Theories for Expatriation Numbers Abound, but Answers Are Elusive

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After three previous quarters of increasing expatriations — which many attribute to the reporting requirements imposed under the Foreign Account Tax Compliance Act — the number of U.S. expatriates dropped considerably for the most recent quarter. This has left some observers with theories but no definitive answers for the reason behind the change.

''I think it's anyone's guess at this point,'' Dianne Mehany of Caplin & Drysdale Chtd. said.

As the IRS reported July 30, only 483 individuals gave up their U.S. citizenship during the quarter ending June 30, 2015. That is compared with the 1,336 individuals who expatriated in the first quarter of 2015. (Prior coverage: *Tax Notes*, May 11, 2015, p. 625.) Since withholding under FATCA began July 1, 2014, expatriations had been up every quarter compared with the previous year's corresponding quarter. But the most recently reported expatriations number was down 19 percent from the quarter ending in June 2014.

Despite the drop, the pace for 2015 is still higher than the record pace set just last year. 2014 saw more than 3,400 individuals expatriate, which was nearly a 15-fold increase over the number of renunciations just six years prior. The IRS expatriate reports, required quarterly under section 6039G, do not provide a high level of detail, however, limiting the information to the names of the individuals, which can make extrapolating from that information more difficult. Some say FATCA obligations are just one factor among many contributing to the rise in expatriations. (Prior coverage: *Tax Notes*, Oct. 28, 2013, p. 382.)

''It's hard to know from these figures what is really behind renunciations,'' said Marylouise Serrato, executive director of American Citizens Abroad. ''Clearly in the last couple of years, with the increase in compliance, it's obvious that there was a huge community of Americans overseas who had no real understanding of how they were supposed to file or that they were supposed to file.'' She added that the recent media attention given to overseas compliance resulting in increased awareness of duties may have played into increased renunciations.

FATCA and Reporting Lags

''If you could do Mylar overlays on the renunciation trends, I think that you might see some funny things,'' said Charles Bruce of Bonnard Lawson, who is also legal counsel for American Citizens

Abroad. "Before FATCA, one of the things that drove a big spike years ago were news stories [involving renunciations] being written up in *Forbes* magazine." He added that recently, FATCA had also led to renunciations, not so much because of a desire to save on taxes, given high foreign tax rates, but more to avoid the compliance burden. "People are getting a paper blizzard," he said, also citing the complexities in reporting foreign bank and financial accounts and completing Form 8938, "Statement of Specified Foreign Financial Assets."

An increasing fear of penalties linked to tax evasion, rather than the tax itself, may also be playing a role in the general upward trend in expatriations, Serrato said, citing foreign bank account report and FATCA penalties. Failure to report foreign financial assets on Form 8938 may result in a penalty of $10,000 and a penalty of $50,000 for continued failure after IRS notification. Further, underpayments of tax attributable to nondisclosed foreign financial assets will be subject to an additional substantial understatement penalty of 40 percent. Under recent IRS guidance, in most willful FBAR violations, the total penalty amount for all years under consideration will be limited to 50 percent of the highest aggregate balance of all unreported foreign accounts under exam. (Prior coverage: *Tax Notes*, June 8, 2015, p. 1098.)

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Mehany speculated that the dip in quarterly expatriations could be explained by the lag time in reporting by the U.S. government. She said that even though the names of individuals who expatriate should appear in the *Federal Register* each quarter, the reporting does not always happen immediately. Moreover, the IRS may not receive information immediately, given that an expatriate usually does not receive a formal Certificate of Loss of Nationality for more than a month because of processing time at the State Department, she said. Low expatriation numbers for some quarters, notably the 45 reported for December 2012, have led some to wonder whether the quarterly data are sometimes incomplete. (Prior analysis: *Tax Notes*, Aug. 26, 2013, p. 851.)

"I have had clients whose names did not appear for one quarter at least," Mehany said. "In that case, the March numbers would actually reflect those Americans who expatriated before December, while the June numbers would show those persons expatriating by March. This would make sense, logically, as there is always a rush to the embassy before the year-end to avoid an extra year of status as a U.S. person and a noticeable slowdown in the beginning of the following year." She added that often those seeking to expatriate have found the wait for an appointment toward the end of year to exceed two months, while in the new year one can receive an appointment within days of the request.

