

Overseas Americans: Time to Say 'Bye' to Uncle Sam?

Chased by the U.S. Government, Thousands Are Severing Ties With America. Here's What You Need to Know

By LAURA SAUNDERS and LIAM PLEVEN – 08/19/2013

Here is a sign that life is getting complicated for U.S. taxpayers with assets abroad: More of them are deciding they are better off cutting official ties with America.

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In the first half of 2013, 1,809 people renounced their American citizenship or permanent-resident status, according to a tally by Andrew Mitchel, a tax lawyer who tracks U.S. data. At that pace, the 2013 total would double the previous high of 1,781 renunciations in 2011.

Daniel Kuettel, a Colorado native who lives near Zurich, says he gave up his U.S. citizenship in October because he feared he wouldn't be able to get a mortgage now that some Swiss banks are cutting ties with American clients.

"It was a really difficult decision. I had to think about what was best for me and my family, to reduce the risk," says Mr. Kuettel, a 41-year-old software developer. He says his income was below the limit the U.S. allows overseas taxpayers to exempt and he owed no U.S. taxes.



The increase in renunciations is one sign that ordinary Americans who have lived and worked abroad for years, as well as green-card holders in the U.S. and overseas, believe they are at growing risk because of the intensifying government pursuit of undeclared foreign assets.

The crackdown started in the wake of the 2001 terrorist attacks, and it gathered force after Swiss banking giant UBS AGUBSN.VX +0.94% agreed in 2009 to pay \$780 million to settle charges it had helped U.S. taxpayers hide assets.

Since then, more than 80 U.S. taxpayers have been criminally charged, and Switzerland's oldest bank, Wegelin & Co., closed down after pleading guilty to helping U.S. taxpayers hide more than \$1.2 billion abroad.

On Friday, a prominent Swiss lawyer pleaded guilty in U.S. court to helping U.S. taxpayers hide millions of dollars abroad.

U.S. officials are enforcing rules established by Congress—some widely ignored for years, and others added more recently—that threaten stiff penalties and even prison for failure to comply. The crackdown has brought more than \$6 billion in taxes and penalties into U.S. coffers, and experts say another \$5 billion is in the pipeline. A representative for the IRS declined to comment.

But many U.S. taxpayers who aren't wealthy also are finding it harder to attend to routine financial matters abroad, because some foreign institutions don't want to face the cost of complying with U.S. requirements.

Much of the money comes from well-heeled taxpayers. The top 10% of taxpayers who went through one of the Internal Revenue Service's limited-amnesty programs had account balances over \$4 million, the U.S. Government Accountability Office estimated in a March report. The programs are one way for taxpayers who have missed past filings to come into compliance.

Amid the crackdown, some face stiff U.S. tax bills and crippling fines over undeclared assets. Paying lawyers and accountants to help meet the various reporting and filing requirements routinely costs at least \$1,000 a year, and often much more, experts say.

Other people say they are considering whether to renounce but are reluctant to take such a drastic step. Renouncing can cause additional complications, including another steep bill because of an exit tax the U.S. imposes on those who meet certain income or asset thresholds.

Although the U.S. State Department doesn't keep official statistics, it estimates that 7.2 million U.S. citizens live abroad. And the U.S. Department of Homeland Security estimates there were 13.3 million green-card holders living here as of Jan. 1, 2012.

Despite the campaign against undeclared accounts, U.S. taxpayers filed only 825,000 foreign-account reports last year—meaning that millions of people likely aren't complying with the law.

"It's clear that compliance is dismal, and also why the IRS is being aggressive in its enforcement efforts," says Jeffrey Neiman, a former federal prosecutor now practicing law in Ft. Lauderdale, Fla.

So many people could be affected by the crackdown that mass-market tax preparer H&R Block has expanded services for taxpayers with international ties. In May, the company launched a tax-preparation service via the Internet that is targeted at expatriates and highlights the firm's ability to help taxpayers with unfiled prior-year returns.

U.S. laws and rules provide few options for people who are in a showdown with Uncle Sam. Here is some of what U.S. taxpayers need to know:

Understand what is different about the U.S. Unlike almost all other countries, the U.S. taxes citizens and permanent residents on all income, wherever it is earned in the world. So a U.S. taxpayer living in India could owe U.S. levies on income from a British investment.

The U.S. tax code does allow taxpayers living overseas an exemption for wages earned abroad of up to about \$100,000, plus a housing allowance, but taxpayers must file a return to claim the benefits.

Tax treaties might help U.S. citizens or green-card holders who live abroad avoid double taxation, but there can be gaps, experts say. For example, treaties typically don't provide an offset for foreign sales or value-added taxes. And if the tax rate is lower abroad than in the U.S., the U.S. taxpayer could owe the difference to Uncle Sam.

The U.S. also has an expansive definition of who is a citizen. It includes people born on U.S. soil as well as people born to U.S. citizens living abroad.

Kevin Packman, a partner with law firm Holland & Knight in Miami, has a Canadian client who was born in the U.S. to Canadian parents but moved to Canada as an infant. "She had no idea she was a U.S. citizen until she was nearly 50," he says. Experts say there are many similar "accidental citizens."

Know what has changed. While U.S. taxes on world-wide income have existed for decades, experts say laws regarding such income were seldom enforced.

