84 below).

⁶ Section 1411. The tax is sometimes referred to as the Affordable Care Act tax or Obamacare tax.

⁷ The U.S. rules on foreign currency transactions are well beyond the scope of this article.

⁸ Section 1012.

⁹ See Sections 1245 (personal property) and 1250 (real property).

¹⁰ Section 301(b).

¹¹ See Section 83.

¹² Sections 1014 and 1015.

^{12.1} See, e.g., Benichou, TCM 1970-263 (taxpayer from Algeria claimed loss on property expropriated after he became a U.S. resident; loss was limited to taxpayer’s basis, computed under U.S. rules).

^{12.2} *Elek*, 30 TC 731; *Pap*, TCM 1962-82. Regulations require the use of the straight-line method of depreciation when no allowance for depreciation was claimed. Reg. 1.1016-3(a)(2)(i).

¹³ Section 877A.

¹⁴ Articles 13(6), (7), (8).

¹⁵ See, e.g., 2001 U.S.-U.K. income tax treaty, Article 26(4).

¹⁶ Sections 351 (tax-free incorporation) and 368 (tax-free reorganization).

¹⁷ Section 1031.

¹⁸ Section 1033.

¹⁹ There is one significant exception, where the shareholder was a “United States shareholder” and the company was a controlled foreign corporation with certain kinds of previously undistributed income accumulated while the shareholder was a U.S. shareholder. A distribution of such undistributed income will be taxed as a dividend. Section 1248.

²⁰ This description assumes that any installment not paid when the sale closes will bear interest at not less than the applicable federal rate. If no interest is charged, interest will be imputed and a portion of the installment will be treated as interest rather than purchase price. Also, the description assumes that the amounts of the installments are fixed; if the installments were variable or contingent as to amount or timing, additional rules may come into play. However, we understand that in the present case the installments will bear interest at the AFR and the amounts are indeed fixed.



apply, the United States generally disregards transactions that may have been taxable in foreign countries but would not have been taxable in the United States. For migrants, this is particularly problematic when a country imposes an exit tax in the form of the deemed sale of property by an individual whose residence in that country ceases (similar to the market-to-market regime that applies to “covered expatriates” under U.S. law¹³). The result can be double taxation—gain is deemed realized in the departure country and the United States later taxes the same gain.

Tax treaties sometimes alleviate this problem partially. One reasonably specific provision is in the 1980 U.S.-Canada treaty¹⁴ but these types of provisions are the exception rather than the rule. In some cases not covered in the treaty, relief might be obtained through the general provision permitting competent authority consultation for the elimination of double taxation.¹⁵

With regard to the specific questions posed in the outline:

The United States generally does not impose tax on capital gains in connection with dispositions by gift. (This means that a gift on which capital gains tax has been imposed in a foreign country will not result in an increase in the property’s basis—the United States will take no account of the deemed disposal under foreign tax law.) There are two noteworthy exceptions: First, if donated property is security for debt in an amount that exceeds the adjusted basis of the property, the excess is taxed as gain and there will be a concomitant increase in basis for the donee. Second, a gift of shares in a passive foreign investment company (even to charity) is treated as a sale of the shares in exchange for the fair market value of the shares. This can be problematic for

a new resident seeking to dispose of shares in offshore funds, if the disposal takes place after he moves to the United States.

The United States has extensive rules governing nonrecognition of gains on corporate organization, contribution, or reorganization transactions. In general, if the transactions meet detailed statutory, regulatory, and case law requirements, the parties disposing of shares or assets do not recognize gain or loss and the parties acquiring the shares or assets receive a carryover basis.¹⁶ These rules can apply to pre-residence transactions. So, for example, a transfer or contribution by a nonresident alien of property to an entity classified as a corporation that meets the U.S. requirements of a tax-free incorporation, reorganization, or liquidation will not result in a basis step-up to either transferor or transferee, even if neither the parties nor the assets had any connection to the United States when the transaction occurred.

There are several other tax-free exchanges of property or rollover of gains. The most important ones are the tax-free exchange of like kind property¹⁷ and the tax-free reinvestment of proceeds of insurance and other compensation for property that has been destroyed or condemned.¹⁸

Special rules apply to property received by gift or inheritance. Property received by gift typically has a basis equal to the lower of its basis in the hands of the donor and the fair market value of the property at the date of the gift, whereas inherited property receives a basis equal to the fair market value at the date of death or, in some cases electively, six months after the date of death. These rules apply even if, at the relevant date, the donor, decedent, and recipient were all nonresident aliens and property was located outside the United States. If the owner of the property or the beneficiary of a trust that owns the property becomes a U.S. person, U.S. rules will determine the basis of the property if it is sold subsequently. A distribution by a company in liquidation is generally treated as if the shareholder sold his shares to the company in exchange for the distribution.¹⁹

