

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. What do Eduardo Saverin, Terry Gilliam,¹ W.E.B. Du Bois, Ted Arison, Bobby Fischer have in common? The answer is that all five have renounced their U.S. citizenship. These individuals are not alone! Record numbers of U.S. citizens living in Canada and around the world are in the process of renouncing. Why would a country like the United States, 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 that no one likes to hear: TAX.

The United States is the only major country in the world that taxes the income of its citizens and permanent resident status holders regardless of where they live.² With the U.S. tax filing deadline seemingly always right around the corner, U.S. citizens living in Canada and across the globe are annually faced with the burden and cost of meeting their IRS filing and reporting obligations.³ The recurring nightmares of 1040s, FBARs, and other information returns are causing increased blood pressure and heartburn to U.S. citizens who don't call America 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.⁴ To make things even more stressful, the Foreign Account Tax Compliance Act (“**FATCA**”)⁵ went into full effect on July 1, 2014. This dragnet, 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 asking why they have not been filing U.S. tax returns or reporting all their non-U.S. assets.

But wait my fellow U.S. expats living 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. 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 it is right for him or her and 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 its benefits”? Clients are often emotionally and financially drained after becoming U.S. tax-compliant through a voluntary disclosure program, staying U.S. tax-compliant, and continuously planning for cross-border tax issues. Not only can the filing and reporting costs

¹ 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.”

² I.R.C. § 7701(b)(6). Lawful permanent resident, otherwise known as “green card” holders.

³ June 15 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.

⁴ I.R.C. § 2033 and Treas. Reg. § 20.01(b)(1).

⁵ Foreign Account Tax Compliance Act, Pub. L. No. 111-147, 124 Stat. 71, 97 (2010).

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seem ludicrously expensive and intrusive, but the penalty regime for noncompliance 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. Who could blame them?

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 landmines along the way. There are no mulligans once a Certificate of Loss of Nationality ("COLN")⁶ 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 landmines, renouncing your U.S. citizenship will relieve you of your yearly filing and reporting obligations,⁷ as well as worldwide estate and gift tax exposure.⁸ Even so, renouncing is not for everyone.

B. BENEFITS OF U.S. CITIZENSHIP

A U.S. citizen living abroad who is considering renouncing his or her U.S. citizenship should first ask 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 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.

1. **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. Generally for U.S. citizens living in Canada, this is not a determinative factor when considering retaining U.S. citizenship. Outside of a natural disaster or health epidemic in Canada, U.S. citizens will rarely need the U.S. armed forces to keep them safe in a sticky situation abroad (though if they do, it would be difficult to discount the comfort of knowing the United States, with its 11 active aircraft carriers and SEAL Team Six, is on call).⁹
2. **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, with passport issues, and with cross-border legal affairs.
3. **The Right to Vote in U.S. Elections:** Many individuals holding U.S. citizenship feel strongly about exercising their right to vote and with U.S. citizenship comes a constitutionally-granted privilege to participate in U.S. elections. Renouncing citizenship eliminates this privilege.

⁶ A COLN is issued by the Bureau of Consular Affairs of the U.S. Department of State.

⁷ It is important to note that an individual who successfully renounces U.S. citizenship could still have filing and reporting obligations moving forward under the I.R.C. § 7701(b) definition of resident. Even though not a U.S. citizen, an individual whose days spent in the United States for the tax year at issue exceed the allotted days under the substantial presence test, then that individual has the same reporting and filing obligations as a U.S. citizen.

⁸ I.R.C. § 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 Treas. Reg. §20.0-1(b)(1)). Thus, a renounced individual could still face estate tax exposure if considered domiciled in the U.S.

⁹ 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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4. **Access to the U.S. Job Market:** This may be the most important factor to consider when renouncing U.S. citizenship, especially for younger individuals. U.S. citizens are legally able to live and work anywhere in the United States. Giving up citizenship closes off the U.S. employment market without going through the proper immigration channels to obtain visas and work permits.
5. **Travel to the United States:** U.S. citizens are able to travel into and out of the United States at their leisure. More details in reference to potential travel restrictions after renouncing are discussed below.

