Expatriating from US

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W. L. Dueck & Co. LLP
US and Cross-Border Tax Solutions

Outline

I. Introduction
II. Expatriation Pros and Cons
III. US Tax Implications of Expatriation
IV. Covered Expatriate Status
V. Expatriation Process and Other Issues

Disclaimer etc.

- This presentation is of a general nature and does not apply to all circumstances.
- Individual situations should be evaluated separately by tax practitioners with the relevant experience and expertise.
- All amounts identified are in US dollars.

I. Introduction

A. Expatriation from the US
B. Citizenship-Based Taxation
C. History of Expatriation
D. US Exit Tax – Summary
E. Comparison with Canada

Expatriation from US

- Expatriation from US arises from ceasing to be a:
  - US citizen
  - Lawful permanent resident of the US ("green-card" holder)
- Expatriation does not necessarily occur because:
  - A US citizen:
    - Resides outside the US
    - Becomes a citizen of another country
  - A green-card holder ceases to live in the US

Citizenship-based Taxation

- 1864 – Began in Civil War
- Modified by
  - Foreign Tax Credits – 1918
  - Foreign Earned Income Exclusion - $101,300 in 2016
- 1966 – US a tax haven for non-US persons
  - 30% US tax rate for non-US citizens not resident in US
  - US tax rates up to 70% for US citizens and residents

History of Expatriation

Old Rules
- Must pay US tax for 10 years after revocation
- No rules for non-US citizens

1996 – Clinton changed expatriation law
- Established more objective standards
- Introduced "long-term resident" rules for non-US citizens

2008 – Ended 10 year US tax requirement
- US "Exit Tax" similar to Canada's "Departure Tax"
- Introduced "covered expatriate" rules

US Exit Tax - Summary

Covered Expatriates are subject to US tax on:
- Unrealized appreciation of worldwide assets
- Immediate tax on deferred compensation
  - Reduced to 30% on eligible deferred compensation
- US estate and gift tax on transfers to US persons

Covered Expatriates – includes both
- US citizens
- Long-term residents

Who meet specific criteria

Covered Expatriate

Covered Expatriates – subject to US Exit Tax
- US citizens
- Long-term residents

Covered Expatriates meet one of three criteria:
- > $2 million net worth
- >$161,000 average annual US tax liability
- Fail to certify compliance with US tax law for past 5 years

Comparison with Canada

	US Exit Tax	Canada Departure Tax
Applies to:	Covered Expatriates	All Emigrants
Tax – Unrealized Appreciation	Yes*	Yes
Tax – Deferred Compensation	Yes*	No
Tax – Estate and Gift Tax	Yes – 40%*	Not Applicable
Defer Payment	Yes	Yes
Interest Rate	Statutory Rate	None if security provided

US Exit Tax – Example

- John Doe is a US citizen as are his spouse and children
- John Doe:
  - Net worth $10 million
  - Unrealized appreciation $2 million held >12 months
  - Canadian pension – fair market value $1 million
  - Compliant with US tax returns for last 5 years
- John Doe revokes US citizenship
- John Doe is a Covered Expatriate – Net worth >$2 mil.

US Exit Tax

	US Exit Tax	Canadian Departure Tax
Tax – Unrealized Appreciation	$261,400	$480,000
	20% x ($2,000,000 - $693,000)	24% x $2,000,000
Tax – Deferred Compensation	$396,000	Not Taxed on Departure
	39.6% x $1,000,000	
Tax – Transfer to Spouse	$0	Not Applicable
	Unlimited Marital Deduction	
Tax – Transfer to Children	$4,000,000**	Not Applicable*
**Tax payable by recipient	40% x $10,000,000	
Total Tax	$5,218,800	$480,000
* Canadian tax would only	apply if assets are Taxable Cdn	Property and appreciate.

II. Expatriation Pros & Cons

A. Why Expatriate?
B. Why Not Expatriate?
C. Non-Tax Issues

Why Expatriate?

