



## Worldwide Tax Daily

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### Budget Proposal May Offer Escape From U.S. Tax for Dual Citizens


**Andrew Velarde**

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Summary by **taxanalysts**

A proposal buried deep in the U.S. Treasury green book explaining the revenue proposals of the Obama administration's 2016 budget may provide escape for some dual citizens from the burdens of the U.S. worldwide tax system, including the requirements of the Foreign Account Tax Compliance Act, practitioners told Tax Analysts.

Full Text Published by **taxanalysts**

A proposal buried deep in the U.S. Treasury green book  explaining the revenue proposals of the Obama administration's 2016 budget may provide escape for some dual citizens from the burdens of the U.S. worldwide tax system, including the requirements of the Foreign Account Tax Compliance Act, practitioners told Tax Analysts.

"It would provide these individuals residing abroad with an unambiguous way of relinquishing U.S. citizenship and thereby avoiding unnecessary withholding and reporting under FATCA," Roy A. Berg of Moodys Gartner Tax Law LLP in Calgary said February 3.

Jonathan Jackel of Burt, Staples & Maner LLP framed it as an issue of fairness and saw the proposal as a step in the right direction. "If this were enacted, it would deal with a lot of the unfairness imposed by the worldwide taxation system that the U.S. has," he said February 4.

Jackel added that he has repeatedly seen client situations with individuals who are unaware that they are U.S. citizens. "Part of the problem is it is seen as kind of a technicality. It is also so hard to deal with the tax consequences of being a U.S. citizen, once you find out about it, because of the expatriation provisions in [section 877A](#)."

Section 877A requires citizens who are covered expatriates and who relinquish their U.S. citizenship to pay a mark-to-market exit tax on a deemed disposition of their worldwide assets immediately before their expatriation. A covered expatriate is one who meets any one of three tests: the tax liability test, applicable to individuals with an average annual net income tax liability in excess of an inflation-adjusted specified amount; the net worth test, for individuals worth more than \$2 million; or the certification test, for individuals who fail to certify compliance with U.S. tax

obligations for the five years preceding their expatriation date.

Under the proposal to "provide relief for certain accidental dual citizens," individuals will not be subject to tax as a U.S. citizen and will not be covered expatriates subject to the exit tax if they were a dual citizen at birth, have been a citizen of the other country at all times, have not been a resident of the U.S. since turning 18-1/2, and have never held a U.S. passport or only held one for the sole purpose of departing from the United States. The proposal states that citizens seeking the relief must relinquish their citizenship within two years of the later date of January 1, 2016, or upon learning that they are a U.S. citizen. They must also certify under penalties of perjury that they have complied with all U.S. tax obligations that would have applied during the five years preceding the year of expatriation if the individual had been a nonresident alien during that period.

Berg said that under the proposal, most dual citizens would not have to file anything more than what they had previously filed to satisfy the certification requirement, since they would only have to "catch up" on filings if they actually had reportable U.S. income.

"Individuals who became citizens of both the United States and another country at birth may have had minimal contact with the United States and may not learn until later in life that they are U.S. citizens," the green book explains. "These individuals may be citizens of countries where dual citizenship is illegal. Many of these individuals would like to relinquish their U.S. citizenship in accordance with established State Department procedures, but doing so would require them to pay significant U.S. tax."

Berg said that in addition to the proposal's advantages for taxpayers, the IRS would be relieved of the administrative burden of having to process five years' worth of returns from individuals, many of whom do not owe tax. The compliance burden under FATCA would also be substantially reduced. "It's really a win-win if you consider it that way," Berg said. Practitioners have previously commented [on] how U.S. citizens living abroad have had difficulty opening bank accounts because of FATCA, whose implementation, some have argued, may be responsible for the recent spike in expatriations. (Prior analysis 📄.)

Jackel said that expatriation would not free the individuals of all the encumbrances of FATCA, however. Rules requiring financial institutions to document renunciation of citizenship for customers born in the U.S. would still impose burdens.

