IMI

The Tax-Efficient Way to Renounce US Citizenship

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Before undertaking his current solo practice, Mel was a private client partner in the Boston office of McDermott, Will & Emery, and also worked as a senior wealth advisor at JP Morgan Private Bank, and he began his legal career in the General Counsel's office of the IRS National Office in Washington, DC. He holds an L.L.M. (Tax) from Georgetown University.

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David is one of the world's leading advisors on international tax and immigration, an area in which he has worked for more than 30 years. Over the years, he has helped hundreds of Americans successfully expatriate.

A published author in the field, David's personal interest in these areas grew from his experience working as a Canadian immigration and customs officer while studying law.

Since being called to the bar in Ontario in 1990, he has established his expertise with major law firms, his own law firm and as a private consultant.

Routinely cited in the world's most respected publications, David has successfully advised hundreds of high and ultra high net worth individuals and their families, many of whom continue to seek his counsel today.

David is supported by a team of professionals, some of whom have worked with him since the early 1990s.

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WHY ARE AMERICANS GIVING UP THEIR CITIZENSHIP?

Every quarter, the US government publishes a list containing the names of a select group of American citizens and Green Card holders who have expatriated; who have legally given up their citizenship or long-term resident status.

This list of so-called *Covered Expatriates* only contains the names of those who exceeded the minimum thresholds of over US$2 million in worldwide assets and/or who have paid average annual federal tax over the last five years of at least US$190,000 (2023 threshold indexed for inflation).

In practice, this type of tax burden requires a federal taxable income greater than US$5-600,000 a year. Once an individual exceeds the net worth or tax paid threshold, there is no further indication of whether their net worth was $2 million or $2 billion or whether their average federal tax burden was $190,000 or $1.9 million.

Over the past 17 years, the total number of *Covered Expatriates* each year has ranged from a low of 278 in 2006 to a high of 6,705 in 2020, at a yearly average of 2,717 as of the end of 2022. Almost invariably (with the exception of the Covid years, when the US government made expatriation almost impossible in most cases), that average has kept moving upward year by year.

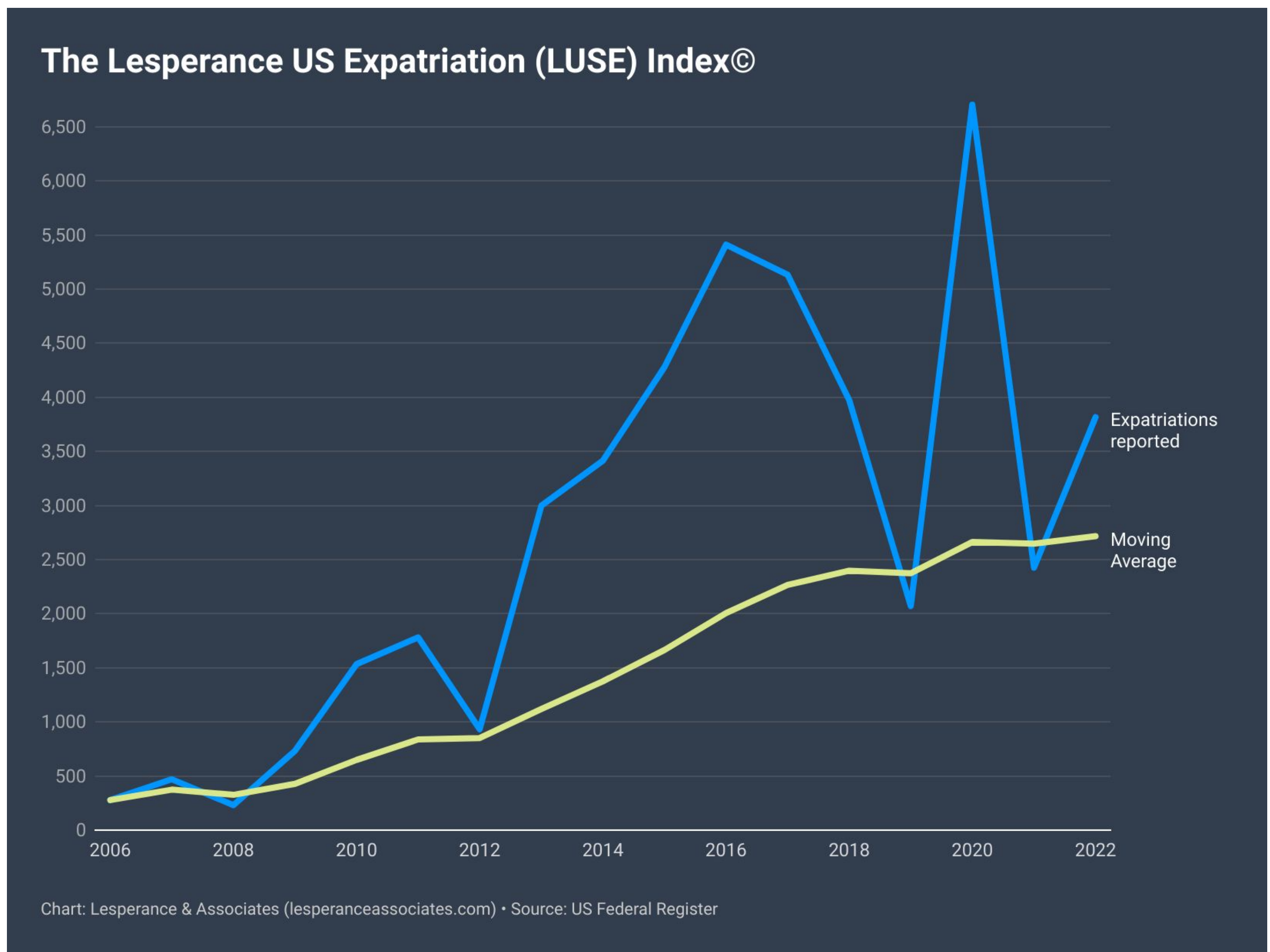
You are probably already asking yourself the same question we do each quarter: Why is this happening?

Unfortunately, the US government does not provide much information that might shed some light on this question. Although published quarterly, the names that appear are not the names of those who expatriated in the prior quarter.

Instead, the names appear at least 12 months after their corresponding renunciations actually took place. In the case of one current mutual client of ours, his name has still not appeared, despite his expatriating in April 2021 - almost 24 months ago!

Moreover, no explanation or commentary is provided along with the list. No

reasons for increases or decreases. Nothing. It's almost as if the government doesn't want to shed any light on this increasingly common occurrence.



Another question we often receive from Americans who are in the same financial category as the Covered Expatriates is whether having an expatriation strategy makes sense for them.

To answer this question, Mel and I have teamed up to provide a report for IMI on the interesting and complex topic of expatriation. Interesting because each application to renounce represents real people with complicated and successful lives and well-considered reasons for expatriating. Complex because there are potentially severe and impactful implications of renouncing that must be carefully and thoroughly considered and addressed, such as:

- Pre-expatriation tax planning;
- The specific processes you need to follow to successfully renounce or relinquish US citizenship or to relinquish Green Card status;
- Post-expatriation tax filings and compliance; and
- Future travel to the US.

This report will explore these four areas so that you - or your wealthy American clients - can determine whether to add the optionality of an expatriation strategy to your tax and succession planning.

PART 1: PRE-EXPATRIATION PLANNING

The Expatriation Tax Regimes

Every year, more and more US citizens renounce their citizenship, and green card holders give up their visa status. These actions could well trigger a tax problem: the US Expatriation Tax Regimes.

The current US Expatriation Tax Regimes have two significant underlying components; the "Exit Tax" (IRC s.877A) and the "Inheritance Tax" (IRC s. 2801). The US Expatriation Tax Regime Exit Tax rules impose an income tax on certain people called "Covered Expatriates" who have made their exits from the US tax system.

The defining feature of the Exit Tax is that all worldwide appreciated assets are treated "as if" they are sold on the day before citizenship or resident status is terminated. If applicable, net capital gain (after an exclusion amount of roughly $821,000 in 2023) from the deemed sale is taxed when the expatriate's final US tax return for the year of expatriation is filed. There are other rules that accelerate income for a person leaving the United States. These other rules apply to items such as IRAs, pensions, deferred compensation plans, and beneficial interests in trusts.

The Inheritance Tax Rules impose a liability on US citizens or tax residents who are the recipients of a gift or bequest from a Covered Expatriate in excess of a de minimis annual exclusion amount. The tax burden of 40% is on the recipient, and not on the donor, of the gift or bequest.

