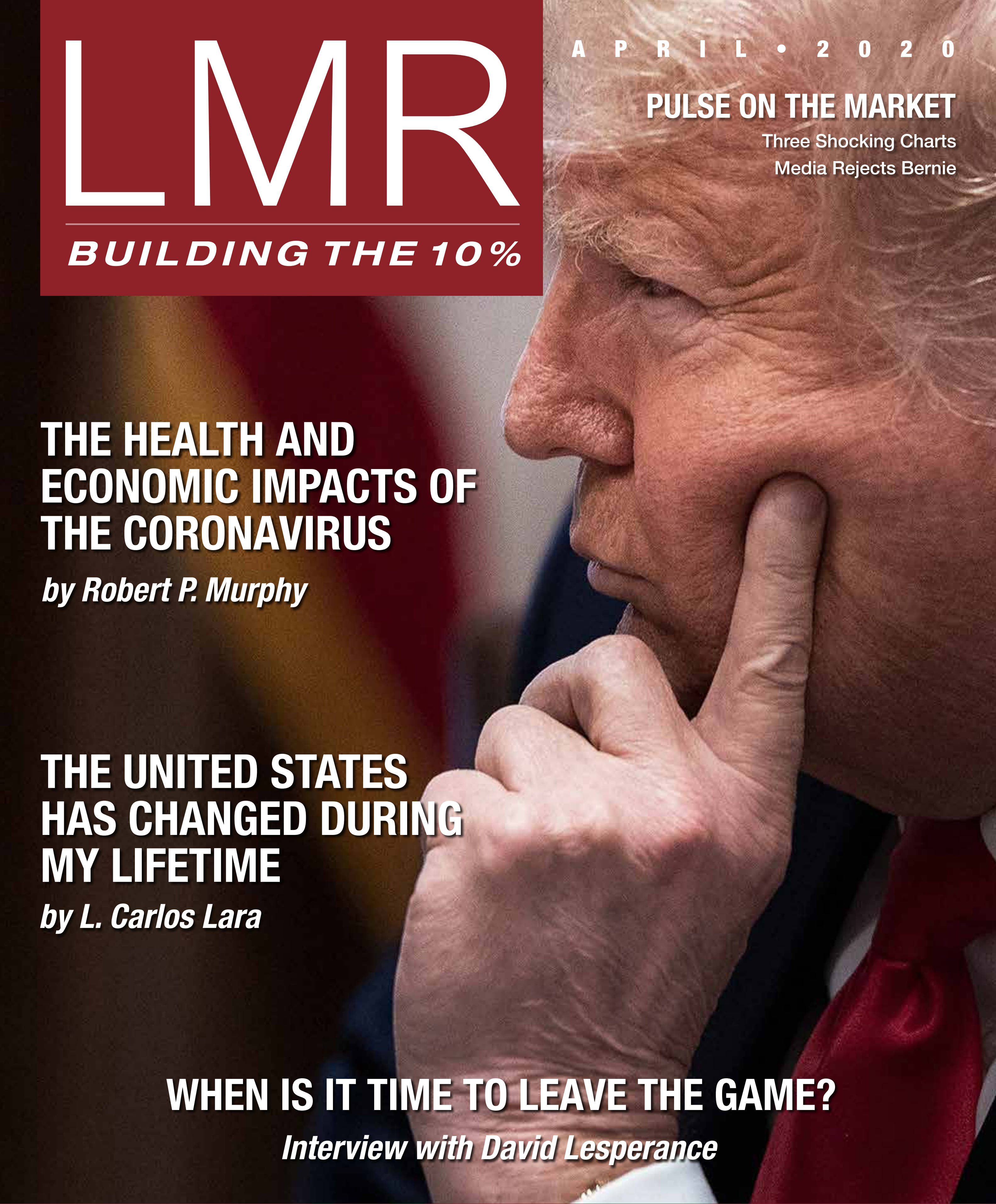
LMR

BUILDING THE 10%

APRIL • 2020



PULSE ON THE MARKET

Three Shocking Charts

Media Rejects Bernie

THE HEALTH AND ECONOMIC IMPACTS OF THE CORONAVIRUS

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THE UNITED STATES HAS CHANGED DURING MY LIFETIME

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WHEN IS IT TIME TO LEAVE THE GAME?

