Expatriation

In light of all the recent and new US filing requirements including FBAR and reporting Foreign Financial Interests and FATCA requirements as implemented by Israeli (and other non-US banks) under direction of the Israeli Tax Authorities (see our website at www.GalitzerCPA.com) and the related potential penalties for non-compliance, many clients have started to think about giving up their US citizenship – "Expatriation".

The US tax requirements and consequences of giving up US citizenship or giving up US permanent residence (Green Card status) have changed in recent years. It used to be that expatriation would require the person who gave up his US citizenship or Green Card would be subject to regular US income tax requirements on his world-wide income for ten years after expatriation. Those rules are no longer in effect. They have been replaced by the rules discussed below.

A. Non-Covered Expatriation

If a US citizen or Green Card holder meets ***all*** the following requirements, he would have no apparent adverse direct US tax consequences nor special filing requirements:

1. Average annual net income tax liability of less than $151,000 for the period of 5 years prior to and ending with his date of expatriation;
2. Net worth of less than $2,000,000 at date of expatriation (based on a net worth statement -- similar to the Israeli הצהרת הון); and –
3. The individual certifies (subject to penalty of perjury if not true) that he has met all his requirements under the US tax code for the 5 years prior to expatriation.

Alternatively, even if a person has had average income tax liability of more than $151,000 and has a net worth of more than $2,000,000 (linked to the US inflation rate) he may still be exempt from the tax and filing requirements discussed below in section B if;--

4. the individual expatriating (a) was born as a dual citizen of the US and another country, (b) continues to be a citizen of and taxed as a resident of that other country, **and** (c) was resident in the US (under the substantial presence test) for no more than 10 years out of the 15 years prior to expatriation; ***OR -***
5. the individual expatriating is, at that date, under 18+1/2 years of age, and was resident in the US (under the substantial presence test) for no more than 10 years before expatriation.

B. Covered Expatriation

If an expatriating US citizen or Green Card holder ***exceeds*** any of the threshold amounts listed in paragraphs 1 and 2 above, ***or*** does not certify his compliance with US tax laws for the prior five years as noted in paragraph 3 above, then he would be considered a ***Covered*** Expatriate and would be subject to all the following:

1. **Mark-to-market**—Such individual will be deemed to have sold all his world-wide assets on the day before expatriation at their fair market values, including any "Grantor Trust" assets. The resulting gain in excess of $651,000 (indexed for 2012) would be taxable in that year's US tax return. US real estate would not be included in that Mark-to-market calculation since any future sale as a non-resident alien would be taxed under other US tax rules. **Note:** Although the post expatriation cost basis for subsequent US taxation would be that fair market value, for Israeli tax purposes the original cost basis would continue to be the basis for subsequent taxation without the US tax paid as an off-setting foreign tax credit.

2. **Deferred Compensation**--- The value of deferred compensation arrangements would be currently taxable as part of the mark-to-market calculation, unless meeting certain requirements for deferring the tax until paid. When paid, such income would be taxed by the US at a flat 30% tax rate. **Note:** All Israeli deferred compensation arrangements would be currently taxable.

3. **Non-Grantor Trusts**--- The non-grantor trust interests of an expatriating beneficiary would be taxable when such income is paid to him at a flat 30%, unless electing to pay the tax immediately as part of the mark-to-market calculation.

4. **Waiver of Treaty Rights**--- Such individual with world-wide assets entitled to the deferred tax regimen would be required to formally agree to waive any and all rights under treaty for deferral or exemption of US tax on such income in the future. Such agreement would be in a written contract with the IRS and based on a private IRS ruling agreeing the value of all his deferred income. Failure to agree to such waiver of treaty rights would cause all deferred assets to be currently taxed under the mark-to-market rule.

5. **Form W-8CE** --- A Covered Expatriate will be required to file Form W-8CE with all US payors of future deferred income such as trustees and retirement plan administrators instructing them to withhold 30% tax on all subsequent payments of deferred income.

The discussion above is designed to give readers a taste of the IRS requirements of a US citizen or Green Card holder who gives up his citizenship or permanent US resident status. The subject is a very complex one with very detailed and complex requirements. Therefore careful consideration and analysis should be made by anyone considering expatriation before engaging in that significant step.

For example, such person should evaluate the consequences of becoming a non-resident alien ("NRA") of the United States. An NRA living outside the USA will not be paid Social Security benefits upon retirement even though he may have earned those benefits over many years. Also, the potential US estate tax on the estate of an NRA decedent with US assets is substantially higher than the estate tax of a US citizen's estate with similar assets. In addition, the current annual income tax on US source income of an NRA is generally higher than the US tax on similar income of a US citizen.

Let us know if we may help in making such analysis if you are considering taking the dramatic step of giving up your US citizenship or Green Card.

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