

## Choosing to Renounce US Citizenship or Legal Permanent Residence (Green Card)

Departures Effective June 17, 2008 Forward

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The goal of this article is to provide a comprehensive checklist of information for the US person to consider prior to choosing to renounce US citizenship or legal permanent residence. This article is not intended to teach you the technical competence required to perform self compliance; however it will certainly arm you with the knowledge to determine if your US tax preparer knows all that they should know to provide you with technically competent professional services.

### Expatriation After June 16, 2008:

Effective June 16, 2008 (different rules applied to expatriation: 1) before June 4, 2004, 2) Between June 3, 2004 and June 17, 2008 and 3) after June 16, 2008 in accordance with IRS Notice 2005-36, by Section 804 of the American Jobs Creation Act of 2004, and then Effective June 17, 2008 in accordance with The Heroes Earnings and Assistance Relief Act of 2008) IRC Section 877- Expatriation to Avoid Tax- and Form 8854- Expatriation Information Statement- reporting requirements, were amended and Section 877A- Tax Responsibilities of Expatriation were added.

Expatriation is defined as: 1) applying to US citizens or 2) long term residents whom have renounced. A long term resident is defined as a green card holder- legal permanent resident- in at least 8 of the last 15 tax years ending with the year your residency ends. Do not count any tax year where you were treated as a tax resident of a foreign country that has an income tax treaty with the US and where you do not waive treaty benefits. Such that only tax years with a green card while you are present in the US count towards the 8/ 15 tax year rule.

If you meet the above requirements 1) or 2), the expatriation rules will apply and you will be deemed a 'covered expatriate' to you if ANY of the following apply: 1) Your average annual net income tax for the 5 years ending before the date of expatriation is more than \$145,000- for 2009 (2008- \$139,000), 2) Your net worth is 2 million or more on the date of your expatriation or 3) (effective June 3, 2004 forward) You fail to certify on Form 8854- Expatriation Information Statement- that you have complied with all US federal tax obligations for the 5 years preceding the date of expatriation. Effective June 3, 2004 there no longer remains a 'presumption' of tax motivation and therefore you can no longer request a private letter ruling to avoid IRC Sec 877. If you meet these tests after June 16, 2008 you are now subject to the IRC Sec 877 and 877A- Expatriation provisions.

### Exceptions- \*\*\*\*\*New effective after June 16, 2008- definition changes:

An exception (effective June 3, 2004 forward) to the expatriation rules applies for Dual citizens and certain minors as follows (however the Form 8854- Expatriation Information Statement- certification regarding US federal tax compliance for the last 5 years must still be supplied):

1) Dual citizens- defined as: At birth a US citizen and citizen of another country and you continue as a citizen there, in addition to being taxed there as a resident of that other country and were not US resident for more than 10 years during the last 15 years or

2) Certain minors-defined as: expatriation before 18 ½ years old and were a resident of the US for not more than 10 years before expatriation.

Old rules before June 17, 2009- US Presence & Tax Consequences After Expatriation:

As long as you do not meet the above 2 exceptions, if during the 10 year period following expatriation you are physically present in the US for more than 30 days per calendar year, you will be treated as a US resident alien and taxed on your worldwide income for that whole calendar tax year. Requiring the filing of a resident US income tax return Form 1040. Do not count any days up to a limit of 30 days in which you performed personal services in the US for an unrelated employer if either of the following apply: 1) You have ties with other countries – obtained citizenship/ residency of another country after expatriation in which you/ spouse or either parents were born and you become fully liable for income tax in that country or 2) You are physically present in the US for less than 30 days per calendar year during each of the 10 years after expatriation.

Expatriation Effective Date- \*\*\*\*\*New effective after June 16, 2008- definition changes:

You are considered to have expatriated the latter of the date you relinquish US citizenship or terminate long-term residency. There is no longer effective after June 16, 2008 a requirement to file a Form 8854 to establish an effective expatriation date.

