Should I Stay or Should I Go? Tax and Immigration Considerations for U.S. Permanent Residents and Citizens

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A new client, who came into the office with a regal carriage and investment holdings to match, was happy about securing his U.S. permanent resident card six years ago. He now wanted to engage in tax planning. He had job opportunities in both the U.S. and France, and aging parents in France. He was wrestling about where to live, and wanted advice on how his decision would impact his finances. He was shocked to learn about the new punitive taxes that might hit if he continued to hold his permanent resident card (his "green card") and later moved abroad to be in close proximity to his family. While tax clients present an infinite constellation of personal and financial configurations for the advisor to navigate, this situation is very common. Unfortunately, it is also common for even the most sophisticated multinational executives, managers, entrepreneurs, and investors to fail to account for the tax and immigration consequences that will flow from their decisions as to the choice of residence and their attainment or relinquishment of U.S. immigration status. Before seeking or retaining U.S. permanent residence status, a foreign national should be aware of the U.S. tax and immigration law issues which are associated with that status.

Taxes

Income and Transfer Taxes

While the permanent resident holds the green card, he or she faces both income and transfer tax issues. With respect to the income tax, a permanent resident is deemed to be an income tax resident of the U.S. for as long as the green card is retained.[1] As a result, all of the permanent resident's worldwide income is subject to U.S. income tax.[2] Because the foreign national is also a citizen of one or more other countries, he or she may be subject to further income tax in other jurisdictions. In such event, the person may benefit to some extent from the U.S. foreign tax credit[3] or the availability of relief from double taxation under an income tax treaty.[4]

What may be less intuitive to the permanent resident is the applicability of U.S. transfer taxes, which include gift, estate, and generation-skipping transfer taxes.[5] These types of taxes, often referred to as inheritance taxes, are less prevalent across the globe than income taxes, and the foreign national may very likely come from a country which does not have them. As a resident of the U.S.,[6] the foreign national will incur inheritance taxes on the gratuitous transfer of assets to spouse, children, grandchildren and others, with generally the same rates of taxation, exemptions and deductions as a U.S. citizen. Beginning January 1, 2011 and continuing through December 31, 2012, there is a cumulative US$5,000,000 gift/estate tax exemption for each resident, with a flat rate tax of 35% on transfers above that amount.[7] It is noteworthy,

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however, that a transfer to a spouse who is a non-U.S. citizen will not benefit from the unlimited marital transfer exemption that is otherwise available for transfers to a spouse who is a U. S. citizen.[8] A treaty may also be available to enhance deductions and exemptions.[9]

If the foreign national takes affirmative steps before becoming a U.S. resident for transfer tax purposes, he or she can avoid much of the burden imposed by the transfer taxes. There are trust mechanisms available for such purposes. Before making a transfer to such a trust, however, the foreign national's advisors need to assess the tax impact in the person's then-current jurisdiction of residency and, if different, the person's country of nationality.

The Exit Tax

Since June 17, 2008, the United States has imposed an enormous "exit tax" or "expatriation tax" on certain permanent residents who give up their green cards and on U.S. citizens who renounce American nationality.[10] For the permanent resident to qualify for taxation under this regime, he or she must have held the green card for any part of eight of the previous fifteen years.[11] Furthermore, the permanent resident must have either: (a) a net worth, considering all assets worldwide, of US$2,000,000 or more, or (b) an average U.S. net income tax liability over the previous five calendar years of $147,000.[12] If either of these criteria is met, then upon giving up the green card, the person becomes a "covered expatriate."[13]

The exit tax includes both income taxes and an inheritance tax. The flagship income tax is a "mark-to-market" tax on the inherent gain in all of the covered expatriate's worldwide assets (except for certain retirement assets, which are taxed differently).[14] The rate of taxation depends on whether the gain is long-term capital gain under U.S. law, short-term gain or ordinary income. There is an exemption for the first $636,000 of gain, which the taxpayer allocates proportionately among the assets.[15] As complements to the mark-to-market tax, there are other income taxes on, in general, Individual Retirement Accounts, qualified retirement plans and other deferred compensation arrangements, and distributions from certain nongrantor trusts.[16]

The inheritance tax instituted under the exit tax regime involves later gratuitous transfers from a covered expatriate to U.S. citizens or residents. These recipients may include, for example, children who have been raised or educated in the U.S. and choose to stay for career or marital reasons. Any gift to them by the covered expatriate during life or at the expatriate's death will be taxed at the maximum gift or estate tax rate then in effect, which is currently 35%.[17] There is only a yearly $13,000 exemption per recipient. The inheritance tax is paid by the recipient.

