

## **Renouncing Your U.S. Citizenship: Is Divorcing Uncle Sam Right For You?**

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### **A. INTRODUCTION**

The billionaire co-founder of Facebook, the only American member of Monty Python, a Civil Rights Leader with a PhD from Harvard, the founder of Carnival Cruise Lines and owner of the Miami Heat NBA franchise, and arguably the best chess mind to ever live have more in common than you might think. So what do Eduardo Saverin, Terry Gilliam,<sup>1</sup> W.E.B. Du Bois, Ted Arison, Bobby Fischer and thousands of U.S. citizens living abroad have in common? The answer is all five have renounced their U.S. citizenship. These individuals are not alone, record numbers of U.S. citizens living in Canada and across the world are in the process of renouncing. Why would a country with a seven to ten year wait list to acquire citizenship have so many citizens headed for the exit? The reason is that three letter word no one likes to hear-TAX.

The United States is the only major country to tax the world-wide income of its citizens and foreign persons admitted as permanent residents,<sup>2</sup> and with the April 15 filing deadline right around the corner, U.S. citizens living in Canada and across the world are faced with the burden and cost of meeting their annual filing and reporting obligations to the IRS.<sup>3</sup> As such, the recurring nightmares of 1040s, FBARs, and voluntary disclosure programs are causing increased blood pressure and heartburn to U.S. citizens who call Canada home. In addition to the filing and reporting obligations, U.S. citizens living abroad must also deal with the consequences of the U.S. estate and gift tax regime during life and at death.<sup>4</sup> To makes things even more stressful, the implementation of the Foreign Account Tax Compliance Act (“FATCA”)<sup>5</sup> went into full effect on July 1, 2014. This drag net, enacted to catch non-compliant U.S. taxpayers with funds located abroad, is causing many U.S. citizen expats sleepless nights in anticipation of a notice from the IRS.

But wait my fellow U.S. expats living in Canada and abroad don't lose hope quite yet. There is a silver lining in this doom and gloom story and it comes in the form of renouncing your U.S. citizenship. However, hold your applause until the end because when things appear too good to be true, they usually are; and renouncing one's U.S. citizenship is riddled with potential pitfalls along the way. While renouncing may work for a Facebook co-founding billionaire, any individual U.S. citizen considering this action must decide if the election is right for them and must be properly advised along the way.

The million dollar question U.S. citizens living abroad must ask themselves, is whether their “U.S. citizenship juice is worth the squeeze?” In other words, do I need my U.S. citizenship and, if so, what are the benefits? Clients are often emotionally and financially drained after the process of becoming U.S. tax compliant, staying U.S. tax compliant, and continually planning for cross border U.S. estate and gift tax issues. Not only can the filing and reporting costs seem ludicrously expensive and intrusive, but the penalty regime for non-compliance can be catastrophic if not dealt with properly. Add those factors to FATCA's arrival to the cross border compliance party in 2014 and more and more U.S. citizens living abroad are looking for a way out; and who could blame them?

<sup>1</sup> When asked why he renounced in 2006, Mr. Gilliam replied, “*The reality is, when I kick the bucket, American tax authorities assess everything I own in the world—everything I own is outside of America—and then tax me on it, and that would mean my wife would probably have to sell our house to pay the taxes. I didn't think that was fair on my wife and children.*”

<sup>2</sup> IRC § 7701(b)(6). Lawful permanent resident, otherwise known as a “U.S. Green Card” holder.

<sup>3</sup> June 15<sup>th</sup> for filers abroad. You may be allowed an automatic two month extension of time to file your return and pay any federal income tax that is due. You will be allowed the extension if you are a U.S. citizen or resident alien and on the regular due date of your return you are living outside of the United States and Puerto Rico and your main place of business or post of duty is outside the United States and Puerto Rico, or you are in military or naval service on duty outside the United States and Puerto Rico.

<sup>4</sup> IRC §2033 and Regulations § 20.01(b)(1).

<sup>5</sup> The Foreign Account Tax Compliance Act enacted as revenue offset provisions of the Hiring Incentives to Restore Employment Act of 2010.



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It is important to remember that renouncing your U.S. citizenship is permanent and there are a number of U.S. immigration and U.S. tax land mines along the way. There are no mulligans once the Certificate of Loss of Nationality (“COLN”)<sup>6</sup> is issued and the only way to regain your U.S. citizenship is through the long and difficult process of naturalization under current U.S. immigration law. If you manage to avoid these land mines, renouncing your U.S. citizenship will relieve you of your yearly filing and reporting obligations,<sup>7</sup> as well as world-wide estate and gift tax exposure,<sup>8</sup> brought about by your citizenship. Even so, renouncing is not for everyone.