Former US citizens- You are considered to have relinquished your US citizenship the earliest of: 1) The date you renounce US citizenship before a diplomatic or consular officer of the US (provided followed by issuance of certificate of loss of nationality), 2) date you furnish the State Department a signed statement of voluntary relinquishment of US nationality (provided followed by issuance of certificate of loss of nationality), 3) date State Department issues issuance of certificate of loss of nationality, or 4) date US court cancels your certificate of naturalization.

Former Long- Term Residents- You are considered to have terminated your long-term residency the earliest of: 1) The date you voluntarily relinquish/ abandon your ‘green card’ by filing with DHS Form I-407 with a US consular or immigration officer, 2) date you became subject to a final administrative order for removal from the US under the IN Act and actually left the US, 3) dual resident of the US and the country of new residence has income tax treaty with the US, you are resident of that new country and filed Form(s) 8833 and 8854.

EXPATRIATION TAX:

Old tax before June 17, 2009- If the expatriation rules apply: 1) (new effective June 3, 2004 forward) you must file Form 8854 – Initial and Annual Expatriation Information Statement – each year during the 10 year period following expatriation even if you owe no tax (there is a \$10,000 penalty for failure/ incorrect filing) and 2) You are subject to US tax on Form 1040NR at graduated rates on US source gross income and gains unless you are subject to the higher 30% flat tax or reduced by treaty. – A statement listing your dividends, interest, all items of US or foreign source whether or not US taxable.

(\*\*\*\*\*New tax effective June 17, 2008) New IRC Sec. 877A- Tax Responsibility of Expatriation:-  
New Expatriation- Mark-to-Market Exit Tax:

\*\*\*\*\*Effective June 17, 2008 in accordance with The Heroes Earnings and Assistance Relief Act of 2008, IRC Section 877A- Tax Responsibilities of Expatriation was added to implement the abolishment of the above expatriation rules with regards to the filing of US tax returns for a period of ten (10) years, to be replaced by a one time mark-to-market tax on an individual’s net unrealized gain on property, as of the day before the expatriation date.

These new rules align the US with tax rules similar in other income tax treaty countries. Accordingly if these individuals meet the expatriation rules they will now be treated as if they sold (deemed sale) all of their property for fair market value on the day prior to the expatriation date. The mark-to-market tax is imposed on the property’s net unrealized gains to the extent it exceeds \$626,000- for 2009 (2008- \$600,000). That will become \$627,000 in 2010.

This exclusion amount must be allocated to all built in gain property that is subject to the mark to market regime and owned by the covered expatriate on the day before expatriation, regardless of whether the covered expatriate makes an election (as below) to defer tax with respect to any property. Specifically the exclusion must be first allocated pro rata to each of the built in gain property by multiplying the exclusion by the ratio of built in gain per asset over total built in gains of all assets. The allocated exclusion may not exceed the per asset built in gain. If the built in gains of all assets is less than the total exclusion, then the exclusion is limited to this total built in gain amount.

The exclusion is once per lifetime; however any unused initial exclusion subject to a future years inflation adjusted exclusion may be applied to a second expatriation.

Gains arising from the deemed sales must be taken into taxation for the tax year of the deemed sale. Deemed losses are treated under existing IRC law and regulations.

Step-up in Basis-For purposes of determining the tax imposed, a stepped up basis rule applies to property that was held by an individual on the date the individual first became a U.S. resident (within the meaning of Code Sec. 7701(b)). The individual is treated as having a basis on that date of not less than the fair market value of the property on that date. However, the individual may make an irrevocable election not to have this rule apply on a property by property basis and this rule will not apply to US real property interests and property held or used in connection with the conduct of a trade or business within the US. Unless in the later case the individual was a resident of a US treaty country and the nonresident alien held the property in connection with the conduct of a US trade or business that was not carried on through a permanent establishment in the US.

