Industry Insights:
Good Luck Living Overseas, But Before You Go…

Professional Advisor Group Consulting

ON THE MOVE

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As noted in our earlier piece focused on The Great Wealth Transfer, a current trend effecting global wealth and planning for High- and Ultra-High Net Worth Global Citizens is ***migration***.

There are many reasons people decide to change their residence, including outgrowing a starter home, changes in marital status or employment, and the search for a better climate. For some wealthy Global Citizens another reason might be increased uncertainty or "sovereign risk" in their home country. For others, a key motivation may be to minimize or avoid taxes.

ENTER THE "EXIT TAX"

Several countries impose an expatriation, emigration or departure tax (often referred to simply as "exit tax") when an individual ceases to be a *tax resident*. In most countries, one's tax status and liability to income tax is based on residency. Citizens of the United States and the small African nation of Eritrea are subject to income tax on worldwide income regardless of where in the world they reside.

While the rules vary by country, exit tax is typically calculated based on a deemed sale, disposal or disposition of certain assets based on the fair market value at the time of expatriation. The deemed gain is subject to tax at the applicable rate(s).

Countries that currently impose some form of exit tax include:

- ✓ Australia
- ✓ Canada
- ✓ Denmark
- ✓ Estonia
- ✓ Finland
- ✓ France
- ✓ Germany
- ✓ Italy
- ✓ Japan
- ✓ Norway
- ✓ Poland
- ✓ South Africa
- ✓ Spain
- ✓ Sweden
- ✓ United States

A QUICK HISTORICAL VIEW

In 1931, Germany implemented the "Reich Flight Tax" (*Reichsfluchtsteuer*) to dissuade wealthy Germans (or more specifically their wealth) from leaving Germany. The tax was later utilized by the Nazi party to tax assets owned by Jewish expatriates, including those sent to concentration camps outside of Germany.

The United States introduced exit tax in 1966 to dissuade wealthy Americans from expatriating to take advantage of the newly passed (lower) flat tax on U.S. investment income for nonresident aliens. Under the original law, anyone who expatriated, including giving up U.S. citizenship or permanent residency, for tax avoidance purposes was subject to the tax. The law, which is codified as IRC §877, has been amended several times, including in 1996 when it was modified to include language presuming emigration was for tax avoidance purposes if certain financial tests were met. In 2008, the law was modified to remove the presumption of tax avoidance but added adverse gift and estate tax treatment for future gratuitous transfers to U.S. beneficiaries.

In 2024, the exit tax is a hot button issue in the UK. The new Labour government may be considering the introduction of an exit tax in response to a feared mass exodus of wealthy non-domiciled residents ("res non-doms") due to its proposed changes to the centuries old "non-dom" tax regime. In other words, like the U.S. in 1966, the UK is considering a new tax on wealthy residents who leave the UK specifically to counter the potential impact of a different, in this case proposed, tax law change.

Impact on The Planning Discussion

In addition to the obvious increased need for pre-emigration and pre-immigration planning, the migration of wealthy Global Citizens impacts even the most basic elements of estate and tax planning, starting with the ***fact finder***. A key role of a trusted client advisor is to know what the client doesn't. This certainly includes having or finding the right answers, but it is equally important to know <u>the right questions</u>.

A typical fact finder or client questionnaire will include the usual suspects like name, date of birth, address and marital status. When planning for Global Citizens, key data points clearly include *current* country(ies) of citizenship and residency. What is uncommon, but nonetheless important, is also inquiring to clients about *past* citizenship and residency. Why does that matter? Let's examine a few case studies:

<u>Former Green Card Holder</u>

- The advisor completed standard fact finding and due diligence onboarding a new Latin America resident client.
- During a life insurance underwriting follow-up meeting, a simple "throw-away comment" uncovered the client had relinquished his Green Card years earlier.
- It was confirmed the client was a "*covered expatriate*" under the current U.S. "mark-to-market" expatriation regime.
- Since the client's children were the intended life insurance beneficiaries and the children were each still U.S. citizens, the life insurance death benefit proceeds could be considered a "covered bequest" and subject to U.S. estate tax under IRC §877.
- To mitigate the potential risk, the ownership and beneficiary structure was modified from individuals to a trust with provisions to delay distributions until the children also expatriated.

<u>UK Domicile of Origin</u>

- An Asia resident client was implementing a life insurance-based solution involving a portfolio of term and permanent policies.
- During the onboarding process, the client disclosed plans to move "*back to the UK*" in a few years.
- Since the advisor worked with Professional Advisor Group Consulting, they were aware of the 2017 "non-dom" law changes in the UK.
- The advisor inquired further and learned the client was born in London and moved to Asia for work after she completed university twenty years earlier; shedding her residency and domicile status for UK tax purposes.
- Since the client was born in the UK and had a UK domicile of origin, under the current law she is considered a "*formerly domiciled resident*", which subjects her to worldwide UK income and capital gains in her first year of residency and worldwide UK inheritance tax in her second year.
- As a result of the thorough fact finding, additional UK-focused planning and structuring were incorporated to maximize the overall tax efficiency of the solution.

We Can help

Cross-border and international life insurance planning is complicated and complicated problems require expert solutions. We know the "*have you ever…*" questions to ask. To learn how we can help, contact us at peter@pagconsultingllc.com or visit us at www.pagconsultingllc.com.