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Immigration

The pros and cons of renouncing U.S. citizenship

By **Veronika Chang**

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(April 24, 2018, 8:52 AM EDT) -- On Dec. 22, 2017, U.S. President Donald Trump signed off on the *Tax Cuts and Jobs Act*, which marked the first significant overhaul of U.S. tax law since the Reagan era. Although the Act lowered the tax rate for most Americans, the new rules may have a negative effect on a number of Americans abroad and may also provide an incentive to those who want to renounce their U.S. citizenship.

After Trump's election in November 2016, Canada's immigration department website was crashed by the onslaught of Americans looking to flee the U.S. But Americans living in Canada will find that it is not easy to leave the U.S. They may physically cross the border only to learn that Uncle Sam is crossing with them.

The U.S. is one of two countries in the world that imposes tax on its citizens no matter where they reside. This means Americans living here must comply with U.S. tax laws by filing U.S. tax and information returns every year. While Americans living in Canada will owe little or no U.S. tax since they get a credit for taxes paid in Canada, the process can take time, effort and cost.

If they own a business in Canada and/or have a significant investment portfolio, special tax forms must be filed. Penalties for failing to file such forms properly can result in a minimum penalty of US$10,000 per form, so Americans in Canada should seek help from a professional who specializes in U.S. tax.

How do you get rid of Uncle Sam? To divorce him, Americans living in Canada must renounce their U.S. citizenship and do it from both the immigration and tax perspective. For immigration, renunciation is fairly simple. Just e-mail the U.S. consulate, and get instructions and forms. Then submit the completed forms and documents and request an appointment for an exit interview.

It takes about four to six months to get an exit interview appointment at the consulate. At the interview, a consular officer who administers an "Oath of Renunciation of the Nationality of the United States" and a "Statement of Understanding," will want to know if that renunciation is a voluntary act. Also, the exiting American must pay US$2,350 for the privilege of losing their U.S. citizenship.

From the tax perspective, the road to renunciation is more complicated.

An exit toll is involved if the person is considered a "covered expatriate." That means they have an average net income tax liability for the past five years of over US$165,000 (for 2018), net worth of US$2 million or more, or have not certified on the IRS Expatriation Statement (Form 8854) that U.S. federal tax obligations have been complied with for the past five years. (Failing to file this form leads to a US$10,000 penalty).

The U.S. exit tax is similar to the Canadian departure tax. The U.S. citizen is deemed to sell all their assets at fair market value, and the gain from this deemed sale above a certain amount is subject to U.S. tax. If a covered expatriate makes a gift or bequest to a U.S. citizen or resident, the recipient must then hand over 40 per cent to Uncle Sam.

Those lucky enough to have been born a dual citizen of the U.S. and another country, and remain dual citizens at the time of expatriation, get a break. They do not need to concern themselves with the US$2 million threshold in determining whether they are a covered expatriate. For those not born a dual citizen, the U.S. tax reform may help them exit the U.S. without paying the toll.

Americans are subject to the U.S. estate tax if worldwide gross assets exceed the current U.S. estate tax exemption amount, which in 2017 was US$5.49 million. They can use the exemption amount to offset any taxable gifts they make during their lifetime. Those with assets over the unused exemption amount at the time of their death are required to hand over 40 per cent to the IRS.

During the election campaign, Trump spoke about repealing the U.S. estate tax. It didn’t happen, but the exemption amount was doubled until 2025, which is good news for those considering renouncing. U.S. citizens with assets over the US$2 million threshold may be able to avoid the exit toll by gifting part of their assets.

Another reason to renounce is to protect from any future U.S. tax reforms which may adversely affect Americans living abroad. For example, U.S. tax reform introduced a new Internal Revenue Code Section 965, which imposes a one-time transition tax on American citizens and residents who own a foreign corporation.

The details of Section 965 are complex, but a simple explanation is this: if a U.S. citizen owns a Canadian company and that Canadian company has accumulated untaxed earnings and profits (think retained earning) as of Nov. 2, 2017 or Dec. 31, 2017, whichever is greater, they are subject to either 15.5 per cent tax for cash assets or eight per cent tax for non-cash assets. Complexities and additional tax burden aside, this is surprising to many.

The tax reform bill was released in the U.S. House of Representatives on Nov. 2, 2017, which means Americans were given no time to plan, based on the initial draft of the bill. The next tax reform may contain similar surprises.

Wherever they reside, U.S. citizens always must deal with U.S. taxes. But is that reason to renounce? It should be a personal choice. A client who recently renounced his U.S. citizenship told me it was the “most positive thing I have done for my mental health in the last 30 years.”

So, ultimately, it depends on you.

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