

Expatriating won't solve your past US tax issues



Many Americans living abroad harbor a misconception about how expatriation affects their U.S. tax obligations. When I speak to various groups of Americans living overseas, inevitably the subject of tax compliance comes up during Q&A. One or two people almost always state that they are not in compliance, and rather than spending the time and money to get in compliance, they will simply expatriate (renounce their U.S. citizenship). Their logic is, if they are no longer a citizen, then they no longer have U.S. tax obligations.

WRONG! Expatriating will not solve their problem; in fact, it will most likely make it worse. Expatriating doesn't alleviate you of past U.S. tax obligations from when you were a citizen.

If you expatriate without being tax compliant for the prior 5 years, you will be classified as a "covered expatriate". The majority of the people, if they were tax compliant, would be considered non-covered expatriates (i.e. having net worth of less than \$2M and average income tax liability for the past 5 years under the \$161,000 threshold). By not being tax compliant at the time of expatriation, you will be considered a covered expatriate, and be subject to all the tax consequences associated with that including; a market-to-market tax on unrealized gains, most retirement accounts being treated as distributed upon expatriation, and burdening your U.S. heirs with estate and/or gift tax on any amounts given or left to them. In addition, covered expatriates can have difficulty even visiting the U.S. because they are assumed to have expatriated for tax purposes.

Fortunately, most people I meet at my presentations have not expatriated yet, which gives them the opportunity to get in compliance for the past 5 years before expatriating. When things are straightened out, they can then expatriate as non-covered expatriates (assuming the other criteria are met). Having expatriated, they will be relieved of their future U.S. tax obligations, other than for U.S. source income.

On occasion I do run into a poor soul who expatriated without getting advice; unfortunately, all I can do is help them clean up the mess as best I can.

Bottom line—expatriating will not fix your tax problems!

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