

LEGAL

Tax problems for dual passport holders and 'accidental Americans'

■ ANDREA DARLING DE CORTES
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Despite all that's been written about U.S. worldwide income taxation and complex informational reporting requirements, many individuals, particularly those living outside the U.S., remain non-compliant. Some individuals do not realize they are U.S. citizens or tax residents. Some know they are U.S. citizens or residents but do not understand that they continue to have tax and reporting obligations while living outside the U.S.

The purpose of this article is to bring awareness to U.S. worldwide taxation and reporting (regardless of physical residence), and to provide further information for becoming compliant under one of several available IRS programs.

U.S. citizenship – how it works

If you were born in the U.S. or one of the following U.S. territories: Puerto Rico, Guam, Northern Mariana Islands, or U.S. Virgin Islands, you are a U.S. citizen subject to U.S. taxation on your worldwide income, as well as a host of reporting obligations with respect to U.S. and non-U.S. assets.

You also may be a U.S. citizen subject to the same tax and reporting requirements if you were born outside the U.S., provided that one or both of your parents, who were married to each other at the time of your birth, resided in the U.S. for a period of time before you were born.

If your parents were not married when you were born, your citizenship status is a bit more complex. You would be a U.S. citizen if your mother was a U.S. citizen and had been physically present in the U.S. (or U.S. territory) for at least one year. You also would be a U.S. citizen if your father was a U.S. citizen, provided that additional requirements are met, including that your father was physically present in the U.S. for at least five years prior to your birth and has agreed to provide for your financial support, among other factors.

U.S. tax filing obligations

Your status as a U.S. person determines whether you should pay

U.S. income tax and, if so, how much you should pay. You are a U.S. person if you are a U.S. citizen or a U.S. resident. While U.S. citizen status is discussed above, you are a U.S. resident if you are substantially present in the U.S. (not relevant for the purposes of this article) or you are a U.S. green card holder, also known as a lawful permanent resident.

Furthermore, you remain a green card holder until your status is rescinded, or administratively or judicially determined to have been abandoned. Not renewing your green card and letting it expire does not terminate your status as a U.S. resident for tax purposes. To formally relinquish or abandon your green card, you must file Form I-407 (Record of Abandonment of Lawful Permanent Resident Status) with the U.S. Citizenship and Immigration Service (USCIS, formerly known as the Immigration and Naturalization Service, or INS) by mail or in person at a USCIS international field office, U.S. Embassy or U.S. Consulate.

As a U.S. person, you are subject to U.S. income tax on your worldwide income, irrespective of where you reside or the source of your income. This citizenship-based tax regime is unique compared to the residence-based taxation utilized by most other countries, and it also creates the opportunity for double taxation. Double taxation occurs when two tax jurisdictions both claim the right to tax your income. For example, a U.S. citizen living and working in Switzerland would have the U.S. and Swiss tax authorities claiming the right to tax the Swiss source income – clearly an undesirable result.

By effectively using foreign tax credits and bilateral income tax treaties, you can mitigate the burden of double taxation. Generally, you can claim foreign tax credits for certain foreign taxes paid on your foreign source income to offset your U.S. tax liability on the same income. In addition, the U.S. has negotiated and executed several bilateral income tax treaties that grant exclusive tax jurisdiction to one country, or shared jurisdiction with one country having primary tax jurisdiction and the other country having secondary tax jurisdiction at a reduced tax rate.



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What should you file?

As a U.S. person, you generally are required to file individual income tax and applicable information returns by April 15 of each year, with extensions of time available to extend the due date to Oct. 15.

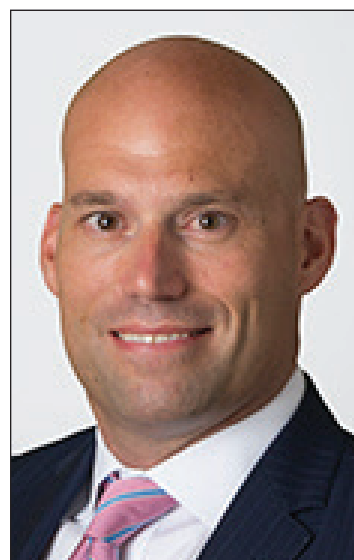
The following table and subsequent summary descriptions illustrate some of the filings potentially applicable to you as a U.S. person.