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 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:

1. **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 that you appeared at the U.S. Embassy or Consulate General, took the oath of renunciation, and completed the exit interview. A timely-filed U.S. tax return is still due for the year in which you renounced, though it is a partial year return that reflects from January 1 to the date the oath of renunciation was taken. Once you have been issued a COLN, you will generally no longer have U.S. reporting and filing obligations past the day of your renunciation.¹⁰
2. **Eliminated Exposure to Future U.S. Tax Law Changes (Benefit):** Despite pleas from U.S. expat groups, Congress declined to create a residence-based tax system for individuals in its December 2017 tax reforms. In fact, though the Tax Cuts and Jobs Act¹¹ represented the most comprehensive overhaul of the U.S. tax code in over three decades, for many U.S. expats the situation got worse. Congress imposed a one-time “transition tax” on controlling U.S. owners of non-U.S. corporations, taxing “earnings and profits” of these corporations at 15.5 percent or 8 percent.¹² Congress also created the ongoing concept of “global intangible low-tax income” (“GILTI”), a type of income which is both immediately includible in the income of certain U.S. shareholders who control non-U.S. corporations and broadly defined.¹³ Both the transition tax and GILTI regime may prove very expensive for certain U.S. shareholders of non-U.S. corporations. The particulars of those taxes are beyond the scope of this article, but the changes underscore the continued possibility of unfavorable and sudden shifts in U.S. tax law as well as a trend of U.S. lawmakers (from both major political parties) remaining unwilling to provide tax relief to U.S. citizens abroad.
3. **Reduced or Eliminated U.S. Estate and Gift Tax Exposure (Benefit):** U.S. citizens and certain residents are subject to estate tax on their worldwide incomes and are afforded the full unified credit available.¹⁴ Assuming an individual who successfully renounces his or her U.S. citizenship is not considered a resident for U.S. estate and gift tax purposes,¹⁵ he or she will not be subject to U.S. estate tax on his or her worldwide assets at death, but only on any U.S. situs property.¹⁶

¹⁰ Contingent on not being classified as a U.S. resident for income tax purposes. See substantial presence test referenced, supra note

¹¹ Pub. L. No. 115-97, 131 Stat. 2054 (2017).

¹² I.R.C. § 965 (2018).

¹³ I.R.C. § 951A (2018).

¹⁴ \$11,400,000 USD in 2019 (indexed for inflation). Estate tax rate is 40 percent.

¹⁵ Residency for estate and gift tax purposes is a domicile test. Residency for income tax purposes is a separate test. Referenced supra.

¹⁶ I.R.C. § 2103.

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4. **End to Risk of Double Taxation on Common Canadian Transactions (Benefit):** While most U.S. citizens resident in Canada do not end up owing U.S. tax because they can claim credit for Canadian taxes paid, this is not true in all cases. There are a number of differences between Canadian and U.S. tax law that can result in double tax to a U.S. citizen even after accounting for the U.S. foreign tax credit system and relief available under the Canada-United States Tax Treaty.¹⁷ Notably, for example, Canada does not tax capital gains on the sale of a principal residence while the United States only allows a \$250,000 USD exclusion on this gain.¹⁸ Likewise, Canada allows an inflation-indexed lifetime capital gains exemption (\$866,912 CAD for qualified property in 2019) while the United States does not.¹⁹ Other common situations in which a Canadian-resident U.S. citizen can owe U.S. tax because he or she paid reduced or no Canadian tax include estate freezes, receipt of stock options, gambling or lottery winnings, contributions to a non-group RRSP, receipt of capital dividends, and certain charitable contributions.²⁰
5. **Travel to the United States (Consequence):** After successfully renouncing U.S. citizenship, traveling into or through the United States may become difficult.²¹ Individuals who suffer from certain communicable diseases or who have committed crimes of moral turpitude in the past may be denied entry into the United States if they do not obtain permission before traveling.²² If flagged for these reasons, the renounced individual can be denied boarding of a plane en route to the United States or physically detained (and even arrested) if the individual attempts to cross a U.S. ground border.
6. **Statelessness (Consequence):** Persons intending to renounce U.S. citizenship should be aware that, unless they already possess another nationality, they may be rendered stateless and, thus, lack the protection of any government. This may create enormous problems regarding travel, employment, and housing.
7. **Name and Shame Game (Consequence):** Every quarter the names of individuals who lose U.S. citizenship are published in the *Federal Register*. This includes individuals who renounce U.S. citizenship. Over the last decade, the number of individuals losing U.S. citizenship has increased dramatically from 742 recorded in 2009 to 5,133 in 2017 (numbers for 2018 were not finalized at the time of writing).²³

