International Law Office

September 2 2021

Changing times: tax and reporting requirements for US citizens and Green Card holders moving abroad

JENNIE CHERRY, STANLEY A BARG, ANDREW P STONE

Kozusko Harris Duncan | Private Client & Offshore Services - USA

- Introduction
- Tax and reporting obligations continue and expand while living abroad
- Considerations when establishing residency abroad
- Moving to treaty countries versus low-tax jurisdictions
- Death while living outside United States does not eliminate estate tax
- Gifts made while living abroad still subject to gift tax
- Other considerations
- FATCA
- Retaining US citizenship or maintaining Green Card status
- Comment

Introduction

Whether because of the covid-19 pandemic, politics, work opportunities or other personal considerations, some US citizens and Green Card holders ("US persons") are considering living abroad. How tax professionals and trust officers worldwide advise these individuals depends on their objectives. Does the individual want to live in another country for a limited number of years or to change domicile and resettle permanently? Will the individual be working abroad or living off savings and unearned income? Regardless of the length of time spent living outside the United States, the US person must be advised to continue all annual US tax reporting.

Tax and reporting obligations continue and expand while living abroad

Sometimes US citizens are surprised to learn that they will continue to be subject to federal income tax on worldwide income, regardless of where in the world they reside or for how long. Similarly, Green Card holders sometimes do not consider that their immigration status as lawful permanent residents of the United States also makes them conclusively resident for income tax purposes, regardless of the number of days spent in the United States.

In addition to continuing US income tax and reporting obligations, while living abroad, the US person may also be subject to the tax and reporting obligations of the foreign country. For example, if a US person with a British passport wants to live in England for four or more years, the individual's advisers or family office will want to hire a qualified accountant or accountants able to handle both US and UK tax filings. As well as the US calendar year reporting tax system, these professionals must also consider that the UK tax year runs from 6 April to 5 April annually.

Extension of time to file

No matter where in the world a US person lives, they must still file US income tax returns. While living abroad full time, the US taxpayer receives an automatic two-month extension from the Internal Revenue Service (IRS) so that their US income tax return is due on 15 June rather than 15 April. Interest will accrue on any tax not paid by 15 April but no penalties are imposed. To minimise double taxation, the US person will be entitled to a credit for foreign tax paid when calculating US income tax liability.

Earned income and housing cost exclusions

The US tax rules provide for a foreign earned income exclusion and foreign housing cost exclusion but this is only for US persons working abroad. The exclusions are unavailable to a US person living off savings and unearned dividend and interest income. Similarly, a US person receiving distributions from trusts of which the US person is a discretionary beneficiary cannot offset distributed income with these exclusions. In general, trusts will add another layer of consideration as regards tax and reporting, depending on the country where the US person decides to reside (for further details please see "Preparing US tax and information returns: Forms 3520 and 3520-A").

Reporting foreign financial assets

In addition to a US income tax return, since the US person will likely have a bank account in the other country, a foreign bank account report (FBAR) must be filed annually by 15 April if certain account-balance thresholds are met. It may also be necessary for the US person to file Form 8938 – Statement of Specified Foreign Assets with their US income tax return (for further details please see "Overview (January 2021)").

Considerations when establishing residency abroad

Some countries are now offering digital nomad visas or renewable residency certificates for remote workers. This type of residency may appeal to US persons with flexible remote work options looking for a refuge from the pandemic or a change of scenery. The criteria for residency and the application process will be carefully controlled by each country.

More generally, whether a US person is a tax resident in another country depends on the laws of that country. For example, countries will often specify the number of days per year spent in that country that will trigger tax residency. Being present in that country for a specified number of days (often 183 days) of the year will cause the US person to be considered a tax resident. For some countries, the prescribed threshold is lower. Moreover, many countries, such as the United Kingdom, will look at the number of days that an individual has been present in their own country over a three-year period in addition to just a single year. An intent to reside in a country may also cause tax residency therein even before a day-count test is met.

Although a US person may want to live abroad and may have the financial resources to do so, family advisers must consider where and by what process the US person and their family will be permitted to become resident in that foreign jurisdiction. There are few countries that allow an individual to become a permanent resident by merely moving there with the intent to remain. Most countries require an individual to obtain a visa in order to stay for more than a few weeks. The type of visa most suitable generally depends on whether the US person is planning to study or work in that country or whether they could make a considerable investment in the country's real estate or economic development. If the US person is hired as an employee of a company in the foreign country, obtaining a visa is

relatively straightforward. Alternatively, US persons not planning on working may have to demonstrate that they have sufficient assets for self-support, which can involve significant financial disclosure.

