Topsnik v. Commissioner, 146 T. C. 1 (2016)

In Topsnik v. Commissioner, the U. S. Tax Court ruled that Gerd Topsnik, a German citizen and former U. S. lawful permanent resident (LPR), was liable for U. S. taxes on gains from an installment sale of stock and on the deemed sale of his installment obligation under I. R. C. § 877A upon expatriation. The court determined that Topsnik expatriated on November 20, 2010, when he formally abandoned his LPR status, and was a "covered expatriate" due to non-compliance with U. S. tax obligations, thus subjecting him to the mark-to-market tax regime.

Parties

Petitioner: Gerd Topsnik, a German citizen who was a lawful permanent resident of the United States from February 3, 1977, until his expatriation on November 20, 2010. Respondent: Commissioner of Internal Revenue.

Facts

Gerd Topsnik, a German citizen, became a lawful permanent resident of the United States on February 3, 1977. In 2004, he sold his stock in Gourmet Foods, Inc. , a U. S. corporation, for $5,427,000 in an installment sale. The sale terms included an initial down payment and subsequent monthly payments of $42,500 until the full amount was paid. In 2010, Topsnik received $510,000 in monthly installment payments. On November 20, 2010, he formally abandoned his LPR status by filing a Form I-407 with the U. S. Citizenship and Immigration Services. Topsnik did not file a Form 8854 to certify compliance with U. S. tax obligations for the five preceding years nor did he file a U. S. income tax return for 2010 until August 2, 2011, when he filed a delinquent Form 1040NR claiming the installment payments were exempt under the U. S. -Germany Tax Treaty.

Procedural History

The Commissioner issued a notice of deficiency for the 2010 tax year, asserting a deficiency of $138,903, an accuracy-related penalty of $27,781, and an addition to tax for failure to timely file of $13,890. The deficiency included tax on the first 11 monthly installment payments received in 2010 and on the deemed sale of the installment obligation under I. R. C. § 877A. Topsnik moved for summary judgment, contending that he was a German resident in 2010 and that § 877A did not apply. The Commissioner cross-moved for partial summary judgment, asserting that Topsnik was not a German resident and was a "covered expatriate" subject to § 877A. The Tax Court granted the Commissioner's motion for partial summary judgment and denied Topsnik's motion.

Issue(s)

Whether Gerd Topsnik was a resident of Germany during 2010 under the U. S. -Germany Tax Treaty?

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Whether Gerd Topsnik was a “covered expatriate” under I. R. C. § 877A and thus subject to the mark-to-market regime upon his expatriation on November 20, 2010? Whether I. R. C. § 877A applies to the right to receive installment payments from the 2004 sale of stock and whether the Commissioner correctly applied § 877A to Topsnik’s transaction?

Rule(s) of Law

Article 4 of the U. S. -Germany Tax Treaty defines a “resident of a Contracting State” as any person liable to tax therein by reason of domicile, residence, place of management, place of incorporation, or any other similar criterion, excluding persons liable to tax only on income from sources within that state. I. R. C. § 877A imposes a mark-to-market regime on “covered expatriates,” treating all property as sold on the day before expatriation. A “covered expatriate” includes any long-term resident who ceases to be a lawful permanent resident of the United States and fails to certify compliance with U. S. tax obligations for the five preceding years. An installment obligation is treated as property for purposes of the Code and is subject to valuation.

Holding

The Tax Court held that Gerd Topsnik was not a resident of Germany during 2010 under the U. S. -Germany Tax Treaty. Topsnik expatriated on November 20, 2010, when he formally abandoned his LPR status. He was a “covered expatriate” under I. R. C. § 877A due to his failure to certify compliance with U. S. tax obligations for the five preceding years. Consequently, Topsnik was liable for tax on the gains from the first 11 monthly installment payments received in 2010 before his expatriation and on the deemed sale of his right to receive future installment payments under § 877A.

Reasoning

The court determined that Topsnik was not a German resident in 2010 because he was not subject to German taxation on his worldwide income, as required by Article 4 of the U. S. -Germany Tax Treaty. Topsnik’s German contacts, such as a driver’s license and passport, were insufficient to establish residency under the treaty’s definition. The court found that Topsnik’s expatriation date was November 20, 2010, when he filed a Form I-407 and surrendered his green card. As a long-term resident who failed to certify tax compliance for the five preceding years, Topsnik was a “covered expatriate” subject to the mark-to-market regime under § 877A. The court rejected Topsnik’s argument that § 877A could not be applied retroactively to his 2004 transaction, finding that the installment obligation was property subject to valuation on the day before expatriation. The court also upheld the Commissioner’s application of § 877A, finding that the fair market value of the installment obligation was correctly determined based on the unpaid principal and accrued interest as of November 19, 2010.

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Disposition

The Tax Court granted the Commissioner’s motion for partial summary judgment and denied Topsnik’s motion for summary judgment. An appropriate order was issued.

Significance/Impact

The Topsnik decision clarifies the application of I. R. C. § 877A to long-term residents who expatriate and fail to certify compliance with U. S. tax obligations. It reinforces the importance of the mark-to-market regime in ensuring that expatriates are taxed on unrealized gains upon expatriation. The decision also underscores the stringent requirements for establishing residency under tax treaties, requiring liability for worldwide income taxation. Subsequent cases have cited Topsnik in interpreting the scope of § 877A and the definition of “covered expatriate. ” The ruling has practical implications for tax practitioners advising clients on expatriation and the potential tax consequences of failing to comply with certification requirements.

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