The last two June-ending quarters did see some of the lowest numbers of expatriations in recent years, though for the quarter ending June 30, 2013, there were 1,128 expatriations, which had been the highest recent number until it was surpassed this March. FATCA regs were released on January 28, 2013, which may have had an effect on that June-ending quarter's numbers if lag time in reporting was present.

But a delay in reporting is only one theory behind the drop in reported expatriations. Mehany also hypothesized that the decline may be because of a realization by the community at large that an expatriation during 2015 does not remove a person from classification as a "specified U.S. person" for FATCA reporting purposes. Under reg. section 1.1473-1(c), a specified U.S. person is defined by excepting U.S. persons who are not included under the definition. Mehany said that many U.S. citizens and green card holders may have previously, and mistakenly, believed that because their countries of residence would begin reporting under an intergovernmental agreement in mid-to-late 2015, expatriating by that date would enable the expatriate to avoid application of the FATCA regime.

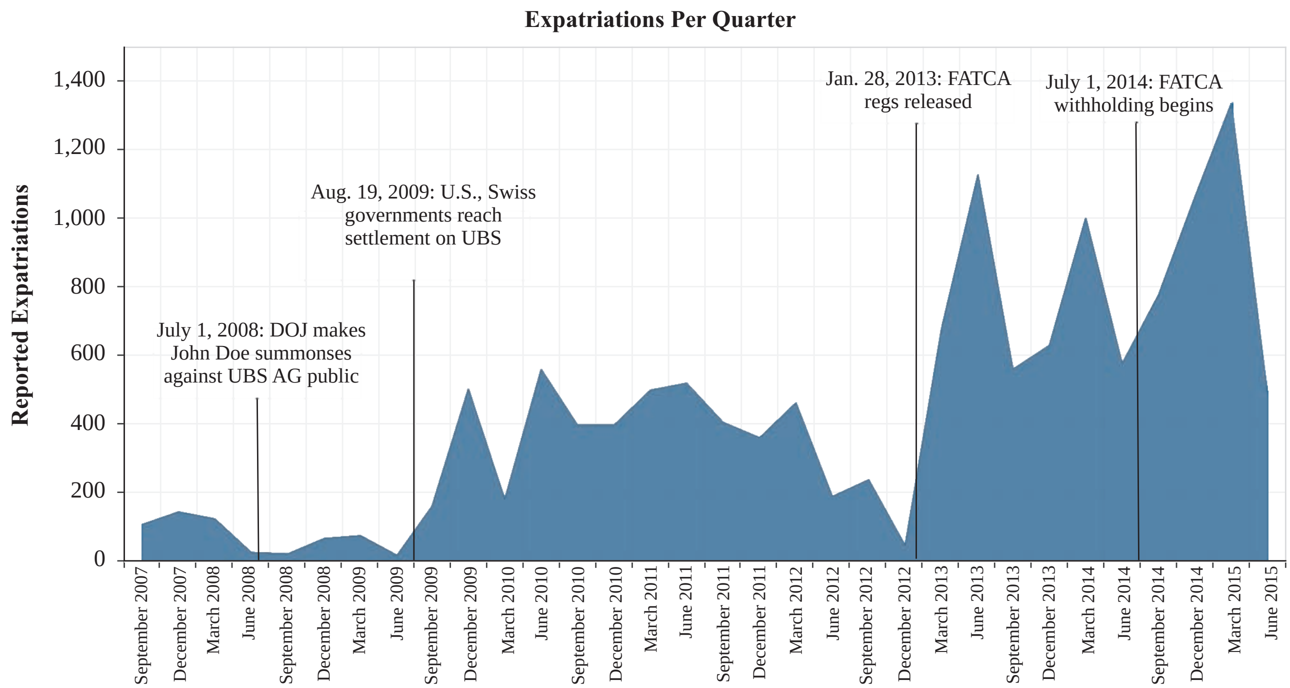
"That is, of course, patently false. Classification has already occurred, and expatriating in 2015 does not accomplish anything from a FATCA perspective. Clients are becoming educated to this truth, and this may explain the corresponding downturn in expatriations," Mehany speculated.