### **No Legislation Needed**

Compared with other items in the budget, the cost of the proposal is not imposing. Treasury estimates that over the next decade, the dual citizen relief would only cost \$403 million.

Berg said that the implementation cost seemed "remarkably low," but it was unclear whether the estimated fiscal loss is on a gross basis, taking into account only lost tax revenue, or on a net basis, taking into account lost revenue and the reduction in processing cost. According to the Taxpayer Advocate Service's 2012 annual report 📄 to Congress, more than 80 percent of U.S. taxpayers abroad claiming the foreign earned income exclusion and foreign tax credit did not have any U.S. tax liability.


"By allowing these individuals to renounce without forcing five years of compliance on them, the U.S. fisc will benefit," Berg said. What's more, the administration may not have to wait for legislation from Congress to give effect to the proposal, he argued.

"While the proposed relief was contained in the revenue proposal, there is a chance that it could be given near-immediate effect if Treasury issues regulations to that effect. [Section 7701\(a\)\(50\)\(B\)](#) authorizes Treasury to adopt regulations that address the same dual citizen issues as does the proposal. This is very exciting," Berg said.


Section 7701(a)(50) addresses the termination of U.S. citizenship and states that individuals do not cease to be treated as citizens before the date on which their citizenship is treated as relinquished under [section 877A\(g\)\(4\)](#). It also allows the prescription of regs that would except individuals who are dual citizens from birth.

Jackel agreed with Berg's assessment that regs without legislation were possible. "I do think this provision does seem to have a chance," he said. "It doesn't expand the taxing authority in any way, and it does seem to deal with an issue of fundamental fairness . . . where [taxpayers] haven't had any meaningful contact with the U.S. as an adult. It is probably inappropriate to tax that kind of person on their worldwide income."

### Shortcomings and Other Consequences

Berg argued that however the relief is potentially carried out, either through legislation or under the authority of the tax code, the proposal may "spell the death-knell" to the Canadian legal challenge to implementing FATCA and the intergovernmental agreement. Two Canadians filed suit against their government on August 11, arguing that its IGA implementing FATCA is unconstitutional. (Prior coverage )

"Both of the plaintiffs in that lawsuit are individuals who were dual citizens at birth, and the efficient procedure for relinquishing U.S. citizenship in the proposal might procedurally vitiate their claims," Berg said.

It has been estimated that Canada has the second largest population of U.S. dual citizens with about 800,000. Mexico has the largest population, with more than 1 million. (Prior coverage )

Berg said the proposal may also affect potential filers in the IRS's offshore voluntary disclosure program and streamlined program.

"Many of our clients who are in either [the] OVDP or streamlined [program] wish to renounce their U.S. citizenship. Under the proposal, assuming they otherwise qualify (and don't have U.S. source income), they could renounce without having to participate in these programs," Berg said.

Jackel said that the deadline imposed by the proposal could create hardships for some individuals who may be aware of their U.S. citizenship but not of the tax consequences of citizenship. But, he added that many of the affected individuals may be wealthier individuals who are customers of private banks and will likely be advised if the proposal were to become law. He said that there is a "creeping realization" of U.S. tax law requirements, especially in light of recent Justice Department activities in Switzerland and Israel, and that wealthy customers of banks may have already been exposed to this issue.

"The word is getting out, but it hasn't got out to everybody, by any means," Jackel said.

Berg added that many of his clients would like to see the proposed relief expanded even further to include individuals not born dual citizens.

"Many of these individuals were told by both Canadian and U.S. immigration officials that they had lost their U.S. citizenship when they took the Canadian oath of citizenship, only to find that immigration law had changed retroactively, restoring their U.S. citizenship and therefore their U.S. tax filing obligations. We are hopeful this issue will be addressed as these matters are considered in Congress," Berg said.

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## Tax Analysts Information

**Code Sections:** Section 877A -- Expatriation Tax Responsibilities  
Section 7701 -- Definitions

**Jurisdictions:** [United States](#); [Canada](#); [Mexico](#)

**Subject Areas:** FATCA  
Compliance  
Individual income taxation  
Information disclosure  
Withholding

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