Interview with David Lesperance

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David Lesperance is an international tax and immigration advisor with over 30 years experience helping high-net-worth individuals and families. David is the co-author of *The Flight of the Golden Geese* with London School of Economics Professor Emeritus Ian Angell. David has written for or been featured in numerous media outlets including *The New York Times, Wall Street Journal, Bloomberg, The Economist, Financial Times, Mother Jones,* CNBC, BBC, and several leading Asian journals such as the *South China Morning Post* and *The Asia Times.*

David's interest in these areas grew from his experience working as a Canadian immigration and customs officer while studying law. Since being called to the bar in 1990, he has firmly established his expertise with several major law firms, his own law firm and as a private consultant. His blog, *'The Lesperance Letter'* can be found at: http://lesperanceassociates.com

NOTE TO READERS: This interview was conducted in December 2019, well before the coronavirus crisis struck.

Lara-Murphy Report: How did you discover Austrian economics?

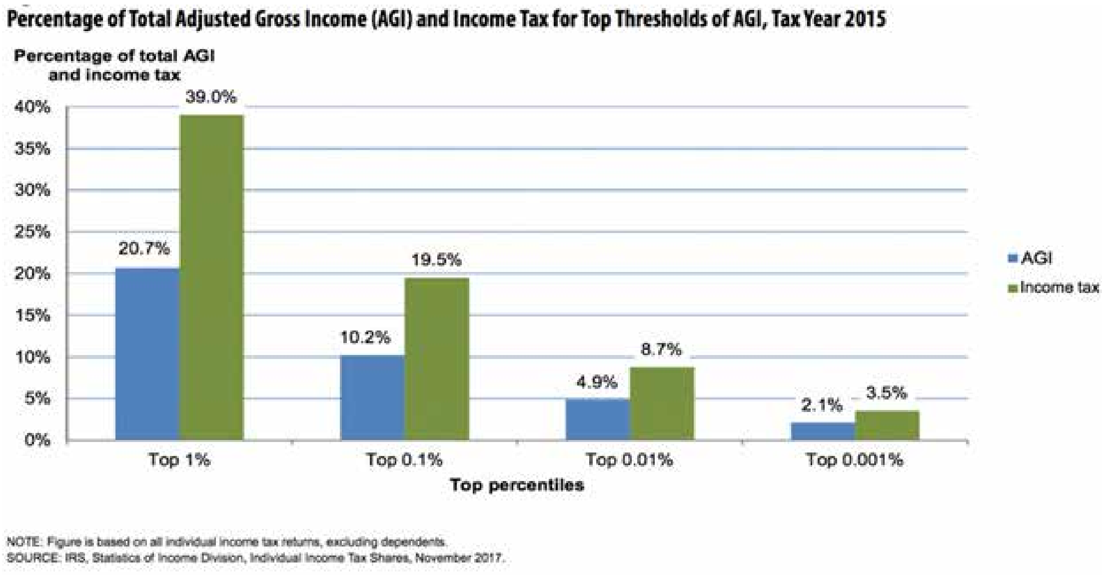
David Lesperance: Prior to law school I studied business at university. In my first economics course I was introduced to various theories, and it was the Austrian School that made the most sense to me. During the three decades since completing my formal studies, I have continually read in this area and been able to observe and speak with countless successful businesspeople as clients. Finally, I have travelled extensively in countries that experienced the harsh economic outcomes of alternative systems such as communism—and presently live in one. My first-hand observations have only served to reinforce my initial conclusions.

LMR: You responded to Bob Murphy's recent article on the wealth tax proposals of Elizabeth Warren and Bernie Sanders taking the position that they wouldn't raise the expected tax revenues. Can you summarize your argument?

