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# Frequently asked questions about the changing expatriate environment

## How are you affected by the US Individual Expatriation Tax Rules?

The U.S. imposes income tax on the worldwide income of its citizens and green card holders even if they reside overseas. U.S. citizens and certain green card holders residing overseas are also subject to U.S. gift and estate tax on transfers of worldwide assets. As a result, such individuals sometimes consider relinquishing their citizenship or green card with the hope of freeing themselves from the U.S. tax system. However, giving up U.S. citizenship or a green card on or after June 17, 2008 — the date of enactment of the Heroes Earning Assistance and Relief Tax (HEART) Act, P.L. 110-245 — may cause the expatriating individual to be subject to an exit tax and treated as if all assets were sold on the day before the expatriation date. Furthermore, U.S. persons receiving gifts from persons expatriating under the HEART Act may be subject to tax.

This publication provides a brief overview of the U.S. expatriation rules under the HEART Act. Please note that the HEART Act repealed the expatriation rules that were previously enacted under the American Jobs Creation Act of 2004 (AJCA). However, any individual who expatriated prior to the date of enactment of the HEART Act may be subject to the AJCA rules, including the information reporting requirements of such AJCA rules, which extended for up to a 10-year period from the year of expatriation. Please consult your tax advisor in order to determine whether any of the HEART Act rules, AJCA rules, or prior expatriation rules apply in your specific situation.

## Who is subject to the U.S. expatriation rules?

All U.S. citizens who relinquish or "give up" their citizenship status on or after June 17, 2008, and "former long-term residents" who give up their green cards after June 17, 2008 are subject to the new expatriation rules under the HEART Act if they meet any of the following three tests:

- Net Income Tax Test — For the five-year period before expatriation, the individual had an average annual U.S. income tax liability of at least $139,000 in 2008, (adjusted annually thereafter).
- Net Worth Test — The individual's net worth is at least $2 million.
- Certification Test — The individual fails to certify that he or she satisfied all applicable U.S. tax obligations for the five years before expatriation.
- An individual who is subject to the expatriation rules contained in the HEART Act is referred to as a "covered expatriate."

## What is the definition of "former long-term resident"?

A "former long-term resident" is an individual who has held a green card for any portion of at least eight of the fifteen tax years preceding expatriation. Please note that one day is considered a portion of a tax year; therefore, if an individual obtained his or her green card on December 31, 2002, and relinquishes the green card on January 1, 2009, he or she will have held his or her green card for a portion of eight tax years and will therefore be considered a former long-term resident for purposes of these rules.

An individual who has been resident in the U.S. for eight years under any other immigration status, such as a work visa, is not a long-term resident for purposes of the expatriation rules. For example, if an individual was resident in the U.S. for seven years under a work visa and for six more years under a green card, he or she would not be considered a long-term resident.

## What steps do you need to take to be considered to have "expatriated" for purposes of these rules?

Under the HEART Act, the actual act of expatriation for a U.S. citizen for tax purposes occurs when the individual formally renounces U.S. citizenship.

A U.S. citizen shall be treated as relinquishing his or her citizenship on the earliest of the following dates:

1. Date on which he or she renounces nationality before a diplomatic or consular officer of the U.S.
2. Date on which he or she furnishes a signed statement of voluntary relinquishment to the U.S. Department of State.
3. Date on which U.S. Department of State issues to the individual a certificate of loss of nationality.
4. Date on which a U.S. court cancels a naturalized citizen's certificate of nationalization, provided that renunciation or relinquishment under (1) or (2) above is subsequently approved by the issuance to the individual of a certificate of loss of nationality by the U.S. Department of State.

A green card holder shall be deemed to have expatriated on the date that lawful permanent resident status ceases. This occurs either on the date a green card is determined to have been revoked or judicially or administratively abandoned, or on the first day of a tax year for which a long-term resident invokes a tax treaty to be treated as a resident of a foreign country and does not waive the benefits offered by the treaty to residents of such foreign country. Appropriate advisors, including immigration counsel, should be consulted before a treaty position is taken, and anytime planning is conducted that affects an individual's residency status for tax purposes.

Please note that under prior law, an additional step was required in order for an individual to be considered to have expatriated for tax purposes (the filing of a specific tax form). This additional step is not required under the HEART Act.

## If you are a "covered expatriate," how will you be taxed?

The new expatriation rules under the HEART Act contain two key components: a deemed sale of all assets as of the day before expatriation, and a tax on the receipt of gifts or bequests by a U.S. person from an individual who expatriated on or after the date of enactment of the rules.

- **Deemed Sale**

  An individual will be deemed to have sold all assets on the day before the date of expatriation for fair market value. Losses may be taken into account, but only to the extent of gains; therefore, application of the expatriation rules may not result in a loss for tax purposes. The first $600,000 of net gain is excluded for each expatriating individual; this $600,000 amount will be indexed annually. Note that this exclusion is not applicable with respect to certain deferred compensation assets, certain interests in non-grantor trusts, and specified tax-deferred accounts.

  A basis adjustment will be applied to all property subject to the deemed sale provisions; such adjustment will ensure that an actual sale at a future date would not result in double taxation due to the prior application of the deemed sale rules.

  For purposes of determining the basis of property subject to the deemed sale rules, property that was held by an individual on the date the individual first became a resident of the U.S. shall be treated as having a basis equal to the fair market value of such property on the residency start date. An individual may elect not to have this step-up in basis apply. Basis of property acquired after the residency start date would be computed under the "standard" basis rules.

  Special rules apply to certain deferred compensation assets, certain interests in non-grantor trusts, and specified tax-deferred accounts.