Citizenship-Based Taxation

The United States is not alone in having an Expatriation Tax Regime containing an Exit Tax.

Other countries have exit taxes, too. The United States is unique, however, in tying its Exit Tax to a change in visa or citizenship status. This is called "citizenship-based taxation". If you are a US citizen or resident alien, you are taxed on worldwide income.

If you are a US citizen or domiciliary, you are subject to US gift, estate, and generation-skipping tax on worldwide assets in excess of currently extraordinarily generous but temporary lifetime exclusion amounts.

Every other country on earth (except Eritrea and a few other limited-case exceptions) follows a “residence-based taxation” system. If you are a resident (however defined) of that country, you are taxed. If you are a nonresident (however defined), you are not taxed.

In these cases, what usually triggers an Exit Tax is a change in tax residence status. This is why it is easy for Canada (residence-based taxation) to allow its citizens to live abroad and be taxed as nonresidents, while it is impossible for the United States (citizenship-based taxation) to do so.

The citizenship-based tax principles are part of the DNA of the US Internal Revenue Code and are the reason that giving up citizenship or residence is a tax recognition event. They're also the reason the Expatriation Tax Regimes exist in the US in the first place.

Some US tax commentators suggest that the Expatriation Tax Regime reflects the lack of a sympathetic lobby in Congress. But fair or not, it is the law.

Who Should Worry About the Expatriation Tax Regimes?

The Expatriation Tax Regime applies to two categories of people:

- US citizens: Who terminate their citizenship; and
- Long-term residents: Lawful permanent residents of the US (green card holders) who terminate that status after holding it for many years.

If you do not fall into one of those two categories, you needn't worry further about the Expatriation Tax Regime and its exit and inheritance tax rules. Thus, for instance, someone living for decades in the United States under other visas (student, H-1B, L-1A, etc.) will never have a concern about paying

exit or inheritance tax following a departure from the US.

Citizens

Citizens of the United States - when they voluntarily or involuntarily terminate that status - may trigger the US Expatriation Tax Regimes. By giving up citizenship at a formal final renunciation interview at a US consulate, he or she becomes an "expatriate" under the Internal Revenue Code.

It is usually simple to determine US citizenship. If you are born in the United States (and not the child of a diplomat or foreign service woman or man), you are a US citizen. It is sometimes a bit complex to determine whether someone born outside the United States (with US citizen parents) is a citizen or not. A naturalized citizen will have a vivid memory – and some paperwork – to prove the acquisition of US citizenship. People will almost always know whether they are citizens of the United States or not.

Dual citizenship does not matter. Simply acquiring citizenship of a second country will not in itself terminate US citizenship.

Long-Term Residents

People who are not citizens of the United States may also be subject to the US Expatriation Tax Regimes if they are long-term residents of the United States.

Resident status means that they are lawful permanent residents of the United States. In normal conversation, we call these people green card holders.

Long-term means that they have held lawful permanent resident status - even for a split-second of time - in at least eight out of the last 15 years (sometimes known as the "8 out of 15 test"). In satisfying this "8 out of 15 test," there are special rules for disregarding years in which these people lived abroad and filed US income tax returns claiming non-resident status under the terms of an

applicable income tax treaty. This is done by attaching Form 8833 to Form 1040NR for the tax year, claiming a permanent home and center of vital family, business, and economic interests in another country that has a tax treaty with the US.

Electing under a tax treaty not to be treated as a US tax resident for a year has the effect of suspending and possibly ignoring the counting of that year for purposes of determining whether a person satisfies the "8 out of 15 test" as of the year of expatriation.

What Actions Trigger the Expatriation Tax Regime?

You are not subjected to the Expatriation Tax Regime simply because you are a citizen or a long-term resident. You must do something to trigger the application of the US exit and inheritance tax: Renounce your citizenship or abandon your long-term resident status.

US Citizens Renounce/Relinquish Citizenship

US citizens can choose to give up citizenship, or have it taken away from them. Losing citizenship makes a (former) US citizen an expatriate under the US Expatriation Tax Regimes.

Long-Term Residents Give Up Visa Status

Green card holders are also affected by the US Expatriation Tax Regimes.

A green card holder must have been a lawful permanent resident in 8 of the 15 years ending with the year of expatriation. In other words, the green card holder is a long-term resident (a defined term in the Code). Only green card holders who are long-term residents are affected by the exit tax rules. If you are a "substantial presence" taxpayer but never held a green card, you cannot be subject to the US Expatriation Tax Regimes.

Example

You become a lawful permanent resident in 2018. In 2022, you have been a lawful permanent resident for five out of fifteen years. You are not a long-term resident, so you need not worry about the exit tax rules if you decide to give up your visa and leave the United States.

Once the long-term resident status is attained, there are three ways a green card holder can trigger the US Expatriation Tax Regimes:

- First, the green card holder can voluntarily abandon the visa status.
- Second, the government may forcibly cancel the visa.
- Third, the green card holder can make a treaty election.

These events cause the long-term resident to become an expatriate and potentially subject to the US Expatriation Tax Regime.

Green Card status is voluntarily abandoned by filing Form I-407 with the US Citizenship and Immigration Service (USCIS). The effective date is the date that is stamped on your Form I-407 confirming receipt of the form by the US government.

Green Card status is involuntarily taken away as of the date you became subject to a final administrative order that you abandoned your lawful permanent resident status (or, if such order has been appealed, the date of a final judicial order issued in connection with such administrative order).

It could also be the date you became subject to a final administrative or judicial order for your removal from the United States under the Immigration and Nationality Act.

Finally, the long-term resident may trigger the Expatriation Tax Regime (i.e., become an expatriate) by making a treaty election to be a nonresident of the US, thereby ceasing to be a permanent resident for tax purposes. The green

card holder makes this election by filing a Form 1040NR for the year in question, with the treaty election on an attached Form 8833.

The election, if made after the green card holder becomes a long-term resident, will cause the individual to be an expatriate despite his still holding the immigration status of a lawful permanent resident. Many long-time lawful permanent residents are ignorant and unaware of this highly technical provision, which could spell disaster to a carefully conceived plan of expatriation from the US.

Are You a Covered Expatriate or Not?

Once you have determined that you have expatriated (given up citizenship for citizens, abandoned visa status or elected nonresident tax status for long-term residents), the next task is to figure out the consequences of that event.

The US Expatriation Tax Regimes will create two possible income tax consequences for citizens and long-term residents who expatriate:

- paperwork only; or
- paperwork plus tax.

“Covered Expatriates” face the prospect of paperwork plus tax liability. In contrast, noncovered expatriates bear the paperwork burden only.

US persons who receive gifts or bequests from Covered Expatriates also suffer further US inheritance tax burdens. Such US recipients of “covered gifts” or “covered bequests” from a Covered Expatriate pay a tax when receiving a wealth transfer from a Covered Expatriate.

In addition, the receipt of material gifts and bequests and all distributions from a foreign trust must be reported on an annual informational tax return.

Further compounding the complexity of the inheritance tax is that although

the inheritance tax was enacted in 2008, the IRS has yet to issue Form 708 so US heirs are in a holding pattern pending issuance of the final inheritance tax regulations.

Covered Expatriate vs. Non-Covered Expatriate

The term "Covered Expatriate" is defined in the Internal Revenue Code. It means someone who:

- is an expatriate (a citizen who has relinquished citizenship, or a long-term resident who has given up green card visa status or has made a treaty election to be a nonresident); and
- has failed (or passed, depending on perspective) one of the following three tests:

The Net Worth Test

The first way to become a Covered Expatriate is to have a net worth of US$2 million or more on the date of expatriation. The amount is not indexed for inflation.

The Net Tax Liability Test

The second way to become a Covered Expatriate is to have a high-enough average net federal income tax liability for the five tax years before the year of expatriation. The threshold amount for expatriations in 2023 is $190,000, and it is indexed for inflation.

The Certification Test

The final way to become a covered expatriate is to be non-compliant with any US tax obligations for the five tax years before the expatriation year. Complete compliance with all US tax filing obligations is demanded. You must certify full compliance under penalty of perjury and, if audited, prove it. Full

compliance with US income tax returns and forms is not sufficient; the individual must also be fully compliant with any US gift tax and employment tax returns that were required to be filed.

The three criteria are designed to identify people who are either relatively wealthy (in the eyes of the Internal Revenue Code) or non-compliant with US tax law. These people are Covered Expatriates. Expatriates who are fully tax-compliant and of relatively more modest means (from the Code's point of view) are not Covered Expatriates. The Code does not give these people a name, but for clarity's sake, they are informally referred to as "non-covered expatriates".