Some noncompliant taxpayers mistakenly rationalize that little or no U.S. presence puts them and their assets beyond the U.S. government's reach. However, the IRS has used the following collection tools in international cases to reach taxpayers and their assets.

Levy on Domestic Branch of Financial Institution: Under certain conditions, the IRS can seize deposits held in offshore accounts if the financial institution is engaged in the banking business in the U.S. or a U.S. territory.

Writ Ne Exeat Republica: A court order prohibiting the taxpayer from traveling outside the jurisdiction often filed in connection with some other action against the taxpayer such as a repatriation order. The IRS deems this action appropriate when the taxpayer is about to leave the U.S. and is unlikely to return or has left the U.S. and is likely to return, and has concealed assets to be removed from the U.S.

Repatriation Order: A court order requiring the taxpayer to transfer assets to the U.S. where the taxpayer previously transferred such assets out of the U.S. or acquired such assets in a for-



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foreign country. The repatriation order must demonstrate that the taxpayer's U.S. assets are insufficient to satisfy the outstanding tax liability.

Mutual Collection Assistance Request: Provisions in five bilateral income tax treaties wherein the foreign treaty partner treats the taxpayer's U.S. tax liability as if were a liability of the respective foreign country, with the foreign country utilizing its domestic laws to collect U.S. taxes.

How can you fix your noncompliance?

There are multiple avenues through which you can resolve your U.S. tax filing noncompliance. Determining the most appropriate course of action depends on your specific circumstances. You should discuss these remediation options with your U.S. tax counsel to determine your preferred path toward U.S. tax compliance.

Offshore Voluntary Disclosure Program (OVDP): Designed for willful violators and subjects taxpayers to a 27.5 percent penalty (50 percent if account held at certain financial institutions). Taxpayers receive criminal clearance and a closing agreement. All voluntary disclosures must be submitted in full by Sept. 28, 2018.

Streamlined Filing Compliance Procedures: Designed for non-willful violators and without imposition of a penalty for taxpayers living outside the U.S. (5 percent penalty if taxpayer resides in the U.S.). The taxpayer does not receive a closing agreement or

any IRS acknowledgement.

Delinquent International Information Return Submission Procedure: Designed for taxpayers not needing OVDP or Streamlined to report income and pay tax but who have reasonable cause for failure to timely file information returns (e.g., Forms 5471, 3520, 8938, etc.).

Delinquent FBAR Submission Procedure: Designed for taxpayers not needing OVDP or Streamlined to report income and pay tax but who need to file late Foreign Bank Account Reports (FBARs).

Leaving the U.S.

Certain individuals feel that the U.S. tax system is overly burdensome, unfair or otherwise simply want to escape its reach. If this applies to you, you can elect to renounce your citizenship or terminate your permanent resident status.

Most U.S. citizens expatriate under Section 349(a)(5) of the Immigration and Nationality Act by "making a formal renunciation of nationality before a diplomatic or consular officer of the United States in a foreign state, in such form as may be prescribed by the Secretary of State."

Similar to U.S. citizens renouncing their citizenship, U.S. green card holders can voluntarily terminate their U.S. residency. U.S. resident status continues until it is rescinded or administratively or judicially abandoned. A green card holder can initiate abandonment of resident status by filing Form I-407 (Record of Abandonment of Lawful Permanent Resident Status) with the USCIS by mail or in person at a USCIS international field office, U.S. Embassy or U.S. Consulate.

U.S. citizens and long-term permanent residents (status as a permanent resident in at least eight out of the past 15 years) should exercise caution to avoid being considered covered expatriates. Covered expatriates generally are subject to an exit tax whereby the covered expatriate's property will be treated as sold on the day before the expatriation date for its fair market value.

An expatriate is a covered expatriate if: the average annual net income tax for the last five years ending prior to the loss of citizen-

ship is greater than \$162,000; the individual's net worth as of the expatriation date is \$2 million or more; or the individual fails to certify that he or she has been U.S. tax compliant for the preceding five years.

U.S. tax noncompliance has consequences beyond potential civil and criminal penalties. As noted above, you cannot simply expatriate as a solution for U.S. tax noncompliance. Such noncompliance in any of the five years preceding abandonment of U.S. residency results in covered expatriate status, the deemed sale of property and the imposition of an exit tax.