For wealthy clients, another option involves obtaining residency status or citizenship in exchange for investment in that country. Several countries offer "investor visas" or residency permits for a minimum investment of a specified amount over a prescribed period. In some cases, but not all, a minimum number of days spent residing in the country will be stipulated. "Investment" generally means debt or equity in local companies, government bonds, real estate or some combination thereof. The amount of investment required can range from $250,000 to several million dollars.

Moving to treaty countries versus low-tax jurisdictions

From a US tax perspective, since the US person will continue to be subject to US income tax, the most cost-effective approaches to residing outside of the United States are for the US person to move to a foreign country that:

- has an income tax treaty with the United States; or
- imposes little or no income tax on its residents.

Moving to treaty countries

As stated above, a US person will continue to be subject to tax on worldwide income while living abroad. However, in cases where the United States has a treaty with the foreign country, the treaty can limit the extent to which an individual may be taxed by the treaty-partner country. In particular, the treaty will govern the determination of the individual's tax residency and the extent to which the foreign country will tax a US person and provide relief from double taxation. In general, if the individual is considered a resident of the treaty-partner country, that country will have the authority to tax the individual on income from sources both within and outside of that country.

If a US person moves to a treaty-partner country and spends most of the year in that country (as opposed to a third country), the US person could be considered a resident of that country. A US person who receives income from a treaty country and who is subject to taxes imposed by foreign countries may be entitled to certain credits, deductions, exemptions and

reductions in the rate of taxes of those countries. A US person residing in a foreign country may also be entitled to benefits under that country's tax treaties with third countries.

For example, a US person tax resident in Spain is subject to US tax on worldwide income, including income sourced to Spain. In addition, the US person is also taxed as a Spanish resident on income derived from sources outside of Spain. The tax treaty between Spain and the United States stipulates that the US person will receive a US tax credit for taxes paid to Spain that were not otherwise sourced to Spain, but such credit is limited to the amount of US tax applicable to such income. Accordingly, in the case of a US person who is deemed resident of a treaty-partner country, the treaty will not provide relief from US income tax liability, but it can reduce a US person's overall tax liability by providing tax credits for at least a portion of the tax paid to the other country.

Moving to countries with little or no income tax

Since a US person will continue to pay US income tax on worldwide income, they may opt to move to a country that does not impose its own income tax. For example, a US person can become a resident and work in Bermuda by obtaining one of several types of work permit, including the new work from Bermuda certificate, allowing executives and students to work and study remotely from Bermuda. Alternatively, the US person could obtain residential status in Bermuda by applying for a residential certificate.

Bermuda has no income tax, capital gains tax or capital transfer tax. However, there is a payroll tax, a land tax on property owners and a stamp duty on conveyances of real and personal property in Bermuda.

Death while living outside United States does not eliminate estate tax

In addition to tax on income earned during life, the worldwide estate of a US citizen is subject to US estate tax, regardless of where that individual is domiciled at death. Likewise, the worldwide estate of a Green Card holder who is considered to be resident in the United States for estate tax purposes is also subject to US estate tax (for further details, please see "Overview (January 2021)").

Domicile
For a US citizen, because federal estate tax is due regardless of where that citizen is living at the time of death, a US citizen living abroad should consider maintaining a domicile in a US state rather than evidencing an intent to become domiciled in their country of residence if that other country also levies an estate or inheritance tax. However, care must be taken to also consider whether that US state levies its own estate tax. For Green Card holders, domicile will have to be determined at death and changing or maintaining domicile should be planned for accordingly. Likewise, if a US person moves to a country that is party to an estate tax treaty with the United States, the treaty may provide some protection for citizens of one country who were not present in the other country for a substantial period before death.

Domicile, unlike income tax residency, is based on the facts and circumstances of the individual case. Most importantly, for US tax purposes, domicile in a country is presumed to continue until it is established elsewhere. Domicile does not revert to the individual's domicile of origin the way it can under English law.

The location of business or employment activities does not necessarily determine domicile. Since domicile is less clearly related to current income-producing activities than the US income tax concept of residency, a domicile could be maintained in a US state even while living abroad. Facts and circumstances should support that the US person intends to return to that US state. Continuing to own a home in that state is especially helpful.

