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Expatriation from the United States

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Bahamas

Discussion Points

- Tax Rules Applicable to Expatriations on or After June 17, 2008
- Reporting Requirements
- Planning for Expatriation
- Ex-Patriot Act

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Expatriation Tax Regime For Expatriations On or After June 17, 2008

Overview

- Law changed in 2008
- Applies to "Covered Expatriates" who relinquish U.S. citizenship or terminate long-term residency on or after June 17, 2008
  - Mark-To-Market Exit Tax
  - Other Income Tax Rules
  - Estate and Gift Tax Rules

Covered Expatriate

Covered Expatriate

- **An "Expatriate" is a U.S. citizen who relinquished U.S. citizenship or a U.S. lawful permanent resident (i.e., green card holder) who ceases to be a lawful permanent resident after maintaining such status for at least 8 of the last 15 years**

- **A "Covered Expatriate" is an Expatriate who either (i) fails the Certification Test or (ii) meets the Tax Liability Test or the Net Worth Test**

Certification Test

- An Expatriate must certify under penalties of perjury that he or she is in compliance with all U.S. federal tax obligations for the prior 5 years, including, but not limited to, obligations to file all applicable income tax, employment tax, gift tax and information returns and obligations to pay all relevant tax liabilities, interest, and penalties

- Certification made on IRS Form 8854

- May not be able to certify compliance if making a voluntary disclosure and process is incomplete (could cause automatic treatment as a Covered Expatriate)

Tax Liability Test

- This test is met if the average annual net income tax of the Expatriate for the period of 5 taxable years ending before the date of expatriation is greater than a certain dollar amount (adjusted annually for inflation):

- Annual Inflation Adjusted Amounts:
  - 2008 Amount: $139,000 USD
  - 2009 Amount: $145,000 USD
  - 2010 Amount: $145,000 USD
  - 2011 Amount: $147,000 USD
  - 2012 Amount: $151,000 USD

Net Worth Test

- **This test is met if the Expatriate has a net worth of $2,000,000 USD (not indexed for inflation) as of the expatriation date**

- **For purposes of the net worth test, an individual is considered to own any interest in property that would be taxable as a gift if the individual were a citizen or resident of the United States who transferred the interest immediately prior to expatriation**

Expatriation Date

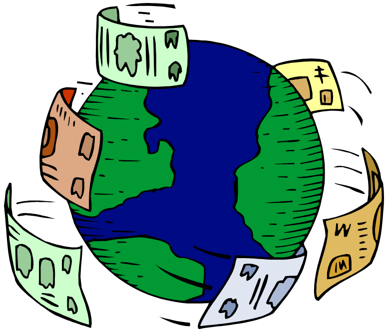
- The determination as to whether an individual is a Covered Expatriate is made as of the expatriation date, which is defined as the date an individual:
  - relinquishes U.S. citizenship or,
  - in the case of a long-term resident of the United States, the date on which the individual ceases to be a lawful permanent resident of the United States

Exceptions to Tax Liability Test and Net Worth Test

- An Expatriate shall not be deemed to have met the Tax Liability Test or the Net Worth Test if the Expatriate is a:
  - Qualifying Dual Citizen; or
  - Qualifying Minor

Qualifying Dual Citizen

- An Expatriate is a Qualifying Dual Citizen if the Expatriate:
  - became at birth a citizen of the United States and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and
  - has been a resident of the United States for not more than 10 taxable years during the 15-taxable year period ending with the taxable year during which the expatriation date occurs



Qualifying Minor

- **An Expatriate is a Qualifying Minor if the Expatriate:**
  - **relinquishes United States citizenship before attaining age 18 1/2; and**
  - **has been a resident of the United States for not more than 10 taxable years before the date of relinquishment**

Mark-to-Market Exit Tax

Deemed Sale

- **Property of Covered Expatriate is treated as having been sold for its fair market value on the day before the expatriation**

Property Included in Deemed Sale

- Any interest in property that would be taxable as part of the Covered Expatriate's gross estate as if he or she had died on the day before the expatriation date as a citizen or resident of the United States

- Assets held by grantor trusts (except to extent IRC Sec. 684 applies)

