Bloomberg Tax

Tax Management
International Journal™

Tax Relief for Certain Expatriates: Tax Compliance After the Fact

By Robert E. Ward, J.D., LL.M.
WardChisholm, LLP.
Vancouver, British Columbia and
Bethesda, Maryland

On September 6, 2019 the Internal Revenue Service announced the terms of a new procedure (the ''Relief Procedure'') which will allow certain former United States citizens to avoid covered expatriate status.[1] The Relief Procedure allows an individual otherwise characterized as a ''covered expatriate'' because of a failure to satisfy the five-year filing requirement of §877(a)(2)(C)[2] at the time of expatriation to file U.S. tax and information returns for the year of expatriation, as well as the five preceding years, well after expatriation. If the eligibility and submission requirements of the Relief Procedure are satisfied, the individual will avoid covered expatriate status. From the background and hypotheticals set forth in the explanation of the Relief Procedure, it appears intended primarily for individuals who might be described as ''accidental Americans'': those who acquired U.S. citizenship as a result of being born to parents who were briefly living in the United States at the time of birth. However, other expatriates will benefit from the Relief Procedure as well.

Background. Covered expatriates are subject to the exit tax regime of §877A. With limited exceptions noted below, individuals who relinquish U.S. citizenship (expatriates) and long-term U.S. residents who cease to be lawful permanent residents, are characterized as ''covered expatriates'' if they have one or more of the following characteristics:

(1) an average annual net income tax liability which exceeds an inflation-adjusted amount of $168,000 (in 2019) for the five years prior to the year of expatriation (the ''tax liability test'');[3]

(2) a net worth of $2,000,000 or more on the expatriation date (the ''net worth test''); or

(3) failure to certify under penalties of perjury on Form 8854 having met all U.S. tax filing and payment obligations for the five years preceding the year of expatriation.[4]

Individuals who satisfy certain residence requirements and either (a) are dual citizens from birth or (b) renounce U.S. citizenship before attaining age 18½ are not subject to the tax liability or net worth tests, but must satisfy the five-year filing requirement nonetheless. Section 877A requires covered expatriates to recognize and pay tax on unrealized gains in excess of an inflation-adjusted amount of $725,000 (in 2019) and certain items of deferred compensation.[5]

Eligibility. The Relief Procedure enables former U.S. citizens — *not long-term permanent residents* — to avoid covered expatriate status by satisfying the five-year tax compliance requirement of §877(a)(2)(C) after the expatriation event.[6] Generally, former U.S. citizens who expatriated after March 18,

[1] The relief, procedures, eligibility, and FAQs can be found at https://irs.gov/indivisuals/international-taxpayers/relief-procedures-for-certain-former-citizens (Sept. 6, 2019).

[2] All section references are to the Internal Revenue Code, as amended (the ''Code''), unless otherwise indicated.

[3] The average annual net income tax amount of $124,000 set forth in §877(a)(2)(A) is subject to cost-of-living adjustments. §877(a) (flush language).

[4] *See* §877A(g)(1)(A), §877(a)(2). *See generally* Notice 2009-85, 2009-45 I.R.B. (Nov. 9, 2009).

[5] *See* §877A(a)(1), §877A(d)(2). The $600,000 exclusion on gain recognition under §877(A)(a)(3)(A) is subject to cost-of-living adjustments. *See, e.g.,* Rev. Proc. 2018-57, 2018-49 I.R.B. (Dec. 3, 2018), §2.38.

[6] Informal statements from IRS personnel indicate the Relief Procedure may be extended to long-term permanent residents. *See More Guidance Coming on U.S. Expat Relief Procedures*, Tax Notes Today Federal (Oct. 11, 2019).

ISSN 0090-4600

2010 may take advantage of the Relief Procedure. However, excluded from eligibility for relief are expatriates

- with a net worth of $2,000,000 or more on the date of expatriation,
- whose aggregate U.S. tax liability for the year of expatriation and the five preceding years totals more than $25,000,
- who filed a U.S. tax return as a U.S. citizen or resident, or
- whose average net income tax liability for the five years prior to the year of expatriation exceeds the $124,000 amount of §877(a)(2)(A) as adjusted for inflation for the year of expatriation ($168,000 for individuals expatriating in 2019).

Expatriates not excluded by one or more of the preceding circumstances must satisfy a further requirement: the failure to file required U.S. income tax and information returns and pay taxes and penalties for the five years prior to the year of expatriation was due to non-willful conduct. ''Non-willful conduct'' is defined in the same manner as under the Streamlined Filing Compliance Procedures: ''conduct that is due to negligence, inadvertence or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.''[7]

As noted above, the aggregate U.S. tax liability for the year of expatriation and the five preceding years cannot total more than $25,000. In computing the amount of tax due, the expatriate may reduce the expatriate's worldwide income by all available deductions and credits, including foreign tax credits and may take advantage of the foreign earned income exclusion under §911. However, U.S. tax withholding does not reduce the aggregate total tax liability.

For the limited group of expatriates who satisfy the eligibility requirements, the relief provided by the new procedures is significant.

- Covered expatriate status is retroactively lost.
- There is no liability for unpaid taxes and penalties for the six years for which returns must be submitted and all prior years.
- The IRS will confirm receipt and completeness of the expatriate's submission.

The Relief Procedure may be relied upon by former U.S. citizens who expatriated after March 18, 2010.[8] Relief is not limited to circumstances in which expatriation was the result of voluntary renunciation. The Relief Procedure is expressly made available to naturalized citizens whose certificate of naturalization was cancelled by court order and, presumably, also applies to the other circumstances described in §877A(g)(4) by which U.S. citizenship may be relinquished.

