Expatriation (2016)

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Taxation of US Citizens has varied over the years, with terms shifting periodically from one methodology to another, but it remains today that expatriates face substantial taxation on assets at point of departure and upon renouncing citizenship. For US citizens considering such a move, they need to be mindful of not only the tax but also the reporting and logistical issues associated. They also need to be aware of that there are significant opportunities to mitigate US taxation associated with such a move that can greatly reduce net taxation. What follows is an overview of the relevant taxes that are applied upon expatriation from the US.

For US citizens and long-term tax residents who elect to expatriate in 2016 they face two separate taxes:

1) Mark-to-Market Tax (IRC 877A): A wealth tax on on expatriation. This tax is on net unrealized capital gain for the expatriate's worldwide assets. This tax applies to worldwide assets which are in excess of a threshold amount, which in 2016 is $693,000 (up from $690,000 in 2015). Under this test, the property subject to tax is any interest in property that would generally be taxable as part of their gross estate for federal estate tax purposes if the taxpayer died on the day before the expatriation date. (See IRC 877A(a)(1); IRS Notice 2009-85, Rev. Proc. 2014-61, Rev. Proc. 2015-53).

Under the Mark-to-Market Tax gain is determined as if a sale of the property for the market value had taken place on the day before the expatriation date. Losses from the "deemed sale" are taken into account as otherwise provided by the Internal Revenue Code. The "wash sale rules" do not apply. The taxpayer must make adjustments to the basis of any property by the amount of gain or loss taken into account.

The covered expatriate may irrevocably elect to defer payment of the Mark-to-Market tax subject to providing adequate security to the IRS to ensure payment of the tax and irrevocably waiving any right under an income tax treaty that would preclude assessment or collection of the tax. The election is made on an asset by asset basis. The tax for a particular property is determined by multiplying the total mark-to-market tax by the ratio of the gain on the deemed sale of the property over the total gain taken into account with respect to the property deemed sold. The election defers payment of the tax until the due date for the tax return for the tax return for which the property is disposed or until the taxpayer's death. Tax payment may not be extended beyond the due date for the tax return for the tax year in which the covered expatriate dies. (See IRC 877A(b); Notice 2009-85).

The covered expatriate who is subject to a Mark-to-Market tax must also annually file an information return on Form 8854 in each tax year they are subject to the Mark-to-Market tax (IRC 6039G; Notice 2009-85). Form 8854 provides notice that the taxpayer has relinquished their US citizenship or long-term residency status.

2) Succession Tax (IRC 2801): An inheritance tax on gifts paid by the gift recipient. The tax imposed is 40% on gifts over $14,000 (2016). A US citizen or income tax resident who directly or indirectly receives a "covered gift or bequest (a gift, devise, bequest or inheritance from a covered expatriate), after the date of expatriation pays this special transfer tax for gifts received during the calendar year that exceeds the annual gift tax exclusion in effect

under IRC 2503(b) which in 2016 is $14,000 (unchanged from prior years). See IRC 2801 (c), Rev. Proc. 2014-61, Rev. Proc. 2015-53.

The succession tax is reduced by the amount of any gift or estate tax paid to a foreign country with respect to such covered gift or bequest (IRC 2801(d). A covered gift or bequest made to a domestic (US) trust is subject to the succession tax and the trust is required to pay the tax imposed (IRC 2801 (e) (4)(A).

A covered gift or bequest made to a foreign trust is also subject to tax, but only at the time a distribution, whether from income or principal, is made to a US citizen or resident from the trust that is attributable to the covered gift or bequest (IRC 2801 (e) (4) (B) (i). The recipient is allow an income tax deduction under IRC 164 for the amount of tax paid or accrued under IRC 2801 by reason of distribution from a foreign trust, but only to the extent the tax is imposed on the portion of the distribution included in the recipient's gross income (IRC 2801 (e) (4) (B) (ii). For purposes of IRC 2801, only, a foreign trust may elect to be treated as a domestic trust (IRC 2801 (e) (4) (B) (iii).

3) For purposes of the Mark-to-Market tax and the Succession Tax they only apply to "covered expatriates" (and their donees). A "covered expatriate" is a wealthy American who renounces their US citizenship or surrenders their green card. They may be classified as a covered expatriate and subject to tax under 1 of 3 tests:

Net Worth Test: A net worth of $2m or more on the expatriation date: or

Tax Liability Test: Average Annual Net Income Test Liability for the 5 years preceding their expatriation exceeds $161,000 in 2016 ($160,000 in 2015); or

Certification Test : Fails to certify under penalties of perjury that they have complied with all US tax obligations for the 5 preceding years or fails to submit evidence of compliance required by the IRS on form 8854 (see IRC 877A (g), Notice 2009-85, Rev. Proc. 2014-61; Rev. Proc. 2015-53).

Dual citizens and minors may be excepted from the tax liability and net worth requirements.