

COVERED EXPATRIATES: IRS PROPOSED REGS

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On September 9, 2015, the IRS issued proposed regulations (reg-112997-10, 2015-39 IRB 422) under Code section 2801, which taxes US citizens and residents who receive a “covered gift” or “covered bequest” from a “covered expatriate.” The rule was added to the Code as part of the HEART [Heroes Earnings Assistance and Relief Tax] Act of 2008 and is an estate and gift tax consequence of relinquishing US citizenship or terminating long-term permanent resident status, in addition to section 877a’s well-known exit tax. Reporting and payment of tax due under section 2801 is deferred until final regulations are issued.

For both sections 877a and 2801, a “covered expatriate” is an individual who, after June 16, 2008, relinquished US citizenship or terminated long-term permanent resident status and (1) meets either a US income tax liability test (in 2015, an average US income tax liability of \$160,000 over five years) or a net worth test (\$2 million) and does not meet a “dual citizen from birth” exception to those tests or (2) fails to certify compliance with US federal income tax obligations for the five preceding tax years.

Section 2801 imposes a tax, at the highest gift or estate tax rate (now 40 percent), on any US citizen or resident who receives a covered gift or a covered bequest from a covered expatriate who acquired the transferred property either before or after expatriation. The definition of a “covered gift” incorporates the Code’s gift tax definition; the gift must be received directly or indirectly from a covered expatriate. A “covered bequest” means any property (1) that is acquired, directly or indirectly, because of a covered expatriate’s death and (2) that would have been includible in his or her gross estate if he or she had been a US citizen at death. The terms “covered gift” and “covered bequest” do not include (1) a charitable donation that would qualify for the estate or gift tax charitable deduction and (2) a gift or bequest to a covered expatriate’s US-citizen spouse that would qualify for the gift or estate tax marital deduction if the transferor was a US citizen or resident. A broad range of transfers are subject to section 2801, and the US tax implications of expatriating may persist long after an individual relinquishes US citizenship or terminates long-term permanent resident status.

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Unlike traditional US gift and estate taxes imposed on the donor or the estate, respectively, the tax under section 2801 is imposed on the US-citizen or US-resident recipient of the covered gift or bequest. For this purpose, a domestic trust that receives a covered gift or bequest is treated as a US citizen and is thus liable for the tax. A foreign trust generally is not liable for the tax imposed under section 2801: the US citizen or US resident recipient of a foreign trust's distribution is generally liable for the tax on receipt to the extent that the distribution is attributable to covered gifts or bequests to that trust. A foreign trust, however, may elect to be treated as a domestic trust for the purposes of section 2801, and in that case it is taxed thereunder on its receipt of a covered gift or bequest: the tax on a US citizen or US-resident recipient is eliminated.

Under the proposed regulations, a gift's or bequest's recipient bears the burden of determining whether he or she received a covered gift or bequest. The preamble to the proposed regulations acknowledges the difficulty of this task. The proposed regulations provide that the recipient may request, with the expatriate's consent, the IRS's disclosing of certain information about the donor's or deceased's return that may assist in determining whether he or she is or was a covered expatriate. It is unclear how such consent can be obtained, especially from a decedent's estate. According to a US Treasury representative, Treasury is actively working on a Revenue procedure that will explain the process for requesting disclosure. If authorized, the IRS may disclose returns and return information upon request, but it will not determine covered expatriate status. The proposed regulations further provide that if the expatriate donor does not authorize the IRS to release the relevant return information to the recipient, then a rebuttable presumption exists that the expatriate donor is a covered expatriate and that each gift from him or her to a US citizen or resident is a covered gift. The proposed regulations do not offer guidance on how the presumption may be rebutted.

The IRS intends to release form 708, "United States Return of Tax for Gifts and Bequests from Covered Expatriates," when the proposed regulations are finalized. Final regulations will establish the due date for the form's filing and the section 2801 tax's payment. Consistent with Announcement 2009-57 (2009-29 IRB 158), a US recipient will be given a reasonable time to file form 708 after the final regulations are issued and pay the section 2801 tax on all covered gifts and bequests received after June 16, 2008.

Because expatriations are on the rise for US-citizen Canadian residents, the proposed regulations should be carefully reviewed. A Canadian-resident covered expatriate should be aware that generally any gift or bequest that he or she made after June 16, 2008 to a US person will eventually be subject to tax and reporting under section 2801, and therefore all such gifts and bequests must be analyzed.