

State of Expatriation – 2012

TTN Conference New York 2013



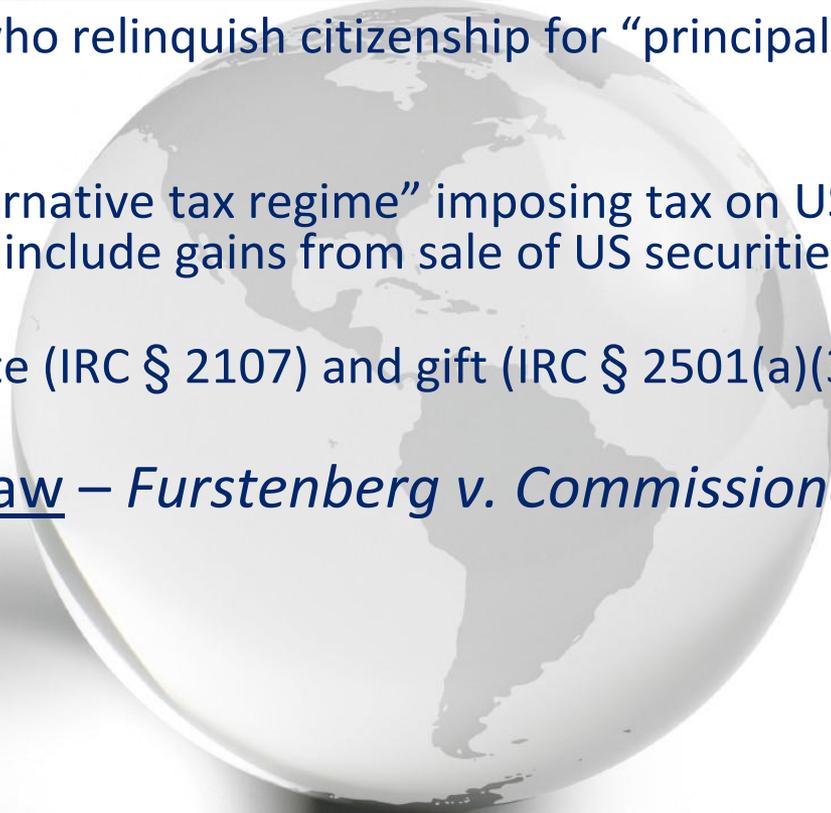
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Session Overview

- HISTORY OF EXPATRIATION RULES (“Alternative Tax Regime” to “Mark-to-Market”)
 - MARK-TO-MARKET RULES (IRC § 877A)
 - Including Notice 2009-85
 - ESTATE AND GIFT TAX RULES (IRC § 2801)
 - POTENTIAL PLANNING ISSUES?
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History of Expatriation Rules

- Foreign Investors Tax Act of 1966
 - US citizens who relinquish citizenship for “principal purpose of tax avoidance.”
 - 10-year “alternative tax regime” imposing tax on US source income expanded to include gains from sale of US securities.
 - Limited estate (IRC § 2107) and gift (IRC § 2501(a)(3)) rules.
- Limited case law – *Furstenberg v. Commissioner*



