



Writing Off U.S. Citizenship

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By Caren Chesler

Kenneth Rubinstein, a tax attorney, was at a party thrown by his clients—a husband and wife who were both physicians—when the conversation turned to President Obama's health care initiative. The hosts and two guests said if the plan's impact were as dire as they imagined, they would leave the country. They then asked Rubinstein where they should go.

"Whether or not they really meant it, I don't know. Whether or not the health care plan will be so bad for them that they would carry out this threat, I don't know. The point is, I'm sitting there with four physicians, and there was never a point when one of them turned to the others and said, 'You don't really mean that, do you?'" Rubinstein says. "I have a number of clients who have said that if their tax burden gets any worse, they see no reason to stay here."

Rubinstein's experience is not unique. Tax experts are seeing more and more clients either giving up their U.S. citizenship for financial reasons or making inquiries about whether they should. Many of those clients already live overseas. But some actually live here and are considering a move abroad.

As many as 743 people with American citizenship or legal resident status renounced their U.S. citizenship in 2009—three times as many as the 235 renunciations in 2008, according to the Office of the Federal Register. Another 180 did so in the first quarter of 2010, according to the Internal Revenue Service, which publishes the actual names of those individuals each quarter.

The figures highlight a growing dissatisfaction with the Obama administration's tax policies, tax experts say. Rubinstein says in the past, he might have gotten one or two questions about expatriation per year. Now it's more like one or two inquiries a month, he says.

Those already living overseas have long complained that the U.S. is the only industrialized country to tax citizens on income earned abroad, even when they are taxed in their country of residence, though they are allowed to exclude their first \$91,400 in foreign-earned income.

"This has always been an issue for Americans living abroad," says Howard Gluckman, a CPA with Metis Group LLC, a New York City-based accounting firm. "Some countries will only tax you where you reside and earn money. But in the U.S., you'll be taxed on your income regardless of where it's generated."

It can feel particularly egregious to people working in a place like the Cayman Islands, where the tax rate is just 5%, yet they're subject to a U.S. tax rate of about 25%, Gluckman says.

But it's not just Americans living abroad who are considering renouncing their U.S. citizenship. Those in the highest tax bracket often squawk about America's high tax rates, particularly if they live or work in New York City. Between federal, state and city taxes, they wind up paying about 45% to 55% of their income to tax authorities. Moreover, the federal income tax rate is due to rise from 35% to about 39.6% for the highest tax bracket in 2011—though, at press time, President Obama and Republican congressional leaders were close to working out a compromise that would extend the lower tax rates for two more years. David Adams, a CFP with Southwestern Investment Services, a Raymond James affiliate in Nashville, Tenn., says about seven of his about 100 clients are considering giving up their U.S. citizenship for tax reasons.

"I have quite a few business owner clients who have been talking about this out of frustration with what they see as a non-business-friendly tax environment," Adams says. "Some were just venting, but I have several clients who have taken it a little further, and we're actually looking into it."

One client, a 60-year-old man who owns a family business with about 500 employees, wants to scale down his company, take a modest salary and move to South America because he feels he is being taxed too much, Adams says. He also fears his employee health care costs are going to go through the roof.

"He feels the current administration has said anyone earning over \$250,000 is bad and that they're going to tax them a lot," Adams says. "But that was before November 2. If we now see the Bush tax cuts get extended, that may put a damper on his desire to move."

Adams has another client, a professional baseball player in his early 30s who currently lives in Japan and earns about \$1 million a year. The client feels he's being taxed to death in the U.S. Whether that's perception or reality is hard to say, Adams says.

Peter Guang Chen, a CPA and partner at the Chinese law firm DeHeng Chen, says a number of his clients have already given up their U.S. citizenship and moved to Asia, and several more—most of whom earn seven-figure salaries and have at least \$20 million in assets—are currently considering it. Several are considering moving to Hong Kong, which has a flat tax rate of 16% and taxes only salary income. Hong Kong also did away with its estate tax in 2006. In the U.S., there was no estate tax in 2010, but it's due to return with a vengeance on January 1, imposing levies of up to 55% on estates valued at more than \$1 million (the compromise proposed by President Obama and Republicans in December would lower the rate to 35% on assets of more than \$5 million).

Relinquishing citizenship is not hard. The person must appear before a U.S. consular or diplomatic official in a foreign country and sign a renunciation oath—though they cannot say they are doing it for tax reasons. Moreover, renunciation does not allow a person to escape pending tax obligations.

Part of the problem for both expats and U.S. citizens with foreign bank accounts is that stringent new banking regulations under the Patriot Act of 2001—intended to prevent money from flowing to terrorist groups—have made it more difficult to keep bank accounts overseas. The law originally had no teeth, but civil penalties were added in the Jobs Creation Act of 2004 and the IRS started to aggressively pursue secret account holders in 2009.

In addition, the Foreign Account Tax Compliance Act (FATCA) was signed into law in March as part of the Hiring Incentives to Restore Employment Act, which, among other things, introduced a 30% withholding tax on certain payments made to foreign entities that fail to comply with specified reporting requirements. The law essentially increased the number of disclosures for U.S. citizens with foreign accounts and assets and increased the penalties for non-compliance.

"The new law made it much more difficult for U.S. citizens and tax residents to hide foreign income," Gluckman says. "These people who had been in nowhere land are all of a sudden saying, 'Now I'm going to have to pay taxes I never paid before. Maybe I'll just give up my U.S. citizenship instead.'"

"The IRS was trying to do this for many, many years, but they couldn't get cooperation from foreign countries, and they couldn't get cooperation from Congress. There was just a feeling that it was too harsh to make people tell you all about all their accounts outside the U.S.," Gluckman says.

That all changed when terrorists began using the international banking system to move money in and out of the U.S. banking system.

There were always rules about reporting foreign bank accounts, and there were even criminal penalties, but there was little enforcement, Gluckman says. Now there are strict penalties if you don't file the forms. The IRS has offered secret account holders amnesty periods to turn over their information, and said publicly it will go after the people who didn't come forward, Gluckman says.

The irony is that tax rates abroad aren't necessarily lower. Tax rates in the Netherlands, the United Kingdom, Poland, France, China and Japan, for instance, can be significantly higher than they are in the U.S. Steven Elliott, tax director at Schwartz & Co. LLP, in Bellmore, N.Y., says most of the people he's seen expatriate have done so for a variety of reasons—not just to avoid taxes.

"In most cases, taxes are still going to be part of the mix, but like anything else, it's a global thought process. People look at other countries' health system, entertainment, sports, theater—whatever is important to that person," Elliott says.

And while some people living and working abroad complain about still having to pay taxes in the U.S. on their foreign-earned income, they are allowed certain credits and exclusions that help alleviate double taxation. But one must spend a certain amount of time overseas to be eligible. An individual working in Ireland or the U.K., for instance, needs to be out of the country 330 out of 365 days to qualify for the maximum annual earned income exclusion of \$91,000. They can also deduct from their U.S. tax bill a certain amount for living expenses and housing allowances overseas, as well as a foreign tax credit, meaning they deduct the amount of taxes they paid overseas.

"When you go to pay your taxes in another country, it offsets your taxes here, dollar for dollar," Elliott says.