Two Exceptions to Covered Expatriate Status

There are two categories of expatriates for whom the Net Worth Test and the Net Tax Liability Test will not apply:

- Dual citizens who acquired US and another citizenship at birth; and
- People who expatriate before age 18 1/2.

For those who qualify for one of the exceptions, personal wealth and prior years' income tax liability will not cause the individuals to be covered expatriates. However, the taxpayers will still be required to satisfy the Certification Test, and failure to do so will make them Covered Expatriates.

How Covered Expatriates are Taxed

Covered Expatriates face the prospect of being forced to pay US Exit Tax in return for being allowed to leave the US tax system's worldwide tax reach. The general principles are easy to understand:

- **Pay tax as you receive income.** If the IRS can rely on tax withholding rules to ensure full collection of income tax, the Covered Expatriate pays tax at a 30% rate on US source income as it is received.

- **Pay tax on everything now.** If the IRS cannot be assured of timely collection of tax at the source, the US exit tax rules impose a deemed sale of worldwide appreciated assets under the so-called “mark-to-market” exit tax regime or deemed distribution (from an IRA, for example) for certain ineligible deferred compensation. Both force immediate recognition and taxation of unrealized income and capital gains while the individual is still a US taxpayer and must be reported on the individual’s final US tax return.

The Code lays this out by identifying three categories of income for which special exit tax rules have been written. Everything else is subjected to a mark-to-market system that causes a deemed sale of assets at fair market value.

Specified Tax-Deferred Accounts

Specified tax-deferred accounts are things like IRAs or Health Savings Accounts. If the Covered Expatriate has any of these accounts, they are deemed to have received a full distribution on the day before expatriation. Early distribution penalties are not applied.

Deferred Compensation

Deferred compensation means pensions as well as other deferred compensation arrangements. If the covered expatriate has any of these, expatriation will trigger tax liability.

Pay-as-you-go. Some deferred compensation arrangements are taxed to the Covered Expatriate on a 30% pay-as-you-go arrangement. These are “eligible” deferred compensation arrangements. “Eligible” deferred compensation plans are those where the payor is a US person. There is a simple reason why the government is willing to collect 30% as benefits are paid.

The presence of a US plan administrator or custodian means that there is a US withholding agent in place. If a US withholding agent fails to undertake

the required tax withholding, they are personally liable to the IRS for the tax that should have been withheld but was not. The US IRS generally will not receive tax from the taxpayer (if withholding is done correctly by the US plan administrator or custodian).

However, be forewarned that in order to elect this “pay as you go” method for “eligible” deferred compensation, such as 401(k) accounts, the expatriate must comply with very stringent time requirements to provide notice of their expatriation to the US plan administrator. Failure to comply with these tight deadlines will force the expatriate to use the more punitive “lump sum” system (see below) and lose continued US tax deferral on their 401(k) account.

Lump sum. “Ineligible” deferred compensation arrangements are those where the payor is not a US person. A foreign pension plan is a simple example of this. Here, the IRS cannot rely on a withholding agent to act, in effect, as a guarantor of tax payments.

A foreign pension plan administrator, making a pension distribution to a foreign person (the covered expatriate) might not feel any particular compunction to satisfy an IRS request for tax withholding compliance.

For “ineligible” deferred compensation arrangements, a Covered Expatriate is treated as having received a lump sum distribution on the day before expatriation equal to the present value of the accrued plan benefits.

Beneficiaries of Non-Grantor Trusts

Covered Expatriates who are beneficiaries of non-grantor trusts must pay a 30% tax on the taxable portion of trust distributions they receive.

Mark-to-Market Rules

Everything that falls outside of these three special categories will be taxed

according to “mark-to-market” tax principles. All worldwide assets are deemed sold on the day before expatriation at fair market value. Capital gain or loss is computed in the usual way.

A special exemption amount (US$821,000 for expatriations in 2023; indexed for inflation) is applied, and any net capital gain above the exemption amount is taxed using the usual capital gain tax rates. The 3.8% net investment income tax (“NII”) is added to the amount of gain since the taxpayers are generally US persons on the day before expatriation.

The Expatriation Tax Regime Paperwork

Predictably, the Expatriation Tax Regime has resulted in special-purpose US IRS tax forms.

Form 8854. Form 8854 is the main tax form. This form is due on the normal income tax filing deadline for the year of expatriation. Both Covered Expatriates and noncovered expatriates are required to file this form.

Form 8854 captures all of the information that the Service needs to determine whether the taxpayer is a Covered Expatriate or not by requiring the submission of a Balance Sheet of all assets owned on the day before expatriation. For Covered Expatriates, this form provides the details of the taxable income triggered by the event of expatriation and where that income is reflected on the income tax return.

Note that the instructions to Form 8854 require the taxpayer to also disclose to the IRS by an attachment a statement of all significant changes in assets and liabilities for the five years preceding the year of expatriation.

Our experience is that many seasoned tax return preparers are unaware of this disclosure requirement and never raise it with the client when preparing Form 8854. If an individual fails to include the attachment and therefore fails to disclose significant changes in assets and liabilities in the pre-expatriation period, we presume this is an incomplete Form 8854, which should result in

the expatriate flunking the Certification Test. An outcome of lifetime Covered Expatriate status would be a shock to an otherwise tax-compliant client. We have worked on remediating clients who fall into this category.

Form W-8CE. A special Form W-8CE must be submitted by Covered Expatriates to US plan administrators of "eligible deferred compensation" or trustees of non-grantor trusts.

The Covered Expatriate gives the Form W-8CE to retirement plan administrators, pension and deferred compensation plan administrators, and trustees of non-grantor trusts where the Covered Expatriate is a beneficiary. This notifies the payor of the taxable income of the recipient's Covered Expatriate status so that the correct tax withholding can be applied.

The recipient is also required to provide specified information to assist the Covered Expatriate's calculation of the exit tax. For instance, an IRA custodian must report the value of an IRA on the day before expatriation so that the Covered Expatriate can treat that amount as a deemed distribution of the entire balance prior to expatriation.

Form 708. This Form will eventually relate to the tax liabilities under the inheritance tax and will be published whenever the IRS issues final regulations in this area.

Form 708 will be filed by US citizens or green card recipients of so-called "covered gifts" or "covered bequests" from a Covered Expatriate. The recipients pay US inheritance tax at the highest gift tax rate on amounts received from Covered Expatriates.

There are only a few exceptions, and the US inheritance may be imposed on US recipients years after the Covered Expatriate departed the US as well as many years after the Covered Expatriate has died. Status as a Covered Expatriate is determined on the day before expatriation and remains with the individual for life.

Guidance for Would-Be Expatriates

Avoid Expatriate Status

When considering expatriation, the first line of defense against the US exit tax is to avoid becoming an expatriate in the first place. This is impossible for citizens, but for green card holders, the strategy is to avoid becoming a "long-term" resident. Leave the United States and abandon the green card visa before the eighth year of holding that visa status.

Avoid *Covered* Expatriate Status

If expatriate status is unavoidable, paperwork burdens are unavoidable. But it may be possible to eliminate the tax cost of expatriation. This might be possible by reconfiguring your daily life to eliminate Covered Expatriate status. Find ways to properly bring your net worth below $2,000,000, but this is impractical for most very wealthy expatriates.

For corporate executives, find ways to bring your average income tax liability for the previous five years to a number below the inflation-adjusted threshold that applies to you. And, most important of all, fix any noncompliance in tax returns for the five prior years by remediation through an IRS-approved voluntary compliance program.

Typically, remediation may be undertaken by the eligible individual in a so-called Streamlined Domestic Offshore Procedures submission (for US residents) or Streamlined Foreign Offshore Procedures submission (for non-US residents).

In our experience, many clients believe they prepared and filed correct US income tax returns, but a significant number of American taxpayers, especially those who live abroad, have missed something when filing their tax returns.

Minimize Capital Gains

If Covered Expatriate status is unavoidable, you should plan to try and reconfigure your asset holdings to minimize capital gain that will be subject to the mark-to-market rules. Holding $1,000,000 of cash assets yields zero capital gain when applying “mark-to-market” principles. Holding appreciated real estate or stock will generate a capital gain.

Perhaps, for instance, you can engineer asset transfers via gifts so that an expatriating spouse can take full ownership of a $1,000,000 joint bank account while a non-expatriating spouse receives full ownership of the $1,000,000 family home.