Pre-residence sales when proceeds received post-residence. The United States taxes sales when payments from a sale are received over more than one tax year using the installment method. Under the installment method, in any year in which one or more payments are received, the gross profit from the transaction (essentially, the gain) is recognized based on the ratio of the payments to the total contract price. The same result is reached (and is also understood more intuitively) by requiring recognition of every payment reduced by a portion of the seller’s basis, where the portion is the payment(s) for the year divided by the contract price.²⁰

The IRS generally treats a newly resident taxpayer as if he had elected out of installment sale treatment in the case of pre-residence sales, so that the principal element of installment payments received after the taxpayer becomes a resident will not be a taxable gain.²¹ The IRS apparently does not require an actual election, which might be difficult to make for sales in years in which the taxpayer may have had no connection with the United States. However, it is generally desirable that an election be made with respect to any sale during the year in which residence begins or, indeed, during a year when

the taxpayer otherwise must file a U.S. return, if possible U.S. residence is contemplated. The new resident will need to recognize any interest income related to the installments. Interest can be imputed to the deferred price of a pre-residence sale and taxed if earned after the residency starting date.²²

Treatment of distributions by trusts. The U.S. rules relating to trusts are complicated and, for purposes of this article, only the rules applying to foreign trusts with foreign income are discussed since this is the situation most likely to apply to a new resident.²³ There are two classes of trusts—grantor and non-grantor.²⁴ The income and gains of a grantor trust are simply passed through to the grantor, who is taxable on such income and gains as if he owned the assets and income of the trust. In effect, the trust and the beneficiaries are ignored. Any gain that the trust realizes or loss that it incurs will be treated as if the grantor realized or incurred it and all the rules described above with respect to the gains and losses of individuals apply to the gains and losses of the trust in the hands of the individual grantor. A distribution of property by a grantor trust to the grantor is usually a complete non-event for tax purposes; a distribution to some other beneficiary is treated as a distribution to the grantor followed by a gift by the grantor to the beneficiary.²⁵

If a foreign trust is a non-grantor trust, it is subject to tax in the same manner as a nonresident alien, meaning that it will not be taxable unless it has some U.S.-related income as described above. However, if current trust income is or is required to be distributed to a beneficiary, the income is passed through to the beneficiary, who will be taxable as if he had earned the income directly. If a foreign trust makes a distribution attributable to prior-year income, the U.S. beneficiary will pay tax on the income (with credit for any foreign or U.S. tax paid by the trust passing through to the beneficiary). Any distribution by a foreign trust to a newly resident



beneficiary out of trust income will be taxable whether earned before or after the residency start date.

The amount of a distribution of trust property other than U.S. dollars is equal the trust's basis in the property and will be taxable to a U.S. beneficiary to the extent that the trust had income.²⁶ A distribution of property by the trust does not cause the trust to recognize gain or loss. The beneficiary who receives the distribution receives basis in the distributed property equal to the basis in the hands of the trust and will

²¹ Section 453(d). In Ltr. Rul. 9412008, a Canadian resident sold Canadian real property in 1986 for a price payable by installments; she became a U.S. resident in 1993 while installments were still due, before which she had never been required to file a U.S. tax return. The IRS ruled that consequences of the installment sale should be determined as if she had elected under Section 453(d) not to report the sale on the installment method. The IRS based its ruling on the legislative history for the Installment Sales Revision Act of 1980, which says: "It is anticipated that the regulations will prescribe election rules relating to the treatment of gains from deferred payment sales of property by a nonresident alien. Under the installment method rules of present law, these gains do not become taxable as payment[s] are received after the seller becomes a resident or citizen subject to U.S. income tax for a taxable year subsequent to the year in which the sale was made. It is intended that the election regulations will continue this treatment in appropriate cases." The IRS has never in fact issued such Regulations but apparently feels that it must follow the legislative history.

²² Section 1274. There are several exceptions to the imputed interest requirement for sales, especially sales involving proceeds of less than \$250,000.

²³ A trust is classified as a foreign trust unless it meets two tests to be classified as a domestic trust: (1) court test—the trust is under the primary supervision of a U.S. court; and (2) control test—all substantial decisions concerning the trust must be under the exclusive control of one or more U.S. persons. See Section 7701(a)(30) and Reg. 301.7701-7.

²⁴ The terms "non-grantor trust" and "grantor trust" do not appear in the Code. The grantor of a trust means, essentially, the person who funded (or is deemed to have funded) the trust with "gratuitous transfers" (gifts). "Non-grantor trust" generally refers to any trust that is not a grantor

trust. Broadly, a "grantor trust" is one in which, under Sections 671-679, the grantor retained some interest or power such that he did not fully give away his property to the trust. The definition is narrower when the grantor is not a U.S. person (see Section 672(f)). It is, therefore, possible for a trust that was a non-grantor trust while the grantor was a nonresident alien to become a grantor trust when the grantor becomes a resident alien or U.S. citizen.

²⁵ Rev. Rul. 69-70, 1969-1 CB 182.

