

Proposed Legislation Once Again
Seeks to Alter the United States Expatriation Rules

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Recently, legislation was once again proposed that would alter the United States (the “U.S.”) tax consequences with respect to a person who is deemed to “expatriate” from the United States. The proposed rules, which are similar to prior proposals which were never enacted into law, would subject certain U.S. citizens and long-term residents who relinquish their U.S. citizenship or residence status to tax on the appreciation in all property they own at the time of their expatriation as if such property were sold for fair market value (commonly referred to as a “mark-to-market tax”). Any gain from such deemed sale would be subject to current U.S. taxation to the extent it exceeds \$600,000 (\$1.2 million in the case of married individuals filing a joint return, both of whom relinquish citizenship or terminate residency). This \$600,000 exclusion amount will be increased each year by a cost of living adjustment factor.

Two exceptions exist to this new proposed mark-to-market rule. The first exception applies to an individual who was born with citizenship both in the U.S. and in another country; provided that (1) as of the expatriation date the individual continues to be a citizen of, and is taxed as a resident of, such other country, and (2) the individual was not a resident of the U.S. for the five taxable years ending with the year of expatriation. The second exception applies to a U.S. citizen who relinquishes U.S. citizenship before reaching age 18½, provided that the individual was a resident of the U.S. for no more than five taxable years before such relinquishment.

Notwithstanding these proposed rules, a person expatriating will be permitted to make an irrevocable election to continue to be taxed as a U.S. citizen with respect to all property that otherwise would be subject to the mark-to-market tax. This election is an “all or nothing” election; an individual is not permitted to elect this treatment for some property but not for other property. Under this election, following expatriation, the individual continues to pay U.S. income taxes at the rates applicable to U.S. citizens on any income generated by the property and on any gain realized on the disposition of the property. In addition, the property continues to be subject to U.S. gift, estate, and generation-skipping transfer taxes. In order to make this election, the taxpayer is required to waive any treaty rights that would preclude the collection of the tax.

In addition, under the proposal, an individual is permitted to defer the payment of the mark-to-market tax. Under the election, the deferred tax attributable to a particular property is deferred until the property is sold or otherwise disposed of. In such case, interest will be charged for the period the tax is deferred at a rate two (2) percentage points higher than the rate normally applicable to underpayments of taxes. The election is irrevocable and is made on a property-by-property basis.

As similar legislation has been proposed in the past, it is unclear if this new proposal will ultimately be passed into law. Furthermore, if in fact enacted, it is unclear when the new law

would become effective. Consequently, any person contemplating expatriation from the U.S. should seek legal counsel in the U.S. and keep a close eye on the state of the law.

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