Submission. In order to take advantage of the procedures, the expatriate must submit the following documents to the Internal Revenue Service Center in Austin:

- a certificate of loss of nationality stamped ''Approved'' by the United States Department of State or a copy of the court order canceling the naturalized citizen's certificate of naturalization;
- a copy of either a (a) valid passport or a (b) birth certificate and government issued identification;
- a ''dual status'' Form 1040-NR with Forms 8854 and 1040 reporting worldwide income to the date of expatriation;
- any other required information returns for the year of expatriation; and
- Forms 1040 with all required information returns for the five tax years preceding the year of expatriation.

Each document submitted should be captioned in red ink with ''Relief for Certain Former Citizens'' at the top of each document.

Social Security Number. The expatriate need not acquire an SSN in order to submit the required returns. If the expatriate mistakenly acquired an ITIN, it is to be used in place of an SSN. Expatriates who mistakenly filed a Form 1040NR, *U.S. Nonresident Alien Income Tax Return,* remain eligible for relief, despite the requirement the expatriate have no filing history as a U.S. citizen or resident.

Examination. Returns submitted under the Relief Procedure will be subject to ''existing audit selection processes applicable to any U.S. tax return and may also be subject to verification procedures in that the accuracy and completeness of submissions may be checked against information received from other sources.'' However, all returns submitted under the Procedure will apparently be subject to at least cursory review. The guidance provides that submissions will be reviewed to confirm the eligibility criteria have been met. Further (and quite unlike streamlined submissions), ''the IRS will send a letter notifying you that your submission was received and complete.'' Apparently, the IRS intends notification to be given within two months of submission.

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[7] *Cf.* https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures (June 22, 2019).

[8] The date of FATCA's enactment by the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147.

ISSN 0090-4600

Duration. The Relief Procedure is immediately effective and will remain effective until sometime after its withdrawal is announced by the IRS.[9]

Observations. The Relief Procedure should be considered in the broader context of the six Large Business & International compliance campaigns announced on July 19, 2019 which include campaigns directed at post-OVDP and expatriation compliance. The post-OVDP campaign is directed at taxpayers who took advantage of the Offshore Voluntary Disclosure Programs but failed to meet subsequent U.S. tax compliance obligations. The expatriation campaign is directed at U.S. citizens and long-term residents subject to the exit tax regime of §877A because of expatriation after June 17, 2008 who ''may not have met their filing requirements or tax obligations. The IRS will address non-compliance through a variety of treatment streams, including outreach, soft letters, and examination.''[10] Perhaps the IRS is clearing smaller taxpayers whose non-compliance does not merit imposition of the exit tax in order to focus on bigger fish. However, many expatriates who reside in countries in the European Union or Canada with relatively high-income tax rates often have foreign tax credits which reduce total U.S. taxes for the year of expatriation and the five preceding years to or below the $25,000 ceiling. Prior to expatriation many of these individuals may also have owned significant assets which were transferred to spouses who are U.S. citizens using the gift tax marital deduction or spouses who are not U.S. citizens and other family members using the U.S. gift tax exemption so as to reduce the expatriate's net worth to less than $2,000,000.[11]

Perhaps the most surprising and helpful aspect of the Relief Procedure is that the expatriate need not obtain a Social Security Number in order to submit the required returns. The ability of expatriates to take advantage of the Procedure without obtaining a Social Security Number is in and of itself a compelling reason to plan to take advantage of the relief it offers instead of purposefully satisfying the five-year filing requirement of §877(a)(2)(C) prior to expatiration. The Procedure favors non-compliant expatriates in other ways. No tax payment is required if the aggregate tax liability for the year of expatriation and the five preceding years totals $25,000 or less. The guidance describing the Relief Procedure is explicit that ''filing FBARs is not an eligibility criterion. . . .''[12] Apparently, other deficiencies in the returns will also be tolerated as long as ''best efforts'' were made to properly compute the amount of U.S. tax due.[13] Unlike with Streamlined submissions, the expatriate is not required to explain his or her noncompliance or confirm under penalties of perjury that the non-compliance was non-willful. The Relief Procedure follows a disturbing pattern of tax administration by the IRS in the area of international compliance by offering a better deal to taxpayers who wait than taxpayers who comply.[14] Whatever else the Relief Procedure does, it should dispel the myth that tax compliance is necessary to relinquish U.S. citizenship . . . or that the State Department and Treasury speak with one another.

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[9] https://www.irs.gov/individuals/international-taxpayers/relief-procedures-for-certain-former-citizens (Sept. 6, 2019).

[10] https://www.irs.gov/businesses/corporations/the-irs-large-business-and-international-division-lbi-announces-the-approval-of-six-additional-compliance-campaigns (July 24, 2019).

[11] The United States Gift Tax exemption for 2019 is $11.4 million.

[12] While it is not necessary for FBARs to be submitted at the time the other documentation required by the Procedure is submitted, the FBAR filing requirement is clearly not waived. The guidance describing the Procedure provides instructions for electronic submission of the FBARs.

[13] Hypothetical 1 under FAQ 9 posits omission of Form 8621, but confirms the expatriate is eligible for relief, nonetheless.

[14] In this regard, consider the IRS's announcement of Streamlined filing procedures in 2012, more than three years after initiation of the first offshore voluntary disclosure program in 2009.

ISSN 0090-4600