²⁶ The rules described in this paragraph are in Section 643(e). When we speak of the trust having income, we mean either income in the year of distribution or, in the case of a foreign trust, income earned in prior years but not distributed in the year that it was earned.

²⁷ There are, however, estate tax consequences of distributions by trusts. The distributions may clear out undistributed income at a time that the beneficiary is not yet a U.S. person, but may increase the size of the beneficiary's estate, which may become taxable if the beneficiary gives or bequeaths the property after having become a U.S. domiciliary or citizen for gift or estate tax purposes.

²⁸ Section 877A.

²⁹ Section 864(c)(6). The IRS apparently takes the view that this rule applies even if the individual was a U.S. resident at the time of the sale, although the statutory language is not entirely clear on this point.

³⁰ Section 864(c)(7).

³¹ See Section 865, particularly Sections 865(a) (sales of personal property sourced according to residence of seller) and 865(g)(1)(A)(i)(II) (nonresident alien with "tax home," i.e., principal place of business, in the United States is a United States resident for these purposes).



recognize gain or loss only when he later sells or otherwise disposes of the property in a taxable transaction. However, the trust may elect to recognize gain or loss on such a distribution, in which case the amount of the distribution will be equal to the fair market value of the property and the beneficiary will receive a basis equal to the fair market value of the property. It is not clear if this election can be used affirmatively as a planning device in the case of a trust with a beneficiary who has not yet moved to the United States.

Post-residence distributions by companies of pre-residence profits.

The all-or-nothing rule means that any distribution from a corporation to a newly resident alien will be taxable in full to the extent of the new resident's share of the corporation's earnings and profits, whether earned before or after the alien became a resident. Similarly, if the corporation owns appreciated property and sells the property after the alien became a U.S. resident, it makes no difference that the gain resulted from any increase in value that occurred before residence began. The United States has complex rules relating to controlled foreign corporations and passive foreign investment companies, which are beyond the scope of this article. Suffice it to say that any individual contemplating residence should plan for the impact of these rules if he owns, or is the settlor or beneficiary of a trust that owns, shares in a foreign company.

Planning and noteworthy rules. Planning. Because a sale of property that results in gain or loss may occur long after the property was acquired or the original basis was established, and the holding period (during which adjustments to basis may occur) may last many years, a taxpayer may have diffi-

culty in proving adjusted basis and other facts relevant to the tax attributes of the property. This difficulty is not confined to new residents, but it is particularly acute because the relevant events for property acquired before residence will have occurred in many cases without regard to the potential application of U.S. rules and recordkeeping requirements. Efforts to establish basis should begin as soon as U.S. residence is contemplated seriously.

Similarly, when it is known or even contemplated that an individual beneficiary of a trust is or may become a U.S. resident, the trust should begin maintaining records and books of account that will facilitate planning and compliance. It can be difficult to persuade trustees of the need to incur the expense, but the costs of not doing so can be high, even ruinous, for beneficiaries who become U.S. residents.

The U.S. rules generally encourage prospective residents (and foreign trusts of which they are beneficiaries) to find ways to realize gains (and defer realization of losses) before becoming U.S. residents. The rules also encourage the distribution to prospective residents of the previously undistributed income of non-grantor trusts and corporations.²⁷ However, if residence will be only temporary, realization of gains can be deferred until the resident resumes his nonresident status.

Some noteworthy rules. The United States has some rules for individuals who leave. "Covered expatriates" may be subject to deemed realization of their assets as of the day before the date of expatriation, although a basis step-up is allowed for property owned by the covered expatriate at the time that he first became a U.S. resident.²⁸ Also, if an alien sells or exchanges property used or held for use in a U.S. trade or business, installment payments received after he ceases to be engaged in the trade or business will nevertheless be taxable as if he remained engaged in the trade or business.²⁹ If property was used or held for use in a U.S. trade or business but ceases to be so used or held, gain on sale of the property within the following ten years will be taxable.³⁰

Finally, two other rules that may be regarded as traps: The first is Section 871(a)(2), which imposes a 30% tax on U.S. source capital gains of nonresident aliens who are present in the United States for 183 days or more in the tax year. This rule can apply to individuals who, though present for 183 days or more, are not residents because they can exclude days present as a diplomat, student, or teacher; because of presence through medical necessity; or because they have a fiscal year that differs from the calendar year and the 183 days span two calendar years (residence for non-green card holders is tested on a calendar-year basis). The combination of a special residence rule and source rule can operate with surprising breadth in these circumstances and cause gains that intuitively one might think of as foreign to be treated as having a U.S. source.³¹

The second is Section 7701(b)(10), which imposes a tax on U.S.-source income and gains of nonresident aliens who cease to be U.S. residents but resume residency before the end of the third year following the year of cessation. In short, an alien cannot leave the United States, realize a large U.S. gain, and then return too soon without paying tax. ●

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We'll Be Landing Soon



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