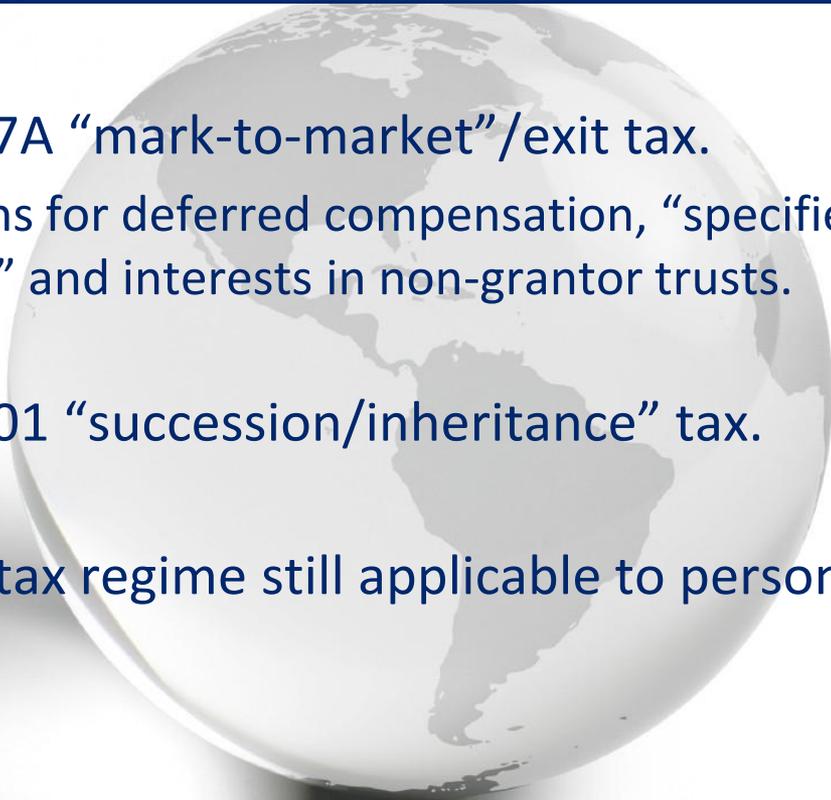
History of Expatriation Rules

- Health Insurance Portability and Accountability Act of 1996
 - Significantly tightened “alternative tax regime.”
 - Expanded types of “US source income” subject to the regime.
 - Created presumptive tax avoidance standard based on 5- year average income tax liability or net worth at time of expatriation.
 - Included “long-term residents” (i.e., green card holders taxable as residents in 8 of the 15 pre-expatriation taxable years).
 - Permitted taxpayers to apply for ruling that no tax avoidance purpose.
 - Introduced limited reporting.

History of Expatriation Rules

- American Jobs Creation Act of 2004
 - Further tightened “alternative tax regime.”
 - Dropped principal tax avoidance test in favor of straight income tax liability or net worth tests.
 - Added 5-year US tax compliance certification.
 - New definition of expatriation date requiring dual notice to DOS/DHS and IRS (Form 8854).
 - Added 30-day short residence rule applicable for all tax purposes in any of 10 post-expatriation years.
 - Enhanced reporting to annual basis regardless of tax liability.

History of Expatriation Rules

- Heroes Earnings Assistance and Relief Tax Act (HEART Act) of 2008
 - Added § 877A “mark-to-market”/exit tax.
 - Exceptions for deferred compensation, “specified tax deferred accounts” and interests in non-grantor trusts.
 - Added § 2801 “succession/inheritance” tax.
 - Alternative tax regime still applicable to persons subject to prior law.
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HEART Act Rules

- “Covered Expatriate” – same as under prior law
 - Income tax liability test (indexed for inflation; \$155,000 in 2013); net worth test (\$2 million; not indexed); AND tax certification test (tax compliant for 5 previous years; if don’t certify, covered expatriate even if under financial thresholds).
- Exceptions:
 - Certain dual citizens from birth; not US substantial presence resident > 10 of prior 15 years; and taxable as “resident” of other country of nationality.
 - US citizens under age 18 ½ not substantial presence residents > 10 years.

HEART Act Rules

- “Mark-to-Market Tax - deemed sale of worldwide assets (excepting 3 categories mentioned above) on day before expatriation date at applicable rates on gains in excess of \$600,000 (indexed for inflation; \$668,000 in 2013).
 - Can elect to defer tax on asset-by-asset basis if “adequate security” provided (with 30-day cure period); deferral until asset sold/transferred or taxpayer dies, if sooner; taxpayer must agree to waive tax treaty benefits; interest accrues on deferred tax at underpayment rate.
 - Basis step-up (but not down) rule for long-term residents for purposes of calculating gain.
 - Ownership and valuation based on estate tax principles.
 - All nonrecognition deferrals and tax payment extensions terminated as of day before expatriation.

HEART Act Rules

- Deferred Compensation Items:
 - “Deferred Compensation” broadly defined.
 - “Eligible Deferred Compensation” (i.e., US payor): subject to 30% withholding tax on taxable portion under IRC § 871 rules.
 - “Ineligible Deferred Compensation” (i.e., non-US payor): present valued and includible in income on day prior to expatriation date at marginal tax rates (unless non-US payor elects to be treated as US payor under guidance to be issued – or not?).
 - Exception for deferred compensation attributable to non-US services performed while taxpayer not a US resident.
 - Retirement plan payments excepted from early distribution penalties.

HEART Act Rules

- Specified Tax Deferred Accounts: A covered expatriate's entire interest in following accounts includible in income on day prior to expatriation date:
 - (1) individual retirement plan (including roll-over IRA's);
 - (2) qualified tuition program;
 - (3) Coverdell education savings account;
 - (4) health savings account; and
 - (5) Archer MSA.

HEART Act Rules

- Non-grantor Trusts. Post-expatriation distribution from non-grantor trust in which taxpayer considered to have beneficial interest prior to expatriation subject to 30% withholding tax on the “taxable portion” under IRC § 871 rules; no time limit on taxation of distributions.
 - “Non-grantor trust” defined as *any* trust of which taxpayer is not grantor immediately prior to expatriation date.
 - Broad definition; includes trusts that are grantor trusts as to other persons; legislative intention? IRS position?
 - Non-grantor trust must recognize gain on distributions of appreciated property.
 - Taxpayer deemed to waive any treaty benefits, unless obtains special IRS ruling to have ascertainable value of beneficial interest includible in income on day prior to expatriation date.
 - If non-grantor trust becomes grantor trust after expatriation treated as taxable distribution.
 - Potential foreign tax credit issues under IRC § 906.