An important note is that while the US Exit Tax can be reduced by proper gifting just prior to expatriation, to reduce your net worth to below the $2M net worth test until further clarification from the IRS, a pending expatriate is best advised that the gifts must be made in the calendar years before the calendar year of expatriation.

Another oft-overlooked strategy is to take advantage of valuation discounts of non-publicly traded or illiquid assets for US gift tax purposes. Remember, though, a non-US citizen grad student or young entrepreneur whose sole asset is $3M in cash and who has young children born in the US would not incur a US Exit Tax. However, such an individual would be classified as a Covered Expatriate for US Inheritance Tax purposes. If the individual leaves the US and thereafter acquires or creates a fortune, the inheritance tax will apply to the fortune left to his or her US children.

Use of Pre-expatriation Trusts

The best solution may be to set up a pre-expatriation trust in a calendar year before the year of expatriation. In the ideal situation, the would-be expatriate should make gifts of highly appreciating assets for which a valuation discount is available to an irrevocable completed gift trust undertaken in a US state that

has adopted asset protection legislation. Often the expatriate-settlor of the pre-expatriation trust will not be a permissible beneficiary of the trust. The pre-expatriation trust should be a non-grantor trust taxed as a separate US taxpayer and must remain a US domestic trust forever.

The pre-expatriation trust accomplishes at least two objectives.

First, assets held in the pre-expatriation trust should not be subject to the "mark-to-market" US Exit Tax.

Second, any future trust distributions from the pre-expatriation trust to US persons should avoid the US Inheritance Tax because, at the time of the gift to the pre-expatriation trust, the expatriate-settlor was not yet classified as a Covered Expatriate for life.

PART 2: RENOUNCING US CITIZENSHIP OR GREEN CARD

Losing US Citizenship

8 U.S.C. § 1481(a) lists all seven potentially expatriating acts by which a US citizen can give up US citizenship. Renunciation of United States citizenship is a legal term encompassing two of those acts: Swearing an oath of renunciation at a US embassy or consulate in a foreign territory or, during a state of war, at a US Citizenship and Immigration Services office on US territory.

The other five acts are:

- naturalization in a foreign country;
- taking an oath of allegiance to a foreign country;
- serving in a foreign military;
- serving in a foreign government; and
- committing treason, rebellion, or similar crimes

– with the intention at the time of committing such acts to voluntarily relinquish US citizenship.

Renouncing US Citizenship

By far, the most common way that US citizens rid themselves of US citizenship is under subsection 5) of the USC. § 1481(a). This requires making a formal renunciation of nationality before a diplomatic or consular officer of the United States in a foreign state.

Renunciation is accomplished in 5 steps:

Step 1 – Acquire a Second Citizenship

Readers of IMI are already familiar with the various ways in which Americans can acquire a second citizenship:

- at birth through either parents or birthright (i.e., jus sanguines or jus soli);
- through naturalization in a foreign state;
- through descent; or
- through citizenship by investment.

There is some discussion online that one might choose to renounce US citizenship without first obtaining second citizenship. This is legally possible under US law. In practice, however, this is very rarely done because, post-renunciation, the individual would be stateless. This is not a situation in which most clients would like to find themselves.

Second, on the two occasions when I had clients who initially did not want to reveal their second citizenships, the consular officers then questioned whether they fully understood the ramifications of their renunciation. This brought up the issue of lack of capacity, which is one of the two ways (duress being the other) that a consular officer can challenge the individual's ability to exercise their right to renounce.

Both times, after conferring with me, the clients provided evidence of their second citizenship. It is worth noting that this took place during the period when those renouncing their US citizenship were allowed legal counsel. That is not the case today, which underscores the importance of being properly advised throughout the process.

Step 2 – Organise an appointment with a US mission (embassy, consulate, or institute)

While renouncing US citizenship is a right that every US citizen possesses, from a practical sense, it is often delayed or even sometimes thwarted by the US government. US missions erect this hindrance by simply limiting or even stopping the granting of interview slots given by their consular section, US

Citizen Services. As I've often discussed in other IMI articles, this was especially prevalent during the Covid pandemic. Even today, missions like the US Embassy in London are still working through a backlog where they are offering appointments for individuals who made their appointment request in Q3 of 2021.

Along with finding a mission that will schedule an appointment in a timely fashion, it is often also a challenge to work through the scheduling staff who respond to phone or email requests.

Generally, this job is assigned to locally engaged staff who mistakenly apply the rules relating to visa applications to consular appointments. In the former, it is foreigners who are applying for the mission to exercise their discretion in granting a visitor status. In this context, missions have a specific geographic area of responsibility as they need to have "local knowledge" to make sure that visa applicants can overcome the "intending immigrant" presumption under s.214 B of the INA.

In the case of renunciation, a US citizen is exercising a right, which does not require local knowledge. Refusing a renunciation appointment to a US citizen who is not residing within the visa section's area of responsibility is nonsensical. It would be equivalent to denying that US citizen the right to apply for a replacement passport that was lost or stolen at a US mission in a country that they happen to be visiting.

Although in an ideal world, it should not be necessary, we devote a considerable amount of time to keeping up on which missions are offering appointments. Predictably, once we locate a specific mission that is booking appointments, within two or three months, that office develops a backlog or even closes off scheduling appointments completely. This situation would not exist if the US government simply adopted the same rules of applying for a replacement passport to having a renunciation appointment. The fact that they have not done so lends credence to the theory that the US government is applying the maxim, "A right delayed is a right denied," to slow the pace of Americans expatriating.

Step 3 – Preparing documentation for the renunciation appointment
It will often be necessary for the individual to complete this third step before even scheduling an appointment.

Other missions require the forms to be completed and sent after the appointment is scheduled but before the actual date of the appointment. Although some missions have their own local additional forms, the standard five forms are:

- DS-4079 REQUEST FOR DETERMINATION OF POSSIBLE LOSS OF UNITED STATES NATIONALITY
- DS-4080 OATH/AFFIRMATION OF RENUNCIATION OF NATIONALITY OF UNITED STATES
- DS-4081 STATEMENT OF UNDERSTANDING CONCERNING THE CONSEQUENCES AND RAMIFICATIONS OF RENUNCIATION OR RELINQUISHMENT OF US NATIONALITY
- DS-4082 WITNESSES' ATTESTATION RENUNCIATION/RELINQUISHMENT OF CITIZENSHIP
- DS-4083 CERTIFICATE OF LOSS OF NATIONALITY OF THE UNITED STATES

While the expatriating individual should complete all the forms in advance, he must sign them in front of the official conducting the formal renunciation appointment.

Step 4: Attending the renunciation appointment

Generally speaking, a pre-appointment call or meeting will take place before the formal renunciation appointment. Some missions do this pre-appointment by phone. Others schedule two meetings a day or two apart at the mission. The purpose of this pre-appointment is to make sure that the US citizen has the appropriate documentation and clearly understands the implications of the right that he is about to exercise.

The rules for the US official with whom the US renunciant is meeting are set out in the Foreign Affairs Manual. While it is useful to read this material before the appointment, it does not fully explain every element involved in the process or each element of the various forms. A perfect example is item 10 in Form DS-4081, which reads as follows:

> *10) My renunciation/relinquishment may not exempt me from United States income taxation. With regard to United States taxation consequences, I understand that I must contact the United States Internal Revenue Service. Further, I understand that if my renunciation of United States nationality is determined by the United States Attorney General to be motivated by tax avoidance purposes, I will be found excludable from the United States under Immigration and Nationality Act, as amended.*

The first part of this statement is technically correct but highly misleading. A "US person for tax purposes" does include a US citizen (a status the person is in the process of shedding), but also includes those individuals who trigger the Substantial Presence Test. Therefore, a US citizen who renounces citizenship *may* still be a US taxpayer if he subsequently spends too much time in the US.

Likewise, someone who renounces US citizenship but does not trigger the Substantial Presence Test may still have US tax issues relating to certain US situs assets or US source income. We explain this latter situation elsewhere in this report.

The second part of this statement relates to the so-called "Reed Amendment", the impotence of which provision we will illustrate in greater detail later in the report.

This one example is indicative of the many potential misunderstandings that can occur by those who are not properly advised about the ramifications of various elements of exercising their right to renounce their US citizenship. In some cases, the results can be catastrophic for the individual.

