



## International Tax ADVISORY ■

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### No Love Lost Between Taxpayer Topsnik and the Tax Court

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In late January, the Tax Court handed another loss to Gerd Topsnik (*Topsnik v. Comm’r*, Jan. 20, 2016). Topsnik last encountered the Tax Court in a 2014 case, in which he unsuccessfully argued that “informally” abandoning his green card relieved him from U.S. taxation. In the earlier case, the court held that Topsnik remained on the hook for U.S. tax at least until he abandoned his green card in accordance with U.S. tax regulations by filing DHS Form I-407, Abandonment of Lawful Permanent Resident Status, in November 2010. As a result, Topsnik was taxable on gain from his 2004 installment sale of stock and required to file U.S. tax returns reporting such gain for the years 2004 through 2009.

For the 2010 tax year, Topsnik filed a (delinquent) nonresident tax return on Form 1040NR, claiming exemption on the installment payments under Article 13 (Gains) of the U.S.-Germany income tax treaty. In response, the IRS sent Topsnik a Notice of Deficiency seeking tax on the 11 monthly installment payments the taxpayer received in 2010 before filing the Form I-407. Moreover, the IRS claimed that Topsnik was subject to tax on the deemed sale of his right to future installment payments under Section 877A’s mark-to-market regime. Topsnik chose to bring suit, again, claiming that he was a German resident in 2010 and that Section 877A did not apply. Unfortunately for Topsnik, the Tax Court sided with the IRS, again, seemingly impervious to each of Topsnik’s entreaties.

Based on information from the German competent authority under Article 26 (Exchange of Information) of the treaty, the court concluded that during 2010 Topsnik was not a German resident within the meaning of Article 4 (Residence). A person is a resident of Germany under Article 4 if he is subject to German tax on his worldwide income. The Tax Court found “the evidence in the record ... uniformly to the contrary.” Despite the taxpayer’s professed German contacts—a driver’s license, passport and property ownership—information from the German competent authority revealed that Topsnik was registered as a nonresident for German tax purposes in 2010, had not filed a German tax return for 2010 and lacked a registered residence or habitual abode in Germany for the year.

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Next the Tax Court considered whether Topsnik was a covered expatriate subject to Section 877A. An expatriate includes a "long-term resident" who ceases to be a lawful permanent resident of the United States. A long-term resident is an individual, other than a U.S. citizen, who is a lawful permanent resident of the U.S. in at least eight years during the 15-year period ending with the year of expatriation; however, an individual is not considered a lawful permanent resident for any year that he is treated as a resident of a foreign country under a U.S. tax treaty and does not waive treaty benefits. Topsnik became a lawful permanent resident when he received his green card in 1977 and did not abandon the green card until 2010. In tallying the requisite eight years, the court cited its prior decision for six years (2004 through 2009), counted 2010 based on the holding described above and noted Topsnik's failure to show (or even claim) that he had not been a lawful permanent resident in at least three other years (1996 through 1998) of the relevant 15-year period. Having determined that Topsnik was an expatriate, the court then decided that he was a "covered expatriate" because he had failed to file Form 8854 to certify, under penalties of perjury, U.S. tax compliance for the five years preceding his expatriation. (Failure to make this certification is one of three conditions that can make someone a covered expatriate. The other two conditions are a net worth test and a tax liability test.)

The court's final blow to Topsnik was its conclusion that the IRS had applied Section 877A correctly to his right to future installment payments. The Section 877A mark-to-market tax applies broadly to all property that would be included in a taxpayer's gross estate if he died the day before his expatriation. Citing the installment sale and estate tax regulations, the court held that Topsnik's right to receive future monthly installment payments on the 2004 stock sale constituted property, the value of which would be included in his gross estate if he had died the day before his expatriation. (Because the taxpayer owned this property at the time of his expatriation, the Tax Court rejected his argument that Section 877A, enacted in 2008, could not apply to his 2004 sale.) Consequently, under Section 877A, Topsnik was deemed to sell this property for its fair market value on the day before he expatriated.

Reviewing the Tax Court's 2014 and 2016 decisions (and the facts described therein), it is hard to see Topsnik's claims as more than misadventured piteous overthrows. Perhaps the third time will be a charm for the seemingly star-crossed taxpayer and the Tax Court?

### **Court Loves Me, Court Loves Me Not: District Court Reverses Itself**

In a recent decision (*Starr International Co., Inc. v. U.S.*, D. Colo. Feb. 2, 2016), a federal district court in Colorado held that it "lack[ed] the power" to adjudicate a Swiss corporation's refund claim because of consultation provisions of the U.S.-Switzerland income tax treaty.

The refund claim related to withholding taxes on U.S. source dividends. Under Article 10 of the Swiss treaty, these taxes may be reduced for treaty-eligible taxpayers. In 2007, the Swiss corporation had requested discretionary benefits of the treaty from the U.S. competent authority under Paragraph 6 of Article 22 (Limitation on Benefits), a measure that plainly reveals to the IRS that a taxpayer does not satisfy any of the enumerated Limitation on Benefits provisions. With no response to its request, the taxpayer, in 2010, filed a return for 2007 claiming overpayment of taxes on the U.S. source dividends.

The taxpayer filed a refund suit in 2014 after the U.S. competent authority denied its request for treaty benefits. The government moved to have the suit dismissed, arguing that its discretionary denial of benefits was not subject to judicial review. The district court, in a September 18, 2015, memorandum opinion, declined to dismiss the taxpayer's suit on the basis that the treaty and Treasury technical explanation provided a "manageable standard" for determining if the IRS had abused its discretion.

The government asked the court to reconsider its September decision, positing that the court had given insufficient consideration to the treaty's requirement that the IRS consult with its Swiss counterpart before a final decision to grant treaty benefits. The government maintained that, under separation-of-powers principles, the court cannot force the IRS to consult with the Swiss tax authority or dictate the outcome of any such consultation. Consequently, according to the government, the court is "powerless" to uphold the taxpayer's refund claim (or order any specific monetary relief) because consultation is a prerequisite for the grant of treaty benefits.

The court's recent decision did not abandon its prior ruling wholesale. Indeed, the court reaffirmed its belief that there is a standard to judge whether a taxpayer qualifies for treaty benefits and that the IRS's decision to deny benefits could be subject to judicial review. The court did, however, walk back its prior finding that the consultation requirement was not implicated. (The prior decision was based on the fact that the IRS had denied benefits while consultation is required only before a grant of benefits.) While expressing skepticism at the government's argument that the court could not compel the IRS to consult with the Swiss competent authority, the court agreed that it should not be able to dictate the outcome of a diplomatic consultation and that granting the taxpayer's refund claim (or any specific monetary relief) would improperly trespass on the executive's choice to consult by rendering consultation "meaningless."

Before dismissing the taxpayer's suit without prejudice, the court considered whether this decision would leave the taxpayer without remedy. Both parties agreed and the court found that the taxpayer could bring a claim under the Administrative Procedure Act to set aside the U.S. competent authority's denial of treaty benefits.

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