HEART Act Rules

- Date of Expatriation

- US citizens: date of relinquishment of US nationality; earliest of (1) renunciation, (2) voluntary relinquishment, (3) DOS issues Certificate of Loss of Nationality, or (4) US court cancels certificate of naturalization.
 - Possible unconstitutional retroactive tax legislation?
- Long-term residents: date of cessation of lawful permanent resident status; if “tie-break” residence under treaty, date of “commencement” of foreign residence if don’t waive treaty benefits.

HEART Act Rules

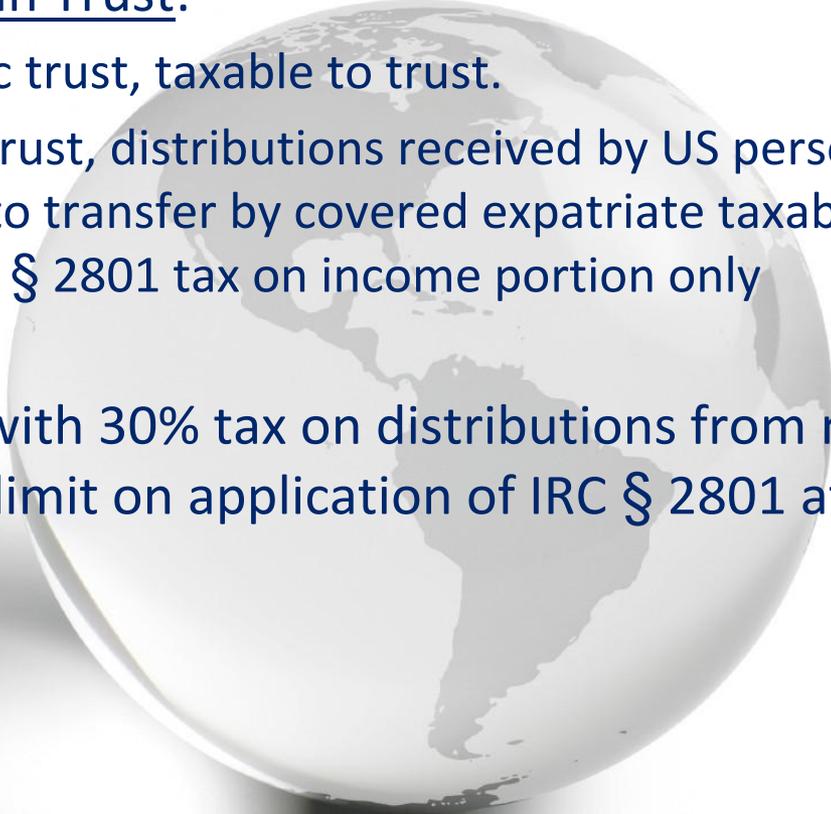
- Reporting Requirements:

- Form 8854 must be “timely filed” with final income tax return or else deemed to be “covered expatriate.”
- Annual Form 8854 filing for eligible deferred compensation items, beneficial interests in non-grantor trusts and taxpayers who deferred payment of tax.
- In case of income items excepted from mark-to-market rule, Form W-8CE to be filed with payor by earlier of first post-expatriation distribution or 30 days after expatriation date.
 - Likely loosely enforced.
- If foreign fiduciary fails to withhold 30% tax, taxpayer required to file Form 1040NR per Reg. § 1.6012-1(b).

HEART Act Rules

- “Covered Gifts/Bequests”: Under IRC § 2801, US persons receiving gifts or bequests from “covered expatriate” under HEART Act will be taxed at the highest applicable gift or estate tax rate (40% in 2013).
 - Exceptions for annual exclusion gifts and gifts or bequests entitled to marital or charitable deduction.
 - Exceptions also for amounts shown on timely filed gift or estate tax return.
 - Reduction for any gift or estate tax paid to a foreign country with respect to the property transfer.
 - Inapplicable to transfer made while taxpayer subject to tax as US citizen or resident?