Once the various forms are signed, the final step in the process is the payment of the fee to the cashier at the mission. Currently, the fee is US$2,350 but,

recently, the US government agreed to reduce the fee to the prior rate of US$400. As of the date of publication of this article, the government has yet to gazette this change, but we expect it to do so soon. One pro tip is to have this fee in USD cash because, on occasion, the credit card machine at the mission may not be working on the date of the appointment.

Step 5 – Issuance of Certificate of Loss of Nationality

A Certificate of Loss of Nationality ("CLN") is a document the US government issues that confirms the individual is no longer a US citizen. It is also the document that most financial institutions' compliance departments require to prove that an individual account holder is no longer a US person for tax purposes and the institution is able to accept a W-8BEN rather than a W-9.

Traditionally, the US mission where the renunciation appointment takes place does not issue the CLN. Rather, they would forward the entire package of executed documentation, along with their notes regarding capacity and lack of duress, to State Department headquarters in Washington by diplomatic pouch.

A consular official at headquarters would open the package, review the same and, if the forms were properly completed and executed and there was no question regarding the ability of the individual to exercise their right to expatriate, would stamp the CLN and forward it to the mission by return diplomatic pouch. The mission then contacts the individual to arrange pickup of the CLN.

Over three decades, I have seen the turnaround for this process take six months or more. Currently, the turnaround time is four to eight weeks but can be dramatically impacted if the State Department seconds headquarters staff to deal with matters it deems more urgent. In the past, this has occurred when staff were reassigned to deal with the issuance of emergency travel documents to US citizens caught in a war zone or visas in a refugee crisis arising out of a natural disaster.

Interestingly, over the past year, we have seen at least one US mission have a consular official at the appointment mission appropriately stamp the CLN within days of the renunciation appointment. One can hope this process becomes the new standard in the future. We will discuss the potential impact of this delay in the issuance of a CLN on future travel in Part 4 of this report.

One area of significant misunderstanding is the effective date that the individual ceases to be a US citizen. Although the CLN clearly states that the individual ceased to be a US citizen as of the date of the formal renunciation appointment, many people mistakenly believe that they are still Americans until the CLN is stamped. This misunderstanding is sometimes fuelled by consular officials returning the individual's US passport to them at the interview.

On rare occasions, I have even heard of consular officials mistakenly telling the individual that they were Americans until the CLN was issued. Such misinformation is a perfect example of where a misinformed renunciant can cause himself significant future harm. If, after the expatriation appointment, that individual were to subsequently enter the US on their US passport, he could be deemed to be fraudulently seeking entry. This could easily result in a future prohibition of travel to the US.

In reality, the individual ceases to be a US citizen the moment he signs the various forms and pays the fee at the formal appointment. The subsequent issuance of the CLN is simply the confirmation of an existing state of fact. Although, in theory, the State Department could subsequently question the capacity of the individual to exercise his right to renounce or claim that this right was only being exercised under duress, we have never seen this occur in more than three decades of assisting hundreds of Americans in renouncing their US citizenship.

Relinquishing US citizenship

As previously noted, 8 USC. § 1481(a) lists all the five other potentially expatriating acts. Specifically, these are:

1. naturalization in a foreign country;
2. taking an oath of allegiance to a foreign country;
3. serving in a foreign military; serving in a foreign government; and
4. committing treason, rebellion, or similar crimes.

Beginning with a 1907 law, Congress had intended that mere voluntary performance of potentially expatriating acts would automatically terminate citizenship. However, a line of Supreme Court cases beginning in the 1960s, most notably Afroyim v. Rusk (1967) and Vance v. Terrazas (1980), held this to be unconstitutional.

Instead, along with committing one of these acts, the individual must have the specific intent to relinquish citizenship at the time the act is committed. This intent must be proven by the totality of the individual's actions and words.

If someone can demonstrate both the prior committing of the act and provide indisputable contemporaneous evidence of an intention to thereby relinquish US citizenship, this can result in a CLN being applied for and issued confirming loss of US citizenship as of the date of the expatriating act.

Unfortunately, while many people can demonstrate the commitment of a potentially expatriating act, few can years later adequately demonstrate their simultaneous intention to thereby relinquish their US citizenship.

Relinquishing Green Card Status

In our global practices spanning cumulatively three-quarters of a century, we find that green card holders, too, are often oblivious to the fact that they must take formal steps to relinquish US their permanent residency status (aka "Green Card status").

Neither allowing a green card to expire nor remaining outside the United States permanently or for long periods of time are sufficent to lose Green Card status.

Although the US government can formally revoke Green Card status as a result of either fraud or abandonment, this only occurs after an initial report

is filed, a long administrative process is undertaken, and all appeals are exhausted.

By far, the most common way that individuals lose their Green Card status is by voluntary relinquishment. The procedure to surrender a green card/LPR status is pretty straightforward: The Green Card holder needs to fill out and mail USCIS Form I-407, Abandonment of Lawful Permanent Resident Status. Along with the form, the individuals will need to send in the Green Card or provide a reason why they cannot (for example, that it has been lost or destroyed). Unlike renouncing US citizenship, there is not currently a fee for relinquishing a Green Card.

After retaining a copy, the renunciant must send the I-407 form and Green Card to the address listed on the I-407 page of the USCIS website. USCIS anticipates that processing times, from receipt to completion, will be within 60 days, which does not include mailing time to or from outside of the United States.

It is worth noting that the date of deemed abandonment of the Green Card is the date of receipt of the I-407 by the USCIS. For this reason, it is best to send the package by registered mail or courier. If appropriate, an alternative is to submit Form I-407 to a US Customs and Border Protection officer at a US port of entry. The date of relinquishment is, therefore, the date that the I-407 and Green Card are handed to the port of entry official.

Post Expatriation Tax and Financial Filing

When you expatriate from the US (i.e., relinquish or renounce US citizenship or relinquish long-term Green Card status), you are required to declare all of your assets and liabilities and compute your net worth.

As we previously discussed, if your net worth is above $2 million, or you have too high of a five-year average of prior annual US federal tax payments, you are a so-called "Covered Expatriate." However, many people who do not run afoul of either the net worth or average tax-paid tests still find themselves designated as Covered Expatriates because they fail to properly certify their tax compliance for the prior five years on Form IRS 8854

Form 8854

Form 8854 is required of all expatriates for the year in which they expatriate, regardless of whether they are filing a dual-status return, filing a resident return for the full year, or filing a nonresident return for the full year. Form 8854 is filed along with the expatriate's income tax returns for that year, and has the same due date.

Form 8854 asks for some basic information about the filer, such as when they expatriated, whether they were a citizen or green card holder, etc. It then asks for information that will tell the IRS whether they are Covered Expatriates or not.

Covered Expatriates have to fill out a section of the form about their assets to show the IRS what assets are subject to the "deemed sale" or "mark-to-market" exit tax rules and what assets get a different tax treatment. Non-covered expatriates do not fill out that information but must still file Form 8854.

Finally, both Covered Expatriates and non-covered expatriates must provide the details of their personal net worth and information about income reported on their US income tax returns.

What goes on your Form 8854 Balance Sheet?

Specifically, what goes on your Form 8854 Expatriation Statement balance sheet? What, specifically, is an asset you own?

Here's how you figure it out:

- Assume you are a US citizen or a resident of the United States (as "resident" is defined for estate/gift tax purposes).
- There is an asset that you are wondering about. Should you include it on your balance sheet or not?
- Pretend you gave it away.
- Ask yourself: "In my "pretend" status as a US citizen or (estate/gift tax) resident, would I hypothetically owe US gift tax on that transfer?"

The IRS Viewpoint

The relevant authority is at Notice 97-19, Section III, published by the US IRS.

Determination of net worth

For purposes of the net worth test, an individual is considered to own any interest in property that would be taxable as a gift under the US Tax Code if the individual were a citizen or resident of the United States who transferred the interest immediately prior to expatriation[1].

An interest in property includes money or other property, regardless of whether it produces any income or gain. In addition, an interest in the right to use property will be treated as an interest in such property. Thus, a nonexclusive license to use property is treated as an interest in the underlying property attributable to the value of the use of such property.

Notice 97-19 guides expatriates even today under the current post-2008 exit tax rules. Notice 2009-85, Section 2.B tells us to use these ideas for expatriations from 2008 and onwards.

Gift tax rules for green card holders domiciled abroad

This is sometimes tricky to understand for green card holders living abroad. Green card holders living permanently outside the United States are usually treated as residents of the United States for income tax purposes, but as non-domiciliaries of the United States for estate and gift tax purposes.

Non-domiciliaries of the United States (the estate/gift tax definition) can make gifts without US gift tax.

