

NEW IRS REGS ESCALATE TAX CONSEQUENCES OF RENOUNCING CITIZENSHIP OR SURRENDERING GREEN CARD

International Tax Alert
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On September 9, 2015, the IRS released long-awaited proposed regulations under Internal Revenue Code (Code) section 2801, which imposes a tax on the recipient of a gift or bequest from certain individuals who relinquished their U.S. citizenship or terminated their long-term permanent resident status (i.e., an individual who has held a green card during any part of at least 8 of 15 years prior to termination) after June 17, 2008. Code section 2801, which Congress added to the Code as part of the Heroes Earnings Assistance and Relief Tax Act of 2008, is an estate and gift tax consequence to relinquishing U.S. citizenship or terminating long-term permanent resident status that is in addition to Code section 877A's more widely known expatriation income tax. Code section 877A imposes a mark-to-market tax on the worldwide assets of individuals who, after June 17, 2008, relinquished their U.S. citizenship or terminated their long-term permanent resident status if they meet a U.S. income tax liability test (\$160,000 average U.S. income tax liability over five years) or a net worth test (\$2 million) and they do not meet a dual citizen from birth exception, or if they fail to certify their compliance with U.S. federal income tax obligations for the five preceding tax years. An individual who meets one of those tests is classified as a "covered expatriate" for purposes of both Code sections 877A and 2801.

What Is Taxed?

Code section 2801 imposes a tax, at the highest applicable gift or estate tax rate, on any U.S. citizen or resident who receives a "covered gift" or a "covered bequest" from a covered expatriate, regardless of whether the covered expatriate acquired the transferred property before or after expatriation. The proposed regulations define a "covered gift" as, essentially, a gift as defined under the gift tax provisions of the Code, received directly or indirectly from a covered expatriate; a "covered bequest" means any property acquired, directly or indirectly, by reason of the death of a covered expatriate that would have been includible in the gross estate of the covered expatriate if he or she had been a U.S. citizen at the time of death. Notably excepted from the terms "covered gift" and "covered bequest" are charitable donations that would qualify for the estate or gift tax charitable deduction and a gift or bequest to a covered expatriate's U.S. citizen spouse, if the gift or bequest would qualify for the

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gift or estate tax marital deduction (if the transferor was a U.S. citizen or resident). Based on the breadth of the transfers subject to Code section 2801, the U.S. tax implications of expatriating may continue long after an individual relinquished his or her U.S. citizenship or terminated his or her long-term permanent resident status.

Who Is Taxed?

Unlike the traditional U.S. gift and estate taxes, which are imposed on the donor or the estate, respectively, the tax under Code section 2801 is imposed on the U.S. citizen or resident recipient of the covered gift or bequest. For this purpose, a domestic trust that receives a covered gift or bequest is treated as a U.S. citizen and is therefore liable for the tax. A foreign trust generally is not liable for the tax imposed under Code section 2801; rather, a U.S. citizen or resident who receives a distribution from a foreign trust generally is liable for the tax on the receipt of that distribution to the extent the distribution is attributable to covered gifts or bequests to that trust.

How Does One Determine if He or She Is Subject to the Tax?

The proposed regulations place on the recipient of a gift or bequest the burden to determine whether he or she received a covered gift or bequest. In other words, the burden is on the recipient to determine whether the donor or decedent is or was a covered expatriate. As the preamble to the proposed regulations acknowledges, this is easier said than done. The proposed regulations provide that a recipient of a gift or bequest may submit a request to the IRS, with the consent of the expatriate, to disclose certain return information of the expatriate that may assist the recipient in determining whether the donor or decedent is or was a covered expatriate. Although the IRS, if authorized, may disclose returns and return information upon request, the IRS will not make determinations of covered expatriate status. This is an extremely intrusive proposal, and it does not solve the threshold issue of the recipient knowing that the donor is an expatriate, to even consider requesting such information from the IRS. The proposed regulations further provide that if the expatriate donor does not authorize the IRS to release the relevant return information to the recipient, there is a rebuttable presumption that the expatriate donor is a covered expatriate and that each gift from that expatriate to a U.S. citizen or resident is a covered gift. There is no guidance in the proposed regulations regarding how one rebuts the presumption.

Reporting

The IRS intends to release Form 708 “United States Return of Tax for Gifts and Bequests from Covered Expatriates” once the proposed regulations are finalized, and those final regulations will provide the due date for filing Form 708 and for the payment of the Code section 2801 tax. Consistent with Announcement 2009-57, U.S. recipients will be given a reasonable period of time after the date the final regulations are published to file Form 708 and pay the Code section 2801 tax on all covered gifts and bequests received on or after June 17, 2008, to the present. Thus, all gifts and bequests made after June 17, 2008, will need to be analyzed.

After several years of waiting, the IRS provided welcome guidance in the proposed regulations; however, U.S. recipients of covered gifts or bequests from covered expatriates still need to wait until the final regulations are published and the mechanics for paying this tax are in place before paying their 2801 tax liability. Also, the IRS still has some work to do to address issues raised by the proposed regulations and to clarify certain provisions in the proposed regulations.