While arguing that the seasonal fluctuations in expatriation numbers would probably remain, regardless of future trends, Mehany guessed that a continued overall drop in the numbers could depend on IRS budget cuts and levels of enforcement.

"People are starting to hear about the dramatic budget cuts, the drop of enforcement personnel at the IRS," Mehany said. "If FATCA materials obtained are not processed in a way that leads to prosecutions of so-called tax dodgers, then I think it will calm down, and I think we will see a return to the pre-2008 numbers, because it won't be in the forefront of everyone's mind." Conversely, future highly publicized prosecutions may also result in a rise in expatriations, she surmised.

2008 was a notable year for tax evasion, given that in July of that year the Justice Department

FATCA or Fiction: Is Foreign Asset Tax Compliance Causing People to Renounce U.S. Citizenship?



Source: Quarterly *Federal Register* reports made by the IRS, required under section 6039G.

With expatriation numbers showing dramatic spikes since the last quarter of 2012, some tax professionals are blaming the compliance burdens imposed by FATCA, as well as prior high-profile U.S. anti-evasion efforts. Signed into law in March 2010, FATCA increased reporting requirements for taxpayers with assets offshore. For more information, see http://www.irs.gov/Businesses/Corporations/Summary-of-FATCA-Timelines.

announced that a federal judge had granted the IRS a John Doe summons of UBS to identify citizens who used Swiss bank accounts to evade taxes. In August 2009 the U.S. and Swiss governments signed an agreement to settle the summons enforcement and produce the identities of the holders of the accounts. It was against that backdrop of heightened scrutiny of foreign account holders that then-Senate Finance Committee Chair Max Baucus and House Ways and Means Committee Chair Charles B. Rangel, D-N.Y., introduced FATCA legislation in October 2009. (Prior coverage: *Tax Notes*, Aug. 24, 2009, p. 744.)

A Blip, or Something More?

Len Wolf of the Wolf Group PC said he thought the most recent quarterly drop in expatriations was an anomaly.

"On a very regular basis, we speak to clients and prospective clients who express an interest in at least exploring the option for expatriation," Wolf said. "I'm surprised that the numbers are as small as they are." He added that most of his clients inquiring about expatriation were long-term residents who were considering abandoning their permanent residence status. "If anything, it seems like the pace is accelerating, not decelerating."

For purposes of expatriate reporting, long-term residents are treated as if they were citizens of the United States who lost citizenship. Under section 877(e)(2), a long-term resident is an individual who is a lawful permanent resident of the United States for at least eight of the last 15 years.

Serrato said the drop in expatriations may be from a "comfort level" now filtering into the overseas taxpayer community, with banks increasing their familiarity with FATCA. "We may start seeing that things are equalizing out a little bit."

Bruce said he thought that while a FATCA spike had occurred, numbers should level off in the future, although the numbers may differ depending on which jurisdiction was under consideration. "FATCA has not been as hot a subject in London as it has been in Switzerland," he said, adding that political instability would lead to fewer renunciations in some parts of the world as well, such as the Middle East.

Some taxpayers may be ignoring the exit tax under section 877A — a mark-to-market tax on deemed disposition of a taxpayer's worldwide assets immediately before expatriation — figuring that they will not likely be caught, Bruce speculated.

''I think buried in this phenomenon [is that] there is some exit tax noncompliance,'' Bruce said. ''Like all noncompliance these days, that is not a good idea.''

While the United States' system of worldwide taxation might be an underlying point of contention for citizens and permanent residents as well, it is difficult to ascribe a lot of influence on any recent statistical trends to that fact, given that the system has remained unchanged, Wolf said. He likewise attributed the general rise in expatriations to FATCA reporting and foreign banks abandoning their U.S. clients as a result of the law's burdens.

The increasing complexity of the tax regime in the United States is ''compelling people to question whether they want to remain,'' Wolf said. ''Personally, I still see [the numbers] climbing. As to when it will peak, who's to say?''