Mark-to-market exceptions-:

1) Eligible Deferred Compensation Items (per IRC Sec 219(g)(5)- all basic work related qualified retirement plans- Profit Sharing plans, including 401(k)/ 403(b)/ Annuity Plans and Contracts, SEP's, Simple Retirement Accounts, interests foreign pension plans or similar retirement arrangements or programs, any item of qualified deferred compensation 'substantially vested'- qualified or un qualified options, restricted stock awards, stock appreciation rights or IRC Sec 83)- subject to 30% withholding at source and make irrevocable waiver of any right to claim any reduction in withholding under ant treaty with the US,

2) Ineligible Deferred Compensation items- any item not covered or referred to above as eligible deferred compensation- treated as having received the present value of the accrued benefits the day prior to expatriation,

3) Interests in Nongrantor Trusts- domestic or foreign - subject to 30% withholding at source and make irrevocable waiver of any right to claim any reduction in withholding under ant treaty with the US and

4) Specified Tax Deferred Accounts- (per IRC Sec 408(a) or (b) Individual Retirement Accounts or Annuities, but not 408(k) or (p), IRC Sec 529 plans, Coverdell, HSA or Archer MSA)- treated as receiving a distribution the your entire interest in the account the day before expatriation.

Items 1 and 3 are subject to withholding at source. Items 2 and 4 are subject to tax as specified above. In all four (4) cases Form W-8CE must be supplied to the payers of all four (4) items above to either inform them of their 30% withholding responsibilities or request the present value or value of the individual's entire interest, such that the proper amount of income may be included upon filing and resultant tax paid.

Specific definitions of the above items 1- 4 referenced exceptions may be found in IRS Notice 2009-85 pages 26- 31

No early distribution tax by virtue of IRC Section 72(t) will be imposed as a result of the above.

Expatriation tax return- if you are subject to the mark-to-market tax, you must file Form 1040 or dual status 1040NR with Form 1040, as appropriate and attach Form 8854- Expatriation Information Statement.

Once the actual sale of property occurs adjustments are made to the amount of the gain or loss realized to take into account the gain or loss under these new mark-to-market rules, without regards to the \$626,000- for 2009 (2008- \$600,000) exemption.

Deferral of Payment of Tax-:

Opportunity exists for an individual to elect by tax deferral agreement with the IRS to defer payment of the mark-to-market tax imposed upon deemed sales, where interest at the prescribed rate would apply. The election is irrevocable and is made on a property-by-property basis. Form 8854 must be continued to be filed for all years up to the point where the full amount of the deferred tax and interest is paid.

Under this deferment agreement the deferred tax attributable to the property is due the earlier of: i) voluntary, ii) when the return is due for the taxable year in which the property is actually disposed of and iii) death.

However acceptable security must be furnished to the Secretary, which includes a bond or another form of security including letters of credit and be conditioned upon payment of the amount of tax due, plus interest and must be in accordance with the regulation requirements including being accepted by the Secretary. This election is made on Form 8854. Additionally you must make an irrevocable waiver of any right under any treaty of the US which would preclude assessment or collection of the mark-to-market tax.

These procedures are addressed by IRS Notice 2009-85 page 18, with a sample agreement in Appendix A to be filed by the due date of the return that includes the day before the expatriation date. The covered expatriate must attach a copy of the deferral request to their tax return that includes the day before the expatriation date and may file such request simultaneously with said tax return.

The agreement is filed and arranged by the IRS, SBSE Advisory Office, 7850 SW 6<sup>th</sup> Court, Mail Stop 5780, Plantation, FL 33324-3202, telephone number 954-423-7344.

Additionally the covered expatriate must appoint a US agent to accept communication from the IRS, to permit timely enforcement and generally facilitate the implementation. The covered expatriate and agent must enter into a binding agreement, example in Appendix B to IRS Notice 2009-85. This agreement must be submitted with the deferral request. If the US agent resigns or otherwise terminates the covered expatriate must notify the IRS within 90 days at Advisory, 7850 SW 6<sup>th</sup> Court, Mail Stop 5780, Plantation Florida 33324-3202. Subject to provisions of Page 20 of IRS Notice 2009-85.

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