If the covered expatriate chooses to give to the children or others through a U.S. domestic trust, the trust will pay the inheritance tax upon receipt, regardless of the actual citizenship or residency of the beneficiaries.[18] If a foreign trust is used, a U.S. citizen or resident beneficiary will pay the inheritance tax as distributions are received from the trust.[19]

As a result of the exit tax, the permanent resident will have to plan carefully before he or she determines to renounce the green card and go back home or elsewhere. It is indeed very difficult to extricate oneself from the U.S. tax system. With planning, however, a good deal of the tax bite can be avoided through the use of trust mechanisms and asset transfers.[20] It is important, however, to consult with foreign advisors as to tax consequences of any such transfers under the laws of the jurisdiction of the person's new residence and, in some cases, the person's nationality.

Immigration

Seeking, Retaining or Relinquishing U.S. Permanent Residence Status After Evaluating Tax Considerations

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Attaining U.S. Permanent Resident Status

It is not at all uncommon for foreign nationals to suffer from what one might term the *Field of Dreams* syndrome. The syndrome refers to the iconic 1989 film starring Kevin Costner. Costner's character, Ray Kinsella, hears a voice in his head which tells him to build a baseball field in his cornfield in Iowa and people will come to watch the ghosts he sees of former baseball greats play ball. The principal symptom of this syndrome is that if a foreign national initiates a permanent resident case, the permanent resident card will automatically arrive in the mail. In actuality, there is always a risk of a government denial and, particularly during this recession, U.S. Citizenship and Immigration Services (CIS) has been more aggressive than in the past in challenging and denying cases. However, it is also true that with careful planning and execution, the great majority of permanent residence cases for high net worth individuals will succeed and the formulation and implementation of a well-designed strategy will typically boost such odds.

If after consulting with one's tax advisor, a foreign national decides that he would like to seek permanent resident status, the next step is to devise a strategy to pursue such objective. For high net worth individuals, the most common routes to achieving U.S. permanent resident status are via an employment-based process or via sponsorship by a family member who is a U.S. citizen or lawful permanent resident. Some of these processes can take months if not years to complete depending on many factors. These include the immigrant category being utilized, the existence of any immigration quota limitations applicable to such category, government processing times, and the qualifications of the individual at issue. Consequently, many foreign nationals first arrive in the U.S. in a work visa status to start their U.S. life and subsequently or simultaneously work towards achieving permanent resident status. The key is to identify which of the many visa categories offers the best odds of success and the most relatively expeditious path through the immigration maze. The wisest navigators of the immigration process have consulted with both immigration and tax lawyers before embarking on the first step of any immigration-related process since there are many hidden traps that may snare the unwary immigrant. A knowledgeable, savvy navigator is more likely to experience blue skies during the process and, if some governmental turbulence does occur, it is much less likely to be unexpected.

It is advisable for the foreign national who is working with the immigration lawyer to navigate the immigration process to keep the tax advisor informed as to the progress, because the attainment of different temporary visas and permanent resident status can impact the tax filings in a variety of ways.

Retaining U.S. Permanent Resident Status

If, as it is for most, the objective, after consulting with one's tax advisor and family members, is to retain U.S. permanent resident status, normally nothing special must be done if one continues to live in the U.S., does not commit any crimes and does not undertake any foreign assignments or other personal absences that reach 180 consecutive days abroad without proper advance planning.

If one accepts an assignment abroad or goes abroad for other reasons for a period that may be protracted, such as to care for an elderly family member, then certain protective steps should be taken before initial departure, including forming a plan by which the foreign assignment or absence will be for a finite period of years, applying for a re-entry permit, ensuring that 1040 tax returns will be filed each year even if the permanent resident does not work in the U.S. at all or receive U.S. source income, and maintaining ample ties with the U.S.

Permanent residents who are living and working abroad for a period of years may face intensive questioning from U.S. Customs and Border Protection (US CBP) upon re-entry since CBP can readily *see* the absences on its electronic manifest upon inspection at the airport. An immigration

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lawyer can lay out what documents to have in hand to reduce the risk of problems. In general, those who undertake a temporary absence of up to about five years, with proper planning, will generally be able to hold onto their permanent resident status if they take the right steps, although naturalization eligibility will typically be delayed. For periods beyond that, the ability to retain permanent resident status may become tenuous.

Relinquishing U.S. Permanent Resident Status or U.S. Citizenship

Due to the U.S. government's imposition of the "expatriation" tax in 2008 as outlined earlier in this article, there are increasingly situations where high net worth individuals voluntarily decide to relinquish their permanent resident status. In our practice, this tends to almost always happen in the same dynamic. This is where a permanent resident decides that it is very likely that they will ultimately return to live permanently abroad. A projected career trajectory involving assumption of foreign (non-US) executive or managerial posts, a need to care for aging parents in one's native land, or lifestyle or political factors can trigger a decision to return abroad permanently and voluntarily relinquish permanent resident status.

