EXPATRIATION: AMERICA, LOVE IT OR LEAVE IT

by Paula Jones and Carmen DiPlacido [*]

LOSS OF U.S. CITIZENSHIP AND NATIONALITY

The right of U.S. citizens (USC) to expatriate, effectively casting off citizenship, was codified by the 40th United States Congress on July 27, 1868.[1] The Expatriation Act of 1868 stated that*..."the right of expatriation is a natural and inherent right of all people, indispensable to the enjoyment of the rights of life, liberty, and the pursuit of happiness...."* It continued, saying that *"any declaration, instruction, opinion, order, or decision of any officers of this government which denies, restricts, impairs, or questions the right of expatriation, is hereby declared inconsistent with the fundamental principles of this government."*

It was not until the Expatriation Act of 1907,[2] however, that Congress identified specific conduct by USCs that would lead to loss of citizenship. Today such conduct is statutorily prescribed in chapter 3 of the Immigration and Nationality Act of 1952 (INA);[3] specifically at §349 [8 U.S.C. 1481]. Under these precepts, a USC, acting voluntarily and with an intent to divest citizenship, can relinquish or renounce citizenship.

Relinquishment of United States Citizenship

A USC may lose citizenship by voluntarily performing an act made expatriating by statute with intent to relinquish all rights and privileges of citizenship. It is enough to establish one of the expatriating acts specified in INA §349(a), since Congress has declared each of these acts to be inherently inconsistent with the retention of citizenship.[4] Voluntariness of the commission of the enumerated acts of expatriation is presumed (but rebuttable) by statute, pursuant to INA §349(b).[5] However, the U.S. Supreme Court has emphasized that loss of citizenship requires the individual's "*assent*" in addition to the voluntary commission of the expatriating act.[6] Further, the Court said that it is difficult to understand that "assent" to loss of citizenship would mean anything less than an intent to relinquish citizenship, whether the intent is expressed in words or is found as a fair inference from proven conduct.[7] This same view—that expatriation depends on the will of a citizen as ascertained from words and conduct—also was reflected in the United States' response to the petition for certiorari in *United States v. Matheson.* In the last analysis, say the courts, "expatriation depends on the will of the citizen rather than on the will of Congress and a trier of facts assessment of the citizen's conduct."[8]

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[*] **Paula Jones** is an attorney at Reed Smith in Philadelphia. She advises high net worth individuals in wealth planning matters, with a focus on international planning. She advises clients on all aspects of U.S. estate and gift taxation, the creation, migration and maintenance of U.S. and foreign trusts, pre-immigration planning for non-resident aliens coming to the United States, expatriation tax planning for residents and citizens leaving the U.S., charitable giving overseas, offshore account compliance, administration of estates of foreign individuals with U.S. property, and other related matters. Ms. Jones is a frequent speaker and author.

Carmen DiPlacido is a member of the Ohio bar and is admitted to practice before the U.S. Supreme Court. He practices law at Carmen Anthony DiPlacido and Associates, Inc. and is of counsel to Tafapolsky and Smith in California. Prior to entering private practice, Mr. DiPlacido worked for the U.S. Department of State. He is a graduate of the University of Akron School of Law, the Federal Executive Institute, the OPM Executive Development Program, and the National War College. Mr. DiPlacido is an AILA mentor and has served on numerous committees and working groups.

[1] Expatriation Act of 1868, 15 Stat. 243.

[2] Expatriation Act of 1907, 34 Statutes at Large 1228.

[3] Immigration and Nationality Act of 1952 (INA), Pub. L. No. 82-414, 66 Stat. 163, (codified as amended at 8 USC §§1101 *et seq.)*.

[4] 8 U.S. Code (USC) §1481(a). *See also Afroyim v. Rusk*, 387 US 253, 257 (1967).

[5] 8 USC §1481(b).

[6] *Vance v.Terrazas* 444 US 252 (1980).