- **Tax on Gifts and Bequests**

  A U.S. person who receives a gift or bequest from a covered expatriate is subject to U.S. tax on the receipt of such gift. The total value of the gift is first reduced by the available annual exclusion ($12,000 in 2008), and tax is then assessed at the highest applicable gift tax rate at the time of the gift (in 2008, the top gift tax rate is 45 percent).

## Are any exclusions or deductions available under the tax imposed on gifts from covered expatriates?

Yes, marital and charitable deductions are available for transfers to a U.S. citizen spouse or a qualified charity.

## What are the special rules applicable to deferred compensation assets, interests in foreign trusts, and specified tax-deferred accounts?

Special rules apply to deferred compensation assets, tax-deferred accounts, and trust interests.

In general, deferred compensation includes all types of employer retirement plans including foreign plans, qualified retirement plans, and nonqualified retirement plans. In addition, it includes property transfers or the right to future property transfers that an individual is entitled to receive in connection with the performance of services to the extent that amounts have not been previously included in taxable income. Tax-deferred accounts include individual retirement plans, qualified tuition plans, Coverdell education plans, health savings accounts, and Archer MSAs.

- Eligible Deferred Compensation Items and Interests in Nongrantor Trusts
  - For eligible deferred compensation items and nongrantor trusts from which a distribution is made to a covered expatriate subsequent to his or her expatriation date, the plan administrator or trustee is required to withhold U.S. tax at the rate of 30 percent on the taxable portion of a distribution. This withholding tax at the time of distribution is imposed in lieu of the application of the deemed sale rules on the day before the expatriation date. For grantor trusts, the mark-to-market rules apply and this special withholding rule is not applicable. The expatriating individual may elect not to have this deferral/withholding rule apply and may instead treat the eligible deferred compensation asset or interest in the nongrantor trust as having been distributed on the day before the expatriation date.
- Tax-Deferred Accounts and Other Deferred Compensation
  - For other deferred compensation and tax-deferred accounts, the account will be treated as having been distributed on the day before the expatriation date. With respect to property transfers or the right to transfers, amounts are assumed to have been transferred and not subject to a substantial risk of forfeiture on the day before the expatriation date. The deemed distribution will be subject to income tax at ordinary income rates, but the penalties that normally apply to early withdrawals from such accounts will not apply to a deemed distribution under the expatriation rules. A basis adjustment will be made to reflect the taxation incurred as a result of the deemed distribution under the expatriation rules.

## What is eligible deferred compensation?

Eligible deferred compensation is any deferred compensation item with respect to which:

- The payor is either a U.S. person or certain non-U.S. persons who elect to be treated as a U.S. person for purposes of withholding.
- The covered expatriate notifies the payor of the covered expatriate status and irrevocably waives any claim to withholding reduction under any U.S. treaty.

## How should employers prepare for the application of these rules?

Employers will need to focus on three areas when preparing for the application of these rules:

- Compliance — Employers will need to adopt processes to ensure proper withholding and/or reporting related to taxation under the HEART Act. Further, pending guidance concerning the valuation of certain deferred compensation such as retirement plans, employers will need to determine appropriate valuation for purposes of compliance with these rules.
- Policy Review — Employers will need to review their human resource policies to determine if they have any potential obligation to reimburse the taxes resulting from this Act. For example, policies covering relocation and international assignments may contain tax reimbursement provisions that could be used to seek reimbursement of these taxes.
- Education — Employers may want to take steps to help their employees understand the implications of expatriation and its potential tax impact. Such education may be directed at employees who are in the process of obtaining their green card or who are permanently leaving the United States.

## What if you have a deemed sale event under the expatriation rules and you do not have cash available to pay the tax?

A covered expatriate may elect to defer the tax resulting from the application of the deemed sale rules (but not the special rules for deferred compensation, tax-deferred accounts, or nongrantor trusts) until the later of:

- The due date of the tax return for the year in which a particular asset for which the deferral election was made is actually sold or otherwise disposed of.
- The due date of the individual's final income tax return in the case where the covered expatriate dies owning property for which the deferral election was made.

Interest is charged during the period the election is in place with respect to the deferred gain, and security must be posted as collateral.

The deferral election may be made for all assets subject to the deemed sale rules or only for certain select assets. The election to defer tax under the HEART Act expatriation rules may compromise the ability of a covered expatriate to take certain treaty positions. Note that the deferral election is not applicable with respect to deferred compensation, specified tax accounts, and foreign trusts. Please discuss with your tax advisor.

## Are there any exceptions to the HEART Act expatriation rules?

The HEART Act contains two very limited exceptions to the expatriation rules. In order to be exempt from the expatriation rules, an individual must meet one of the following requirements:

- Dual-Citizen Exception: An individual will meet this exception if the following three factors are met:
  - The individual was born with dual citizenship (i.e., U.S. and some other country).
  - The individual retains his or her non-U.S. citizenship and is taxed as a resident of such other country.
  - The individual has been a resident of the U.S. for no more than 10 taxable years during the 15 taxable years prior to (and including) the expatriation year.
- Exception for Certain Minors: An individual will meet this exception if: the individual relinquishes U.S. citizenship before reaching age 18½, and the individual was not a U.S. resident for more than 10 years preceding expatriation.

Any expatriate who meets the net worth or net income tax tests, or who fails to meet the certification requirement, will be subject to the expatriation rules unless he or she falls under one of the two exceptions listed above. Obviously, these exceptions are very narrow; therefore, very few expatriates will meet the exceptions.

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Deloitte Tax LLP has a team of professionals who specialize in expatriation. Additional information can be obtained by contacting Karen Brodsky, Thomas P. Jaffa, Dawn Angermaier, Jennifer Rooney or Jennifer Einziger in our New York office at +1 212 436 2000.

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