Forbes

Robert W. Wood
THE TAX LAWYER

TAXES 12/12/2015

To Renounce U.S. Passport, Get In Line -- Or Just Don't Pay Your Taxes

You have to love the irony. In recent years, there has been a big spike in Americans handing in their passports. The fees to renounce U.S. citizenship spiked too, by 422%. With dual State Department and IRS filing protocols, many people trip during the process. The government seems to be making it tougher, more time consuming, and more expensive. And if you try to handle it at a US embassy overseas—which is often the best place for expats in this situation—the lines and wait times can be weeks or months.

Yet ironically, a new law gives the IRS the power to revoke passports if you don't pay your taxes! It says the IRS can have the State Department *revoke* your passport with no application and no waiting in line! Of course, losing passport privileges isn't the same as losing citizenship. So if you stop paying taxes you would not go on the quarterly name and shame list of those who renounced their U.S. citizenship.

On that note, Americans renouncing citizenship is at an all-time high. The new fees are more than twenty times the average level in other high-income countries. Americans abroad must report and pay tax where they live. But they must also continue to file taxes in the U.S. What's more, U.S. reporting is based on their worldwide income, even though they are paying taxes in the country where they live. Many can claim a foreign tax credit on their U.S. returns, but it generally does not eliminate all double taxes.

Moreover, the annual foreign bank account reports known as FBARs carry civil and criminal penalties all out of proportion to tax violations. FATCA has ramped up worldwide and requires an annual Form 8938 filing if foreign assets meet a threshold. Foreign banks are sufficiently worried about keeping the IRS happy that many simply do not want American account holders. Still, leaving America can be costly. To exit, you generally must prove 5 years of IRS tax compliance. Plus, if you have a net worth greater than $2 million or have average annual net income tax for the 5 previous years of $160,000 or more, you can pay an exit tax.

Long-term residents giving up a Green Card can be required to pay the exit tax too. There have been some citizenship backlogs at U.S. consulates, which makes the new passport-for-taxes law especially ironic. It was H.R. 22 – Fixing America's Surface Transportation Act, the "FAST Act." that added the new passport section of the tax code. The law says the State Department can revoke, deny or limit passports for anyone the IRS certifies as having a seriously delinquent tax debt in an amount in excess of $50,000.

The list of affected taxpayers will be compiled by the IRS. The IRS will use a threshold of $50,000 of unpaid federal taxes. But this $50,000 figure includes penalties and interest, which can add up fast. If you are contesting a proposed tax bill administratively with the IRS or in court, it does not count as a tax debt.

You will also still be able to travel if your tax debt is being paid in a timely manner under an installment agreement. Still, you could have your passport revoked merely because you owe more than $50,000 and the IRS has filed a notice of lien. A $50,000 tax debt including interest and penalties is common, and the IRS files tax liens routinely. It's the IRS way of putting creditors on notice. In that sense, it looks as though it may be easy to lose a passport this way, easier than getting in line. The legal consequences of the two approaches though are quite different.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This article is not legal advice.