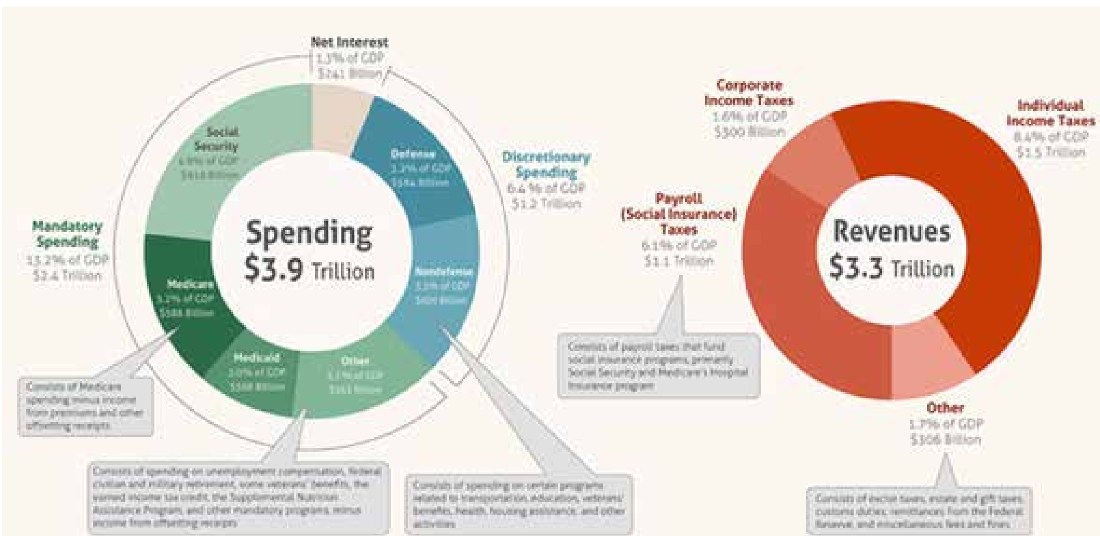
DL: Murphy's article was an insightful critique of the Warren/Sander's wealth tax proposals and their devastating impact on capital formation. I wished to point out that along with the negative economic impacts identified by Murphy and the Penn-Wharton Budget Model, another predictable but unwelcome consequence of a wealth tax could be an actual *reduction* in current tax revenue levels. Specifically, their wealth tax proposals could increase the departures of UHNW [ultra-high-net-worth] taxpayers from the US...taking their significant tax contributions with them.

In assessing my position, it is worth looking at two undisputed empirical facts:

Fact 1: Not all taxpayers are equal contributors. Whether you think it fair or not, currently 39% of the total personal tax take consistently comes from only the top 1% of taxpayers. Furthermore, 1/10th of each subset of the 1% pays about half of the total taxes paid for that entire group. So, clearly the US personal tax revenue model is dangerously overdependent on a minuscule number of taxpayers.



Fact 2: Personal tax revenues in the US form a significant percentage of total US government revenues. As the table below shows, 45% of US tax revenues in 2018 came from Individual Income Taxes.



Source: United States federal budget

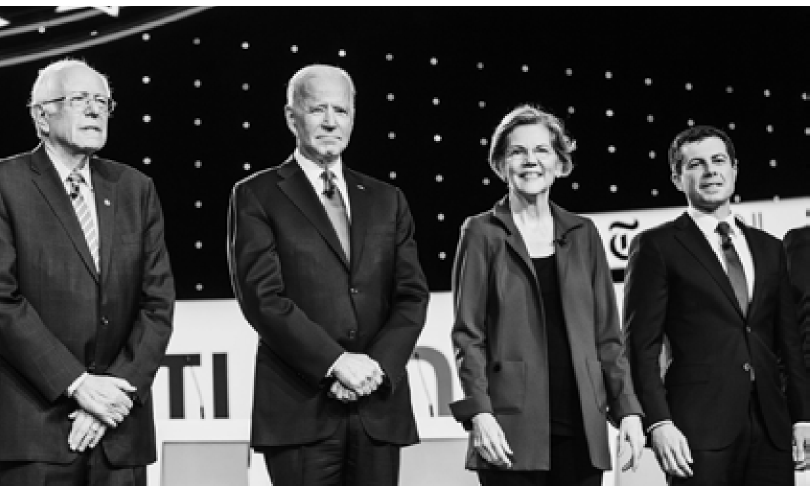
If one takes the position that Payroll Taxes (paid by individuals) should be also be included with Individual Income Taxes, then the percentage rises to 79%!