- US Income Tax – conflicts with Canadian tax including:

Mutual Funds	Professional corporations
Family Trusts	Registered Educ. Savings Plans
Capital Dividends	Estate Freeze
Principal Residence	Stock Options
Flow-Through Shares	Lottery/Gambling Winnings

- US Net Investment Income Tax – no foreign tax credits
- Cost and complexity of US tax reporting
- Foreign Account Tax Compliance Act (FATCA)
- US Estate and Gift Tax

Why Not Expatriate?

- Protection of US citizens abroad
- Views of friends and family
- Right to:
  - Enter the US
  - Vote in US
- Access to:
  - Reside in US
  - US job market

Expatriation – Non-Tax Issues

- Names of expatriates published quarterly
- US entry for non-US persons is a privilege not a right
- Reed Amendment
  - Bars entry where expatriation is to avoid US tax
  - Widely viewed as unconstitutional
  - US State Dept. has advised US consulates to not enforce
  - Only one case of enforcement

III. Expatriation – US Tax Implications

A. US Expatriation Rules Apply to?
B. Who is a US Citizen?
C. Who is a Long-Term Resident?
D. Deemed Disposition
E. Deferred Compensation
F. Non-Grantor Trusts
G. US Estate and Gift Tax

US Expatriation Rules Apply to?

US citizens:

- Born as US citizens
  - Born in US
  - Born outside US to US citizen(s) parents
- Naturalized as a US citizen – adult

Long-Term Residents of US

Who is a Long-Term Resident?

- US lawful permanent resident ("green-card")
- Has green-card in 8 of last 15 years

Warning – Green Cards

- Green-card holders only terminate their US tax status if:
  - Formally abandon card and receive Form I-407,
  - It is judicially rescinded or revoked or
  - Claiming Canadian residency under tax treaty in US tax return.
- Green-card holders resident outside US must:
  - File required US tax returns
  - Claim Canadian residency under tax treaty in one or more years
  - Failure to do so may expose them to US Exit Tax

US Exit Tax – Unrealized Appreciation

Covered Expatriates taxable on:

- Unrealized appreciation of worldwide assets
- Fair market value determined day before renunciation
- Reduced by $693,000 exemption (2016)

May defer payment of tax until asset disposed if:

- Adequate security is provided
- Interest is payable
- Death constitutes disposition

US Exit Tax – Unrealized Appreciation

Covered Expatriates who are Long-Term Residents:
- Taxable on date US lawful permanent residency ceases
- Only taxable on appreciation after becoming US resident

US Exit Tax – Deferred Compensation

Covered Expatriates
- Included into income and taxed at graduated rates
- Date of renunciation

Deferred Compensation includes:
- Pension plans (both US and non-US)

Eligible Deferred Compensation – 30% tax on receipt
- Payer is or elects to be a US person
- Covered Expatriate must notify payer and waive rights.

US Exit Tax – Deferred Compensation

Specified Tax Deferred Accounts:
- Taxed at graduated tax rates
- Treated as distributed day prior to renunciation
- Adjustments made to subsequent distributions
- No early distribution tax applies

Specified Tax Deferred Accounts includes:
- Individual Retirement Plan
- Qualified tuition program (529 Plan)
- Coverdell education savings account
- Health savings account, and
- Archer Medical Savings Account

US Exit Tax – Non-grantor Trusts

- 30% US tax on distributions to Covered Expatriates
- Applies to "taxable portion" of distribution
  - amount otherwise taxable if recipient was a US person
- Only applies if Covered Expatriate was beneficiary at renunciation

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US Exit Tax – Estate and Gift Tax

Covered Expatriates:
- Subject to 40% US estate and gift tax
- Tax payable by recipient
- Only applies transfers to:
  - US citizens and residents
  - US trusts
  - Non-US trusts when distributed to US persons
- Excludes transfers to US citizen spouse

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IV. Covered Expatriate

A. Covered Expatriate Thresholds
B. $2 Million Net Worth
C. Average Annual US Tax Liability
D. Five Year Certification
E. Strategies to Avoid Covered Expatriate Status

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Covered Expatriate Thresholds

Covered Expatriate will apply to any:

- US citizen who renounces their US citizenship or
- Long-Term Resident who ceases to be a lawful permanent resident

If they meet any of the following thresholds:

- Net worth exceeds $2 million,
- Average annual US tax liability exceeds $161,000 (2016)
- Fail to certify compliance with US tax law for past 5 years

$2 Million Net Worth

Net worth includes all of taxpayer's property:

- Owned directly or indirectly worldwide
- Jointly-owned property
- Pensions, annuities and other assets using IRS tables
- Real estate including principal residence
- Inventory, real property, etc.
- Any property that may be gifted

Average Annual US Tax Liability

- Threshold is $161,000
- Average annual US tax liability net of foreign tax credits
- Computation is made over last five years
- Joint taxpayers liable for their US tax and their spouse's

Five Year Certification

- Must certify US tax compliance for last five years
- Including all US income tax filing requirements for:
  - Interests in non-US financial accounts
  - Interests in non-US entities including:
    - Corporations
    - Partnerships
    - Trusts
    - Mutual Funds, etc.
  - Transfers to non-US entities

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Dual Citizen at Birth

If a citizen of US and another country at birth and

- Continues to be a citizen of the other country and
- Taxed as a resident of the other country and
- Not a US resident for more than 10 of prior 15 years

Or

- Renounces prior to age 18 ½ and
- Not resident in US for more than 10 years prior to renunciation

Avoids Covered Expatriate with certifying 5 years of US tax returns

Other limits not applicable ($2 mil. net worth or $161,000 US tax)

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Avoiding Covered Expatriate Status

Net Worth

- Gifting Strategy
- Valuation
- Clarify Ownership

Average Annual US Tax Liability

- Investment Strategy
- Waiting Game

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Avoiding Covered Expatriate Status

Five Year Certification

- Streamlined – 3 delinquent years (6 for non-US accounts)
  - Foreign – no penalties requires
    - Less than 35 days in US in one of last 3 years
    - Non-willful
  - Domestic – 5% penalty on non-US financial accounts
- Offshore Voluntary Disclosure
- Quiet Disclosure
- International Information Return Submissions

V. Other Expatriation Issues

A. Renunciation Process
B. Post-Renunciation
C. Travel to US
D. US Tax Residency
E. Tax Domicile v. Tax Residency

Renunciation Requirements

Must renounce at a US consulate outside the US:

- Canada – Calgary, Vancouver, Toronto, Montreal, Halifax
- Most other countries also have US consulates
- Backlog of 3+ months in Calgary

Fee - $2,350

Avoid Covered Expatriate status if at all possible

- Renounce only after no "thresholds" will be exceeded

Renunciation Process

Consulate will interview renouncing individual to:

- Confirm desire to renounce
- Give statement of consequences of renunciation
- Affirm/swear decision is voluntary
- Advise that renunciation is not reversible
- Question regarding the individual's purpose or intent

Date of consular meeting is date of renunciation

Certificate of Loss of Nationality will be issued 6+/- months

Post Renunciation

Taxpayer must:

- File final US tax return for year of renunciation
- Same due date as in prior years
- IRS Form 8854, Initial and Annual Expatriation
- Dual-Status tax return subject to US tax on:
  - Worldwide income while a US citizen
  - On US source income only after renunciation

Post Renunciation

Only subject to US tax in future if:

- Earns US source income
- Becomes a US resident or domicile
- Subject to US estate tax on US situs property or
- US gift tax on gifts of tangible property completed in US

Travel to US

Former US citizens traveling to US should travel with their:
- Canadian passport/Nexus card and
- Certificate of Loss of Nationality

Entering the US is not a right for former citizens of the US

US Tax Residency

- US lawful permanent resident ("green-card"),
- Substantial Presence Test – "any part of a day is a day"
- Tax Residency ≠ Immigration Residency
- Tax Residency ≠ Domicile

Substantial Presence Test

Over 182 days present in US in current year
- Must claim relief under treaty and
- File IRS Form 1040NR if resident in Canada

<u>or</u>

Less than 183 days present in US in current year
- Sum of days present in US in current year plus
- Third of days present in US in preceding year, and
- Sixth of days present in US in second preceding year
- Must file IRS Form 8840, Closer Connection Statement

Questions?

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