### B. BENEFITS OF U.S. CITIZENSHIP

A U.S. citizen living in Canada who is considering renouncing their U.S. citizenship should first ask themselves a very important and logical question. What am I giving up by renouncing my U.S. citizenship? Or put more selfishly, what is my U.S. citizenship doing for me? If the benefits of your U.S. citizenship outweigh the compliance and potential estate and gift tax costs that come with it, then renouncing may not be best for you.

Philosophical and patriotic reasons aside, there are a number of general benefits afforded to every U.S. citizen no matter where they are located in the world. The following are some of the main benefits of retaining U.S. citizenship that should be considered by anyone thinking of renouncing:

- i. Protection of U.S. Citizens Abroad: Protection abroad may be an issue for U.S. citizens who find themselves in politically unstable parts of the world (Iraq, Iran, Syria, certain African countries, etc.). Generally, for U.S. citizens living in Canada, this is not a determinative factor when considering retaining one’s U.S. citizenship. Outside of a natural disaster or health epidemic in Canada, U.S. citizens will rarely need the armed forces of the U.S. to keep them safe in a sticky situation abroad. Though if they do, it would be difficult to discount the comfort of knowing the U.S. (with its 11 active aircraft carriers and SEAL Team Six) is on call.<sup>9</sup>
- ii. Consular Services Offered to U.S. Citizens Abroad: Consular services are available to U.S. citizens living abroad and include assistance in situations of detainment by foreign governments, passport issues, and cross border legal affairs.
- iii. The Right to Vote in U.S. Elections: Many individuals holding U.S. citizenship are very proud and patriotic when it comes to being American. With U.S. citizenship comes a constitutionally granted privilege to participate in U.S. elections. Renouncing one’s citizenship eliminates this privilege to vote in U.S. elections.
- iv. Access to the U.S. Job Market: Depending on a client’s situation, this may be the most important factor to consider when renouncing one’s U.S. citizenship, especially for younger individuals. U.S. citizens are legally able to work anywhere in the U.S. and giving up citizenship closes off the U.S. market as an available source of employment without going through the proper immigration channels to obtain the correct visas and work permits.

<sup>6</sup> COLN is issued by the Bureau of Consular Affairs of the United States Department of State.

<sup>7</sup> It is important to note that an individual who successfully renounces their U.S. citizenship could still have filing and reporting obligations moving forward under the IRC § 7701(b) definition of resident. Even though not a U.S. citizen, if an individual whose days spent in the U.S. for the tax year at issue, exceeds the allotted days under the substantial presence test, then that individual shall have the same reporting and filing obligations as a U.S. citizen. See <http://www.irs.gov/Individuals/International-Taxpayers/Substantial-Presence-Test>.

<sup>8</sup> IRC § 2033 provides that the gross estate of a decedent who was a citizen or resident of the U.S. at the time of their death, shall include all of their assets no matter where situated. Residency for estate tax purposes is different than residency for income tax purposes. Residency for estate tax purpose is a domicile test, see, Treasury Regulations §20.0-1(b)(1). Thus, a renounced individual could still face estate tax exposure if considered domiciled in the U.S.

<sup>9</sup> Charles P. Rettig, “Evaluation of an IRS Undisclosed Offshore Account IDR” *Tax Notes*, November 2011. Tip of the hat to Chuck for this illustrative reason for retaining one’s U.S. citizenship.



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- v. Travel to the U.S.: U.S. citizens are able to travel into and out of the U.S. at their leisure. More details infra in reference to potential travel restrictions after renouncing.

These benefits of retaining U.S. citizenship should be taken into consideration when deciding if renouncing is right for you.

### C. BENEFITS AND CONSEQUENCES OF RENOUNCING U.S. CITIZENSHIP

Having covered some of the main benefits of having U.S. citizenship, it is only logical to cover some of the main benefits of renouncing your U.S. citizenship, as well as the consequences that accompany that decision. Some of the main benefits and consequences of renouncing are:

- i. U.S. Tax Filing and Reporting Obligations (Benefit): Once you have renounced your U.S. citizenship you will be issued a COLN effective on the date you appeared before the U.S. Consulate General and took the oath of renunciation and conducted the exit interview. A timely filed tax return is still due for the year in which you renounced. It is a partial year return which will reflect from January 1 to the date the oath of renunciation was taken. Once you have been issued a COLN an individual will generally no longer have U.S. reporting and filing obligations thereafter.<sup>10</sup>
- ii. U.S. Estate and Gift Tax Exposure (Benefit): U.S. citizens and certain residents are subject to estate tax on their worldwide income and are afforded the full unified credit available.<sup>11</sup> Assuming an individual who successfully renounces his U.S. citizenship is not considered a resident for U.S. estate and gift tax purposes,<sup>12</sup> he will not be subject to U.S. estate tax on his worldwide assets at death, but only on any U.S. situs property.<sup>13</sup>
- iii. Travel to the U.S. (Consequence): After successfully renouncing U.S. citizenship traveling into or through the U.S. may become difficult.<sup>14</sup> Individuals who suffer from certain communicable diseases or have committed crimes of moral turpitude in the past may be denied entry into the U.S. if they do not obtain permission from the U.S. before traveling.<sup>15</sup> If flagged by the U.S. for these reasons, the renounced individual can be denied boarding of a plane in route to U.S. soil or physically detained (and even arrested) if the individual attempts to cross a U.S. ground border.
- iv. Statelessness (Consequence): Persons intending to renounce U.S. citizenship should be aware that unless they already possess a foreign nationality they may be rendered stateless and thus, lack the protection of any government. This may create enormous problems regarding travel, legal employment, and legal housing.
- v. Name and Shame Game (Consequence): Every quarter the names of individuals who lose their U.S. citizenship are published in the Federal Registrar.<sup>16</sup> This includes individuals who renounce their U.S. citizenship. Over the last four years, the number of individuals losing their U.S. citizenship has increased dramatically with 742 recorded in 2009, 1534 in 2010, 1781 in 2011, 932 in 2012, 2999 in 2013, 3415 in 2014, and 4279 in 2015.<sup>17</sup>

<sup>10</sup> Contingent on not being classified as a U.S. resident for income tax purposes. See substantial presence test referenced supra note 8.

<sup>11</sup> \$5,450,000 USD in 2016 (Indexed for inflation). Estate tax rate of 40 percent.

<sup>12</sup> Residency for estate and gift tax purposes is a domicile test. Residency for income tax purposes is a separate matter and test. Referenced supra.

<sup>13</sup> IRC § 2103.

<sup>14</sup> In addition to the difficulties facing individuals born on U.S. soil traveling on a Canadian Passport.

<sup>15</sup> 8 U.S.C. §1182 (2011). Including theft, DUI, and any drug related offenses.

<sup>16</sup> 78 Fed. Reg. 31 (February 14, 2013). Names of individuals who lost their U.S. citizenship in quarter ending December 31, 2012.

<http://www.gpo.gov/fdsys/pkg/FR-2013-02-14/pdf/2013-03378.pdf>.

<sup>17</sup> See <http://www.intltax.typepad.com/>.



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### D. THE PROCESS OF RENOUNCING YOUR U.S. CITIZENSHIP AND §877A : TAX ISSUES

If you decide to proceed with renouncing your U.S. citizenship the proper precautions must be taken to avoid the imposition of the U.S. exit tax.<sup>18</sup> Section 877A was enacted in 2008 under the Heroes Earnings Assistance and Relief Act and established a more stringent exit tax regime applicable to a “covered expatriate”.<sup>19</sup> Section 877A classifies an expatriate as a “covered expatriate” when the individual meets any one portion of a three part test, as discussed below, and renounces their U.S. citizenship or loses U.S. residency<sup>20</sup> after June 17, 2008. A covered expatriate subject to the exit tax under section 877A will face a mark to market exit tax regime in which the provision treats the covered expatriate as having sold all of their property the day before the “expatriation date” for its fair market value.<sup>21</sup> The “expatriation date” is the date that the taxpayer renounces citizenship or ceases to be a lawful permanent U.S. resident.<sup>22</sup> The mark to market exit tax regime applies to unrealized net gains in excess of \$693,000 USD.<sup>23</sup> The mark to market rules deviate in application to any deferred compensation items,<sup>24</sup> specified tax deferred accounts,<sup>25</sup> and to interests in non-grantor trusts.<sup>26</sup> The three part test of the statute will classify an individual as a “covered expatriate” if any of the following statements are true:

- i. the individual has a net worth of \$2 million USD or more at the time of renunciation (Net Worth Test);
- ii. the individual had an average annual net income tax liability of more than \$161,000 USD in the five years ending before the date of expatriation (Tax Liability Test);<sup>27</sup> or
- iii. the individual failed to certify on Form 8854 that he or she had complied with all U.S. Federal tax obligations for the five years preceding the date of expatriation (Compliance Test).

