Kronenberg v. Commissioner, 64 T. C. 428 (1975)

Liquidating distributions received by a former U. S. citizen are taxable if one of the principal purposes of expatriation was to avoid U. S. taxes.

Summary

Max Kronenberg, a dual Swiss-U. S. citizen, renounced his U. S. citizenship one day before receiving liquidating distributions from his company, Polymica & Insulation Co. , Inc. (PIC). The IRS sought to tax these distributions under Section 877 of the Internal Revenue Code, which targets expatriation to avoid taxes. The Tax Court ruled that one of Kronenberg's principal purposes for expatriation was tax avoidance, thus the distributions were taxable. The court also determined the fair market value of a note received in the distribution and denied a deduction for moving expenses to Switzerland, as they were not connected to taxable U. S. income.

Facts

Max Kronenberg, a Swiss-born naturalized U. S. citizen, owned a controlling interest in Polymica & Insulation Co. , Inc. (PIC), a mica importing business he founded. In 1966, he sold PIC's assets to James W. Marshall and agreed to work for Marshall's new company, P & I Co. , Inc. , initially in the U. S. and later in Europe. PIC was liquidated in early 1967. In December 1966, Kronenberg learned that renouncing his U. S. citizenship before receiving PIC's liquidating distributions could exempt them from U. S. taxation. He and his family moved to Switzerland on February 21, 1967, renounced their U. S. citizenship on February 23, 1967, and received the distributions the following day. The distributions included cash, securities, and a note from P & I.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Kronenberg's 1967 federal income tax, asserting that the liquidating distributions were taxable under Section 877. Kronenberg petitioned the U. S. Tax Court, challenging the taxability of the distributions, the valuation of the P & I note, and claiming a deduction for moving expenses to Switzerland.

Issue(s)

1. Whether the liquidating distributions received by Kronenberg after he became a nonresident alien are taxable under Section 877 of the Internal Revenue Code.
2. What is the fair market value of the note distributed in the liquidation?
3. Whether expenses incurred in moving to Switzerland are deductible under Section 877(b)(2).

Holding

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1. Yes, because one of Kronenberg's principal purposes for expatriation was to avoid U. S. income taxes on the distributions.
2. The fair market value of the note was $20,679. 36 at the time of distribution, reflecting its speculative nature and the terms of payment.
3. No, because the moving expenses were not connected with the gross income included under Section 877.

Court's Reasoning

The court focused on the timing and circumstances of Kronenberg's expatriation, concluding that his decision to renounce his U. S. citizenship was influenced by tax considerations. The court noted that Kronenberg accelerated his plans to move to Switzerland and renounce his citizenship after learning of the potential tax advantage, just one day before receiving the distributions. This timing suggested that tax avoidance was a principal purpose of his expatriation. The court applied Section 877, which was enacted to prevent tax-motivated expatriation, and found that it applied broadly to all types of income, including capital gains from liquidating distributions. The court valued the P & I note at $20,679. 36, considering its nonnegotiable and unsecured nature, the lack of interest, and the uncertainty of payment. The moving expenses were denied because they were connected to Kronenberg's subsequent income in Switzerland, not the taxable U. S. income from the distributions.

Practical Implications

This decision clarifies that Section 877 applies to expatriates seeking to avoid taxes on any type of income, including capital gains from liquidating distributions. It underscores the importance of the timing and circumstances surrounding expatriation in determining tax liability. Practitioners should advise clients that last-minute expatriation before receiving significant income may trigger Section 877. The valuation of speculative assets like the P & I note highlights the need for careful valuation in tax planning. The denial of moving expense deductions under Section 877(b)(2) indicates that such expenses must be directly connected to taxable U. S. income to be deductible. Subsequent cases, such as *Markus v. Commissioner* and *Hartung v. Commissioner*, have further clarified the scope of deductions for expatriates, though they dealt with different sections of the tax code.

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