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# General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals

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## **ADDRESS COMPLIANCE IN CONNECTION WITH TAX RESPONSIBILITIES OF EXPATRIATES**

### **Current Law**

An individual may become a U.S. citizen at birth either by being born in the United States (or in certain U.S. territories) or by having a parent who is a U.S. citizen. All U.S. citizens generally are subject to U.S. income taxation on their worldwide income, even if they reside abroad.

U.S. citizens that reside abroad also may be subject to tax in their country of residence. Potential double taxation is generally relieved in two ways. First, U.S. citizens can credit foreign taxes paid against their U.S. taxes due, with certain limitations. Second, U.S. individuals may exclude from their U.S. taxable income a certain amount of income earned from working outside the United States. U.S. citizens living abroad are also eligible for the same exclusions from gross income and deductions as other U.S. taxpayers, and therefore may have taxable income that is low enough that no income tax is due.

The Internal Revenue Code (Code) imposes special rules on certain individuals who relinquish their U.S. citizenship or cease to be lawful permanent residents of the United States (expatriates). Expatriates who are “covered expatriates” generally are required to pay a mark-to-market exit tax on a deemed disposition of their worldwide assets as of the day before their expatriation date.

An expatriate is a covered expatriate if they meet at least one of the following three tests: (a) has an average annual net income tax liability for the five taxable years preceding the year of expatriation that exceeds a specified amount that is adjusted for inflation (the tax liability test); (b) has a net worth of \$2 million or more as of the expatriation date (the net worth test); or (c) fails to certify, under penalty of perjury, compliance with all U.S. Federal tax obligations for the five taxable years preceding the taxable year that includes the expatriation date (the certification test).

The definition of covered expatriate includes a special rule for an expatriate who became at birth a citizen of both the United States and another country and, as of the expatriation date, continues to be a citizen of, and taxed as a resident of, such other country. Such an expatriate will be treated as not meeting the tax liability or net worth tests if they have been a resident of the United States for not more than 10 taxable years during the 15-taxable year period ending with the taxable year during which the expatriation occurs. However, such an expatriate remains subject to the certification test.

If a taxpayer renounces U.S. citizenship or abandons lawful permanent resident status, that taxpayer must file Form 8854, Initial and Annual Expatriation Statement, with the taxpayer’s U.S. tax return to make the certification described in the preceding paragraph and provide information to determine whether the individual is subject to the exit tax (and to compute such tax, if applicable).

Generally, the Internal Revenue Service (IRS) has three years from the date a return is filed to assess the tax. However, existing law extends the assessment statute of limitations in certain cases, such as when a taxpayer fails to furnish required information returns relating to various international transactions or assets. In these cases, the statute of limitations does not expire until three years after the information required to be reported is provided. Existing law does not include Form 8854 as one of the information returns that would trigger an extended statute of limitations.

Under the Foreign Account Tax Compliance Act (FATCA) provisions of the Code, a foreign financial institution is required to collect certain information about U.S. persons who hold an account with the institution, including the person's U.S. taxpayer identification number (TIN). A foreign financial institution that fails to comply with these rules may be subject to U.S. withholding tax on certain U.S. source payments. Foreign financial institutions consequently routinely require an account holder who is a U.S. citizen to provide a TIN.

With some exceptions, an individual who is not a U.S. citizen is required to obtain a certificate from the IRS (generally referred to as a "sailing permit") that the individual has complied with all of their income tax obligations before departing from the United States.

### **Reasons for Change**

Form 8854 is critical to the IRS's ability to identify expatriating taxpayers. If a person expatriates but fails to include the form with their tax return, it is difficult for the IRS to identify such a failure, and consequently the IRS may not be aware that the person has expatriated. Although the IRS receives information on expatriating individuals from the Department of State or from the United States Citizenship and Immigration Service, the information is received after the expatriating act and does not include TINs, which means that it is more difficult and time-consuming for the IRS to match this information with taxpayer records. In the case of long-term permanent residents, many are not aware of the requirement to file Form 8854 when they surrender their green cards, and the IRS has no established methodology of identifying such cases. Because of these difficulties, the IRS may not discover that an individual has expatriated and failed to file Form 8854 until more than three years after the individual files their tax return for the year of expatriation. In these circumstances, unless the IRS proves fraud, the IRS may be barred from making any expatriation related tax assessments because the assessment statute of limitation on the taxpayer's tax return may have already expired. These cases can involve substantial amounts of foregone exit tax and related taxes, and high net wealth taxpayers can exploit the tax system by simply failing to file Form 8854 with their tax return.

Lower-income individuals who have spent most of their lives abroad may find complying with these rules difficult when attempting to expatriate. A dual citizen who has spent most of their life outside the United States will be considered a covered expatriate despite having relatively low income and assets if the individual does not certify to the IRS compliance with all U.S. Federal tax obligations for the five preceding taxable years. Some dual citizens who have spent most of their lives outside the United States may not have previously filed a U.S. tax return or obtained a TIN. Foreign financial institutions in some countries have threatened to close bank accounts of

U.S. citizens who do not provide a TIN. U.S. citizens who are citizens and residents of foreign countries and have limited contacts with the United States may wish to expatriate, but in order to avoid being considered covered expatriates such individuals need to be able to certify that they are compliant with all U.S. Federal tax obligations for the five preceding taxable years. For taxpayers with modest incomes who have not been filing U.S. tax returns but have been filing tax returns and paying tax in their countries of residence, the cost and practical difficulties of certifying compliance with their U.S. Federal tax obligations may impede their ability to satisfy the requirements for expatriation. For example, it may be difficult to find a U.S. tax advisor to prepare a U.S. tax return in the taxpayer's country of residence, and the cost of doing so may be significant for a lower-income taxpayer. If the taxpayer would not owe any U.S. tax, the benefit to the IRS of the filing of such tax returns is limited.

The requirement for an alien to obtain a sailing permit is no longer necessary as the IRS has other tools to help ensure tax compliance, including withholding tax requirements applicable to payments to nonresident aliens that have been implemented since the sailing permit requirement was originally enacted.

### **Proposal**

First, the proposal would provide that, in the case where a taxpayer is required to provide Form 8854 to the IRS with their tax return, the time for assessment of tax will not expire until three years after the date on which Form 8854 is filed with the IRS. This will create parity with the current statute of limitation rules for tax returns when other information returns relating to various international transactions or assets are required to be filed with the return. The proposal will reduce abuse and noncompliance with respect to high net wealth expatriates.

Second, the proposal will grant the Secretary and her delegates authority to provide relief from the rules for covered expatriates for a narrow class of lower-income dual citizens with limited U.S. ties. This relief would apply only to taxpayers that have a tax home outside the United States and satisfy other conditions that ensure that their contacts with the United States are limited, and whose income and assets are below a specified threshold. Evidence of limited contacts with the United States may include a demonstration that the taxpayer's primary residence has been outside the United States for an extended period. Evidence of the taxpayer's income and assets may include a foreign tax return, information about the value of property owned by the taxpayer and the taxpayer's sources of income, or information demonstrating that a certain amount of income earned from working outside the United States is excludable from U.S. tax. No inference would be intended that the evidence acceptable to the Secretary under this provision constitutes the filing of a U.S. tax return.

The requirement for an alien to obtain a sailing permit would be repealed.

The proposal would be effective for taxable years beginning after December 31, 2023.