There are two main exceptions to the exit tax regime for expatriates looking to renounce. The first exception is largely limited to dual citizens who live in the country of their other nationality. The second is even narrower and is limited to citizens who did not live in the U.S. for more than ten years before the age of eighteen and a half. As minors are generally not allowed to renounce their U.S. citizenship, it effectively allows only a six month window for such individuals to avoid the imposition of section 877A’s exit tax regime. The following are the two exceptions to section 877A’s exit tax regime:

- i. An individual is exempt from the exit tax regime if he or she:
  - a. files Form 8854;
  - b. became a dual citizen at birth and continued to be a citizen and tax resident of the other country (Canada) at the time of renunciation of citizenship; and
  - c. was a resident of the United States for no more than ten of the fifteen tax years ending with the tax year during which the renunciation of citizenship occurred.<sup>28</sup>

<sup>18</sup> IRC § 877A.

<sup>19</sup> IRC § 877A(g)(2) provides that an “expatriate” means any U.S. citizen who relinquishes his or her citizenship and any long term resident of the U.S. who ceases to be a lawful permanent resident of the U.S. Long term resident defined in IRC § 877A(g)(5).

<sup>20</sup> IRC 877(e)(2). Deemed a long term permanent resident if the individual held a U.S. Green Card for eight of the previous fifteen years.

<sup>21</sup> IRC § 877A(a)(1).

<sup>22</sup> IRC § 877A(g)(3) and (g)(4).

<sup>23</sup> 2016 amount. Indexed for inflation. IRC § 877A (a)(3).

<sup>24</sup> IRC §877A(d)(4).

<sup>25</sup> IRC §877A(e)(2).

<sup>26</sup> IRC §877A(c) and IRC §877A(f)(3).

<sup>27</sup> 2016 amount. Indexed for inflation.

<sup>28</sup> IRC §877A(g)(1)(B)(i).



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- ii. An individual is exempt from the exit tax regime if he or she:
  - a. files Form 8854;
  - b. renounces his or her U.S. Citizenship before the age of 18 and a half; and
  - c. was a resident of the U.S. for no more than ten years before the age of 18 and a half.<sup>29</sup>

In the practical application of these two exceptions a renouncing individual who qualifies under either will not be subject to the Net Worth Test or the Tax Liability Test only. Every renouncing individual, whether qualifying under the exceptions or not, will always be subject to the Compliance Test. Form 8854 is filed with a renounced individual's final year return. On Form 8854, the renouncing individual must affirm under penalties of perjury, that he is compliant with U.S. tax and filing obligations for the period of five years preceding expatriation. Thus, taking the proper steps to avoid the exit tax regime of section 877A requires that the renouncing individual be U.S. tax compliant in all circumstances.

Another common question regarding the renunciation of U.S. citizenship is whether a minor child, parent of a minor child, or guardian of a minor child is capable of renouncing? To renounce one's U.S. citizenship, the renouncing individual "must voluntarily and with intent to relinquish U.S. citizenship:

- i. appear in person before a U.S. consular or diplomatic officer;
- ii. in a foreign country; and
- iii. sign an oath of renunciation."<sup>30</sup>

The U.S. State Department then reviews the renunciation, and, upon its approval, a COLN will be issued.<sup>31</sup> The position of the U.S. Department of State is that citizenship is a status that is personal to the individual U.S. citizen. Therefore, a parent may not renounce the citizenship of their minor child.<sup>32</sup> Similarly, parents and legal guardians may generally not renounce the citizenship of individuals who are mentally incompetent. As for minors seeking to renounce their own U.S. citizenship, they must demonstrate to a consular officer that they are acting voluntarily and that they fully understand the implications and consequences that accompany the renunciation of their U.S. citizenship.<sup>33</sup> The renouncing minor will have to convince this officer that he or she is not subject to duress or undue influence and that he or she voluntarily wants to renounce his or her citizenship.<sup>34</sup>

## E. THE PROCESS OF RENOUNCING U.S. CITIZENSHIP: IMMIGRATION ISSUES

Assuming that the proper tax compliance steps have been or will be taken to avoid the imposition of the exit tax under section 877A, the actual process of renouncing one's U.S. citizenship also has immigration issues of which to be wary. Under the U.S. Immigration and Nationality Act,<sup>35</sup> additional amendments were added to deny re-entry to the United States if it was determined by the U.S. Attorney General that the former citizen renounced their U.S. citizenship for the purpose of avoiding U.S. tax.<sup>36</sup> This provision became known as the Reed Amendment because of its introduction by then U.S. Representative Jack Reed of Rhode Island. Although it appears that this law is seldom enforced, there is no guarantee that it will continue to be in the future. Under this provision, an individual who is found to have renounced for U.S. tax avoidance purposes will be denied access into the U.S. and will be considered "inadmissible" for immigration purposes.

