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IRS Taxes Apply After You Leave U.S. & Departure Can Trigger More

A recent article notes that [denaturalized citizens forced to exit could *still* face exit tax]. The author flags Department of Justice plans for denaturalization proceedings against naturalized citizens who obtained citizenship through fraud or misrepresentation, or who are national security threats. There may be arguments that the tax should not apply in such cases, but if it does--or if you are leaving voluntarily--how does it work?

If you leave the U.S. voluntarily or because the government makes you, how could you still be taxed by the IRS? Several ways, actually. First, if you are a U.S. citizen, the mere fact that you live abroad—even forever—does not mean that you avoid U.S. taxes or the annual slog to file IRS returns. You might be paying tax in two places, to the IRS and to your country of residence. If you want to stop paying U.S. tax, you have to go a step further and give up your passport or your green card.

Moreover, any income tax you owe from the past is still due, and so are taxes on income you earned up to the date of your departure. But more surprisingly for many, the U.S. has an “exit tax” that can hit you, depending on your assets and income. The exit tax applies only to U.S. citizens and to longer term (8 years or more) green card holders. The exit tax is like an estate tax on the gain in your assets, even though you are not actually selling anything. It is the IRS’s last chance to tax you.

Citizens and green card holders leave for many reasons. Common reasons for renouncing are family, tax and legal complications for people who generally live outside the United States. They can include the pressures of America’s global tax reporting and compliance, including FATCA, the Foreign Account Tax Compliance Act. It is easy to think that leaving the U.S. to live abroad means no longer paying IRS taxes—especially if you are paying taxes somewhere else.

The Exit Tax is computed as if you sold all your assets on the day before you expatriated, and had to report the gain. Net capital gains can be taxed as high as 23.8%, including the 3.8% net investment income tax that applies to some types of gains. For a time, Congress talked of hiking the exit tax to 30% after Eduardo Saverin of Facebook decamped for Singapore.

Triggers for Exit Tax

There are three triggers for the Exit Tax, and any one of them will make you a covered expatriate.

$2 Million Net Worth?

First, is your net worth over $2 million? This is the aggregate net value of worldwide assets. It is not just your U.S. assets. For a married couple, each spouse's net worth is calculated separately. If they own their assets relatively equally, a married couple could have a total net worth of up to $4 million without triggering the Exit Tax.

On the other hand, if one spouse owns most of the assets, that spouse could be a covered expatriate, even if the other spouse owns significantly less than $2 million of assets. Thankfully, some couples can gift assets to each other to bring both spouses' net worth below $2 million. If the spouse receiving the gifts is a U.S. citizen, these gifts may escape U.S. gift tax.

On the other hand, if the spouse receiving the gift is not a U.S. citizen, spousal gifts may be subject to gift tax even if the spouse receiving the gift is a U.S. green card holder. For 2025, there is an annual exclusion of $190,000 for gifts to non-citizen spouses. If you need to transfer more than that amount to your spouse to bring your net worth to below $2 million, you would have to rely on your unified tax credit to avoid gift tax, or you would need to plan in advance to make the transfers over multiple years before expatriating.

Average Income Tax Liability Over $206,000

Second, is your average net annual income tax liability over $206,000? This is not your taxable *income*, but your *tax liability* on that income. If you are married and filing taxes jointly, you must use your net tax liability on your *joint* returns, even if only one of you is expatriating. This trigger can sometimes be avoided with careful planning. Filing separate tax returns (not joint returns) often makes sense. As the trigger is your *average* tax liability over the last five years, you may need to file separately for several years before you expatriate.

Five Years of U.S. Tax Compliance

The third way you can be a covered expatriate is if you do not (or cannot) certify five years of U.S. tax compliance. If you haven't filed, or haven't filed properly—say you didn't report an offshore bank account—you will need to fix that before you are in compliance. Fortunately, you can amend your prior tax returns (and other forms) and simultaneously also file an IRS Form 8854 to expatriate. In effect, you sign your Form 8854 last, *after* you've signed the amended tax documents.

What if you trip any of these tests? You need to calculate the Exit Tax. If you are *not* a covered expatriate, it does not matter. If you *are* a covered expatriate, the first *$890,000* of gain is shielded from the Exit Tax for 2025 expatriations. For spouses who expatriate, each spouse files a separate Form 8854, and each spouse can exclude $890,000 of gain (or nearly $1.4 million of gain combined). The Exit Tax on certain assets, notably 401(k) plans, can be deferred.

Thus, you may not have to pay the Exit Tax on the plans' values when you expatriate, and would only pay U.S. tax on the 401(k) plan as distributions are made out of the plan. However, the tax on the future distributions is generally 30%, and you cannot claim a treaty benefit to reduce the tax. For most other assets, you can make an irrevocable election to defer payment on the Exit Tax owed. Still, the IRS wants a bond or adequate security for any deferred Exit Tax, and interest accrues until it is paid.

Even if a covered expatriate has less than $890,000 of gain in his or her assets, being a covered expatriate has negative consequences. If you have friends or family in the U.S., being a covered expatriate could result in your gifts to them coming with a tax bill that *they* would have to pay. Even if your Exit Tax may be slight, or you would not owe any Exit Tax (for example, because of the $890,000 gain exclusion), avoid being a covered expatriate if you can. A goal of many expatriating taxpayers is to have a final, clean break from the U.S. tax system.

Certifying five years of tax compliance can be difficult. U.S. taxes are complex, and if you live or have assets abroad, there are extra levels of complexity. You must report your worldwide income, wherever it is generated. And FATCA requires an annual Form 8938 filed with the IRS if your foreign assets meet a threshold. Then there are annual foreign bank account reports called FBARs. They carry big civil and even potential criminal penalties if you fail to file them or file them falsely. The civil penalties can consume the entire balance of an account, so be careful.