Conclusion

In this article, we demonstrated that you can reside outside the U.S. and still have significant U.S. tax filing obligations. Many people living abroad are not even aware of such requirements. Such individuals can be unknowing U.S. citizens or green card holders yet to abandon their U.S. resident status.

We further demonstrated that the penalties for U.S. tax noncompliance can be severe. However, relief is available for those noncompliant taxpayers – OVDP if you are a willful violator and the Streamlined Program if your noncompliance was due to non-willful conduct.

In addition, the Delinquent International Information Return and FBAR Submission Procedures are available if you have no unreported or unpaid tax but failed to file certain information returns.

The biggest mistake you can make as a noncompliant taxpayer is to ignore the issue. Increased international cooperation among tax jurisdictions, enhanced information exchange and global tax transparency have eroded financial secrecy. The IRS and U.S. Department of Justice have articulated time after time that you will experience better outcomes if you come forward voluntarily before the U.S. tax authorities find you.

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Shipowners use wind again to cut emissions

■ ELLEN MILLIGAN

Hoist the mainsail – a thing that looks like a giant vertical pipe – and switch on your battery the size of a small bus: merchant shipowners are trying out bold new approaches in their battle to improve environmental performance against a backdrop of mounting regulatory pressure.

Maersk Tankers is testing two almost 100-foot-high rotor sails on

one of its fuel carriers, while Norway's Golden Energy Offshore Services this week said it ordered two of Rolls-Royce Holdings Plc's battery-powered energy storage systems for its ships.

Shipowners, responsible for handling about 90 percent of world trade, have been tasked with halving carbon releases by 2050. The target places a great pressure to find successful innovations because there are signs

the industry's rate of improvement in environmental performance might actually be starting to slow.

Tests on the mechanical sails, which use wind to replace up to 20 percent of propulsion power for offshore vessels, have been successful so far, said Tuomas Riski, the chief executive officer of Norsepower, which is providing the sails in the venture with Maersk Tankers.

The other partners in the pro-

ject are Energy Technologies Institute and Shell Shipping & Maritime.

The sails have been proven to reduce 6.8 percent of emissions on offshore vessels and the aim is for reductions to reach 10 percent.

The Rolls-Royce system adds a battery-run generator, which can operate on its own for hours at a time if sailing slowly, to a main diesel engine.

The battery can also be used as

a reserve engine for a shorter period in the event of an emergency.

After a surge in oil prices in the middle of the last decade spurred innovations to optimize vessel and engine performance, there are signs those gains are starting to peak.

Average carbon dioxide emissions per container per kilometer for global ocean transportation routes were reduced by 1 percent from 2016 to 2017, according

to a study published this month by the Clean Cargo Working Group.

Since it began publicly reporting data from the industry in 2009, emissions per container per kilometer dropped 37 percent on average.

Seaborne trade has expanded steadily for decades, as have the distances vessels must travel to make deliveries.

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The Cayman Islands funds and financial services industries have thrived on innovation, cutting edge structures and accompanying legislation. We are now in an era of blockchain and AI. Can legislation, regulation and corporate governance keep pace with technology and technological change?

Friday 2, November 2018
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Fund Focus 2018
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Common Forms	Information Reported	Civil Penalties for Not Filing
Form 1040	Worldwide income from all sources	Failure to file; failure to pay; accuracy-related (for erroneous underreporting)
Form 114 (FBAR)	Financial interest, or signature authority over, foreign financial accounts with maximum aggregate balance > \$10,000	\$10,000 (non-willful); 50% of maximum balance (willful)
Form 8938	Interests in specified foreign financial assets in excess of certain reporting thresholds	\$10,000 per violation
Form 5471	Interests in certain foreign corporations	\$10,000 per violation
Form 8865	Interests in certain foreign partnerships	\$10,000 per violation
Form 8858	Interests in foreign disregarded entities	\$10,000 per violation
Form 3520	Transactions with foreign trusts and receipt of certain foreign gifts	Greater of \$10,000 or 35% of gross reportable amount for foreign trust transactions; up to 25% of gift value for receipt of foreign gifts
Form 3520-A	Trust activities of foreign trusts with a U.S. owner	Greater of \$10,000 or 5% of gross reportable amount