The simple and obvious conclusion from these two facts is that the US has an extreme over-dependence on a tiny number of individuals for a significant percentage of its government revenues. In short, the higher the taxable income or capital gains, the greater the revenue dependency. And it is UHNW Americans that the wealth tax is targeting. So if a wealth tax and other "tax the rich" policies were to trigger the departure of members of this small group, there would be a significant, negative impact on annual tax revenue collection.

The architects of the Warren/Sanders Wealth tax proposals, economists Gabriel Zucman and Emmanuel Saez, have tried to hide this fatal flaw by making the patently false assertion that the US is not subject to tax competition with other countries for its wealthy taxpayers. In a recent Washington Post OpEd, they wrote the following:

> *"The situation in the United States is different. You can't shirk your tax responsibilities by moving, because U.S. citizens are responsible to the Internal Revenue Service no matter where they live. The only way to escape the IRS is to renounce citizenship, an extreme move that in both Warren's and Sanders's plans would trigger a large exit tax of 40 percent on net worth."*

As someone who, since 1990, has assisted hundreds of wealthy American clients permanently legally leave the US tax system by renunciation, I can safely state that Mr. Zucman and Mr. Saez's statement is ridiculous. In fact, the *"extreme move"* of renunciation has been taken by thousands of wealthy Americans annually for years. And the reason the numbers are not even higher is that the system to book the interview to renounce US citizenship is tremendously backlogged!



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Ever since the Democratic POTUS candidates changed their rhetoric from *"Getting money to spend on good things"* to *"Taking money from bad people"*, wealthy Americans have been equipping themselves with *"BackUp Plans"* which will give them the option to *"vote with their feet"* should the increasingly possible outcome of a Democratic political grand slam happen in November 2020. If this occurs, those people with a quality backup plan can then decide whether or not to trigger their departure long before something like Senator Warren and Sander's proposed 40% exit tax could become law.

LMR: Part of your job is to help clients formally leave the United States for more hospitable tax climates. Can you first explain what the tax situation is, for Americans who want to live abroad but retain their U.S. passport?

DL: The first thing for advisors to understand is that the United States is pretty much unique in making citizenship a basis for being a taxpayer. All other countries apply a residence test of either physical presence and/or close connections to determine who is a taxpayer.

US citizens who live outside of the US are 'US persons for tax purposes' and are subject to the exact same income, capital gains, gift and estate tax and financial filing obligations as US citizens still living in the US. This is true even if they hold a foreign citizenship and may have never lived in the US.

The advantage that a US citizen living abroad *may* have is the ability to use the Foreign Earned Income Exclusion and/or the Foreign Tax Credit to reduce their US tax obligation.

LMR: Can you give our readers (who are primarily though not exclusively based in Canada and the U.S.) a framework to help them decide if and when they

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should seriously consider relocating?

DL: There are really two different decisions that an American citizen needs to consider. The first is whether they should establish a *BackUp Plan* that will give them and their family the ability to study, work, and live outside of the US. The second decision is whether or not to "trigger" their *BackUp Plan* ...and when.

A triggered *BackUp Plan* gives each family member the ability to vote with their feet, by taking advantage of the Foreign Earned Income Exemption and Foreign Tax Credit. They can also go further, completely and permanently severing their status as a US taxpayer by renouncing their US citizenship. It is worth noting that in almost all cases only one family member needs to actually renounce US citizenship for the family to enjoy the resulting tax benefits.

The actual renunciation of a US citizenship can only be done during an appointment at an American Embassy or Consulate outside of the US. However, the waiting time for such an appointment can vary from a month to over a year depending on the US mission.

LMR: And if someone does want to renounce U.S. citizenship, this isn't a matter of sending an email and waiting a week for confirmation, is it?