Residents (the estate/gift tax definition) pay gift tax on gifts of everything, no matter where that thing is.

Nonresidents (the estate/gift definition) pay gift tax only on gifts of US real estate and gifts of "tangible personal property" located in the United States.

It's tempting to want to use the liberal gift tax rules for nonresidents (the estate/gift tax definition) when doing your pre-expatriation tax planning, but you should only pursue this strategy upon the advice of qualified counsel.

What is a "significant change" that must be disclosed on Form 8854?

What constitutes a "significant change" in one's financial situation? This is a question that is asked on Form 8854.

What Form 8854 Wants

Form 8854 has a Balance Sheet requirement, where you report your assets and liabilities. This helps the IRS understand whether your net worth is above or below $2,000,000 — making you a Covered Expatriate (see Part 1) or not a covered expatriate (below).

The instructions to Form 8854 have an additional requirement, which you will not find in the Internal Revenue Code (and, in fact, we are aware of many tax return preparers who overlook asking this question in preparing Form 8854):

If there have been "significant changes" in your assets and liabilities for the period that began five years before your expatriation and ended on the date

that you first filed Form 8854, you must attach a statement explaining the changes.

Which five years is logical: They are the same five years that apply for the certification test. The fact that the IRS asks for information that is not specified in the Internal Revenue Code is clearly within the bounds of their discretion.

What is “Significant”?

The big question is the meaning of the word “significant”. The answer is that no definition of “significant” exists for this purpose. You have to make up your own rules.

US tax law is full of terms like this: “Material”, “substantial”, and “significant”. Sometimes, there is a helpful definition attached to the word found in the Tax Code or in the US Treasury Regulations. However, for your Form 8854 balance sheet purposes, there is no guidance.

What We Recommend

Here is what we advise our clients to disclose in an attachment to Form 8854:

- If the transfer during the five-year period triggered the requirement to file an IRS Form 709 Gift Tax Return, tell the government about it in the attached statement.

- If the transfer did not trigger a gift tax return but moved you from covered expatriate territory (net worth above $2 million) to non-covered expatriate territory (net worth below $2 million), tell the government about it on the attached statement.

- If the transfer did not trigger a gift tax obligation (e.g., a green card holder permanently living abroad making a gift of non-US situs assets), you probably want to tell the IRS anyway on the attached statement.

Essentially, think of it this way: If you did not tell the IRS and they found out later that you had transferred assets away during the five-year period, what would you say as to why you did not make the disclosure when required to do so?

Be sure that you can never be accused of lying by omission. Where this disclosure becomes difficult for "long-term" green card holders to comprehend is where the individual may be subject to the exit tax when abandoning green card status, but where he or she has already permanently departed the US. These individuals may make gifts of non-US situs assets to reduce their worldwide appreciated assets subject to the exit tax, which are not reported on a US gift tax return.

While the actual gift of a US situs asset by a presumed non-US domiciliary is not subject to US gift tax reporting, we believe the sounder position is to, nevertheless, disclose such gift on Form 8854 if made during the five-year period prior to expatriation.

We believe the IRS is looking to see if the taxpayer is being truthful and forthcoming. Are you lying about your net worth? Did you make an undisclosed transfer of assets away from yourself in order to save taxes?

Dual Status Returns

All individuals who cease to be taxed as US persons file income tax returns to signal that change in status to the IRS. If the expatriate is going to continue to have US source income post-expatriation, he will file a"dual-status" tax return. This means filing for the part of the year of expatriation during which you are a US person reporting your worldwide income on Form 1040, and for the part of the year you are a non-resident of the US reporting only your US-source income on Form 1040NR.

Background on dual-status returns

The United States is one of very few countries in the world that uses a citizenship-based tax system. Citizens and permanent residents ("green card holders") are taxed on their worldwide income, regardless of where in the

world they happen to reside. Nonresidents are taxed only on US-source income.

When someone switches status from US person to non-US person, the rules under which they are taxed in the US change: They go from being taxed on worldwide income to being taxed only on US-source income.

Individuals must file tax returns covering an entire calendar year; it is not possible to file a short-year return. Therefore, when someone switches status from US person to non-US person, they are filing returns for a calendar year in which they are taxed under two different sets of rules. To report their income properly, they file what is called a dual-status return.

Logistics of dual-status return

The IRS does not have a specific form to use for filing a dual-status return. You have to put together your own dual-status return.

The former expatriates use for the dual-status return a nonresident return (Form 1040NR) with a resident return (Form 1040) attached to the back of it. The package typically also includes Form 8854.

The nonresident return is the tax return that the IRS records as the return filed. The resident return is simply a statement attachment that is used to show income for the resident portion of the year – it is technically not a “return” but instead a “statement”.

Here is what IRS Publication 519 (a generally useful publication for expatriates) says to do:

> *Nonresident at end of year: You must file Form 1040NR or Form 1040NR-EZ if you are a dual-status taxpayer who gives up residence in the United States during the year and who is not a US resident on the last day of the tax year. Write ‘Dual-Status Return’ across the top of the return. Attach a statement to your return to show the income for the part of the year you are a resident. You can use Form 1040 as the statement, but be sure to mark ‘Dual-Status Statement’ across the top.*

Residency termination date other than expatriation date

Usually, your expatriation date will be the dividing line between the non-resident portion of the year and the resident portion of the year. However, that is not always the case. It is possible to have a dividing line between the two portions of the year that is different from your expatriation date.

Your expatriation date generally remains fixed regardless of what the dividing line between the resident and nonresident portions of the year turns out to be.

The dividing line between resident and nonresident status is referred to as the "residency termination date". For those who are exiting the US tax system, IRS Publication 519 has this to say about the residency termination date:

> ***Last Year of Residency:*** *If you were a US resident in 2022 but are not a US resident during any part of 2023, you cease to be a US resident on your residency termination date. Your residency termination date is December 31, 2022, unless you qualify for an earlier date as discussed next.*
>
> ***Earlier residency termination date:*** *You may qualify for a residency termination date that is earlier than December 31. This date is:*
>
> - *The last day in 2022 that you are physically present in the United States, if you met the substantial presence test,*
> - *The first day in 2022 that you are no longer a lawful permanent resident of the United States, if you met the green card test, or*
> - *The later of (1) or (2), if you met both tests.*

You can use this date only if, for the remainder of 2022, your tax home was in a foreign country and you had a closer connection to that foreign country.

We will not discuss the physical presence test or the green card test in detail in this article. For our purposes here, it is sufficient to recognize that the date you turn in your green card, which is generally your expatriation date, may not be the same day as your residency termination date.

The same is true for citizens: the date that you terminate your citizenship may

not be your residency termination date. Your citizenship termination date is still your expatriation date, but in some situations, you would use a different date as the dividing line between resident and nonresident status.

Paperwork after the year of expatriation

After you expatriate, you will be treated as a nonresident alien for all future years, assuming that you do not get a green card or meet the substantial presence test for any year.

In this article, we assume that the paperwork required after the year of expatriation from the US is for someone who does not become a US taxpayer again, either by obtaining a green card or by meeting the substantial presence test.

US tax returns after expatriation

If you have income from US sources after expatriation, you will most likely need to file a US return (i.e., Form 1040NR). But if you have no assets in the US and receive no income from US sources for the rest of your life, you will never need to file a US tax return again. If this is your objective, you may want to sell off 100% of your US assets and make sure you will no longer receive any US source income before you expatriate.

If you do have US source income, you still might be able to avoid filing a US tax return if you have the “right” types of income and if your tax liability is fully satisfied by withholding. In our experience, however, accomplishing this result can be very difficult, because withholding agents do not always withhold the correct amounts of US tax.

Ultimately the responsibility is on the taxpayer to file the required US tax returns and pay the correct amount of US tax, so more often than not, my nonresident clients continue to file US returns for at least a year or two after expatriation.

Withholding for nonresidents in general

After you cease to be a US person, you need to notify all payors of US-source

income that you are a nonresident so that they can withhold the appropriate amounts.

In general, individual nonresidents pay tax at a 30% flat rate on most types of income – basically, everything except income from a US trade or business, or from the sale of US real property.

However, if you live in a country that has a tax treaty with the US, certain types of income may qualify for a lower tax rate. You need to either claim the treaty rate on the withholding forms that you provide to the payor, or you need to make a treaty election on your tax return to qualify for the lower tax rate.

This is typically done by attaching IRS Form 8833 to Form 1040NR. Check the treaty for the country where you reside (not the country of your citizenship, if these are different) to see what treaty rates are available.