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.²⁴ Section 877A of the Internal Revenue Code was enacted in 2008 under the Heroes Earnings Assistance and Relief Act. It established a more stringent exit tax regime applicable to the “covered expatriate.”²⁵ Section 877A classifies an expatriate as a “covered expatriate” when the individual meets any portion of a three-part test (discussed below) and renounces his or her U.S. citizenship or loses U.S. residency²⁶ after June 17, 2008. A covered expatriate subject to the exit tax under § 877A will face a “mark-to-market” exit tax regime, which treats the covered expatriate as having sold all of his or her property for its fair market value the day before the “expatriation

¹⁷ Convention with Respect to Taxes on Income and Capital, U.S.-Can., Sept. 26, 1980, as amended most recently in 2007.

¹⁸ *Income Tax Act*, RSC 1985, c.1 (5th Supp.), s. 40(2)(b) (as amended); I.R.C. § 121 (2018).

¹⁹ *Income Tax Act*, RSC 1985, c.1 (5th Supp.), s. 110.6 (as amended).

²⁰ See Roy A. Berg and Kim G.C. Moody, “US Citizens Resident in Canada – Common Circumstances Where US Tax May Be Payable,” *Moodys Gartner Tax Law LLP Blog* (14 December 2011), <https://moodysgartner.com/us-citizens-resident-in-canada-common-circumstances-where-us-tax-may-be-payable>.

²¹ This is in addition to the difficulties facing individuals born on U.S. soil traveling on a Canadian passport.

²² 8 U.S.C. § 1182 (2011). Crimes of this nature include theft, DUI, and drug-related offenses.

²³ See <http://www.intltax.typepad.com/>.

²⁴ I.R.C. § 877A.

²⁵ I.R.C. § 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 I.R.C. § 877A(g)(5).

²⁶ I.R.C. § 877(e)(2). An individual is deemed a long term permanent resident if he or she held a U.S. green card for eight of the previous fifteen years.

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date.”²⁷ The “expatriation date” is the date that the taxpayer renounces citizenship or ceases to be a lawful permanent U.S. resident.²⁸ The mark to market exit tax regime applies to unrealized net gains in excess of \$725,000 USD.²⁹ The mark-to-market rules deviate in application to any deferred compensation items,³⁰ specified tax-deferred accounts,³¹ and interests in non-grantor trusts.³² The three-part test of the statute will classify an individual as a “covered expatriate” if any of the following statements are true:

1. the individual had a net worth of \$2 million USD or more at the time of renunciation (Net Worth Test); or
2. the individual had an average annual net income tax liability of more than \$168,000 USD in the five years ending before the date of expatriation (Tax Liability Test); or
3. 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).³³

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 were born in and continue to live in the country of their other nationality. The second is even narrower and is limited to citizens who did not live in the United States 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, this exception effectively allows only a six-month window for such individuals to avoid the imposition of § 877A’s exit tax regime.