[7] *Id.*

[8] *Id.*

The U.S. Department of State (DOS) is required by statute to administer the loss of nationality statutes via INA §358.[9] In carrying out these responsibilities, in 1990, DOS established and later codified at 22 Code of Federal Regulations (CFR) §50.40(a), a uniform administrative standard of evidence based on the premise that USCs intend to retain U.S. citizenship when they obtain naturalization in a foreign state, subscribe to a declaration of allegiance to a foreign state, serve in the armed forces of a foreign state not engaged in hostilities with the United States, or accept non-policy level employment with a foreign government.[10]

In light of DOS's administrative premise, an American citizen, for example, who resides and works abroad may become a naturalized citizen of the country of residence without risk of losing U.S. citizenship, because he or she is presumed to intend to retain such citizenship under 22 CFR §50.40(a).

A citizen who has voluntarily performed an act made expatriating with an intent to relinquish citizenship may document loss of citizenship by appearing at a U.S. consulate to complete a questionnaire and sign an affidavit of *Voluntary Relinquishment of Citizenship*.[11] The consulate would then certify the facts on a *Certificate of Loss of Nationality* (CLN) form and submit the CLN with the case documentation to DOS for adjudication and approval.[12] In all loss of citizenship cases, the person who loses citizenship must file with the Internal Revenue Service (IRS) using Form 8854. In addition, DOS must provide a copy of the approved CLN to the IRS.

Renunciation of United States Citizenship

A formal renunciation of U.S. citizenship by voluntarily executing an oath of renunciation before the U.S. consul in the form prescribed at law is the most unequivocal of all the expatriating acts.[13] It is the strongest expression of an intent to lose citizenship a USC can make regarding whether he or she wants to be a USC. Once this procedure is performed it is extremely difficult to reverse. For that reason, U.S. consuls are instructed to be sure the citizen who wishes to renounce understands fully the consequences of renouncing. The consul is supposed to impress upon the citizen how serious an act it is and encourage the citizen to think it over. The consul also is instructed to ensure to the extent possible that no external pressure is being exerted upon the citizen. In addition, the citizen is required to read and sign a *Statement of Understanding* that discusses the effects of renunciation.[14] Once the citizen has read the *Statement of Understanding* and the consul is satisfied that the citizen knows the results of the act he or she is about to perform and is not under any undue pressure from his or her parents or other outside sources, the *Oath of Renunciation*[15] is administered by the consul and a CLN is prepared and forwarded to DOS for approval, as explained above. Again, as a loss of citizenship case, the person renouncing citizenship must file with the IRS using Form 8854, and DOS must provide a copy of the approved CLN to the IRS.

The consul and DOS are reluctant to approve the renunciation of a minor child under age 14, for a person incarcerated abroad, or for a person who would be rendered stateless by renouncing. Such approvals are very rare, if approved at all. Normally, for example, when a minor seeks to renounce citizenship, the consul will privately interview him or her and submit an opinion for DOS to consider; DOS then advises whether to administer the oath of renunciation. Similarly, for incarcerated citizens or those who could be rendered stateless, the consul will interview the potential renunciant and seek the DOS opinion.

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[9] 8 USC 1501.

[10] A citizen who expressly and voluntarily executes an oath of renunciation of citizenship before a U.S. consul under INA §349(a)(5); 8 USC §1481(a)(5) is not subject to the uniform administrative standard. In addition, the administrative premise also does not apply to a person who serves in the armed forces of a foreign state engaged in hostilities with the United States; takes a policy level position in a foreign state; is convicted of treason; or, although very rare, performs acts made potentially expatriating by statute accompanied by conduct which is so inconsistent with retention of U.S. citizenship that it compels a conclusion that the individual intended to relinquish U.S. citizenship.

[11] DOS Form DS-4079. *See* 22 Code of Federal Regulations (CFR) §§50.40(a), (b).

[12] DOS Form DS-4083.

[13] INA §349(a)(5); 8 USC 1481(a)(5).

[14] DOS Form DS-4081.

[15] DOS Form DS-4080.