Historically, we rarely saw such situations, since U.S. permanent residence is a much sought after status due to the freedoms, lifestyle, and economic opportunities that the U.S. offers. Those who lost U.S. immigration status typically fell into the involuntary category. One can lose permanently residence in a variety of situations including due to a conviction, plea or admission to a crime that makes one removable (deportable); returning to live abroad without obtaining a re-entry permit to proactively register such temporarily foreign residence and maintaining sufficient ties to the United States, and failing to file 1040 federal income tax returns as a resident even during years that one temporarily works abroad.

If a resident decides to voluntarily relinquish permanent resident status, there are several issues to consider: (a) if one relinquishes permanent resident status, one may not be able to regain such status if his situation changes; (b) one would not want to relinquish one's status until one truly does not need it any longer; and (c) one would want to relinquish the permanent resident status in a fashion that does not trigger any future problems with the U.S. immigration authorities.

Relinquishment of permanent resident status is referred to as "abandonment." In some cases, the foreign national who plans to abandon permanent resident status may have children attending college or working in the U.S. The naturalization of such children may afford the parent a "Plan B" to regain permanent residence if circumstances later change. This may be important since some permanent residents who abandon their status may find it difficult or impossible to regain such status at a later time, or to regain within a time frame that suits their needs.

Further, abandonment must be accomplished at the right time. If one rushes to do it at the instigation of the tax advisor without consideration of the immigration dynamic, then one might find that one has done it before one has completed a U.S. job or other activity that requires a work authorized U.S. status. Hence, generally one wants to have wrapped up all U.S. work and personal affairs before one abandons status.

The mechanics of abandonment of lawful permanent resident status are relatively simple but there are pitfalls for those who go about it carelessly. In our experience, it is generally wiser and less stressful to abandon one's permanent resident status at a U.S. Consulate or Embassy rather than at the airport in front of a U.S. Customs and Border Protection (CBP) officer. Each U.S. Consulate has its own procedure and some accomplish it by appointment and some allow for a mail-in process. The focal point of the process, regardless of where it is accomplished, is the

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completion and submission of an I-407 abandonment form plus the original permanent resident card. The form contains questions about when and why the permanent resident decided to abandon status and a careless completion of the form to incorrectly intimate that one decided to relinquish one's status and then continued to use the permanent resident card to re-enter the United States after foreign travel when one has already decided not to live permanently in the U.S. can lead to a fraud charge making one permanently inadmissible to the United States. So the permanent resident is well-advised to seek legal counsel before abandoning permanent resident status.

After permanent resident abandonment is complete, the permanent resident should retain the accepted I-407 form signed by the U.S. government officer to facilitate future U.S. visitor visa applications and also entries under the Visa Waiver program, if applicable. The tax advisor also may need a copy to ensure proper recordation of the date upon which permanent resident status was abandoned.

Voluntary abandonment of U.S. citizenship is an even more serious matter and also involves completion and execution of a form, witnessed by U.S. government officials who wish to ensure that the abandonment is willingly and knowledgeably made. In 1996, the U.S. Congress enacted a provision that states that "any alien who is a former citizen of the United States who officially renounces United States citizenship and who is determined by the Attorney General to have renounced United States citizenship for the purpose of avoiding taxation by the United States is inadmissible."[21] In our experience, those who relinquish U.S. immigration status, whether permanent resident status or citizenship, do so for a multitude of reasons, so it would interesting to *see* how this provision might be interpreted in practice. Due to very technical reasons, this provision has not been enforced to date. Interestingly, however, a number of visa application forms still ask whether a visa application has ever renounced U.S. citizenship for tax reasons. It remains to be seen whether the U.S. Congress and regulatory authorities may try to reinvigorate efforts that began with the passage of the 1996 legislation, so it is prudent for foreign nationals who are considering renunciation of U.S. citizenship to consult with an immigration lawyer and, if there are non-tax reasons for such renunciation, consider recording those in a notarized, contemporaneous affidavit.

Conclusion

In enacting the June 17, 2008 legislation that brought us the expatriation tax, the U.S. Congress may have unwittingly created an incentive for some high net worth individuals to exit the United States earlier than they would otherwise do, resulting in a substantial loss not only of tax income, but also of the economic activity spurred by their investment, entrepreneurship and spending. In those few cases, the tax-paying client, Odysseus, may need to lash himself to mast of his vessel to avoid the sultry Sirens luring him to the golden coastline of the United States.

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[1] IRC § 7701(b)(1)(A)(i), 26 U.S.C. § 7701(b)(1)(A)(i).