The following are the two exceptions to § 877A’s exit tax regime:

1. 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 (i.e., 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.³⁴
2. 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 United States for no more than ten years before the age of 18 and a half.³⁵

²⁷ I.R.C. § 877A(a)(1).

²⁸ I.R.C. § 877A(g)(3) and (g)(4).

²⁹ 2019 amount (indexed annually for inflation). I.R.C. § 877A (a)(3); Rev. Proc. 2018-57.

³⁰ I.R.C. § 877A(d)(4).

³¹ I.R.C. § 877A(e)(2).

³² I.R.C. § 877A(c).

³³ I.R.C. § 877(a)(2).

³⁴ I.R.C. § 877A(g)(1)(B)(i).

³⁵ I.R.C. § 877A(g)(1)(B)(ii).

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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. 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 or she 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 § 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:

1. appear in person before a U.S. consular or diplomatic officer;
2. in a foreign country; and
3. sign an oath of renunciation."³⁶

The U.S. Department of State then reviews the renunciation, and, upon its approval, a COLN will be issued.³⁷ 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 his or her minor child.³⁸ Similarly, parents and legal guardians may generally not renounce the citizenship of individuals who are mentally incompetent. Minors seeking to renounce their own U.S. citizenships must demonstrate to a consular officer that they are acting voluntarily and that they fully understand the implications and consequences that accompany the renunciation.³⁹ The renouncing minor will have to convince the officer that he or she is not subject to duress or undue influence and that he or she voluntarily wants to renounce.⁴⁰

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 § 877A, the actual process of renouncing one's U.S. citizenship also creates immigration issues of which to be wary. Congress amended the Immigration and Nationality Act⁴¹ with provisions to deny re-entry into the United States if the U.S. Attorney General determines that a former citizen renounced his or her U.S. citizenship for the purpose of avoiding U.S. tax.⁴² 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 United States and will be considered "inadmissible" for immigration purposes.

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

³⁶ See U.S. Dept. of State, Renunciation of U.S. Citizenship (Feb. 1, 2008),

<https://travel.state.gov/content/travel/en/legal/travel-legal-considerations/us-citizenship/Renunciation-US-Nationality-Abroad.html>;

U.S.C. § 1483(b) (2008); 22 C.F.R. § 50.50 (2008).

³⁷ 8 U.S.C. § 1501 (2008).

³⁸ See http://travel.state.gov/law/citizenship/citizenship_776.html.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ 8 U.S.C. § 1182 (2011).

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

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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.⁴³

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 is critically important. Other categories of individuals on this same “inadmissible list” include known terrorists, members of the Nazi party, and international child abductors.⁴⁴

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 U.S. citizenship is a multi-layered procedure of immigration filings and tax compliance submissions that come to a crescendo with an interview administered at a U.S. Embassy or Consulate General. During this interview the renouncing individual will:

1. be asked to confirm his or her desire to renounce;
2. be given a statement of understanding concerning the consequences and ramifications of renunciation or relinquishment of U.S. citizenship;
3. affirm or swear that this decision is voluntary with no outside influence;
4. be instructed as to the irrevocability of renouncing U.S. citizenship;
5. be asked to read the oath or affirmation of renunciation of nationality of the United States; and
6. be individually questioned regarding the purpose and intent of the decision to renounce.

Answering these questions honestly and in one’s best interests is critically important.⁴⁵ The answers to particular questions can have far-reaching consequences for both the renouncing individual and his or her family. The answers to particular questions can have far-reaching consequences for both the renouncing individual and his or her family. As a result, many individuals pursuing the renunciation process request that a U.S.-trained and licensed attorney accompany them for the interview. If properly admitted and approved by the particular Embassy or Consulate, 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. With U.S. immigration and 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 or by phone at 403-693-5114.

⁴³ Mark-Up of Immigration Legislation: Hearing Before the H. Comm. On the Judiciary, 104th Cong. (1995) in Fed News Services (1995).

⁴⁴ 8 U.S.C. § 1182(a) (2011).

⁴⁵ 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.