CURTIS NEWSFLASH

Exit Tax on U.S. Expatriates

On June 6, 2008 Congress sent legislation to President Bush which will impose an exit tax on certain individuals who expatriate or give up their green card ("covered expatriates" as defined below). The new legislation would generally treat a covered expatriate as having sold his or her global property at its fair market value on the day before expatriation and require that the tax on such deemed sale be paid on any gain from such deemed sale promptly, unless the covered expatriate makes an election to defer the tax on the gain until such property is disposed and posts security for the amount of any liability not paid promptly. In addition, U.S. citizens or residents who receive gifts or bequests from a covered expatriate will be subject to U.S. gift or estate tax on the property they receive. The legislation becomes effective when the President signs the bill, an event that is expected to occur during the week of June 16.

Under current tax law, a U.S. citizen who expatriates and a long-term resident (i.e., green card holder) who terminates his or her status as a long-term resident (together "expatriates") is, subject to certain requirements and exceptions, required to report and pay tax on U.S. source income for ten taxable years following his or her expatriation or relinquishment of his or her status as a long-term U.S. resident.

Individuals Covered

Current law and the new legislation applies to any individual who (i) has a net worth of $2 million or more; (ii) has an average net U.S. income tax liability of greater than $124,000 (adjusted for inflation as of calendar year 2004); or (iii) fails to certify under penalty of perjury that he has complied with all U.S. federal tax obligations for the preceding five years (a "covered expatriate").

Key Changes under the Legislation

1. Covered expatriates will be subject to U.S. income tax on mark-to-market gain on such person's global property. An individual may elect, on a property-by-property basis, to defer payment of the mark-to-market tax imposed on the deemed sale of property to the taxable year when the property is disposed. In order to elect the deferral of the mark-to-market tax, the individual is required to furnish certain types of security to the IRS.

2. Certain gifts and bequests made by a covered expatriate to any U.S. person or resident will be subject to tax at the greater of the highest gift or estate tax rate (the highest marginal rate is currently 45%). For example, a foreign person working temporarily in the United States who is treated as a tax resident of the United States and receives a $50,000 gift from a covered expatriate would be subject to federal gift tax at a rate of 45% on the $50,000 gift.

3. Includes a repeal of the current 10-year taxing and reporting rules that generally apply to covered expatriates.

Mark-to-Market Tax on Expatriates

- Under the legislation, the tax applies to a covered expatriate's worldwide property as if the property had been sold for its fair market value on the day before expatriation or termination of residence.

- Any net gain on the deemed sale is recognized to the extent it exceeds $600,000.
- Exception – mark-to-market rules may not apply to or the tax on gain may be deferred on:
  i. Certain deferred compensation items;
  ii. Certain tax deferred accounts; or
  iii. Certain interests in a non-grantor trust.

Gifts and Bequests from Expatriates

- Under the legislation, gifts or bequests that U.S. citizens or residents receive from covered expatriates are taxed at the **highest marginal** estate or gift tax rate.
- Under the legislation, a U.S. trust is required to pay tax on gifts and bequests from a covered expatriate, as if the trust were a U.S. citizen.
- The legislation also requires U.S. citizens or residents to pay tax on distributions received from a foreign trust if the distribution is in connection with a gift or bequest from a covered expatriate.

Repeal of 10-year reporting and taxing requirements:

- Under current law, an expatriate is taxed on U.S. source income for ten years following expatriation. In addition, current law taxes an expatriate as a U.S. citizen in any year that the expatriate spends 30 or more days in the United States during the ten year period.
- Under the new provision, the ten-year reporting and taxing requirements have been repealed in favor of the mark-to-market rules.

About Curtis

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