EXPATRIATION—SHOULD YOU OR SHOULDN'T YOU?

Back in 2011, a record number of American residents either relinquished their citizenship or their green cards. In 2013, that number rose to 2,999 renunciations, and in 2014 it rose again, to 3,415, all of whom were potentially subject to the US government's new exit tax on their assets. Despite that, it rose again in 2015, and again in 2016, when it hit 5,400 individuals, before dipping slightly in 2017 to still more than 5,100 individuals. That's a lot of US residents who have decided to improve their tax situation by leaving the US. But the US isn't giving them up without a fight.

Why are they leaving? It's not about politics—it's about money. Only two countries in the world double-tax their citizens, the US and the African nation Eritrea. No other country in the world does this. The reason for this in the US dates way back to the Civil War, when the US government instituted the Revenue Act of 1862, according to a February 10, 2017 story in *The Washington Post*, "A potentially historic number of people are giving up their U.S. citizenship." The idea then, the article says, was to punish Americans who fled abroad "to avoid joining the Union army." That war is long over. But the war on high-income-earning individuals rages on.

While green-card holders are only potentially affected if they've held a green card for the last eight years of the past 15 years, American citizens who renounce their citizenship must all meet certain criteria, as set by the IRS, to be judged as either covered (subject to further tax) or uncovered (not subject to further tax) expatriates. Covered expatriates are the ones who are subject to additional taxation by the US if they elect to relinquish their citizenship.

How do you know if you might be in the crosshairs? It depends on whether you meet any one of the following criteria:

1) Has your average annual net income tax liability for the previous five years exceeded each year's set threshold (e.g., $157,000 in 2014, up to $165,000 in 2018)?
2) Is your net worth $2 million or more at the time of expatriation?
3) Have you failed to comply with all US federal tax obligations for any of the preceding five years, meaning you've not yet filed all of your necessary tax declarations and paid any taxes due?
4) If you're a dual national, have you spent more than 10 of the last 15 years living in the US?

If you meet any of the above qualifiers, that puts you at risk for two negative US tax outcomes.

The first is what's known as an exit tax, the idea being that, by expatriating, the US government sees you as having effectively liquidated all of your assets at fair market value on the day before your expatriation date. You must then pay the US income tax on the calculated net gain of that presumed "sale" at the appropriate US tax rate(s). (You don't actually have to liquidate them; the US government just views you as having done so.)

Second, if you have given property to any US-based family members or other US citizens, they may be subject to a special transfer tax—a gift or estate tax which is currently a hefty 40%. So your choice to leave doesn't just affect you—if you give, it can negatively affect the recipient(s).

THE TAX CUTS AND JOB ACT OF 2017

While most of us are at least somewhat aware of the changes wrought by the recent tax cut legislation, few know that the arena most affected by these sweeping tax cuts is the international one. Previously, with proper planning and the right tax advisor, a US taxpayer could defer paying US income tax on foreign earnings, by operating a foreign business through an overseas corporation. That option has since been narrowed considerably. Worse, you can be hit with a one-time fee, what's being called a repatriation tax, which is a retroactive tax on any untaxed foreign earnings that you've accumulated under the umbrella of that overseas corporation, money you weren't required to pay tax on previously. Just how much depends on the asset type (generally illiquid) that produced those previously untaxed earnings.

It doesn't stop there. Despite your exit, any continued earnings of that ongoing non-US business will likely be subject to US income tax going forward. There's a name for this new income category in the Internal Revenue Code: it's called Global Intangible Low-Taxed Income, or GILTI. (Yes, you read that right—"guilty"—someone in the tax department clearly has a perverse sense of humor.) In this category, with few exceptions, lie any foreign earnings that are not already subject to current US income taxation. What's really perplexing is that, under this new category, it's individuals who may arguably be hit harder than corporations! Individuals pay income tax at a rate as high as 37% (it starts at 10%), whereas corporations pay a fixed 21%.

Before you argue that individual rates have at least dropped to a maximum of 37% from the earlier 39.6% ceiling), I need to point out that the decrease for individuals is only valid through 2025. So while corporate tax rates were fixed permanently, the maximum rate for individuals may jump again come 2026. And that's not all. If you're a high-income earner, some of your investment income may be subject to an additional 3.8% levy. (I told you the US government was fighting back.)

There are a couple of other tax blows that hit individuals harder than corporations. Their tax rate on deemed inclusions under that repatriation tax I mentioned earlier, the retroactive tax on any untaxed foreign earnings accumulated through an overseas corporation, is higher. And they are eligible for a number of tax benefits under GILTI, effectively lowering their tax rate from 21% to just half that. That's just half a percentage point above the lowest individual tax rate. Plus, they can deduct more than three-quarters of any foreign taxes paid relative to this type of earned income and fully 100% of certain foreign corporation dividends. You can't. Period.

HOW TO DECIDE

As always, it depends on your individual situation. For example, if you own a foreign business interest directly, you may well be among the group of taxpayers hurt the most by the 2017 Tax Act. And even if you're a US citizen who's already left and maintains few ties to the US beyond citizenship, that citizenship may end up costing you substantially. Is it worth it? If you qualify as a covered expatriate, should you decide to give up your citizenship entirely, you're still subject to that repatriation tax. However, with the right tax planning, you have options.

Here’s one: The 2017 Tax Act doubled the exclusion threshold for combined gift and estate tax amounts, from $5 million to $10 million, adjusted annually for inflation, which translates to an exclusion level of $11.18 million for 2018. So, if you haven’t yet repatriated, you can use that increased exclusion to effectively lower your net worth through gifting tax free, at least until 2026, when that elevated threshold potentially crashes back down again.

Call us to discuss your options before you decide. Together, we can plan your battle strategy and maximize the benefits to you.