The form you provide to US payors to inform them of your nonresident status is Form W-8BEN. Send this to financial institutions where your US accounts are held and other payors of US source income as soon as possible after expatriating.

Special withholding for Covered Expatriates only

As discussed, if you are a Covered Expatriate, certain US assets — deferred compensation plans (including "pensions"), specified tax-deferred accounts (such as "IRAs"), and beneficial interests in certain trusts — will be taxed.

These assets are typically taxed as you – the Covered Expatriate – receive distributions. The tax is 30% of the amount distributed to you. In some cases, the entire lump sum is taxed to you immediately, however, such as with IRAs.

No matter which method is used to calculate your income tax on these types of assets, you must give the pension plan administrator, the IRA administrator, or the trustee a Form W-8CE. This tells them that you are a Covered Expatriate and that they have an obligation to withhold US income

tax from distributions they make to you.

Form W-8CE must be given to them within 30 days after your expatriation date. If you fail to do so within that timeline, then certain assets (e.g., 401(k) accounts) may be taxed to you as a deemed lump sum payment when they would otherwise qualify to be taxed at 30% on distributions only.

Annual Form 8854 for some Covered Expatriates

Some covered expatriates must continue to file Form 8854 each year after they expatriate if they made an election to defer tax for the year in which they expatriated, if they have what is called "eligible deferred compensation" items, or if they have an interest in a non-grantor trust.

There is no quick exit

While leaving the US tax system can result in a significant reduction or even elimination of future US taxation, the strategy must be properly designed. The execution of the strategy takes time and requires a significant amount of properly prepared and timely filed paperwork. There is no shortcut.

Be prepared by familiarizing yourself with the various types of paperwork that will be required for the year of expatriation and in the subsequent years, and engage qualified and experienced advisors to give yourself the comfort of knowing that every "I" is dotted and "T" crossed.

[1]*For this purpose, the determination of whether a transfer by gift would be taxable under Chapter 12 of Subtitle B of the Code must be determined without regard to sections 2503(b) through (g), 2513, 2522, 2523, and 2524.*

PART 4: POST EXPATRIATION TAX AND TRAVEL TO THE US

Tax, Securities, And Regulatory Considerations

Once an expatriate has either renounced US citizenship or abandoned long-term Green Card status in the US, it is very common that there are numerous US tax and US securities and other regulatory law issues that the expatriate must contend with in his or her new status as a non-resident alien of the US. Even if the individual retained his or her US citizenship but gave up residency in the US and is part of the growing US expat community living outside the US in retirement, certain US securities and regulatory considerations must be considered.

Tax Considerations

Perhaps the most obvious requirement for a former US citizen or resident is that the expatriate must notify all US financial institutions with evidence of his or her non-resident alien (NRA) tax status in the US. This is typically done by filing a Form W8BEN with the US custodian or financial institution for any US stocks or other US investment assets.

The US custodian or financial institution controls the money before it flows out of the US. The US government places the burden on the US financial institution to collect the tax. If the financial institution screws up, it must pay the tax.

The US Treasury regulations provide a roadmap to the US withholding agent telling them how much to withhold, but these regulations also contain a number of rules telling the withholding agent that if they do this or that, they are safe. In US tax jargon, these are called “safe harbors.”

One of these safe harbors is “If you receive a Form W-8BEN from someone and you have no reason to think they are lying, you can rely on it and not get penalized by the IRS as a withholding agent if it turns out you screwed up.”

To demonstrate why Form W-8BEN is so important to the expatriate living outside of the US, here is a quick overview of the tax results that a Non-Resident Alien (aka: “NRA” or Not a US Person for Tax Purposes) can expect:

The default rule is that bank interest is taxed at zero in the US for an NRA. Giving Form W-8BEN to a bank will ensure that all interest earned on your US bank account is tax-free.

Capital gains (short-term and long-term) are not taxable by the US for non-real estate investments or real estate located outside the US. The NRA wants the financial institution to have Form W-8BEN in hand so they report the capital gains correctly and don't impose backup withholding tax on the gross proceeds of your stock sales.

The main reason an NRA wants to use Part II of Form W-8BEN is to reduce his or her US income tax bill. The general rule is that dividends, pension payments, IRA distributions, and other types of passive investment income from US sources will be taxed at a flat 30% with no deductions. By completing Part II of Form W-8BEN and delivering it to the financial institution, the financial institution knows they are in a "safe harbor" and can withhold zero (or an amount less than 30%) of tax on payment to you.

Part II of Form W-8BEN is where an NRA can reduce their US income tax withholding rate from a flat 30% to some lower number, possibly zero, by claiming relief under one of the nearly 70 bilateral US income tax treaties. The US has an income tax treaty with numerous countries, including Portugal, the UK, Italy, and many more countries that have favorable tax treatment schemes for mostly wealthy individuals.

For example, in Part II of Form W-BEN, an expatriate who has moved to Portugal would have the opportunity to claim a reduction in the dividend withholding rate by US payors under the US–Portugal income tax treaty.

Suppose you are now a resident of Portugal, and you receive some dividend income from a US corporation. Line 10 of Part II of Form W-8BEN requires you to find the relevant portion of the US-Portugal income tax treaty that discusses dividends. Article 10 of the treaty limits the amount of tax the IRS can take to 15% of the gross dividend amount paid by a US corporation to a Portuguese resident.

This is better than the default 30% rate in the US tax code. (There are

different rules if you own at least 25% of the capital of the payor corporation).

Somewhat less obvious is the potential mismatch of US and Portuguese tax when an appreciated foreign asset not situated in the US (e.g., a residence in Portugal) is held on the day before the expatriation date from the US and then is subsequently sold when the individual is no longer a US income tax resident:

Assume that you buy a residence in Portugal before you decide to renounce your US citizenship because you want to try out living in Portugal before taking the consequential step of surrendering your US passport.

Under the US exit tax rules requiring a hypothetical or deemed sale of all your worldwide appreciated assets on the day before expatriation, US exit tax will likely be paid to the US under the "mark-to-market" part of the US Expatriation Tax Regime on the Portuguese residence.

No tax would be paid to Portugal in connection with such appreciated non-US situs asset on expatriation from the US because this is not a real sale of the Portuguese residence but only a hypothetical or deemed sale for US tax purposes only.

In exchange for including the Portuguese residence in his or her US exit tax calculation, the individual is entitled to a basis step-up to fair market value on the day before expatriation from the US but solely for US tax purposes. There is no basis step-up in Portugal in the Portuguese residence because Portugal does not recognize your hypothetical sale, which is for US tax purposes only.

When the NRA goes to sell the Portuguese residence, which was previously taxed or at least partially taxed as part of the exit tax (i.e., the "mark-to-market" exit tax regime is a hypothetical deemed sale of worldwide assets of a former US citizen or "long-term" Green Card holder), there is full tax in Portugal for all of the appreciation from date of purchase. Thus, the NRA may well pay double tax on some portion of the same appreciation in the Portuguese residence.

Increased Scrutiny and Restrictions Imposed by Financial Institutions of Former Americans Who Are Now NRAs

Of increasing concern to former US citizens and income tax residents is whether any US financial institution will want to continue to do business with you after you cease to be a citizen or income tax resident.

The trend is somewhat discouraging. More and more US financial institutions are declining to do business with NRAs, including some who expatriated. These financial institutions typically want you gone because you are expensive and risky.

As an NRA of the US, you now carry "know your customer" (KYC) risks, even though you may have had an account at the US financial institution for 20 or 30 years prior to expatriation. The financial institution is now concerned with proving that the source of funds for your investment account was from legal sources and not illicit activities.

One day, the US financial institution may be soliciting your business and, a few weeks later, they are worried about your illicit activities.

In addition, you now carry securities law risks. If Fidelity or Merrill Lynch in the US allows you – a resident of Portugal – to buy and sell stocks, there is a risk that Portuguese securities regulations might catch the US financial institution unaware, and Fidelity or Merrill Lynch could find themselves facing stiff fines in Portugal for those violations.

A major new trend is that US banks and brokerage firms are restricting and even closing the accounts of Americans living abroad due to their status as non-US residents. Many of the major US banks and brokerage firms no longer open new brokerage accounts for Americans residing outside of the US.

The major US banks and brokerage firms can now monitor where you are calling them from and, if they sense you are repeatedly calling them from outside the US, they could decide to remove you from their US business platform, which is only available to individuals residing in the US

Among US financial institutions, account restrictions vary between firms, and sometimes the same firm treats tax-favored retirement accounts differently than taxable accounts. Other US financial institutions are closing all US brokerage accounts for non-US residents, while still other firms are only restricting services available to Americans no longer residing in the US.