<sup>29</sup> IRC §877A(g)(1)(B)(ii).

<sup>30</sup> U.S. State Department, *Renunciation of U.S. Citizenship*, (Feb. 1, 2008), available at [http://travel.state.gov/law/citizenship/citizenship\\_776.html](http://travel.state.gov/law/citizenship/citizenship_776.html) ; see 8 U.S.C. § 1483(b) (2008); 22 C.F.R. § 50.50 (2008).

<sup>31</sup> 8 U.S.C. § 1501 (2008).

<sup>32</sup> See [http://travel.state.gov/law/citizenship/citizenship\\_776.html](http://travel.state.gov/law/citizenship/citizenship_776.html).

<sup>33</sup> *Ibid*.

<sup>34</sup> *Ibid*.

<sup>35</sup> 8 U.S.C. §1182 (2011).

<sup>36</sup> 8 U.S.C. § 1182(a)(10)(E)(2011). (Any alien who is a former citizen of the United States who officially renounces United States citizenship and who is determined by the Attorney General to have renounced United States Citizenship for the purpose of avoiding taxation by the United States is inadmissible.)



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The Reed Amendment is intended to prevent a tax motivated expatriate from returning to the U.S. Representative Reed, in proposing the amendment stated:

"In an instrumental way, I would hope in the future if those very slick and smart tax lawyers advising their clients about how to avoid their taxes suggest expatriation they should also indicate very clearly that the consequences are you cannot return at will to the United States."<sup>37</sup>

What is important to remember is that the burden to prove that there was a tax avoidance purpose in renouncing lies with the U.S. government. Consequently, what is said at the exit tax interview before the U.S. Consulate General, as discussed below, is critically important. Other categories of individuals on this same "inadmissible list" include known terrorists, members of the Nazi party, and international child abductors.<sup>38</sup>

Avoiding this determination and classification is vital for those individuals who still desire to visit and travel through the United States after renouncing. The process of renouncing your U.S. citizenship is a multi-layered procedure of immigration filings and tax compliance submissions that come to a crescendo with a one hour interview administered at a U.S. Consulate General office. During this one hour interview the renouncing individual will be asked to:

- i. confirm their desire to renounce;
- ii. be given a statement of understanding concerning the consequences and ramifications of renunciation or relinquishment of U.S. citizenship;
- iii. affirm or swear that this decision is voluntary with no outside influence;
- iv. will be instructed as to the irrevocability of renouncing ones U.S. citizenship;
- v. be asked to read the oath or affirmation of renunciation of nationality of the United States; and
- vi. be individually questioned regarding the purpose and intent of their decision to renounce.

Answering these questions honestly and in one's best interests is critically important.<sup>39</sup> The answers to particular questions given before the U.S. Consulate General can have far-reaching consequences for both the renouncing individual and their family. Having said that, many individuals pursuing the renunciation process request a U.S. trained and licensed attorney accompany them for the interview. If properly admitted and the individual Consulate approves, U.S. legal counsel may accompany the renouncing individual to the hearing. The presence of competent and qualified legal counsel can provide a great deal of comfort to what can be an intense, emotional event.

## F. CONCLUSION: FINAL THOUGHTS

In the end, renouncing your U.S. citizenship is a decision that comes with a number of variables that must be carefully considered before jumping into the pool. With U.S. immigration and U.S. tax pitfalls scattered throughout the process, understanding the repercussions of renouncing and proceeding carefully is imperative to a smooth departure from the U.S. club and all its membership fees.

For questions or inquiries please contact Alexander Marino via email at [amarino@moodysgartner.com](mailto:amarino@moodysgartner.com) or by phone at 403-693-5114.

<sup>37</sup> *Mark-Up of Immigration Legislation: Hearing Before the H. Comm. On the Judiciary, 104<sup>th</sup> Cong. (1995)* in Fed News Services, (1995).

<sup>38</sup> 8 U.S.C. § 1182(a) (2011).

<sup>39</sup> There is a \$2,350 USD fee for renunciation of U.S. citizenship, payable at the time of the exit interview. This fee was increased from \$450 USD on September 12, 2014. In addition, there are a number of heightened security measures when appearing for a matter before a U.S. Consulate General office. <http://canada.usembassy.gov/consulates/security.html> for details.