[2] The Kentucky Supreme Court requires that we advise that Kentucky does not certify specialties in legal fields.

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[2] IRC § 61, 26 U.S.C. § 61.

[3] IRC §§ 27, 901, 26 U.S.C. §§ 27, 901.

[4] There are over sixty bilateral income tax conventions. A list is available at http://www.irs.gov/businesses/international/.

[5] IRC §§ 2001, 2501 & 2601, 26 U.S. C. §§ 2001, 2501 & 2601.

[6] Residency for U.S. transfer tax purposes is defined in Treas. Reg. §§ 20.0-1(b) and 25.2501-1(b). 26 C.F.R. §§ 20.0-1(b) and 25.2501-1(b). For these purposes, residency is defined in a manner that equates to domicile under the Anglo-American common law concept. Thus, a person becomes a domiciliary in a place by living there, even if for a brief period, with no present intention of leaving there, and a later intention to change domicile will not be effective unless the person actually leaves. The definition differs substantially from the income tax tests of residency under I.R.C. § 7701(b). 26 U.S.C. § 7701(b). As a person residing in the U.S. and having a "permanent residence status" under immigration law, it would be difficult to argue that the person is not a resident for transfer tax purposes.

[7] Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. 111-312.

[8] IRC § 2523(i) as to the gift tax (26 U.S.C. § 2523(i)); IRC § 2056(d) as to the estate tax (26 U.S.C. § 2056(d)). A qualified domestic trust (QDOT) may be employed for an estate tax deduction, but subsequent principal distributions during the surviving spouse's life and at death will be taxed without the availability of the surviving spouse's exemption. In effect, the first decedent's estate is grossed up by the amount of the principal distributed from the QDOT or remaining in it at the second spouse's death. This may also cause a higher rate of taxation. IRC § 2056A, 26 U.S.C. § 2056A.

[9] For example, under the U.S. – Canada treaty, the estate of a U.S. citizen or resident decedent, whose "fiscal domicile" under the treaty lies with the U.S., receives a "marital credit" for a bequest to the noncitizen Canadian spouse. This credit results in a tax-free transfer up to the U.S. exemption equivalent, which in the years 2011 and 2012 is $5,000,000. The exemption equivalent is calculated without reduction for any lifetime gifts which might otherwise operate to decrease the exemption available at death. U.S. – Canada Income Tax Treaty, Article XXIX.B.3.

[10] Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. 110-245.

[11] IRC §§ 877A(g)(5), 877(e)(2), 26 U.S.C. §§ 877A(g)(5), 877(e)(2). A tax year, however, does not include any year in which the person is treated as a resident of another country pursuant to a treaty with that other country, and the person has not waived the benefits of the treaty that apply to residents of that country. IRC § 877(e)(2). A key consideration of the 8-of-15 Rule is that holding a green card for just one day within a calendar year counts as a year. Treas. Reg. § 301.7701(b)-1(b)(1), 26 C.F.R. § 301.7701(b)-1(b)(1).

[12] Or, if the person fails to certify under penalties of perjury that he or she has complied with all U.S. tax obligations for the preceding five tax years, he or she will be a covered expatriate regardless of net worth or tax liability. IRC § 877(a)(2), 26 U.S.C. § 877(a)(2).

[13] It is possible to "expatriate" without actually turning in the green card. The unintended expatriation will ensnare the long-term resident executive who moves to one of the over sixty countries which has an income tax treaty with the U.S. and dutifully files his or her U.S. income tax return, and, on that return, takes a treaty-based position providing tax relief. If this occurs, the person is deemed to have expatriated for purposes of the regime. I.R.C. § 7701(b)(6), 26 U.S.C. § 7701(b)(6).

[14] IRC § 877A(a)(1), 26 U.S.C. § 877A(a)(1).

[15] IRC § 877A(a)(3), 26 U.S.C. § 877A(a)(3).

[16] IRC § 877A(d), (e) & (f), 26 U.S.C. §§ 877A(d), (e) & (f).

[17] IRC § 2801, 26 U.S.C. § 2801.

[18] IRC § 2801(e)(4)(A), 26 U.S.C. § 2801(e)(4)(A).

[19] IRC § 2801(e)(4)(B), 26 U.S.C. § 2801(e)(4)(B).

[20] *See* John L. Campbell and Michael J. Stegman, "Confronting the New Expatriation Tax: Advice for the U.S. green card Holder," Journal of the American College of Trust & Estate Counsel, Vol. 35, No. 3, Winter 2009. This article can be downloaded from the author's website, www.internationalestatetax.com.

[21] 8 U.S.C. § 1182(a)(10)(E).

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