Individuals formally renounce U.S. citizenship for myriad reasons. If U.S. citizenship is renounced for reasons unrelated to tax-avoidance, the renunciant should provide a statement for the record accordingly. For instance, he or she may want to declare for the record that the reason(s) are personal—*e.g.*, the person is a dual national and has continuously resided in or practiced her or his profession in the country of the other nationality and will continue to do so; or, for example, he or she is required by the foreign state to have that country's nationality alone to become a public official, such as a judge or an educator. The statement for the record assists the renunciant to make clear his or her motivations, and to avoid possible inadmissibility for renouncing in order to avoid any taxation issues.

Further, an individual who is determined by the AG to have officially renounced U.S. citizenship for the purpose of avoiding taxation by the United States is legally inadmissible under INA §212(A)(10)(e). The phrase "officially renounced" U.S. citizenship was interpreted previously by DOS and legacy Immigration and Naturalization Service as applying only to renunciations under INA §349(a)(5).[16] Since this inadmissibility provision was enacted, no regulations have been issued regarding its administration. It has not been enforced due to inter-agency inability to establish consensus for technically and pragmatically enforcing it. The most salient obstacle to enforcement lies in the privacy laws that protect tax files. Nevertheless, the law is still on the books. This is added reason for the renunciant to execute a statement explaining the reasons for renunciation, assuming they are not related to tax-avoidance. It is also reason for a USC employee wishing to acquire foreign citizenship to be aware of options for dual nationality.

Appealing Loss of Nationality Decisions

Some former USCs may wish to appeal a finding of relinquishment or renunciation. Previous determinations of relinquishment and renunciation of citizenship can be administratively appealed to or reconsidered by DOS. Regulations for such administrative appeals are found at 22 CFR §50.51. There is essentially no time limit for submitting an administrative appeal. The bases for administrative appeals are manifold.

For example, the 22 CFR §50.40 administrative premise, noted above, is applicable to loss of nationality cases adjudicated before the DOS establishment of the policy. Individuals who previously lost U.S. citizenship before 1990, may wish to have their cases reconsidered in light of this policy. Also, previous determinations by DOS that a person lost U.S. citizenship can be reversed if evidence is available and submitted to prove the citizen performed the expatriating act either involuntarily or without the intention of relinquishing U.S. citizenship. An appeal of a denial of a DOS determination of loss of citizenship also can be administratively reviewed. If applicable, a person may initiate such reconsideration by submitting a request to the nearest U.S. consular office, or by writing directly to the Director, Office of Policy Review and Inter-Agency Liaison (CA/OCS/PRI) at DOS.

Judicial review of previous loss of nationality cases is provided by INA §360.[17] Generally, there is a five-year limitation to institute action dating from the administrative denial of right or privilege—*i.e.,* the date of the approval of the CLN or the date DOS disapproves or denies a CLN.

DOS References for Citizenship

Guidelines and procedures for handling citizenship and nationality can be found in Volume 7 of the DOS *Foreign Affairs Manual* (FAM) and on DOS's website: http://travel.state.gov.

7 FAM 1100 contains the DOS guidelines for acquisition of citizenship, and 7 FAM 1200 contains the loss of citizenship guidelines.

HEART LEGISLATION: EXIT TAX FOR "COVERED EXPATRIATES"

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART)[18] legislation passed in the summer of 2008 codified important changes for federal income taxes (FIT), federal estate taxes (FET), and federal gift taxes (FGT).

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[16] 8 USC §1481(a)(5).

[17] 8 USC §1503.

[18] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245, 122 Stat. 1624-1650.

Not every expatriate or legal resident giving up residency in the United States is subject to the HEART legislation. Expatriates and legal residents who severed ties with the United States prior to June 17, 2008, are instead subject to a "10-year rule." In summary, these former citizens and former legal residents were presumed to be leaving the United States for tax avoidance reasons, if they (a)

- Had an average annual income of $145,000 for the five years prior to expatriation from the U.S.;
- Had a net worth of $2 million or more; or
- Failed to comply with expatriation filing requirements for the five years prior to leaving the United States.

For the next ten years after expatriation, these individuals remain subject to the U.S. FET against any U.S. *situs* property upon death, and afforded only a $60,000 FET exemption amount. If they return to the United States for any 30 days within a calendar year, and die within that same year, they resume their status as a U.S. resident and are afforded the FET exemption amount in effect against all property wherever situated.

