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Leaving America for good — record numbers of American expatriate after IRS crackdown on Americans living abroad

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Each quarter, the United States publishes a list of the names of each individual losing United States citizenship. This list includes certain long-term residents who are treated as if they were citizens of the United States who lost citizenship. The quarter ending June 30, 2014 saw another 576 Americans choose to give up their nationality, following 1,001 Americans earlier this year.

While that number is small as compared to the population on the United States as a whole, the rate of expatriation has been much higher in the past few years than historically, with 2014 setting up to break another record high.

'Americans living abroad are reconsidering whether their US citizenship is worth the annual administrative burden and tax costs,' says Shannon Retzke, a partner of Withers Bergman LLP. 'Banks are refusing to allow Americans to open accounts and are forcing Americans out of their financial institution. Even tax compliant Americans living abroad are finding it hard to do business. This is one of the major factors driving Americans to expatriate.'

Worldwide Taxation, Tough Asset Disclosure Rules

The United States taxes its citizens on their worldwide income. Further, Americans with foreign assets must report their financial assets each year or face the threat of criminal prosecution and a host of draconian civil penalties. Click here to read more about these issues and how to resolve them through voluntary disclosure.

A second driver that may be increasing the number of Americans expatriating may be the tone of the Voluntary Disclosure Process or the Streamlined Program. Americans who have 'come clean' though the program have been identified as criminals, even if they were fully tax compliant in their country of residence. "We have seen an increase in the number of individuals who made the decision to expatriate in the past 18 months, primarily motivated by a frustration with how they are being treated by the government," notes Attorney Retzke.

Planning Makes all the Difference

The current US expatriation tax regime applies to citizens and long-term permanent residents that relinquish their US citizenship or US green card (if they have held their green card for at least eight out of the last fifteen years) and fall within the definition of a "covered expatriate" after June 17, 2008. An individual is regarded as a "covered expatriate" if such person: (i) has a net worth of US $2,000,000 or more; (ii) has an average US income tax liability for the five-year period prior to expatriation of greater than US $139,000 (as adjusted from time to time for inflation); or (iii) fails to certify under penalty of perjury that he or she has complied with US tax requirements for the five preceding tax years.

A covered expatriate is subject to a so-called 'mark-to-market' or 'exit' tax which applies to the net unrealized gain on the expatriate's worldwide assets as if such property were sold for its fair market value on the day before the expatriation date. Any net gain on the deemed sale in excess of US $600,000 (as adjusted from time to time for inflation) is taxable at the US capital gains tax rate. Click here to read more about expatriation.

The 'exit tax' on high net worth and high-income taxpayers can make it prohibitive for certain individuals to expatriate. Aaron Schumacher, a partner of Withers Bergman LLP, notes that 'with proper planning and structuring, often this tax can be mitigated or avoided altogether. Even simple pre-expatriation gifting can make a seven figure difference in taxes due.'