

Impact of Joe Biden's tax plan: Considerations when renouncing US citizenship

Toronto, Nov 10, 2020 ([IssueWire.com](https://www.IssueWire.com)) - [I prepared this short video to update you on Joe Biden's tax proposal.](#)

I am Olivier Wagner, EA, CPA. I have operated 1040 Abroad since 2012. I have helped clients in over 100 countries to be tax compliant. You can reach me at 1040abroad.com

I want to present this video to discuss the impact of Joe Biden's tax plan for Americans overseas: those who plan to renounce their citizenship as well as those who stay in the tax system.

We're all thrilled to have a new president and many of his measures will make the world a better place some will have a negative impact on Americans overseas especially those who plan on renouncing your citizenship.

I will discuss the impact it has on your season planning on renouncing will increase your citizenship as well as other points that would impact for instance U.S. shareholders of a foreign corporation.

A U.S. citizen who renounces U.S. citizenship would be classified as either an expatriate or a covered expatriate. An expatriate is not subject to exit tax and would thereafter be treated the same way as any non-resident alien.

Who is a covered expatriate?

If you meet one of these three tests you would be a covered expatriate (there are some exceptions for people born with U.S. citizenship who remained a tax resident of the other country of citizenship, as well as for people who went out before the age of 18.5 years old):

- The asset test would apply if your net wealth is worth more than two million dollars on the day you renounce.
- The income tax test that would be if your tax liability was over 168 000 (as of 2019) over the prior five years. This only includes income tax (after foreign tax credits).
- The compliance test, meaning that you can certify that they've been compliant for the five year period prior to renouncing.

Strategies

In most cases, those who owe that kind of income tax also have assets worth more than \$2 million. And with any prior planning, anyone renouncing would have filed 5 years' worth of tax returns.

That means that the reason why someone would be a covered expatriate would have to do with their having assets worth more than \$2million. A common strategy is to gift the excess assets either to a spouse, children, or some other people that they trust or wish to gift money to.

As such they will gift the money before expatriating and on the day they renounce they would have less than two million dollars of assets and therefore wouldn't meet the asset test.

The U.S. has a gift tax system which allows someone a U.S. citizen to gift up to 11.58 million dollars during their lifetime without incurring any gift tax, they would still file form 709 reporting the gift if it was more than \$15,000 in any given year but they would not be subject to an actual gift or estate tax.

Joe Biden's first proposal is that it would be to reduce that lifetime exemption from \$11.58 million. While he hasn't given an exact number, it seems that it will be about 6 million so to the extent that you would want to make gifts in order to reduce your assets base to less than 2 million that might cause you to have gift tax owing.

Consequences of being a covered expatriate?

One disadvantage of being a covered expatriate one is that you will have a deemed disposition of all of your assets. This is referred to as the "exit tax". It's as if you sold them on the day you renounced and then you would be subject to capital gains on that deemed disposition.

Another disadvantage of being a covered expatriate is that if you make gifts or someone who is a U.S. citizen inherits from you after you renounced and became a covered expatriate, they will be subject to a 40 percent gift tax. It's the only situation in which the recipient pays the gift tax.

Currently, capital gains have a favorable tax rate of 0, 15, or 20 percent. In most cases, it's 15 percent. Joe Biden's proposal would raise it from the current 15 or 20 percent to graduated rates which would rise to 39.6 percent for those earning more than 400 thousand dollars.

Other impacts of Joe Biden's tax proposal?

Shareholders of foreign corporations

Another consideration for Americans living overseas, even if they don't renounce would be for those who own a foreign corporation.

There's a complicated set of rules that cause some of the income that stays within the corporation to be taxed to the shareholders even if no distribution occurred: Subpart F income has been around since the 1960s. Meanwhile, the tax act passed by Trump in 2017 also included created a new category of income that will be taxed even if it's not distributed is called GILTI income.

A section 250 election, which was originally only meant for corporate shareholders, but later extended to individual shareholders, allows only 50% of GILTI income to be taxed. As GILTI income can be taxed at 21%, this means that the effective tax rate would be 10.5%.

Joe Biden plans on removing section 250, meaning that GILTI income would be taxed at 21%.

Another way to avoid GILTI income and separate income is if you live in a country which has a high tax rate and you pay more than 90 percent of the highest U.S corporate tax rate then since you already paid so much to this foreign country you will not be subject to Subpart F and GILTI income provisions.

Currently, the U.S. corporate tax rate is 21% meaning that 90 percent of that would be 18.9 percent; if you pay more than 18.9 percent to a foreign country Subpart F and GILTI income provisions don't apply to you. Joe Biden plans on increasing the U.S. corporate tax rate to 28%, as such 90 percent of 28 percent would be 25.2 percent and you will need to pay at least 25.2 percent to a foreign country to take advantage of that provision which is significantly more than 18.9%.

Shareholders of foreign corporations

Lastly, another consequence of Joe Biden's tax proposal is that he would eliminate the stepped-up basis on inherited property. Currently, if a U.S. citizen inherits property the stepped-up basis will take place and their basis, the basis of the person who inherits the property will be the fair market value as of the time of the death of their decedent. As such they would only be subject to capital gains on the unrealized gain between the fair market value as of the time of that person's death and the time they sell it.

If the step the basis is removed, as would be the case under Joe Biden's tax proposal they will be subject to the capital gains on the entirety of the gains from the time the property was purchased by the original owner to the time it is actually sold which, if the earning period was several decades or so could be a significant amount.

Thank you for being with me. That was my insight on Joe Biden's tax proposal.

Feel free to contact me if you have any questions. I look forward to preparing such videos in the future.
Thank you so much

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