The HEART legislation targets those individuals leaving the United States after June 17, 2008. Individuals subject to the HEART legislation are referred to as "covered expatriates."

In order to be considered "covered expatriates" and, therefore, subject to the HEART rules, former USCs must meet the same three elements:

- Had an average annual income of $145,000 for the five years prior to expatriation from the U.S.; or
- Had a net worth of $2 million or more; or
- Failed to comply with expatriation filing requirements for the five years prior to leaving the U.S.

Not all U.S. residents leaving the country after June 17, 2008, are subject to the HEART legislation. Only lawful permanent residents (LPR) are targeted. An LPR is an individual who has been afforded the privilege of residing permanently in the United States as an immigrant, in accordance with U.S. immigration laws—in other words, green card holders.[19] In addition to the three elements former citizens must meet, former LPRs must have been in LPR status for at least 8 of the prior 15 taxable years in order to be considered "covered expatriates" under the HEART rules. The year of expatriation is included as the last year of the 15-year period.[20]

Once determined to be a "covered expatriate," the person is subject to the "mark to market" exit tax, which operates as a trigger of capital gain on all worldwide property.[21] There is an exclusion on the capital gain up to $600,000, which is adjusted for inflation.[22] The basis for capital gain purposes is the date at which the taxpayer became a resident for federal income tax purposes.[23] "Eligible" deferred compensation items are an exception to the exit tax. An item of deferred compensation is eligible if: the payor is a U.S. resident for purposes of meeting the withholding obligations on the account; a covered expatriate has notified the payor of his or her tax status; and the covered expatriate waives any rights to treaty benefits that could reduce the tax.[24] The payor of "eligible" deferred compensation items, while not subject to the capital gain exit tax, is required to withhold 30% of every taxable payment due (in lieu of any current withholding requirement). This withheld distribution is taxed as if the payee had been a citizen or resident of the U.S.[25] No early withdrawal penalty is imposed. This rule does not apply to any deferred compensation item attributable to services performed outside the U.S. while the covered expatriate was neither a citizen nor resident of the U.S.

"Ineligible" deferred compensation items are treated as if the present value of the item had been received by the covered expatriate on the day before expatriation, as a distribution from the plan.[26] This rule also does

[19] 26 U.S. Code Annotated (USCA) §7701 (b)(6); Treas. Reg §301.7701(b)-1(b).

[20] 26 USCA § 877 (e)(2).

[21] 26 USCA §877A (a).

[22] 26 USCA §877A (a)(3).

[23] 26 USCA §877A (h)(2).

[24] 26 USCA §877A (d)(3).

[25] 26 USCA §877A (d).

[26] 26 USCA §877A (d)(2)(A).

not apply to any deferred compensation item attributable to services performed outside the United States while the covered expatriate was neither a citizen nor resident of the country. If the covered expatriate is the beneficiary of a nongrantor trust (with either a U.S. or a foreign *situs*), any distribution from the trust shall be made after a withholding of 30 percent on the taxable portion. If a portion of the distribution includes appreciated property, the trust must recognize the capital gain. The taxable portion is that amount that would have been included in gross income if the covered expatriate had remained a green card holder.[27]

The payment of tax may be deferred by the taxpayer, but only if the taxpayer furnishes a bond (or other security) to the IRS. The taxpayer must also waive any treaty provision that would prevent the taxpayer from paying the tax.[28] Deferral of the payment of the tax may be made on an asset by asset basis and, once made, is irrevocable.[29] Interest will be charged on the underpayment of tax. Tax is due when the property for which the election is made is disposed of (or the last income tax return is due for a deceased taxpayer, whichever is earlier).[30]

Federal Inheritance Tax for U.S. Beneficiaries of 'Covered Expatriates'

The HEART legislation created a new category of taxation, never before seen in the federal transfer tax system, in 26 USCA §2801. Individuals who receive gifts from covered expatriates, and those beneficiaries of the estate of a covered expatriate, owe a tax on the gift or bequest.