To properly prepare for the possibility that a US person dies while living abroad, consideration should be given to:

- whether the US person intends to maintain a US domicile;
- the specific US state where the US person has lived prior to moving abroad; and
- the possible need for multiple wills.

The US person will maintain a domicile in a US state, provided that the facts and circumstances surrounding the move indicate that the individual intends to return to the United States after living temporarily in the other country.

Gifts made while living abroad still subject to gift tax

As with the estate tax, US citizens, regardless of where they are resident, and non-citizens resident in the United States, for gift and estate tax purposes, are subject to federal gift tax on gifts valued in excess of an annual exclusion of $15,000 per donee (this value is for tax year 2021; it is indexed annually for inflation). Where the US person's spouse is not a US citizen, the marital deduction is not available and non-taxable gifts to that spouse are limited to an annual exclusion of $159,000 (this value is for tax year 2021; it is indexed annually for inflation). Gifts in excess of the relevant annual exclusion amounts begin to use the US person's lifetime exemption amount, which is currently $11.7 million for tax year 2021, and they reduce the credit available to use against estate tax at death (for further details, please see "Overview (January 2021)").

Other considerations

Family advisers should ensure that US clients living abroad do not forget to consider tax planning in the face of changing US tax law. The estate and gift tax exemption amount is set to expire on 31 December 2025, after which date the exemption will revert to the $5 million exemption amount provided under the previous law. The Biden administration may propose further reducing the estate and gift tax exemption amount, possibly coupled with an increase in the highest tax rate. Both a $3.5 million and a $5 million exemption amount along with a top rate of 45% have been discussed.

In some cases, a US person living abroad may be ready to relinquish their US citizenship. This should not be done before obtaining a new citizenship and considering the possible application of the US "exit tax". A Green Card holder may be ready to do the same and should determine whether they fall within the category of "long-term resident" for the purposes of the exit tax. The process for properly relinquishing US citizenship or a US Green Card to be free to return to the United States as a visitor must be carefully followed.

FATCA

Residing in another country generally means that the US person will have a bank account or other financial account in that country. The United States has negotiated intergovernmental agreements with more than 110

countries, requiring financial institutions in those countries to report US account holders under the Foreign Account Tax Compliance Act (FATCA). A FATCA report will alert the IRS that the US person has foreign financial assets. The IRS will then determine whether the US taxpayer has filed:

- an FBAR;
- a Form 8938; and
- other forms which collect data on assets and income sources outside the United States.

US persons residing in a country where the US person has family must also be aware that receiving gifts from non-US persons or distributions from foreign trusts will trigger US reporting requirements, regardless of the fact that the gift was received outside of the United States.

Retaining US citizenship or maintaining Green Card status

If the US citizen decides to obtain citizenship in the country of residence, the United States does not require the individual to relinquish their US citizenship. However, if obtaining citizenship in another country is being done as a step toward expatriation, the individual should carefully consider the tax consequences of expatriating first, before seeking to obtain citizenship in the other country. Advice from US and local counsel should be sought to determine how long the US citizen may live abroad and under what circumstances.

Green Card holders should be aware that living outside of the United States could result in a loss of permanent resident status. If, upon re-entry to the United States, the Customs and Border Protection officers determine that the individual intended to live outside the United States, they can begin removal proceedings. Failing to file income taxes with the IRS while living outside the United States can also trigger removal proceedings. However, there are exceptions to this and there may be an opportunity to obtain a re-entry permit prior to departure. Immigration counsel should be consulted prior to a Green Card holder moving abroad.

Comment

Tax professionals and trust officers advising US persons wishing to live outside of the United States during the next few years should:

- explore the various options available, while making the US person aware of continuing US tax and reporting obligations;
- consult local counsel in the relevant foreign country regarding obtaining resident status;
- consider whether domicile will be maintained in a US state; and
- engage an accountant who can navigate the income tax and additional reporting obligations of both the United States and foreign jurisdiction.

For further information on this topic please contact Jennie Cherry or Stanley A Barg at Kozusko Harris Duncan's New York office by telephone (+1 212 980 0010) or email (jcherry@kozlaw.com or sbarg@kozlaw.com). Alternatively, contact J Andrew P Stone at Kozusko Harris Duncan's Chicago office by telephone (+1 312 580 4949) or email (astone@kozlaw.com). The Kozusko Harris Duncan website can be accessed at www.kozlaw.com.

Copyright in the original article resides with the named contributor.