

Expatriation Bill Introduced in U.S. House to Prevent Tax Avoidance

by KPMG's Washington National Tax practice (KPMG LLP in the United States is a KPMG International member firm)

Legislation was introduced (H.R. 4880, "the Bill") on June 6, 2002, in the U.S. House of Representatives that proposes to further prevent U.S. tax avoidance through expatriation by imposing an exit tax at the time of expatriation on the unrealized appreciation in the value of certain assets of an expatriate. The Bill imposes a transfer tax on U.S. citizens and residents who receive gifts and bequests from expatriates, and specifically defines the terms "expatriation date" and "relinquishment of citizenship" for purposes of avoiding tax as a U.S. citizen. Charles B. Rangel, House Way and Means Committee ranking Democratic member introduced the Bill. Similar to legislation that was proposed in prior years, it is uncertain at this time whether the Bill will attract the political support needed to move forward.

Section 877 and Bill's Provisions

An expatriate for this purpose generally is a U.S. citizen who loses his or her U.S. citizenship or a long-term U.S. permanent resident (green card holder) who terminates his or her U.S. residency. The proposed exit tax would apply in addition to the current expatriation taxation regime under Internal Revenue Code (IRC) Section 877 with appropriate relief to avoid double taxation. Under the current expatriation provisions, nonresident aliens who are former citizens or long-term U.S. residents are potentially subject to an alternative tax regime under Section 877 for a period of 10 years after loss of U.S. citizenship or residency, unless such loss did not have for one of its principal purposes the avoidance of U.S. tax. The alternative tax is imposed on certain net income at normal individual rates with exemptions. The tax applies only to U.S. source income as expansively defined. An expatriate is subject to the alternative tax only if the total tax imposed on all taxable items of income exceeds the total tax that would be imposed on a nonresident alien under Section 871 for those same items of income.

Exit Tax

The exit tax would be imposed on the unrealized appreciation of an expatriate's assets as if the expatriate had sold his or her assets for fair market value on the day before expatriation. The Bill provides for an exemption on the first \$600,000 (\$1.2 million for a married couple) of appreciation from the tax. The tax would not apply to the value of interests in U.S. real property and interests in certain retirement plans. Additionally, an expatriate may elect to defer the tax, with interest, until the assets are actually sold. To make this election, the taxpayer must provide a bond or other security. If enacted, the Bill would be codified as IRC Section 877A.

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KPMG Observation: Currently, former U.S. citizens and long-term residents may request a private letter ruling from the Internal Revenue Service (IRS) that loss of U.S. citizenship or termination of long-term residency did not have for one of its principal purposes the avoidance of U.S. tax (Notice 97-19, modified by Notice 98-34). However, the Bill does not provide for this relief.

Gifts and Bequests from Expatriates

The Bill provides that U.S. citizens and residents would generally be required to pay a tax on the value of gifts or bequests received directly or indirectly from an expatriate. The tax would be imposed at the highest gift or estate tax rate, and applied only to gifts and bequests received in a calendar year in excess of \$10,000. The tax is reduced by any foreign gift and/or estate taxes paid with respect to the gift or bequest. The tax would not apply transfers otherwise subject to U.S. estate or gift tax.

Effective Date

The Bill would apply to individuals formally renouncing their U.S. citizenship or relinquishing their green cards or receiving gifts or bequests from expatriates on or after the date of action by the Ways and Means committee. Such action has not yet occurred, thus these provisions could apply to individuals who renounce their citizenship or relinquish their green cards before the Bill is signed into law.

Footnote:

1 The status of the bill, known also as a bill "To amend the Internal Revenue Code of 1986 to prevent the continued use of renouncing United States citizenship as a device for avoiding United States taxes," can be viewed on the Library of Congress's Thomas Web site at: <http://thomas.loc.gov/>

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