If "covered expatriates" leave assets to U.S. beneficiaries upon their death, no matter how long after the expatriation death occurs, an estate tax, at a flat rate equal to the highest estate tax rate in effect at the time of death, is imposed.[31] There is a vital exception to this rule, however. For any amount in the covered expatriate's estate otherwise subject to the U.S. estate tax, the §2801 estate tax will not apply. So, for a covered expatriate who still owns a home situated in the U.S., for instance, the estate tax for NRAs would apply. The fact that the value of the home is passing to U.S. beneficiaries will negate the beneficiaries' tax liability under the new §2801. The beneficiaries will still owe §2801 estate tax on all remaining assets passing to them.

If a covered expatriate transfers assets during life to a U.S. beneficiary, a gift tax, at a flat rate equal to the highest gift tax rate in effect at the time of the gift, is imposed.[32] The same exception applies to any transfer already subject to the U.S. federal gift tax, which is reported on a timely filed gift tax return. All other gifts are subject to the gift tax, and said tax is payable by the recipient of the gift, not the donor.

As of this writing, the IRS has yet to develop the rules involving the reporting, filing, and payment of the tax imposed under §2801. In early August of 2009, the IRS reported that they would be announcing guidance involving the new tax and unveiling a new Form 708, which will report and impose the tax on gift recipients and estate beneficiaries of covered expatriates.

Planning Considerations

For the Nonresident Alien (NRA) who has never been resident in the United States, pre-immigration planning is still very crucial. The NRA should consider the transfers needed and make them prior to establishing residency in the country. The HEART legislation creates an additional consideration for this type of client, however. NRAs must now reconsider obtaining a green card upon entry to the United States, since it will begin the 8–15-year timeframe subjecting the individual to covered expatriate status. Practitioners should now consult with an immigration attorney to see if a green card is really needed. If the multinational is able to stay in the United States without beginning the clock for the 8–15 year timeframe, it enables the client more flexibility. Clients may now also consider leaving prior to the culmination of eight years of residency in the United States—especially if they do not plan on returning to the country to satisfy the eight-year minimum residency requirement.

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[27] 26 USCA §877A (f)(4)(a).

[28] 26 USCA §877A (b)(4), (5).

[29] 26 USCA §877A (b)(6).

[30] 26 USCA §877A (b)(3)

[31] 26 USCA §2801(a)(1).

[32] 26 USCA §2801(a)(1).

Practitioners should stay attuned to an NRA who is considering obtaining a green card and staying for at least eight years in the United States. If it is likely they will give up U.S. residency (upon retirement or a child's graduation, for instance) and leave U.S. gift recipients and/or U.S. beneficiaries behind, transferring assets prior to entering the United States would avoid both the transfer tax limitations on USCs and U.S. residents, and would avoid the §2801 inheritance tax on their U.S. beneficiaries and gift recipients. Such a situation may be difficult to predict so far in advance, but for the wealthy client, pre-immigration transfers will avoid a transfer tax system that former green card holders are now subject to indefinitely.

There is one bright spot in the HEART legislation—those U.S. residents who are not green card holders are no longer subject to any transfer tax consequences upon their exit from the country. Under the 10-year rule, they were deemed residents by the transfer tax definition, regardless of immigration status. Under HEART, however, only green card holders are targeted. Since the 10-year rule will not apply to anyone leaving the United States after June 17, 2008, U.S. residents who are not green card holders, such as those in the U.S. on a visa, for instance, are free to leave the country without the threat of future transfer taxation by the IRS. Once no longer considered a resident of the United States, they will continue to be subject to the transfer tax rules for NRAs only, with U.S. *situs* assets, which is the same rule for those NRAs who have never formed a relationship with the United States, but for their purchase of U.S. *situs* assets.

For those clients who have been in the United States for many years with a green card, a change in immigration status may serve as an important estate planning technique. One may consider becoming a USC, for instance. Such an individual avoids the exit tax when leaving the United States, and still has the freedom to live abroad as a USC, utilizing any transfer tax treaties to avoid double taxation between countries. One also may try to give up a green card prior to when the eight-year requirement has passed, and remain in the United States on a visa, although this may be a more difficult option.