Tax Notes

# Tax Relief Now Available for Certain Americans Who Want to Give Up Their U.S. Citizenship

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According to recent government statistics, there are roughly nine million U.S. citizens living outside the U.S., many of whom are citizens by birth but have little or no family or economic ties to this country. Under U.S. immigration laws, those who have been born in the U.S. to foreign parents or born outside the U.S. to U.S. parents are U.S. citizens, but may not be aware of their status, or its importance.

These "accidental" Americans, by law, are required to report their worldwide income and pay taxes to the IRS. They also remain subject to an array of disclosure requirements for their non-U.S. financial and securities accounts and other assets under the Foreign Account Tax Compliance Act (FATCA). In addition, non-U.S. banks – in order for the banks to maintain FATCA compliance – red flag these individuals and subject them to onerous scrutiny and documentation requirements to open and maintain the accounts because of their U.S. citizen status. Other foreign financial institutions simply refuse to open an account for them or they close existing accounts.

Are these tax and compliance burdens worth maintaining a passport for a country a person has little connection to? For many, the answer is no, and when they learn of their obligations, they seek to "turn in" their U.S passports, or at least explore the option. What many find out is that it is not so simple for the accidental citizen, particularly for those who have accumulated some level of wealth over their lifetime.

## Expatriation

The first hurdle to explore is the U.S. administrative process for expatriation. Once the decision to expatriate is made, certain expatriating acts must be completed, generally in person. This process can be handled by the individual alone, but at PKF O'Connor Davies, we always recommend that individuals seeking to expatriate obtain assistance from an immigration attorney.

A person who is expatriating also needs to be ready to deal with the potential tax consequences. Before they make their expatriating act, they should be ready and prepared from a tax perspective; however, those who were unaware of the potential tax consequences when they expatriated may now have the opportunity to come into compliance without fees and penalties.

## Exit Tax

In addition to the immigration laws governing the expatriation process, Section 877A of the Internal Revenue Code imposes a reporting requirement on exit (Form 8854, Initial and Annual Expatriation Statement), up-to-date tax compliance for a six-year period, and possibly an "Exit Tax" to terminate their U.S. tax requirements when an expatriation act has occurred.

## Citizens Who Relinquish

Under Section 877A, individuals who are "covered expatriates" are treated as having disposed of all worldwide assets on the day before their expatriation date and are required to pay a mark-to-market exit tax on the gain. In addition, they are also subject to additional tax consequences with respect to certain deferred compensation items and trust distributions.

With some exceptions, an individual is a "covered expatriate" if the person:

- Has an average annual net income tax liability for the five years preceding the year of expatriation that exceeds a specified amount adjusted for inflation (for example, $161,000 for 2016, $162,000 for 2017, $165,000 for 2018, and $168,000 for 2019) ("average income tax liability test"), **OR**
- Has a net worth of $2 million or more as of the expatriation date ("net worth test"), **OR**
- Cannot certify, under penalties of perjury, on Form 8854 that he or she is compliant with all Federal tax obligations for the five tax years preceding the tax year that includes the expatriation date ("certification test").

Under the statute, the only exceptions are for dual citizens with no substantial contacts with the U.S., which is a difficult standard to meet.

To meet the requirements of the certification test, individuals must file a Form 8854 with their tax return for the year of expatriation and certify compliance for the prior five tax years. Certifying compliance for the prior five tax years requires that all Federal tax returns for the five tax years before the year of expatriation were properly filed, complete, and accurate.

Of course, individuals who were unaware of their tax filing requirements at the time of expatriation could not meet the certification test, and would be covered expatriates even if they do not meet the average income tax liability test or the net worth test. That's where the Relief Procedures for Certain Former Citizens provided by the IRS could be beneficial.

## Relief Procedures

Under the Relief Procedures for Certain Former Citizens ("these procedures"), the IRS is providing an alternative means for satisfying the certification test for citizens who expatriate, or have expatriated, after March 18, 2010 (the date of the passage of FATCA), which implemented the asset reporting requirements discussed earlier.

These procedures are only available to U.S. citizens with no history of filing a tax return as a U.S. citizen or resident, a net worth of less than $2 million (at the time of expatriation and at the time of making their submission under these procedures), and an aggregate tax liability of $25,000 or less for the tax year of expatriation *and* the five prior years. The aggregate tax liability can be reduced by foreign tax credits or the foreign earned income exclusion – so if an individual would have had total tax liability of $30,000 over the relevant six-year period, but also could use foreign tax credits to reduce that tax liability to $10,000 in total, that person qualifies for these procedures.

As part of the process, an eligible individual must submit all required Federal tax returns for the six years at issue, including all required schedules and information returns. This does not include the Report of Foreign Bank and Financial Accounts (FinCEN Form 114, formerly Form TD F 90-22.1, the FBAR), although the IRS recommends that those taking advantage of these procedures file FBARs; if they do so, the IRS will not assert FBAR penalties for late filing.

If an individual submits the necessary tax returns and forms and meets the requirements of these procedures, they will not be "covered expatriates" under Section 877A, nor will they be liable for any unpaid taxes and penalties for the six years or any previous years.

These procedures may only be used by taxpayers whose failure to file required tax returns [including income tax returns, applicable gift tax returns, information returns (including Form 8938, Statement of Foreign Financial Assets), and the FBAR] and pay taxes and penalties for the years at issue was due to non-willful conduct. Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.

There is currently no termination date for these procedures.

## Conclusion

These procedures provide an excellent opportunity for those who might otherwise be subject to significant tax and penalties because of their expatriation.

## Contact Us

We at PKF O'Connor Davies are happy to assist individuals with compliance with these procedures – or, better yet, compliance prior to expatriation so that no relief is required. Please contact either of the co-authors:

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