DL: The actual renunciation of a US citizenship can only be done during an appointment at an American Embassy or Consulate outside of the US. However, the waiting time for such an appointment can vary from a month to over a year depending on the US mission. Critically, prior to even considering making such an appointment, an individual needs to do a great deal of analysis and self-reflection, and then take specific actions.

Renunciation is a complex decision that understandably involves facing all of the issues that immigrants throughout history have had to grapple with. These include overcoming *'life inertia'* (for those still living in the US) and emotional ties to the US. One issue that they can rest easy about, however, is that they will have no difficulty visiting the US after they have renounced. In fact, the problem is not getting in…it's staying too long and re-acquiring US taxpayer status as a result.

While each individual will ultimately have to make the decision on their own, those contemplating triggering their *BackUp Plan* by doing a US expatriation should consider the following thought process:

Step 1: Try to get an approximation of your total future US tax savings. This involves looking at your current US tax burden and then working with your tax advisor to calculate your future post-expatriation US tax burden. Then multiply this annual US tax savings by the number of years remaining in your life. For more realism you should also include in your current US estate tax burden. Death is a certain event…with an uncertain event date. This calculation should also take into account the potential cumulative impact of all current populist tax proposals such as the Wealth Tax.

This calculation is necessary even though it is always going to be an approximation because you do not know the following:

a) What is going to be your future income and capital gains? (So you might want to assume that it will stay the same as last year.)

b) How long will you live? (So you might want to assume you will live the average age.)

c) What will be your future US tax burden? (One of the key assumptions you will need to address is whether you anticipate that your tax burden will or will not naturally increase in the future as a result of an aging population impacting entitlement programs revenue requirements.)

Your own estimation as to whether your US tax savings will be greater or lesser will depend upon:

i) Whether you believe your income/capital gain will increase in the future;

ii) Whether you believe you are likely to outlive the average because of your healthy lifestyle; and

iii) Your reasonable expectations of future politicians' directions on tax policy over the remainder of your life.

Step 2: Determine the one-time cost of losing your US tax liability through renunciation.

There are several costs that will need to be estimated, so that the total can be compared to the estimated future tax savings:

A) Second Citizenship: In order to renounce US citizenship, an individual needs to possess a second citizenship. The cost of a second citizenship will vary widely depending on the method of acquiring same:

- Birth Citizenship: Having an existing citizenship from birth;
- Naturalization: Being naturalized in a foreign country after birth in the United States;
- Lineage: Being entitled to foreign citizenship through lineage (Note: Some nations grant citizenship up to the third generation and the US has a high percentage of first and second generation immigrant Americans);
- Aliyah: Being entitled to Israeli citizenship through Aliyah and
- Citizenship by Investment: Even though this is the path most discussed in the press, it should only be pursued if the other avenues are not available. The selection of the "right" CBI for any given client depends upon a number of factors including time available; where the person can live; cost; and so forth

B) Future Tax Home: Contrary to popular opinion, most clients will not choose a future tax home on a small island. Rather, depending on their stage in business and personal life, it is highly likely that they will chose a "high tax country" but on a "low or controlled tax basis".

Choices include those countries such as Canada which do not have an estate, gift, or wealth tax and which allow you to greatly reduce your income/capital gains tax burden through pre-immigration tax planning. Other countries like the UK,

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Ireland, Portugal, Italy, and Switzerland have existing regimes that greatly reduce the global tax burden. The cost of acquiring permission to move to this future tax home may be included in the benefits obtained with the second citizenship.

C) Cost of payment of capital gains aka 'Exit Tax': Firstly, please note that this only applies if you are a Covered Expatriate.

Secondly, please note that there are cost-efficient practical strategies to deal with an Exit Tax. These include looking at valuation, discounting, liquidity, timing, and comparing this to potential increased rates for capital gains or Warren/Sanders expatriation penalty.

Thirdly, please note that many people mistakenly assume that the Exit Tax will be too high a barrier BEFORE they compare their future tax liability to the actual one-time cost if they follow proper strategies.