That changed after the attacks of Sept. 11, 2001, in part because of concerns about terrorism. In 2004, Congress imposed severe penalties—up to \$100,000 or 50% of the account, whichever is greater, per year—on U.S. taxpayers who choose not to tell the IRS about foreign financial accounts totaling \$10,000 or more.

Critics point out that this penalty is for not filing a form, not for evading taxes. Bryan Skarlatos, a New York partner with law firm Kostelanetz & Fink who has handled hundreds of offshore accounts cases, says the total includes more than a dozen in which the tax and interest owed on offshore accounts was less than \$20,000. Yet the IRS assessed penalties of more than \$1 million, he says. The IRS declined to comment.

U.S. officials ramped up their campaign after the 2009 settlement with UBS. As part of the deal, the Swiss bank turned over the names of more than 4,000 U.S. taxpayers with secret accounts. Other banks have since made payments to the U.S. and named names.

In 2010, Congress passed the Foreign Account Tax Compliance Act, known as Fatca, which requires further disclosures by U.S. taxpayers with offshore accounts. The law also requires foreign financial institutions to report information to the IRS about U.S. account holders or face steep costs for not doing so.

Important Fatca provisions have been postponed until July 1, 2014, but the law has a long reach. For example, it could require a foreign-based trust to report information to the IRS about a beneficiary who

holds a green card, even if that person gets no money from the trust and doesn't know it exists, says Dean Berry, a partner with law firm Cadwalader, Wickersham & Taft.

Accidental tax cheats may be able to avoid large penalties. The IRS has a limited-amnesty program that offers protection from criminal prosecution, typically in exchange for stiff penalties.

Taxpayers deemed less culpable—for instance, because they inherited money in a foreign account they didn't touch—can face lesser penalties. But the exceptions are often narrowly defined.

There are other options. People who have already entered the IRS's limited-amnesty program sometimes choose to opt out. That leaves them vulnerable to a regular IRS audit, though the penalties are often lower.

But there are risks: Outside the program, there is less protection from prosecution and penalties can be higher, although experts say both outcomes are rare.

Advisers often recommend that taxpayers whose violations were unintentional and haven't entered the limited-amnesty program should consider making "quiet disclosures" instead. That means catching up with back returns as well as filing them in the future.

The IRS hasn't officially sanctioned such filings, and going this route may not offer protection against prosecution. But experts say the IRS seldom challenges quiet disclosures. In practice, says Mr. Skarlatos, the IRS almost never looks back more than six to eight years.

Taxpayers need to be able to show their violations weren't willful, however. Experts say the evidence could include never having filed a U.S. return if you live abroad, having the undisclosed account in the country where you live, rather than a tax haven, or not having lived in the U.S. for many years. It also helps to have little to no income earned in the U.S. and not to hold the undisclosed account within a trust or foundation.

Expatriation can have stiff costs of its own. People who renounce often have to certify they have complied with U.S. tax laws for the past five years. That means expatriation is a bad strategy for cleaning up past problems.

In addition, U.S. citizens and some green-card holders who formally expatriate are treated as though they sold their property on the day before they renounce. There are few exceptions, says Stow Lovejoy, another lawyer with Kostelanetz & Fink in New York.

Such people owe an exit tax if their net worth is \$2 million or more or their average annual income tax for the past five years is greater than \$155,000. The exit tax is due on net gains, above an exclusion of \$668,000. Deferred income in IRAs and some other tax-deferred accounts becomes taxable at ordinary rates, up to 39.6%, according to Mr. Lovejoy.

Expatriation can also bring severe estate-tax consequences. The U.S. heirs of people who paid an exit tax often owe a 40% tax on assets they inherit from the expatriate, whether the assets are in the U.S. or not. Unlike with typical estates, there usually isn't a \$5.25 million exemption.

In addition, law requires that the names of people who surrender their citizenship be published by the government, which some consider embarrassing.

At the same time, there are important exceptions to the exit tax. For example, people who have been dual citizens from birth can be exempt. For more information, see the instructions to IRS Form 8854.

Green-card holders might have other options. People with permanent-resident status who turn in their green cards are subject to the exit tax if they have held the card in at least eight of the previous 15 years. As with citizens who renounce, their names are also required to be published.

However, under complex treaty provisions the U.S. has with some countries, years when a green-card holder lives abroad might not be included in the eight-year tally. So careful planning can help some holders stay under this threshold.

Cushion the blow of U.S. taxes and disclosure with planning. Although the U.S. rules are strict, there is room to maneuver.

Cadwalader's Mr. Berry points out that a wealthy person who plans to expatriate might be able to use the U.S. gift-tax exemption of \$5.25 million per individual to shift assets into a trust in order to reduce total assets enough to avoid the exit tax.

If trust assets are used to purchase a life-insurance policy, then U.S. heirs could inherit cash from the expatriate who isn't subject to the special inheritance tax, he adds.

In some cases, a wealthy family may choose to have one family member expatriate and hold assets for the benefit of the rest of the family. Using a "foreign grantor trust," the non-U.S. person could hold assets and make taxfree gifts to other family members who are U.S. citizens or green-card holders. However, the non-U.S. person is often required to have authority to revoke the trust and keep the assets, giving that person enormous power.
