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IRS Issues Guidance on Deemed Sale Rule for Expatriates

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When a US citizen relinquishes citizenship or a long-term US resident (green card holder) leaves the US, new rules in effect since June, 2008 can apply to treat the expatriate as if he or she sold all of his or her assets (worldwide) as of the date of expatriation, triggering an immediate income tax on all appreciated assets. This rule is intended to prevent expatriates from moving their assets offshore without paying tax, and can have significant adverse tax consequences.

Last week, the IRS issued Notice 2009-85, which provides 58 pages of detailed guidance regarding the operation of these rules.

A qualifying expatriate, generally speaking, is a US citizen who relinquishes citizenship or a long term resident who terminates US residency, and who meets either (1) the average annual net income tax test (more than \$124,000 average annual income tax in each of the last five years), (2) the net worth test (greater than \$2 million) or (3) the “failure to certify” test (failure to certify compliance with the US tax laws).

The rule triggering immediate income tax on expatriation is mitigated by an exemption for the first \$600,000 of gain (adjusted for inflation). A taxpayer also may be able to defer the payment of tax if a number of conditions are met. Lastly, the deemed sale rules do not apply to deferred compensation items, specified tax deferred accounts and interests in trusts where the expatriate is a beneficiary.

Please contact us if you would like to discuss how these complicated rules may apply to you.

Cole, Schotz, Meisel, Forman & Leonard, P.A.

Court Plaza North
25 Main Street
Hackensack, NJ 07601
Phone:
(201) 489-3000

900 Third Avenue
16th Floor
New York, NY 10022
Phone:
(212) 752-8000

500 Delaware Avenue
Suite 1410
Wilmington, DE 19801
Phone:
(302) 652-3131

300 East Lombard Street Suite 2000
Baltimore, MD 21202
Phone:
(410) 230-0660