Property Excluded From Deemed Sale

- **Mark-to-Market Exit Tax does not apply to:**
  - **Beneficial interest in nongrantor trusts**
  - **Certain deferred compensation items**
  - **Certain tax deferred accounts**

Exception for Nongrantor Trusts

- A nongrantor trust is defined as a trust of which the Covered Expatriate is not considered the owner under the grantor trust rules as of the day before the expatriation date

- Any distribution of property to a Covered Expatriate from a nongrantor trust of which the Covered Expatriate was a "beneficiary" on the day before the expatriation date is subject to a 30% withholding tax on the "taxable portion" of the distribution

Exception for Deferred Compensation Items and Tax Deferred Accounts

- Most U.S. tax-qualified plans and retirement plans sponsored by the U.S. government or a U.S. state
- Foreign pension plans
- Other deferred property rights

- "Eligible" Item subject to 30% withholding tax
- "Ineligible" Items treated as if received on the day before expatriation date

Mark-To-Market Exit Tax Calculation

- Fair Market Value minus Adjusted Basis = Gain (or Loss)
- $600,000 of gain (adjusted for inflation) per taxpayer is excluded:
  - 2008 Amount: $600,000 USD
  - 2009 Amount: $626,000 USD
  - 2010 Amount: $627,000 USD
  - 2011 Amount: $636,000 USD
  - 2012 Amount: $651,000 USD
- If amount of gain exceeds exclusion, the exclusion is applied pro rata to each appreciated asset based on amount of gain
- Basis adjusted for actual sale in future
- Only one lifetime exclusion amount

Deferral of Tax Payment

- May be able to enter into agreement with IRS to defer payment of tax under the Mark-To-Market regime

  - Requires written agreement entered into with IRS
  - Agreement can be made on asset-by-asset basis
  - Must provide adequate security, such as a bond or letter of credit
  - Waive treaty benefits
  - Interest will accrue

Gifts and Bequests

Gifts and Bequests

- U.S. citizens or residents who receive a gift or bequest from a Covered Expatriate will have to pay a special tax on the gift or bequest at the highest rate applicable to gifts or bequests in the year of receipt

- Rate is currently 35%, less any foreign gift tax paid

- Applies only to gifts or bequests in excess of the "annual exclusion amount," which is currently $13,000

- Exceptions:
  - If reported on U.S. federal gift tax or estate tax return
  - Otherwise qualifies for martial or charitable deduction

Gifts and Bequests

- Domestic Trusts
  - Trust will be subject to the gift or estate tax

- Foreign Trusts
  - Tax will apply to any trust distribution attributable to such gift or bequest from such trust (whether from income or corpus) to a United States citizen or resident
  - Foreign trust may elect to be treated as a domestic trust

Reporting Requirements

Reporting Requirements

- **Form 8854 (due when federal income tax return is due)**
- **Form 1040 and Form 1040NR**
- **Form W-8CE**

Planning

Planning

- Become compliant
- Retroactive abandonment (i.e., to a date before expatriation tax existed; to utilize previous expatriation tax laws; never citizen)
- Reduce net worth below $2,000,000 through gifts (Net Worth Test) or otherwise reduce the value of assets
- Reduce taxable income through deferred compensation, tax-free investments, investment in highly appreciating but low yielding assets (Tax Liability Test)
- Plan to avoid status as long-term resident
- Expatriate when fair market value of assets is low

Planning (Continued)

- Eliminate risk of unintentional expatriation! (i.e., treaty position; green card taken away, non-tax actions)
- Consider utilizing full exemption amount for gains
- Consider potential loss of use of losses from deemed sale
- Only one spouse expatriates
- Review/Reorganize estate planning
- Utilize gift tax credit
- Planning with foreign trusts

Ex-Patriot Act

Important Tax Provisions in Bill

- A/K/A – Expatriation Prevention by Abolishing Tax-Related Incentives for Offshore Tenancy
- 30% withholding tax on gains from US sources
- Applies to "Specified Expatriate" -- Specified Expatriate is a Covered Expatriate whose expatriation date is after the date that is 10 years prior to enactment of these changes to the law
- Person is not a Specified Expatriate if satisfies IRS that the loss of citizenship did not result in substantial reduction of taxes

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