Furstenberg v. Commissioner, 83 T. C. 755 (1984)

Expatriation for non-tax avoidance reasons does not subject an individual to U. S. tax rates for former citizens, and trust distributions received before expatriation are taxable at U. S. citizen rates.

Summary

Cecil B. Furstenberg, a U. S. citizen until December 23, 1975, expatriated to adopt her husband's Austrian citizenship. The Tax Court determined that her expatriation was not primarily for tax avoidance, thus she was not taxable under section 877. However, a pre-expatriation accumulation distribution from a testamentary trust was taxable at U. S. citizen rates, whereas a distribution from another trust, received after expatriation, was taxed at treaty rates applicable to nonresident aliens.

Facts

Cecil B. Furstenberg, a U. S. citizen, married Prince Tassilo von Furstenberg in 1975 and adopted Austrian citizenship on December 23, 1975, losing her U. S. citizenship. She received distributions from two trusts in 1975: an accumulation distribution from the Testamentary Trust of Sarah Campbell Blaffer on November 20, before her expatriation, and a distribution from the Cecil A. Blaffer Trust No. 1 on December 23, after her expatriation. Furstenberg did not plan the timing of these distributions in relation to her expatriation and was not aware of their exact timing.

Procedural History

The Commissioner determined deficiencies in Furstenberg's federal income taxes for 1975-1977, asserting her expatriation was for tax avoidance under section 877. Furstenberg challenged this in the U. S. Tax Court, which held a trial and issued a decision in November 1984, finding no tax-avoidance motive in her expatriation but ruling on the taxability of the trust distributions.

Issue(s)

1. Whether Furstenberg's expatriation had tax avoidance as one of its principal purposes under section 877?
2. If tax avoidance was a principal purpose, would the French Tax Treaty govern her taxation over section 877?
3. For the 1975 tax year, are the distributions from the two trusts taxable at U. S. citizen rates or at the French Tax Treaty rate?

Holding

1. No, because Furstenberg's expatriation was primarily to adopt her husband's nationality, not to avoid taxes.

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2. Not reached, as the court found no tax-avoidance motive.
3. The accumulation distribution from the Testamentary Trust was taxable at U. S. citizen rates as it was received before expatriation. The distribution from Cecil A. Blaffer Trust No. 1 was taxable at the French Tax Treaty rate as it was not constructively received before expatriation.

Court’s Reasoning

The court found that Furstenberg’s expatriation was motivated by her marriage and not primarily for tax avoidance, based on her testimony and the timing of her actions. The court applied section 877’s burden of proof and found Furstenberg met it. For the trust distributions, the court determined the testamentary trust’s accumulation distribution was taxable at U. S. citizen rates as it was received before expatriation. The distribution from Trust No. 1 was not taxable at U. S. rates because it was not constructively received before expatriation, as there was no evidence Furstenberg or her agent knew it could be picked up earlier. The court emphasized the importance of actual or constructive receipt in determining the timing of income inclusion.

Practical Implications

This decision clarifies that expatriation not motivated by tax avoidance does not subject individuals to section 877’s tax rates. For legal practitioners, it underscores the importance of proving intent in expatriation cases and understanding the timing of income receipt from trusts. It also highlights the significance of tax treaties in determining the tax rates applicable to nonresident aliens. Practitioners should advise clients on the tax implications of expatriation and trust distributions, particularly regarding actual versus constructive receipt of income. This case has influenced subsequent rulings on expatriation and has been cited in discussions on the tax treatment of trust distributions for nonresident aliens.

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