In other situations, the US investment firm may require very high minimum account values for non-US residents who wish to remain clients. Bans on non-residents, including US citizens, purchasing US mutual funds are now the norm. These new restrictions affect bank accounts, brokerage accounts, and retirement accounts.

It is for this reason that an effective Expatriation Plan should include the acquisition of new foreign bank and brokerage relationships. Often this will be with a foreign branch of the current US relationship. Many major US banks and financial institutions have overseas branches and affiliates. However, the US and non-US branches are often required to operate separately from each other, so the transition from onshore to offshore might not be as smooth as you would hope.

Future Travel To The United States

When you give up US citizenship or Green Card status, the way in which US border officials view you changes fundamentally. Specifically, US citizens and Green Card holders (who can prove the same) have the right to enter the US.

If they are wanted on criminal charges, they may be arrested after entering – but even criminal suspects have the right to enter.

Those who have given up US citizenship or Green Card status become foreigners who are seeking the discretion of the port of entry official to grant them visitor status in the US.

Like all foreigners seeking visitor status in the US, they must first satisfy officials that they are not inadmissible under the Immigration and Nationality Act (“INA”). The grounds of inadmissibility are outlined in s. 212(a) and include:

- Health-Related Grounds of Inadmissibility [INA § 212(a)(1)];
- Criminal Grounds of Inadmissibility [INA § 212(a)(2)];
- Economic Grounds of Inadmissibility [INA § 212(a)(4)];
- Illegal Entrants & Immigration Violators [INA § 212(a)(6)];
- Foreign Nationals Previously Removed [INA § 212(a)(9)];
- Miscellaneous Grounds of Inadmissibility [INA § 212(a)(10)]: eg. Practicing Polygamists, International Child Abduction, Unlawful Voters, Ineligible for Citizenship, or Foreign Nationals who Evaded the Draft
- Documentation Requirements [INA § 212(a)(7)] such as the "Intending Immigrant" [INA § 212(a)(7)(A)(i)(I)] –

This "Intending Immigrant" issue is the most common ground of inadmissibility applied under INA § 212(a)(7). Any foreign national who seeks to enter the US and remain permanently, or who is suspected of seeking to enter the US and remain permanently but who does not have the proper documents to demonstrate that s/he has the authorization to do so, is inadmissible.

What most frequent visitors do not realize is that the US has a certain conceit in its law. Namely that every foreigner seeking entry into the US is presumed to be intending to immigrate to the US. That is why it is critical that those who renounce their US citizenship or give up their Green Card seek proper advice from experienced counsel on their future travel back to the US. [Note: Along with over three decades of experience with former taxpayers traveling to the US, one of the authors also draws upon his experience in working as a port of entry official while going through law school.]

Reed Amendment: Real Issue or Toothless Tiger

In 1996, the US did a major overhaul of the Immigration and Nationality Act ("INA"). This legislative debate occurred in the wake of a November 1994 Forbes Magazine story on expatriation, when there was a great debate raging about Wealthy Americans leaving the US. Tapping into populist adverse sentiment, then-Democratic Representative Jack Reed introduced something that was later dubbed the "Reed Amendment". The Reed Amendment was

an attempt to bring into law the old playground rule that says, “if you take your ball and leave, you can’t come back”.

Unfortunately for those who supported such a rule, over the subsequent 27 years, lawmakers and bureaucrats found that both constitutional and practical issues have prevented such a barrier from being implemented. Therefore, it is very safe to say that despite this rule being alluded to in part of a paragraph in one of the forms filed during the renunciation appointment, the Reed Amendment is a toothless tiger. In short, it is not one of the bases for inadmissibility for either a visa issuance or refusal at a port of entry.

Visa Issues for former US citizens and Green Card holders

When foreigners seek entry into the US, they seek visitor status under a B1/B2 tourist status. Whether or not the foreigner needs to do something before seeking entry at a port of entry depends completely upon the passport they will be presenting at the port of entry.

The US is among the countries that begin with the premise that they always require the foreigner to attend a US embassy abroad to apply for a “visa”. Certain nationalities are exempted from this requirement if the foreigner meets the requirements under the US Visa Waiver Program (“USVW”). The countries included in the USVW program, as well as the eligibility conditions, are listed here.

Only nationals of Canada and Bermuda are completely exempted from both the visa and ESTA requirements before seeking entry from a port of entry official.

If a former taxpayer is from a country that requires a B1/B2 visitor visa before seeking entry, they will need to be able to prove that they are no longer a US citizen or Green Card holder. For those who have renounced their US citizenship, even though under US law they ceased to be a US citizen at the time of their renunciation appointment, they need to be in possession of a Certificate of Loss of Nationality (“CLN”) to apply for a US visa.

This is for the simple reason that a US visa officer only considers visa

applications from foreigners, not US citizens. As we described in Part 2, there is a gap period between the date of the renunciation appointment and the individual's receiving a CLN.

Depending on whether the mission adopts the relatively rare policy of issuing the CLN at the mission itself or sending it to State Department headquarters, the issuance of a CLN can take anything from a week to several months.

As a result, the US citizen expatriate who comes from a country that requires a US visa may have quite a period of time after their renunciation before they can apply for a B1/B2 visa to be able to travel back to the US.

If the former taxpayer is from a country that requires a B1/B2 visa and they gave up their Green Card status, the process is different. As described in Part 2, relinquishing Green Card status involves submitting an I-407 form either by mail or at a port of entry.

Despite the fact that the individual ceases to a Green Card holder the moment the I-407 is received by the US government, they still need to have gotten back from the US government a stamped I-407, acknowledging that the US government has noted they are no longer a Green Card holder.

If the relinquishment is done at a port of entry, the I-407 is immediately stamped and handed back to the individual.

If they are carrying a passport from Canada, Bermuda, or a USVW program country, they can be granted entry at that point. (Note the USVW program national needs to do an online ESTA application before being allowed entry).

If they are from a country that requires a B1/B2 visa, they cannot be immediately granted entry as they need to first apply for and secure a visa from a US mission abroad.

As a result, Green Card holders from countries that require a B1/B2 visa are advised to mail in their I-407 and apply to the local US mission once they receive back the stamped I-407.

Pros and Cons of other Non-Immigrant Visas, such as an E2 Visa

Many former US citizens or Green Card holders are nervous about abandoning their prior position of having an unlimited right to enter the US without first obtaining the permission of US officials to grant them visitor status in the US.

For this reason, former US citizens seek to obtain another non-immigrant status in the US, which gives them the ability to seek entry for longer than a six-month visitor status and have more rights than being a tourist or business visitor. These non-immigrant visa statuses include L-1A Intracompany Transferee Executive or Manager, O-1 Visa: Individuals with Extraordinary Ability or Achievement, and E-2 Treaty Investors.

The E-2 Visa has garnered a great deal of attention in the RBI/CBI world in the past few years, as countries like Grenada, Montenegro, and Turkey were included on the list of countries whose nationals were eligible for this type of visa. This gave these countries' CBI programs a considerable competitive advantage as a way for foreigners to gain early entry into the US while their EB-5 visas for a Green Card were being processed. However, this advantage was severely curtailed in late 2022 by the US National Defense Authorization Act, which noted that an individual needed to be "domiciled" for three years in the E2 treaty-listed country before being eligible.

However, we have long contended that while very useful for foreigners to fast-track their move into the US and its tax system, it was not appropriate for American taxpayers who were leaving the US tax system. This is because unlike the L-1A or O-1 visa categories, the E2 required that the holder be actively managing the business enterprise in the US.

This meant that to renew their E2 visa, the former US taxpayers would require US global tax liability under the Substantial Presence Test. In short, having just gone through great effort to take off the noose of US taxation by renouncing citizenship or relinquishing a Green Card, the individual who sought an E2 visa was climbing back up the scaffolding.

FINAL CONSIDERATIONS

As we have shown through this report, the process of legally leaving the US tax system is highly complex and requires expert advice and planning to achieve the desired goal.

However, if properly designed and executed, the one-time cost of executing such a departure will result in significant future tax savings, which will make the cost and hassle a rounding error.

As more and more wealthy Americans look into the future with concern, many are acquiring Backup Plans to give themselves the comfort of knowing that they can preserve their family's wealth and well-being should they decide to overcome life inertia and leave the US and its tax system behind.