> ***'I think buried in this phenomenon is that there is some exit tax noncompliance,' Bruce said.***

A July 15 report from the taxpayer advocate noted the ''substantial day-to-day compliance burdens and costs of implementation on financial institutions'' involved in FATCA, which would subject U.S.-source payments to foreign financial institutions to a 30 percent withholding tax, unless the FFI provides comprehensive information about U.S. taxpayer accounts.

Bona Fide Residence Exception

Lurking in the background is a potential administrative change that could further shrink quarterly expatriations. To alleviate reporting burdens, in April the taxpayer advocate recommended that the FATCA regs allow for reporting exclusions for some banks organized under the laws of the foreign country of which a U.S. individual is a bona fide resident. The IRS has since provided a small measure of flexibility for bona fide residency with the August 26 release of proposed regs (REG-109813-11) that add a 30-day constructive presence element to the bona fide residency tests for U.S. territories. (Prior coverage: *Tax Notes*, Aug. 31, 2015, p. 938.)

A small bipartisan coalition in the House has taken up the cause in urging the IRS to provide the reporting relief. ''Some Foreign Financial Institutions have simply closed accounts or refused to open new ones for U.S. citizens in order to minimize their exposure to FATCA reporting requirements, withholding fees and potential penalties,'' Reps. Carolyn B. Maloney, D-N.Y., and Mick Mulvaney, R-S.C., said in a July 21 letter to Treasury Secretary Jacob Lew and IRS Commissioner John Koskinen. ''This practice leaves law-abiding American citizens without access to everyday financial tools such as mortgages, bank accounts, insurance policies and pension funds — all of which are critical services regardless of place of residence.''

Serrato said she supports that proposal, telling Tax Analysts, ''Not only would [it] help in a real, concrete way, it would also start to demonstrate to Americans living overseas that a lot of the legislation wasn't passed with them as a target.''

Mehany argued that the implementation of a bona fide residence exception to FATCA could lower the number of expatriations. It could lessen investigations into U.S. citizens abroad who have not historically filed tax returns or FBARs and could also dampen press coverage regarding the long reach of U.S. taxation, which alerts U.S. citizens abroad of the issue, she said.

''I've had many clients reside for 20 or 30 years outside the U.S. and still at their heart consider themselves U.S. citizens, until they are faced with what they see as an unfair targeting, especially if they are in a higher-tax jurisdiction. And that forces the difficult choice of deciding whether [they] still have ties to this country,'' Mehany said.

How much of a compliance gap exists is debatable, although statistics would seem to at least suggest its existence. According to the State Department, as of 2014, there were an estimated 7.6 million citizens living abroad. And while the IRS has stated that FBAR filings have surged over the last decade from a mere 280,000 in 2005, those filings still only exceeded 1 million for the first time in 2014. FBAR filings are required by U.S. persons if they have a financial interest in or signature authority over at least one financial account outside the United States and the aggregate value of all foreign accounts exceeds $10,000.

A bona fide residence exception could further help overseas U.S. taxpayers and alleviate some of the difficulties they are facing with their neighborhood banks, Bruce argued.

These banks are ''signaling to the U.S. community that they are not the preferred customers. Sometimes they are actually pushing them away,'' Bruce said, citing the increased diligence and sometimes actual tax reporting required by the bank. The same-country exception is straightforward and could be implemented with administrative action alone, he said.

According to a paper published by American Citizens Abroad in April, individuals residing in a foreign country could elect to have an account treated as a same-country account by providing an election to the relevant FFI and attaching their regular Form 1040. The FFI would then be relieved of the requirement to treat that account as a U.S. account and to process and report its information. In essence, it would be treated the same as a small account under existing FATCA reg. section 1.1471-5(a)(4), which excludes from the definition of a U.S. account those accounts with $50,000 or less.

The same-country exception is straightforward and could be implemented with administrative action alone, Bruce said.

''I think when FATCA was drawn up that Treasury thought about a same-country exception precept,'' Bruce said. ''It's a good thing for Treasury as well because there are some Americans overseas who are just out of the system, for whatever reason. To get this benefit, they would have to file a return. I think the Treasury Department is inching toward doing this.'' ■

Tom Kasprzak contributed to this article.