D) Cost of overcoming life inertia: This includes the costs to move their personal and business life out of the US and into another jurisdiction(s); and

E) The cost of renouncing US citizenship: This figure will include travel costs to the US mission for the appointment, professional fees, the $2,350 government fee for Renunciation of Citizenship and future filing of your IRS 8854 and terminal tax return.

Step 3: Compare the one-time cost of expatriation to the cumulative future US tax savings.

After completing this financial analysis, an individual can determine whether expatriation is a suitable strategy to consider. For many of the wealthiest people in the US, the financial analysis results in a compelling argument to consider expatriation. In fact, it is the realization of long-term savings—based on step-by-step analysis—that is driving the ever-increasing numbers of expatriations.

Step 4: Compare the tax savings to the benefits of US citizenship (i.e. living full-time, voting, passing US citizenship onto children):

Setting aside blind patriotism for a moment and looking at practical issues, the value that a person places on retaining their US citizenship depends greatly upon their position in life and their view of the future.

LMR: In your experience, what are the consdiderations that can motivate people to activate what you are referring to as their Back Up Plan and move abroad or actually renounce their US citizenship?

It is the realization of long-term savings —based on step-by-step analysis— that is driving the ever-increasing numbers of expatriations.

DL: Triggering Events can be categorized into two groups.

1) Concern about things with catastrophic outcomes but unknown dates:

These include concerns such as growing debt and deficits; huge costs to recover from increasing occurring natural disasters such as hurricanes and earthquakes; entitlement obligations for an aging population; costs to rebuild crumbling infrastructure; and future military expenditures…all made worse by political deadlock. These types of long-term concerns are extremely important but are often ignored because they are not immediate.

2) Concerns about things with unknown outcomes but specific dates

For high-net-worth Americans, *the* issue is the November 2020 election. This is where uncertainty abounds.

On one side are the questions of *"Who will be the Democratic POTUS candidate?"* and *"What will be the Democratic platform?"* Clarity will only occur at the conclusion of the July Democratic National Convention. However, all of the candidates have stated their tax policies…and there is an increasing possibility of a Democratic sweep no matter who is the Democratic POTUS candidate. So we know at a minimum there could be the loss of preferential treatment of carried interest and all capital gains would be taxed at ordinary tax rates. Additional possible Tax the Rich proposals include annual deemed dispositions; loss of step-up on death; limits on charitable contributions; significant estate tax increases; and of course, a new Wealth Tax.

On the other side of the uncertainty coin are a number of events that will occur and impact during 2020. These include the impeachment process, the health of the economy, the resolution of the current trade wars, and geopolitical crises such as Iran and North Korea.

The motivation driving getting a Back Up Plan varies with the client situation but can be a combination of:

1) Wanting to have the financial security of a certain lifestyle;

2) Desire for the financial security of children;

3) For Silicon Valley clients, the ability to self-fund their next business venture, so that they do not have to seek the assistance and restrictions of VC funding; and/or

4) Ability to engage in Strategic Philanthropy

Strategic Philanthropy is quickly becoming the major motivating factor for UHNW clients. If you realize that with the 2020 Unified Credit for combined couples is over 23M USD, then those contemplating the possibility of expatriation for tax purposes are well over this level. This means that they are more likely to be within the net worth range of the Sanders/Warren Wealth Tax proposals.

These individuals want to maintain control over the disposal of their after-tax wealth through strategic philanthropy and/or their chosen heirs. It is what I have called the Anand Giridharadas vs Reid Hoffman debate. In short, should the wealthy:

a) pay more in taxes and trust the government to decide on priorities and implement solutions to societal ills; or

b) use their skills, contacts and focus on determining and implementing strategic philanthropy in solving specific societal ills.

Leon Cooperman made this exact point in his recent rebuttal to Senator Elizabeth Warren. Clearly, the desire to maintain the ability to engage in strategic philanthropy is a powerful one.

Preparing oneself to be able to "leave the game" should you reach your personal triggering point is less complicated than most people assume.

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Note: The economists and financial professionals interviewed in the LMR are given the freedom to express their views, without necessarily implying endorsement from the editors.

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