HEART Act Rules

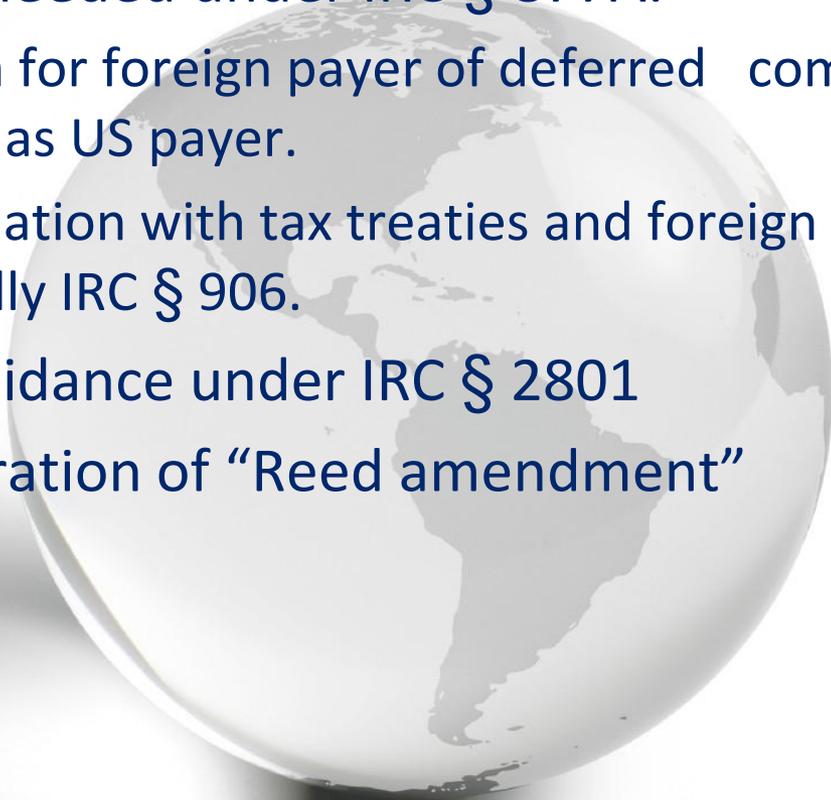
- Gifts/Bequests in Trust:
 - If to domestic trust, taxable to trust.
 - If to foreign trust, distributions received by US persons that are attributable to transfer by covered expatriate taxable; income tax credit for IRC § 2801 tax on income portion only
 - Time Limit: As with 30% tax on distributions from non-grantor trusts, no time limit on application of IRC § 2801 after expatriation.
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HEART Act Rules

- IRC § 2801 reporting requirements:
 - Separate guidance to be issued by IRS.
 - Reporting/tax obligations for gifts/bequests received after June 17, 2008 are deferred until guidance is issued.



HEART Act: Omissions and Need for Guidance

- Guidance needed under IRC § 877A:
 - Election for foreign payer of deferred compensation to be treated as US payer.
 - Coordination with tax treaties and foreign tax credit issues, especially IRC § 906.
 - General guidance under IRC § 2801
 - Reconsideration of “Reed amendment”
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Practical & Planning Issues/Strategies

- Expatriation by Long-Term Residents
 - No statutory exceptions to “covered expatriate” status
 - Try to reduce net worth below \$2 million
 - If US domiciled, make gifts (if not domiciled, should IRC § 2801 apply?)
 - Are assets subject to community property rules?
 - Treaty “tie-break” US residence with amended return(s) to avoid long-term resident status or expatriate under pre-HEART Act law
 - Can’t amend prior joint returns
 - SOL issues: IRS generally won’t process returns for closed years (assume 6-year maximum, unless IRS opens by asserting prior open SOL)
 - Try to time expatriation via, e.g., use of re-entry permits
 - If all else fails, change-up assets or become US citizen! (appropriate cases only)

Practical & Planning Issues/Strategies

- Expatriation by US citizens

- Is “dual national from birth” or “under 18 ½” exception available?
 - Foreign resident taxpayer – any limits?
 - Not “substantial presence resident” > 10 years? Is “closer connection” test available?
- Try to reduce net worth below \$2 million (as above)

- Application of “certification of 5-year compliance test”

- When is standard met?
- Must information returns and FBAR’s be filed?
- What if under audit or participant in voluntary disclosure program?
- What if long-term non-filer (e.g., inadvertent US citizen)?

Practical & Planning Issues/Strategies

- Non-tax factors
 - Need non-US passport
 - Consider whether any high-quality “heritage” passports available
 - Few “economic” passports currently available
 - If future US visits desired, consider visa status
 - Consider foreign tax implications
 - Relinquishing US citizenship
 - Need to locate suitable US overseas outpost and make appointment
 - Issues with minors under 18 (DOS won’t consider minors under 16)



A 3D rendering of a globe, centered on the Americas, with the word "Questions?" overlaid in a bold, blue, sans-serif font. The globe is semi-transparent, showing the continents in a light gray tone. The background is a light blue gradient at the top, transitioning to white below. The globe casts a soft shadow on the surface below it.

Questions?

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