

Live Abroad, File Tax Returns and Pay the IRS at Home

By Robert W. Wood

Wouldn't you like to live in some beautiful or exotic place abroad? You aren't the only one thinking about the allure of such a place. Reports say there's been a big uptick in interest in leaving America with the overruling of *Roe v. Wade*, gun violence, political turmoil and more. Articles and websites advise on how to move out of the US and the best places to escape. There are numerous choices, including moving to Canada. But if you go, is it temporary or permanent?

Either way, most people probably assume that it won't impact their citizenship. After all, there's no reason that moving—moving anywhere—changes that. Yet it is surprising how many people get confused about U.S. taxes, and think that leaving the U.S. to live abroad means no longer paying taxes here—especially if you are paying taxes somewhere else. However, the mere fact that you live abroad—even forever—does not mean that you ever 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 new country of residence. In fact, if you want to stop paying U.S. tax, you have to go a big step further. It's a step that is not unheard of. Official U.S. Treasury Department records show that 2020 set a record for the number of Americans who renounced their U.S. citizenship or gave up their long-term green cards. Common reasons for renouncing can be family, or tax and legal complications for people who generally live outside the United States.

There is an official list published quarterly, and the names for the fourth quarter 2020 made the annual total 6,707, a 237% increase from 2019. That may not sound like many, but the actual number of expatriates is often assumed to be higher, with many apparently not counted. Both the IRS and FBI track Americans who renounce. Some renouncers write why they gave up their U.S. citizenship, but tax considerations are often part of the equation. Expats have long clamored for tax relief and asked for a residency based tax system, which is what most countries have.

Adding fuel to the fire is FATCA, the Foreign Account Tax Compliance Act. This U.S. tax law requires detailed disclosures of what you own outside the US. FATCA spans the globe with an unparalleled network of reporting, requiring foreign banks and governments to hand over bank data about depositors. Non-U.S. banks and financial institutions around the world must reveal American account details or risk big penalties. Some renounce because of global tax reporting and FATCA.

Americans living and working abroad must generally report and pay tax where they live. But they must also continue to file taxes in the U.S., where reporting is based on their worldwide income. A foreign tax credit often does not eliminate double taxes. As an American citizen, green card holder or U.S. tax resident, you must report your worldwide

income, and that includes interest income from bank account overseas. If you don't, there are taxes, interest and penalties.

On top of these tax penalties, there are bigger and uglier penalties for failing to file bank account reporting forms known as FBARs. Another name is FinCEN Form 114. These annual forms are not filed with the IRS, they are filed with FinCEN, the Financial Crimes Enforcement Network, part of the U.S. Treasury Department. Make no mistake, the penalties for failing to file an FBAR are far worse than tax penalties. Failing to file an FBAR can carry a civil penalty of \$10,000 for each non-willful violation. And just to be accurate, FinCEN adjusts FBAR penalties for inflation each year, so for 2022 the non-willful penalty is \$14,489, not \$10,000.

Non-willful means you didn't intend any harm, you were just ignorant. Even then, that \$14,489 is each year, and the statute of limitations on FBAR violations is six years. So you have 10 accounts? That's \$14,489 times 10, times six years, the way the IRS calculates it – even if you were non-willful. That's millions of dollars in penalties, even if you are nonwillful. How these nonwillful penalties are computed is slated to be decided by the U.S. Supreme Court.

A Ninth Circuit case, *United States v. Boyd*, No. 19-55585 (9th Cir. 2021), came out in favor of lower nonwillful penalties, essentially applying the penalties per year, not per bank account and per year. But now the Fifth Circuit ruled for the IRS stacking penalties in *United States v. Bittner*, No. 20-4597 (5th Cir. 2021). The U.S. Supreme Court has announced that it will rule on the penalty stacking question for non-willful FBAR violations in *Bittner v. United States*, No. 21-1195. In *Bittner*, the difference boils down to him paying \$50,000 or \$2.72M.

Of course, willful penalties are worse. In the case of FBARs, if your violation is found to be willful, the penalty is the greater of \$100,000 or 50 percent of the amount in the account for each violation—and each year you didn't file is a separate violation. Criminal penalties for FBAR violations are even more frightening, including a fine of \$250,000 and five years of imprisonment. If the FBAR violation occurs while violating another law (such as tax law, which it often will) the penalties are increased to \$500,000 in fines and/or ten years of imprisonment. Many violent felonies are punished less harshly. The assessment of a civil penalty does not preclude criminal penalties or prosecution.

Is it possible to argue your way out of a tax penalty? A lot depends on which penalty has been assessed. Some penalty defenses involve other concepts, such as the absence of willful neglect. Isn't that proving a negative? Yes, and the taxpayer has to carry this burden too. Who wins in a tax penalty stalemate? This one should not surprise you. The IRS does, of course.

Put differently, taxpayers bear the burden of substantiating that they acted with reasonable cause. We all must exercise ordinary business care and prudence in reporting our proper tax liability. Remember, all tax returns are signed under penalties of perjury. The IRS applies a facts-and-circumstances test on a case-by-case basis to determine

whether a taxpayer meets the reasonable-cause exception. But with foreign account penalties—and many other ones too—it can be particularly difficult to carry the day.

Robert W. Wood is a tax lawyer with www.WoodLLP.com, and the author of *"Taxation of Damage Awards & Settlement Payments"* (www.TaxInstitute.com). This is not legal advice.